

## EXPECTATIONS: THE CHALLENGES OF CREATING A BUSINESS INCUBATOR IN RESPONSE TO STATE AND LOCAL INITIATIVES

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The Center for Emerging Technologies and Entrepreneurial Studies (CETES) was created at Cameron University in Lawton Oklahoma in response to initiatives by the State Regents for Higher Education and an economic development study conducted by leaders within the city of Lawton. From the recommendations and challenges put forth by these efforts, the concept for an economic development program was created. CETES has five components: a business incubator, a networking conference center, a center for regional economic development, an entrepreneurial studies program, and a small business institute. The mission of CETES is to promote the creation and growth of new technology companies, create skilled employment opportunities, and prepare people to be effective contributors to the 21<sup>st</sup> century economy of southwest Oklahoma.

The emphasis of this paper is on the issues surrounding the operational planning and initial start-up of the business incubator. Going through this process, it became clear that the expectations of how the center will operate and what it will achieve were divergent among the four major constituencies involved: the university, the community, the region, and the state. Funding comes directly from two of these groups and support is necessary from all four in order for the incubator to be effective. Each, however, has its own definition of success and its own vision of where they see the incubator fitting within their realm. The focus of this paper is to identify the various expectations and potential land mines along with the response to them as the incubator creates its service network, markets itself, and prepares to open for business.

# **A COMPARISON OF STUDENT BUSINESS PLANS WITH ACTUAL ENTREPRENEURIAL NEW VENTURES**

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## **ABSTRACT**

Using historical data collected over a 5-year period, this study compared student team business plan projects to actual new business ventures created during the same period in a small college-town community. The results support the proposition put forth by previous studies that experiential-based entrepreneurial education can increase the perceptive abilities of young people in isolating attractive business opportunities in their environment. Implications are discussed.

## **INTRODUCTION**

Although much has been published on the perceived benefits of entrepreneurial education (Peterman & Kennedy, 2003; Wang Wong, 2004; Gorman, Hanlon & King 1997; Young, 1997) there has been limited vigorous research on its effects (Henry, Hill & Leitch, 2004; Storey, 2000). Many believe that advancing the research in this direction will move the field beyond its exploratory stage (Alberti, 1999; Curran, 2000; McMullan, Chrisman & Vesper, 2001; Rosa, 2003), thus enhance the credibility and value of entrepreneurial education and training programs at all levels – secondary, college and graduate. Creating a successful enterprise begins with an idea - what service or product your business will provide and what needs it will fill. Successful entrepreneur are adept at finding new market opportunities that satisfy real customer needs. University-based entrepreneurship programs and initiatives are aimed at developing students' skills and knowledge at identifying such opportunities. They also teach students the importance of business plans and how to develop them. According to the SBA, the business plan is a necessary and critical document for anyone who wants to start a small business (SBA, 2004). Some programs provide funding for student ideas to move beyond the business plan phase to implementation (Rosa, 2003), while others end at the business plan development phase. The purpose of this paper is to address a specific question: how closely related are students' business plan ideas to actual new business ventures created in the market environment. This study has implications for university administrators, government funding agencies and the business community.

## **BACKGROUND**

Increasing complexity and dynamism in the economic environment has led to a growing research interest in the role that small and new businesses can play in economic development (Curran,

2000). This awareness has led to an upsurge in research in entrepreneurship. Early research on factors that influence entrepreneurial behavioral centered on trait or personality characteristics of individuals (Brockhaus, 1980; 1982 McClelland, 1961). More recently, there has been growing interest in the role education and training can have on the desire to become an entrepreneur (Peterman & Kennedy, 2003; Henry et al., 2004). University-based entrepreneurship curricula have attracted the bulk of research in the field of entrepreneurship education (Gorman et al., 1997; Young, 1997). The debate in academic circles is whether or not individuals can be educated or trained for the purposes of new business creation and entrepreneurship (Henry et al., 2004). The growth in the number and types of college-based entrepreneurship programs would seem to suggest a causal relationship between entrepreneurship education and entrepreneurial behavior; a relationship supported by research (Gorman et al; 1997).

Despite the recognition that education and training programs influence people's perceptions of the desirability and feasibility of starting a business, there has been little empirical research directed towards evaluating the effectiveness of such programs (Peterson & Kennedy, 2003; Henry et al 2004; Storey, 2000). Scholars have argued that assessment is important because it highlights program benefits rather than just costs (McMullan et al., 2001). This has both funding and administrative support implications.

### **THE SENIOR SEMINAR COURSE**

This research is based on a college senior seminar project whereby business majors in their last semester are required to formulate a comprehensive business plan for a small business venture, to be launched in the community. At the college, the department of business administration is organized into three majors - accounting, business administration, and economics.

#### **Background**

Five years ago, the department underwent a major curriculum review. One of the outcomes of the review was the decision to refocus the senior seminar course on entrepreneurship because of the changing economic environment of the area. For a long time, the local economy was coal dependent. As the demand for coal steadily declined in the 1980's to 1990's, the area suffered significantly. Coal mines and coal related businesses closed, creating double-digit unemployment rates. The key, according to most experts, was to focus on bringing in new industries or creating new businesses. Encouraging small business creation seemed to be a more viable option than bringing in new industries because of the area's remote location and inherent infrastructural weaknesses.

It is against this backdrop that the business department decided to focus on entrepreneurship. The belief was that students represent potential entrepreneurs who through educational training and preparation, can begin to see entrepreneurship as a career choice. The hope was that after the senior seminar experience, more students would show interest in creating their own businesses rather than waiting for a job. This view is consistent with the literature and reflects the growing popularity of entrepreneurship education programs nationwide. According to one study, entrepreneurship education in America's major universities has grown at an incredible rate over the

past 20 years. This is evidence by the increase number of endowed positions, academic programs, journals and other publication (Robinson & Haynes, 1991).

## **Course Design**

The course syllabus starts with a purpose statement stating that the project will help students understand the importance of developing a business plan prior to starting a business. The business idea and resulting plan is evaluated on its accurate and realistic reflection of local market conditions. Each team is required to conduct a comprehensive environmental and industry analysis; target market needs assessment; competitor, location and logistics analysis. Also, the plan must describe the pricing, product/service, and promotion strategies.

Each semester, we form student teams. Each team consists of students from different majors - accounting, economics, and business administration. The multi-disciplinary make up of the teams, coupled with the many functional aspects of the standard business plan, means that students have to collaborate and apply knowledge from just about every part of the curriculum. It is an integrative project where success depends on applying concepts from marketing, finance, accounting, HR, operations, management, strategy and many other disciplines. The project presents students with learning opportunities to develop teamwork skills, effective communication, problem solving, conflict management and leadership.

The class is designed as a totally hands-on experience, with no lectures, readings, quizzes, examinations, or required textbooks. The class is student-centered, with few regular class meetings. Experiential learning involves high levels of active student involvement. Requiring that students envision themselves as entrepreneurs and carry out a comprehensive business plan development project using accurate secondary and primary information, is experiential. There is research to support the use of the experiential learning model (Angelidis, 2004).

## **Course Structure**

Class meets regularly for two to three weeks from the start of the semester. These organizational meetings are designed to accomplish the following: (a) introductions and course review, (b) team foundation, and (c) presentations/workshops to refresh students' knowledge in select topics (such as running effective meetings, conflict management, goal setting, teamwork, effective communication, etc.).

After three weeks, the teams are sent off to start the project. Group members are instructed to formulate group goals, norms, meeting times, and assign individual responsibilities. To keep the project and teams on track, the project is broken-up into specific activities with deadlines. An overview of major activities and due dates for the spring 2004 class is provided in Table 1 below. All groups are required to come to class on these dates. Representatives from each group get a chance to present the group's progress.

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## METHODS

The participants in this study included past student business plans and small business startups in the community. All 58 student business plan projects developed over the past five years were retrieved and organized by year, industry sector and business type. To get information on small business ventures created during the past five years in the community, we contacted the County Administration's Economic Development Office to get data on small businesses launched within the past five years–1998-2003. This information was then organized in the same way as the student business plans–year, industry sector and business type. Frequency analysis was then used to compare the two groups.

## RESULTS

From 1998 to 2004, a total of 58 business plans have been cataloged. The business plans were grouped into 8 major business sectors. These sectors are based on SIC classifications of business types by the government. See below for the 8 business sectors and the number of business plans under each sector.

| Manufac-<br>ture | Apt.<br>Rental | Entertainment | Service | Recreation | Restaurants | Fitness | Retail |
|------------------|----------------|---------------|---------|------------|-------------|---------|--------|
| 2                | 2              | 8             | 7       | 11         | 12          | 3       | 13     |

In the same period of time, new businesses created in the area revealed the following distribution by business sectors.

| Manufacture | Apt. Rental | Entertainment | Service | Recreation | Restaurants | Fitness | Retail |
|-------------|-------------|---------------|---------|------------|-------------|---------|--------|
| 3           | 2           | 2             | 32      | 3          | 10          | 4       | 24     |

Over the past 5 years, students seemed to perceive more opportunities in 5 of the 8 business sectors: entertainment, service, recreation, restaurant, and retail. Three sectors dominate in terms of the number of business plan projects focused on them: retail, restaurant and recreation. In Table 3, the actual businesses launched dominated in three sectors: retail, service and restaurants with the service sector leading in numbers.

It would appear that student have similar entrepreneurial instincts as entrepreneurs when it comes to identifying attractive new business opportunities. An analysis by specific business types reveals a closer similarity between some of the students' business plan descriptions and actual new business ventures. In at least six cases, the new business venture closely matched the type of business that students' business plans had depicted in past years, see Table 2.

It should be noted that, in many cases, the business plans were published long before the actual businesses were ever launched. Also, students are instructed at the beginning of the project to avoid focusing business plan ideas on existing businesses; rather, they are to locate new niches or target markets.

## IMPLICATIONS

This study has public policy implications as 99.7% of all businesses are classified as small business, they employ half of all private sector employees, and they generate 60% to 80% of net new jobs annually (Bounds, 2004). It also has policy implications for university administrators. The fact that students perceive attractive business opportunities in the same sectors as entrepreneurs would indicate to some extent that the entrepreneurship education program is effective at getting students to think like entrepreneurs. This could allow for close collaboration between the college/university business program and the community. Student business plans could be cataloged and made available to prospective entrepreneurs who are ready to go into business for themselves but don't know what areas are attractive. Much of the research and analysis would have been done, shortening the time to prepare and launch a business. Two-thirds of new ventures survive two years and about half survive at least four years. Last year there were over half a million new venture, but about the same number of firms closed their doors (Bounds, 2004). One of the many reasons accounting for this high failure rate is the lack of adequate planning and research. The senior seminar class could market itself as a resource for prospective entrepreneurs. This type of community outreach by a student entrepreneurship program will encourage federal, state or local government support. Support could be in the form of grants and/or loans to graduates with promising ideas. Also, college administrators are more likely to support such programs with resources.

## CONCLUSION

The feedback gathered from this course reveals overwhelmingly that students feel challenged by the course because it forces them to review and integrate knowledge learned from other courses (marketing, management, strategy, finance, accounting, economics, etc.) and also, to work in terms.

The oral team presentations at the end of the course require teams to model and simulate much of their business plan. We have observed the classroom turned into a live restaurant, daycare, sports bar, or laser-tag entertainment center during team presentations. Students learn effective presentation skills and the competitive nature of business. Each team strives to out-present the other by bringing as much of their business idea to life as possible. It is usually the most exciting part of the course.

Follow-up studies to see how many students have carried their classroom ideas to the market place by creating start-up ventures are still lacking. This is a critical area that future research should address because simply having the right idea is not enough. What distinguishes the entrepreneur from the non or potential entrepreneur is the initiative of turning an idea into a business venture – taking the risk.

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**Table 1 Assignment Schedule**

|          |  |
|----------|--|
| 01/24    | Submit three possible business idea topics   |
| 2/3      | Firm up choice of business idea after some preliminary research.   |
| 2/7      | List of activities the group intends to undertake prior to settling down to writing the business plan. This is really the research and information collection phase of the project. This list should document each member's responsibilities and deadline – who, what, when, how, where. |
| 2/21     | An outline of the Business Plan with all the key areas identified. I will like to see evidence that each section of the plan is supported with external data – secondary or primary.   |
| 3/7      | Draft copy of the full Business Plan adequately describing each section identified in the outline of 2/21.   |
| 3/28     | Second draft copy with all deficiencies from first draft address.  |
| 4/2-4/11 | Prepare oral group presentations. Use all necessary steps to make your presentation creative, entertaining, informative, engaging and professional.  |
| 4/14     | Turn in final copy of Business Plan.   |
| 4/21-28  | Group Presentations  |

**Table 2 Comparison of Student Business Plans to New Ventures**

| <b><u>Actual Business Venture</u></b>                   | <b><u>Business Plan Project</u></b>  |
|---|--|
| Bonterra (2004) [Upscale Restaurant]                    | The Warehouse (1998)<br>Carlotta's (1999)<br>Damon's Grill (2000)          |
| Harvest Coffee Shop (2003)                              | The Gray Possum Café (1998)<br>24-7 Café (1999)<br>Wise Choice Café (2002) |
| Bright Beginnings Daycare (2003)                        | Future Kids (2001)   |
| Landmark Financial Service (2002)                       | Taylor-Stanley Tax & Planning (2000)                                       |
| Dyna Body Health & Fitness (2003)                       | World of Fitness (2002)<br>Fantastic Shapes (2001)                         |
| New Apartment Complex (2003) [near the college No Name] | Cavalier Heights Apt. Complex (2002)                                       |

# FINDING COMPETITIVE ADVANTAGE IN MANAGING WORKPLACE ETHICS

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## Abstract

The many breaches of ethical conduct and violation of laws involving high profile executives in recent years have focused attention on the way firms manage business ethics and company values. This paper identifies some of the bottom line benefits and other benefits of actively managing the business ethics process and recommends practical approaches for developing a program for the management of the process. It is especially important for small and medium enterprises to become active in this area.

The management of business ethics and company values have received increased emphasis with the recent incidents of unethical and unlawful behavior on the part of some high profile executives. Many firms have revisited their programs to ensure proper compliance. The Sarbanes-Oxley Act of 2002 now requires that each public company disclose annually its code of ethics for the company's CEO and senior financial officers. Compliance is one matter, but there are other very practical and rewarding aspects to the process of actively managing ethics in the workplace. These are the benefits to the firm's bottom line because the practice of good business ethics makes the firm a desirable one with which to do business and the community image of the firm is enhanced. This paper identifies some of these benefits and proposes a method by which firms can become actively engaged in the management of company values.

## Introduction

The great attention in recent months to violations of ethics and laws by the leaders of such firms as Tyco, Enron, Martha Stewart, Worldcom, and many others have caused a number of companies to review their ethics programs. Customer complaints about improper trading and commission structures by financial institutions are resulting in settlements in sums ranging in the hundreds of millions of dollars. High profile events such as these are causing many to question the worth of formal codes of ethics because the firms involved in untoward business activities had codes of ethics in place. However, a recent informal survey of approximately fifty MBA students, who are employed full time in small and medium enterprises, about the role of formal codes of ethics in their organizations revealed the following:

1. Ethics codes are seen as devices that place the same behavioral expectations on all levels of the organization.
2. Ethics codes enable the employees to understand what is expected of them in the workplace.

3. Ethics codes provide a device for enabling the employees to communicate to customers and suppliers about the expectations of their firm in business dealings.
4. Ethics codes provide a mechanism for handling peer pressure.
5. Ethics codes provide a formal “outside the chain of command” way to communicate upwardly in the organization without fear of reprisal.

These findings provide the basis for exploring some of the benefits of actively managing ethics in the workplace. It should be noted that some are now using the phrase “managing company values” to denote the process of managing business ethics.

## Business Ethics

Discussions of ethics usually involve a concept of moral behavior. Moral refers to a set of principles or values that guide behavior. Ethics, then, is the behavior that conforms to those principles. Placing this in the concept of a business, business ethics is the discipline of developing and practicing business relationships that conform to the moral principles. Sherwin(1983) wrote about what he called “The ethical roots of the business system. Sherwin maintained that to act ethically a manager must ensure that the owners, employees, and customers all share fairly in the business’s gain.

A primary premise of this paper is that all members of the firm have significant roles to play in the active and effective management of ethics in the workplace that will accrue benefits to the firm and its stakeholders. This is illustrated by point 1 above which indicates that codes of ethics place the same behavioral requirements on all members of the organization. The motivations to conduct business in an ethical manner and the positive results will be discussed below.

## Codes of Ethics

Businesses develop formal ethics programs for reasons that range from programs designed to comply with the law to programs that provide for both compliance and conducting business on a higher level of trust between the stakeholders. Recent research indicates that some larger firms have developed formal codes of ethics and appointed a Vice President for Ethics in order to avoid the financial penalties imposed for ethics violations. The rationale is that a firm will likely receive a lighter penalty for ethics violations if it has a strong code and ethics education program in place than if it does not. This approach is merely a tradeoff between the cost of developing an ethics program and the projected cost of possible violations. It neglects some very positive and powerful incentives to actively manage ethics in the workplace.

Whether a code of ethics is formally called a *Code of Ethics*, a *Code of Conduct*, *Corporate Code of Ethics*, or *Values Based Management*, some companies had codes of ethics as early as the beginning of the 20<sup>th</sup> century(Newberg, 2004). Newberg focuses on Section 406 of the Sarbanes-Oxley Act of 2002 that now requires each public company to disclose annually its code of ethics for the company’s CEO and senior financial officers. He maintains that an unexpected result of the code requirement is that the ethical commitments of the codes act as a signal to potential investors, employees, and customers that these are good firms with which to do business.

## Managing the Ethics Process

Business ethics is now considered a management discipline (McNamara, 1999). Some consider this to have been driven by the social responsibility movement that began in the 60's. Archie Carroll (1979) addressed this with his proposal for a definition of corporate social responsibility. Carroll held that corporations had four responsibilities to fulfill to society: economic, legal, ethical, and discretionary. The term "stockholders" was changed to the term "stakeholders" by many firms to recognize that employees, customers, suppliers, and communities and countries in which a firm operates are also impacted by the operations of the firm. The stakeholder concept has been extended to include "primary stakeholders," those directly impacted by a proposed action and "other stakeholders," those for whom there may be some indirect impact. It is common knowledge that environmentalists have included spotted owls, spotted snail darters, and other species of wildlife in their classification of stakeholders in a business action to which they were opposed.

The consideration of these broader implications of the firm's activities led to the emergence of business ethics as a management discipline. The formalization or the management of business ethics has taken the path of many management disciplines on the evolutionary path of the management disciplines. It has been the response to a recognized need, just as the disciplines of strategic management, human resources management, quality management, and other management disciplines have evolved.

## Strategic Benefits of Managing the Ethics Process

A continuing stream of research identifies the strategic benefits to businesses of having actively managed ethics programs. The term Value Based Management is also used to describe what typically has been known as actively managed ethics programs. Some of these will be described below. The research goes beyond the benefits reported from the informal survey described in the introduction, but does support the benefits observed by the MBA students in their companies.

Amie Devero (2003) cites reports on how firms are using corporate values management not only to avoid penalties, fines, lawsuits, and criminal penalties. They are also finding that the programs

- Build employee loyalty, reducing hiring and training costs
- Reduce theft and other anti-company activity
- Drive sales and build customer loyalty
- Create community good will that can lend support for tax advantages and strategic alliances
- Attract quality applicants with minimum investment in recruitment
- Maintain loyal vendor relationships, reducing loss of suppliers and unexpected cost increases

More reports are emerging which support the idea that firms can gain competitive advantage through proper management of business ethics or managing company values as some call the process. Carter McNamara's (1999) research provides insight into some benefits which expand or are broader based than those of Devero.

McNamara's benefits include:

- Attention to business ethics has substantially improved society.
- Ethics programs help maintain a moral course in turbulent times.
- Ethics programs are an insurance policy – they help ensure that policies are legal.
- Ethics programs help avoid criminal “acts of omission” and can lower fines.
- Ethics programs help manage values associated with quality management, strategic planning and diversity management.

### Topics Covered in A Code of Ethics

The topics or areas of emphasis in a code will, of course, depend to some degree upon the industry in which a firm predominately operates. The pressure to develop codes of ethics with certain content can be driven by the fact that the firm has government contracts, the level of required reporting of financial matters and disclosures, and whether a major customer or supplier requires that you develop a code to be sure you are in compliance with their requirements. The Sarbanes-Oxley Law must be used by publicly held firms as one source of guidance. There are industry specific codes which can be used by many firms to guide their efforts. These are recommended for review as the starting point for developing programs. The industry codes are usually more general than what the individual firm will need. Also, the firm as a member of an industry group, such as The National Association of Realtors, has agreed to abide by that code. So, the firm must also ensure that its on code is in agreement with the industry code.

### Suggested Outline for A Code of Ethics

The code of ethics should be a formal statement of the firm’s values concerning ethics and social issues. Lockheed Martin (<http://www.lockheedmartin.com>) has long been recognized as having a thorough and effective code of ethics. Their code evolves from behavior guided by six virtues:

1. Honesty: to be truthful in all our endeavors; to be honest and forthright with one another and with our customers, communities, suppliers, and shareholders.
2. Integrity: to say what we mean, to deliver what we promise, and to stand for what is right.
3. Respect: to treat one another with dignity and fairness, appreciating the diversity of our workforce and the uniqueness of each employee.
4. Trust: to build confidence through teamwork and open, candid communication.
5. Responsibility: to speak up – without fear of retribution – and report concerns in the workplace, including violations of laws, regulations, and company policies, and seek clarification and guidance whenever there is doubt.
6. Citizenship: to obey all laws of the countries in which we do business and to do our part to make the communities in which we live and work better.

One fairly inclusive outline is presented below. This outline came from the work of two MBA students who developed a code of ethics in the Spring of 2003 for their employer. The firm had rapidly grown from a small firm with about 80 employees to 600 employees. They felt that the rapid expansion had created conditions which called for the formalization of company business values. The effort was welcomed by the



management, reviewed by the Corporate Attorney, and is being implemented in the company.

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## 1. THE PERFECT CODE OF ETHICS

- I. Purpose
- II. Policy
- III. Procedures(with examples of behaviors)
  - a. Particularly Sensitive Issues to the Company
    - i. Honesty and Fairness
    - ii. Conflicts of Interest
    - iii. Purchasing and Selling Goods and Services
    - iv. Discrimination, Harassment, and Professional Work Environment
    - v. Confidentiality of Compensation Information
    - vi. Labor and Employee Relations Matters
    - vii. Confidentiality and Insider Trading
    - viii. Intellectual Property
    - ix. Immigration Law
    - x. Compliance with Antitrust Laws
  - b. Foreign Corrupt Practices Act
  - c. Corporate Political Contributions
  - d. Environmental
  - e. Accurate and Complete Records
  - f. Document Retention
  - g. Workplace Safety
  - h. Bidding, Negotiation, and Performance on Contracts
- IV. Reporting
  - a. Reporting Suspected Violations
    - i. General Policy
    - ii. List of Designated Personnel
    - iii. Complaint Procedures
  - b. Discipline for Violations
- V. Training
- VI. Review Procedures
  - a. Employee Input
  - b. Timeline

The ethics program will be a part of each employee's new employee orientation packet and program. Management will discuss the importance of ethical behavior at the company and the intolerance of unethical or criminal behavior.

Training courses will be administered to employees yearly; most likely an online training program, giving examples of situations and "what would you do?" multiple choice answers. All employees will be required to take this training.

The code of ethics and the training program will be reviewed annually to incorporate any new issues that may have recently become important to the company. More frequent

revisions will be allowed if new laws are passed, if the company takes on a new type of work, or if the company shifts its focus.

A committee will be formed with the responsibility of enforcing the code of ethics, guiding employees on the correct course of action to take in questionable situations, and answering employees' questions in regard to the code. Names and phone numbers of these committee members will be provided to employee.

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## Developing Programs for Managing Business Ethics

There are two basic approaches to developing formal ethics or values management programs. First is the do-it-yourself method. The second is to hire a consultant to help develop the program or possibly approach a local college or university to see if students could undertake such a project under the supervision of a faculty member. The small and medium enterprises have some obvious advantages and disadvantages in developing programs for the effective management of business ethics and company values. Some disadvantages are seen as a lack of staff to dedicate to such efforts, lack of money for additional formal programs, and lack of time because of the press of day-to-day business and lack of knowledge of the process. Several small business owners have informed the author that having a formal code of conduct or ethics and actively managing it was high on the list of items in the startup phase of the business. However, the urgency of running the business caused the ethics programs to slip lower and lower on the list of priorities. Some small business owners feel that because of their short communications chains and fewer people it should not be necessary to formalize ethics and values programs. programs. One clear advantage for the smaller firms lie in the fact that there are fewer people both inside and outside the company with which to deal, the lines of communication are shorter, therefore, it should take less time and effort to formalize programs than in a large organization. Employees can be easily involved in the development of programs.

There are some common sense guidelines that should be followed in the whether a firms does its own development or uses the steps to review proposals from consultants.

The steps are:

1. Recognize the need for a formal ethics or values management program.
2. Ask the employees what should be included.
3. Decide whether to develop the program in house, hire a consultant, or ask a college or university for support. Assign an in house person the accountability for the program even if a consultant is hired.
4. Establish a timetable for development of each segment of the program.
5. Establish dates for review and update of the program.

This paper was written in an effort to raise the awareness of the business and social benefits which can be gained by the development of programs for active management of business ethics and company values.

*References available upon request.*

# **CONCEPTS TO PROFITS: HELPING SBI STUDENT CONSULTING TEAMS AND CLIENTS TO UNDERSTAND AND CONTROL SUCCESS**

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## **ABSTRACT**

This paper revisits a core SBI challenge – helping SBI student consulting teams and clients to understand and control business success. Six related Figures describe a useful framework that shows students and clients how to construct pathways to a successful business. The framework is a practical blend of concepts from diverse business specialties.

## **EXECUTIVE SUMMARY**

Most small businesses don't work. "What to do about it" is a popular theme in the business literature, and a continuing challenge for Small Business Institute directors and their student consulting teams. Many novice SBI clients think that small business success is essentially an entrepreneurial sales challenge in a chaotic marketplace. To the experienced, business success is multifaceted and market dynamics become more predictable.

Success is multifaceted, but how does one explain the elements, interactions and predictable consequences to undergraduate student consulting teams, and how do the teams pass such insights on to their clients? After all, most consulting teams are composed of students with diverse business majors -- most of whom only take one capstone strategy class and specialize in one field – only enrolling in basic core business courses in other areas. And, most SBI consulting clients do not have business degrees.

This paper revisits a core SBI challenge – helping SBI student consulting teams and clients to understand and control business success. Six related Figures describe a useful framework that shows students and clients how to construct pathways to a successful business. The framework is a practical blend of concepts from diverse business specialties.

## **INTRODUCTION**

Most small businesses don't work. "What to do about it" is a popular theme in the business literature, and a continuing challenge for Small Business Institute directors and their student consulting teams. (Gerber, 1995) Many small business clients think that small business success is essentially a entrepreneurial sales challenge in chaotic market environment. (Levinson, 1998) Hence, they believe that progress to success is difficult to plan, execute efficiently and track (read: an opportunistic, seat- of- the- pants approach is the only way). More likely, success is multi-faceted and observed market dynamics (economic drivers, sales cycles, and network relationships) are more predictable and controllable by experienced hands than by novice small business owners. (Miller & Sanchez, 1998; Moore, 2002)

For example, the typical SBI small business client is trying to fit products and services into an established supply chain and distribution network. Even if the product or service is highly innovative (read: disruptive to established ways of doing things) it can be professionally marketed and sold to mainstream customers. ( McKnight 2004; Moore, 2002) Marketing is only part of the challenge. Small businesses success is multifaceted. How the company operates its input-transformation-output processes constrains its business model. ( Bossidy & Charan, 2002; Rasiel and Friga, 2002 ; Schonberger, 1990; Walton, 1986; ) So does the firms ability to control needed resources. ( Gladstone & Gladstone, 2004; Nicholas, 1993) However, said business model is amenable to disciplined plans for achieving dramatic, long-term growth in both profits and revenues .(Timmons & Spinelli, 2004; Collins, 2001; Kuratko and Welsch, 2001; Hanon, 1979)

Success is multifaceted, but how does one explain the elements, interactions and predictable consequences to undergraduate student consulting teams, and how do the teams pass such insights on to their clients? After all, most consulting teams are composed of students with diverse business majors -- most of whom only take one capstone strategy class and specialize in one functional area – only enrolling in basic core business courses in other areas. And, most SBI consulting clients do not have business degrees.

This paper revisits a core SBI challenge – helping SBI student consulting teams and clients to understand and control business success. Five related Figures describe components of a useful success framework that students can learn and share with clients to create a common understanding of what it will take for the client’s business to succeed. The framework is a practical blend of concepts from diverse business specialities. Using the framework as a guide, student consulting teams can identify the SBI client’s starting point, identify what the client must do to succeed, and help the client prepare realistic action plans.

## **SUCCESS FRAMEWORK**

Figure I describes the core of the success framework. As shown at the top of Figure 1, small

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Figure 1 about here

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business processes are aptly described by the Input-Transformation-Output (ITO) model. However, achievement efficient transformation is not the whole success story. No business can succeed on its own. The typical SBI client has concurrent marketing challenges as it struggles to fit its products and services into established supply chain and distribution networks. Two basic marketing ideas apply – the marketing concept and branding. The marketing concept argues that a business should sell what its customers want, and charge prices that produce profits. Branding is accomplished by the selling of exceptional customer benefits and creation of the perception that the firm’s products and services have a value that exceeds their price and also exceeds the value of its competitor’s products and services.

Success amounts to both doing the right thing and doing things right. For example, if the small business offers a pivotal transformation to established networks, with no close substitutes from

competitors, the chance of adoption increases (more benefits to customers relative to competition). Also, it is easier to brand the business's offerings (offers exceptional value to the customer relative to competition). If the small business exploits the situation by pricing its offerings to make them bargains relative to their value in use, the business will earn respectable gross margins and rapidly gain much market and operations experience. If the small business learns quickly from its experience, it can also become the most efficient producer in its category, despite its relatively small size. Comparative advantage can result, where the business' prices are set lower than projected costs of aspiring competitors, effectively forestalling new market entrants. Yet, return on equity is high, yielding working capital to sustain growth. (Schonberger, 1986) Using, Figure 1 as a benchmark, SBI student consulting teams explore how well their SBI client's business model measures up.

It takes an able business to exploit the success drivers presented in Figure 1. Figures 2 and 3 add twelve needed abilities to the success framework. To succeed, the business must control resources that have these abilities and, through disciplined application, hone each ability to a competitive edge. SBI student teams can identify which abilities a client lacks, and which need honing. Where can resources with needed abilities be found? How can the resources be enlisted to support the business? How can abilities best be honed?

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Figure 2 about here

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Figure 3 about here

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Within the success framework described in this paper, the transformational abilities listed in Figure 3 (Collins, 2001; Bossidy & Charan, 2002, seem necessary to hone the strategic abilities listed in Figure 2.( Rasiel & Friga, 2002; Moore, 2002). It is important to think of the right things, but *doing* things right is extremely difficult without transformational capability. Organizational effectiveness depends on balanced investment in the six transformational abilities.

In the author's view, the successful small business consistently achieves efficiency in task design and resource deployment to achieve project objectives and strategic goals. To do so, it must make balanced use of resources to support the network of work flows and interconnected projects that lead to timely business success. In other words, to be successful, no matter the business' line of work, its key people must be good project managers. Accordingly, Figure 4 adds the Project Model to the success framework. Student consulting teams often come up with many brilliant recommendations that the SBI client proves incapable of executing.(Ames, 1994; Kerzner, 2003; Rosenau, 1998) Use of the project model, helps the team to bridge the gap between recommendations and results. Each recommendation should be translated into realistic action plans that the client can follow, step-by-step to build profit momentum. Further, once recommendations are translated into project-model format (action plans with tasks, time lines and budgets) the team can more easily reconcile and prioritize the entire recommendation list based on the client's available and potential resources.

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**Figure 4 about here**

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Use of the project model in Figure 4, helps the SBI client make balanced use of resources to support the network of work flows and interconnected projects that lead to timely business success. The model translates diverse activities into common measures of performance, cost, and time, such as conformance to specifications, resource usage (budget) and on-time schedule. When compiled, these measures form an overall picture of the business' profit momentum and permit meaningful use of eight financial concepts to track progress and guide improvement actions. Figure 5 adds the eight financial concepts to complete the success framework.

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Figure 5 about here

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Profit momentum is the name of the game for small business success. Adroit use of the eight concepts in Figure 5 allow the small business client to track financial performance and to take actions to improve. To generate maximum profit to reinvest in growth, each business decision must include a marginal calculation (Figure 5, concept 1) – will the implied activities help profit momentum by bringing more money down to the bottom line?

Financial statements ( Figure 5, concept 2) should aid in the marginal analysis. Historic statements should reflect the work flow so that performance can be traced and pro-forma statements should reflect planned actions to improve rather than simply assume percentage increases. In order, for small business financial statements to best serve the SBI client, fixed and variable costs must be accurately portrayed (Figure 5, concept 3).

For each product or service, when variable cost is subtracted from sales price, what remains is contribution margin (Figure 5, concept 4). Variances between planned margins and maintained margins must be tracked by product/service and market, and used to rebalance product/service offerings.

Contribution margin is not the only tool that the SBI client can use to evaluate profit momentum. Profitability ratios, activity ratios and liquidity ratios give useful views of performance ( Figure 5, concept 5).

Understanding profit momentum also requires a understanding of how financial ratios interact. Formulations such as the Sustainable Sales Growth Rate aid understanding ( Figure 5, concept 6). Derived from Du Pont type systems that link profitability and leverage ratios, the sustainable sales growth rate is the rate at which a firm can grow based on the retention of its profits in the business.(Brigham & Daves, 2004; Leach & Melicher, 2003 )

Financial systems have limited use unless they are used (Figure 5, concept 7). Financial tracking– monitoring of profitability ratios and activity ratios in an ongoing, real-time manner– helps the business owner to keep track of growth and to assess its costs and rewards.

Financial summaries, while useful tools for evaluating small business performance are incomplete when it comes to accounting for development of transformational abilities ( investment in people, teams, work structures, mechanisms for improvement, and leadership). Hence it is valuable to assign responsibility for the collection of key data and the preparation of brief special reports that combine and update key financial data and key transformational data

(Figure 5, concept 8). (Donaldson, 1984); Nicholas, 1993)

## **SO WHAT? IMPLICATIONS FOR SBI STUDENT CONSULTING AND SBI CLIENTS**

SBI student consulting teams and clients must understand and control business success. The five related Figures presented above describe components of a useful success framework that students can learn and share with clients to create a common understanding of what it will take for the client's business to succeed. The framework is a practical blend of concepts from diverse business specialities. Using the framework as a guide, student consulting teams can identify the SBI client's starting point, identify what the client must do to succeed, and help the client to understand the challenges and to prepare realistic action plans.

## **CONCLUSION**

This paper revisits a core SBI challenge – helping SBI student consulting teams and clients to understand and control business success. It presents five related Figures that describe a useful framework that shows students and clients how to construct pathways to a successful business. The framework is a practical blend of concepts from diverse business specialities. Adapted from Mary Walton's description of the Deming chain reaction, Figure 6 summarizes how artful use of the framework components (Figures 1 through 5) leads to a chain reaction of success. (Walton, 1986)

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Figure 6 goes about here

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### Figure 1: Core of Success Framework: Input-Output Model With Success Drivers

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Input→Transformation→ Output (Added Value)

Success Drivers:

Marketing Concept (sell what is wanted, price to gain experience and reasonable profits)  
 Effectiveness ( Maximum Value Among Competitors)  
 => Branding  
 +  
 Efficiency (Minimum Cost for desired quality)  
 => Product/Service Success  
 +  
 Build Track Record (Max Profit/Min Cost For Entire Line)  
 => Achieve Comparative Advantage (Forestall Competition)  
 => Business Success

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### Figure 2: Six Necessary, Strategic Abilities

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**Brand** -- Ability to create perception of exceptional value, more than competition.

**Niche** -- Ability to identify revenue-significant clusters of potential customers, who have strong needs met inadequately by competitors, and who are willing and able to purchase solutions.

**Operate** -- Ability of present operating system to efficiently produce timely solutions for



targeted niches that conform to needed operational characteristics (timely need fulfillment =>quality).

**Reach** --Ability to efficiently present the brand value proposition to niche customers.

**Service** -- Ability to enhance value in use, and profitability, through technical support, maintenance, aftermarket upgrades, product/service bundling, and systems integration.

**Finance** – Ability to document financial results; predict funding requirements; and, when needed, obtain appropriate, affordable outside funding.

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### Figure 3: Six Interdependent, Transformational Abilities

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**Physical Assets** – The ability to cost-effectively design and build/acquire/control and deploy necessary and appropriate plant and equipment, and other durable or fixed assets, in support of timely achievement of business goals.

**People** - Ability to recruit, retain, and build relationships with people, both within and outside the business, and to deploy them so that they can cost-effectively contribute hard work and smart work to the business, and can learn and become increasingly useful to the business as the years pass.

**Teams** – Ability to form, nurture and delegate to effective teams, involving people and utilizing physical assets to yield business results.

**Work Structures** – The ability to cost effectively design, integrate, and train staff in the use of tooling, blue prints, decision aids, rules of thumb, formal procedures, and incentives that facilitate operations by maintaining consistency and predictability (i.e., model good practice and reward those who go by the book).

**Mechanisms for Improvement** – Ability to exploit a changing environment rather than be exploited by it, accomplished by continuously improving the transformation processes served by physical assets, people, teams and work structures (i.e., daily pursuit of improved quality and productivity).

**Leadership** – Ability to understand the survival requirements of the business in a changing world, and to convey what needs to be done and why to scale the business up or down in a balanced manner, while preserving top quality, profitable results (maximum value added in the eyes of stakeholders, both now and in the future, though balanced investment in all six transformational abilities).

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### Figure 4: How the Project Model Lends Itself to Building Profit Momentum

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Activity Based----->

Time Based----->

Set milestones and prepare budgets----->

Set control points----->

Track progress----->

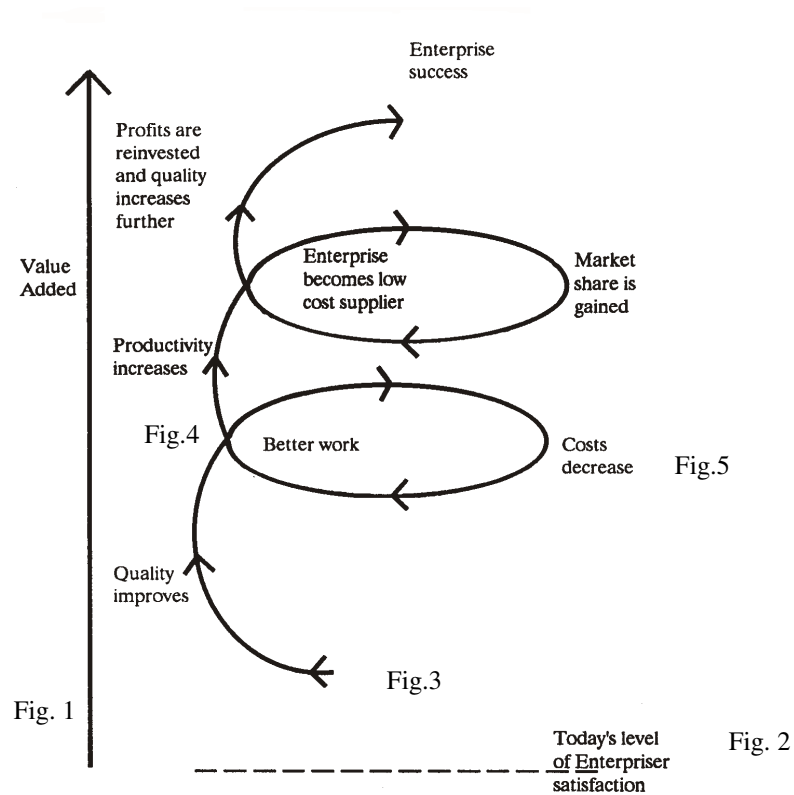
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PROFIT  
MOMENTUM

**Figure 5: Eight Financial Concepts That Underpin Successful Tracking and Action to Improve**

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1. Marginal Benefit vs. Marginal Cost (Maximum Benefit for Minimum Cost –Resource usage is a shadow of work and schedule, and cost is a shadow of resource usage.)
  2. Financial Statements (Balance Sheet, Income Statement, Cash Flow, Sources and Uses of Funds)
  3. Fixed vs.Variable Cost
  4. Contribution Margin
  5. Comparative Ratios and Bench Marking
  6. Sustainable Sales Growth Rate (Dupont System, Additional Funds Needed)
  7. Financial Tracking
  8. Special Reports
-

**Figure 6: Summary of How Five Success Framework Components Contribute To The Chain Reaction of Success**



## **PEACE CORPS EXPERIENCES IN CENTRAL AMERICA: COMMUNITY DEVELOPMENT AND ENTREPRENEURSHIP TRAINING**

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### **ABSTRACT**

The purpose of this paper is to demonstrate the impact of entrepreneurial efforts in the developing world by Peace Corps volunteers. These volunteers intuitively and intentionally foster this spirit within the communities that they serve. Although the USA is repeatedly described as the most entrepreneurial of societies, the Peace Corps and its cadre of innovative, highly-educated, and skilled volunteers has demonstrated that these efforts are alive and thriving around the world. The approach to encouraging and sustaining entrepreneurial efforts involves facilitating an environment where these activities, opportunities, and skills can be discovered and realized. Peace Corps volunteers are catalysts for this self-discovery process by facilitating community activities which promote active involvement in problem-solving and self-education. These activities must take into consideration the cultural context in which each community operates and slowly work to break down barriers which impede the self-realization process. This is particularly common with women who are marginalized within the "machismo" value system of Latin America. By training and using dedicated volunteers from an entrepreneurial society, and having them become instruments for change in their host countries, Peace Corps and other development organizations can overcome numerous barriers to entrepreneurship and the growth of an innovative perspective.

### **Introduction**

The USA is repeatedly described as the most entrepreneurial of societies (Global Entrepreneurship Monitor, 2004). In comparison, many other countries are said to suffer from cultural, structural, governmental, and other constraints not only upon entrepreneurial activity, but even entrepreneurial thinking and perspectives that espouse innovation. However, since 1963, the Peace Corps has contributed to improving conditions in the Third World through the service of a dedicated cadre of volunteers. This paper discusses the role of Peace Corps in rural community development and entrepreneurship training, with examples of programs that contribute to those outcomes specifically in Central America. Programs run by two Peace Corps volunteers, one in Honduras, and one in Costa Rica, are presented as illustrations of how Peace Corps contributes to the communities in which the volunteers serve. This paper briefly introduces the Peace Corps, and describes how Peace Corps volunteers are selected and trained for entrepreneurial characteristics. Cultural conditions in Central America are briefly discussed, and a framework is presented for viewing Peace Corps efforts to encourage entrepreneurial perspectives for community development and for small business projects. Finally, programs are

described to illustrate the outcomes of volunteers' efforts in community development and entrepreneurship training. The authors conclude that Peace Corps can overcome numerous barriers to entrepreneurship and contribute to community development and the growth of entrepreneurial perspective.

### **Peace Corps – An Overview**

The Peace Corps was formally established in March of 1961 under the presidency of John F. Kennedy. Since its inception, over 170,000 Peace Corps volunteers have served in 136 countries around the world. Currently, over 7,500 volunteers serve in 71 countries (peacecorps.gov, 2004). With a significant number of Peace Corps Volunteers assigned to community development and small business development projects, it should be no surprise that a number of volunteers' characteristics reflect archetypical characteristics of entrepreneurs (Table 1). As many volunteers maintain personal responsibility and authorship for their isolated projects, they must be entrepreneurial to succeed. As reported by the first author, Peace Corps trainers training encouraged him that “ideally, your job is to put yourself out of a job” by the successful implementation of his community projects.

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#### **Table 1 about here**

### **Entrepreneurship Training and Culture**

The United States enjoys a very strong culture of entrepreneurship, and as such, cultural models of successful entrepreneurs abound. With entrepreneurship salient in the national conscience, it is common, more so than in most other parts of the world, for Americans to consider making a career as an entrepreneur. Further, this attitude extends into other endeavors, as this cultural component and our freedoms encourage a sense of individual empowerment, not only for business start-ups, but in other dimensions as well. The components of the external environment can either encourage or inhibit entrepreneurial characteristics in people (Hall, 2001). Unlike the USA, many other countries do not enjoy such an encouraging environment for entrepreneurship.

Culture studies have borne out the intuitive conclusion that world cultures are different, and can inform differences in thinking by their participants (cf. Hofstede, 1991). Please see Table #2 below for a brief description of cultural dimensions as they relate to this discussion. Latin American culture has been characterized by collectivist values, high in power distance, high uncertainty avoidance, and quite masculine relative to other cultures. North American culture (U.S. and Canadian), in contrast, tends to be much more individualistic, low in power distance, medium in uncertainty avoidance, and also masculine, though not nearly to the extent of Latin American cultures (Hath, 1988).

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#### **Table 2 about here**

Among particular cultural challenges faced by Peace Corps volunteers in Central America is the strong culture of machismo, where women were generally subjugated into traditional roles and are not encouraged to pursue education or pursuits of their own interests. Another issue is the sense of predestination, or being at the mercy of some higher power. The common saying “*Si Dios Quiere*” (If God wills it) set some immediate barriers to moving forward with any project, idea, innovation, etc. Poverty seemed to magnify these attitudes.

Regardless of the cultural environment, but especially in cultures where entrepreneurial behaviors and values are not encouraged, individuals must be sensitive to opportunities. This may require training in the entrepreneurial perspective and learning entrepreneurial skills. Dr. Ulrich Braukmann and his workgroup at the Bergische Universitaet Wuppertal in Germany have developed the taxonomy of start-up relevant competencies, which can be seen as a roadmap for entrepreneurship training and education (Figure 1).

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**Figure 1 about here**

As shown schematically in the figure, working from bottom to top, the framework begins with Class I objectives at the stage of sensitizing people to the possibilities of entrepreneurship. In the context examined here, this specifically includes the ideas of growth and ability to continue the businesses or projects. Both Central American Peace Corps Volunteers stated that there was extensive interest in small businesses and projects in their host countries, but at very low levels. There were “always village women selling baked goods or foods they had prepared” but that these endeavors never were conceived to lead to any opportunities greater than simply relieving some of the problems of subsistence for poorer women and their families. Parenthetically, it was quite usual practice for women pursuing these low level business practices to turn most or all their profits over to their husbands, so frequently their efforts contributed more to recreational spending by the men rather than any significant bettering of living conditions for the families or for their villages. In contrast, some women hoarded their profits for the survival of their family members, as necessities might not be provided by their men-folk, who spent their money on themselves instead.

Following the framework further upward, Class II objectives are expressed as attitudes, comfort, maturity and perspective for considering entrepreneurial ventures or projects. Included here would be modeling possibilities, and in the case of Central America, the beginning of community and group consciousness of being able and poised to exploit opportunities for advancement. As the framework culminates in Class III objectives, non-business and business skill sets are taught or encouraged, to support the growing interest in exploiting opportunities. While the Peace Corps did not train the volunteers mentioned in this paper in this framework, it provides a natural pathway from naïve to formal thinking on the parts of the potential innovators – describing the process of moving from the untutored, subsistence level perspective of the “folk art of entrepreneurship” to the better-trained, higher level, opportunity-sensitive perspective of the “fine art of entrepreneurship.”

### **COMMUNITY DEVELOPMENT IN HONDURAS**

The first author was posted in the rural Yuscaran area of Honduras after a training program that included technical and practical training among other dimensions such as local language and culture. Community programs developed or extended by the first author were varied, but most revolved around the opportunities to encourage increased levels of tourism for the city and the region, with the objective of growing revenues for the city and for its local business community.

#### **Mango Festival**

Previous to this volunteer's posting, this had been a relatively small and very local festival. The volunteer worked with the local festival committee, encouraging them to take a more entrepreneurial attitude to the promotion of the festival. As a result, sponsors like Coca-Cola donated many more items to the festival, and the committee improved their self-promotion to media in the capital city. Further, new events were added to the Mango Festival, such as a "Donkey Polo" game that has become a popular national event, broadcast by national television and promoted in a new edition of a Honduras guide book. Outcomes from the increased promotion of the festival include: Increased tourism; more commitments for future sponsorship; vastly improved advertising of the festival at the national and regional level; and improved variety in the events offered.

### **International Bike Race**

During the second year of the volunteer's service, he realized that there was an opportunity for the community to exploit the region's justifiable reputation as a mountain biker's paradise. A local committee negotiated with Coca-Cola to persuade them to sponsor the race with publicity and trophies. As the event has grown, participants are now coming from all over Central America to compete in the race every year. The mountain bike race is also promoted in the Honduras guide book. Benefits accruing from the bike race include: Increased tourism and name recognition for Yuscaran; Improved opportunities for sponsorship of future races; Growing promotion of the city and the race due to building connections with media and advertisers.

### **Fundación Yuscarán**

A local non-profit organization had begun shortly before the arrival of the volunteer. With involvement of two other volunteers from the area, the group was able to increase tourism and began projects to save the natural cloud forest reserve in the mountains above the city. A number of seminars were developed to train members of the foundation in basic marketing, tourism, and computer skills, so they would be better able to promote their projects and exploit new opportunities. Benefits to the community of these projects include: Promoting and protecting natural resources and culture of the city; and the Fundacion Yuscaran has attained the status of a legal and recognized non-profit organization, thus improving the probability that it will continue its work in the community.

While the Peace Corps programs in Honduras concentrated more on community development opportunities, those in Costa Rica were more focused on local small business opportunities for citizens in more rural isolated locations.

### **EXPLOITING ENTREPRENEURSHIP OPPORTUNITIES IN COSTA RICA**

The second author of this paper was sent to Costa Rica as a Peace Corps volunteer, and posted in the Rio Celeste-Colonia Naranjena-La Florida area of the country (Cuerpo De paz, 1995). The volunteer assisted area businesses and project groups, assessing their business needs and planning and implementing new viable small enterprises. He organized, taught, and provided consulting to two women's associations, one indigenous cooperative, three agricultural organizations, and several small businesses during his years of service. In addition, he also provided ongoing training in business skills to about forty community business people. Through these training seminars, over 300 community members benefited from increased group and business efficiency and profitability.

### **Asociación de Mujeres Las Celestinas – Plantain Chip Factory**

A factory was planned, funded and built to buy plantains from local farmers, bolstering the local market for this produce and helping to create a product that could be sold nationally. Activities surrounding this project included:

- Formed the association, wrote the charter with members
- Taught business planning and business idea development
- Wrote a funding proposal resulting in \$20,000 for factory construction
- Liaised with department of agriculture to visit similar sites around Costa Rica
- Managed material purchases for the factory construction
- Managed factory construction
- Taught basic accounting, inventory and personnel management
- Marketed the end product
- Additionally developed a small dried spice and herbal medicine business

### **Asociación de Mujeres de Apacona – Dehydrated Produce**

With this local group, a viable small local business was investigated and implemented. Pineapple grown in the area could be marketed nationally after processing. Activities included:

- Assisted in formation of the association
- Taught business planning and accompanying skills
- Assisted with feasibility studies
- Taught basic computer skills
- Developed computer accounting worksheets
- Worked with the dept of agriculture for proper use of chemicals
- Began a composting program

### **Cooperativa Malecu – Native Reservation and Farmer's Cooperative**

Along with working in community development projects for this very small native reservation in the region, this volunteer worked with the reservation cooperative store to make it more efficient and profitable. Activities associated with this project included:

- Taught basic accounting and inventory skills for cooperative store employees
- Worked with the reservation developing an artisan crafts business to serve tourists
- Trained community leaders in assessing and determining strategies for the cooperative.

At the current time, a number of these programs are still in operation. While, as in many cases, the Peace Corps volunteer was the catalyst for training and innovations in entrepreneurial perspective, the volunteers only stay for two years. In Costa Rica, the *Centro Nacional de Aprendizaje* (the National Center of Learning) continues to build the entrepreneurial perspective for residents through ongoing training seminars in business skills and education opportunities, such as graduation equivalency courses. Over the years, the plantain drying factory the volunteer helped to finance and build has metamorphosed into a business incubator and training center for the women of the community. It has become a rich environment for start-ups of women's businesses. Further, it is a training center with classes in tailoring, clothing design, and baking.



For those learning baking, there is even a small bakery in the old factory, which produces goods for sale in the community.

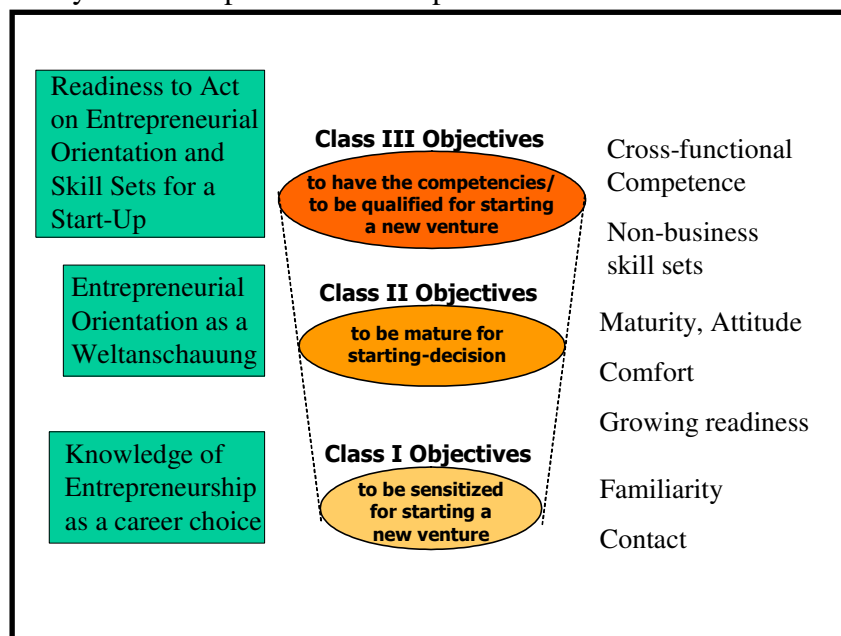
## Conclusion

The reach and impact of the Peace Corps since its inception in the early sixties have been extensive. This paper has examined how this organization capitalizes on the entrepreneurial characteristics of its volunteers to bring an entrepreneurial perspective to rural people in Central America. In spite of traditional, cultural, and structural inhibitions and limitations to entrepreneurial thinking, growth in these dimensions was seen. Through community development projects, business skills training, and encouraging small business start-ups by individuals, associations, and cooperative groups, Peace Corps contributed by helping to encourage innovation, recognition of opportunities, and actual business start-ups in rural areas where these would be unlikely to occur without some external help. The first author commented on the goal of the Peace Corps volunteers to "...do their job by putting themselves out of a job." In the words of the second author:

I believe the true economic impacts have and will come from the self-empowerment of some of the citizens in the small settlements where I worked. I am very proud to have been a part of this process (Toops, 2004).

To the extent that entrepreneurship and innovation depend on the empowerment of the community, Peace Corps volunteers can be seen as community facilitators who help others recognize and exploit opportunities for their own self-empowerment.

**Figure 1 - Taxonomy of Start-Up Relevant Competencies**



**Table 1 – Entrepreneurs and Peace Corps Volunteers (Adapted from Kao, 1991)**

| <b>COMMON CHARACTERISTICS OF ENTREPRENEURS WITH<br/>CORRESPONDING CHARACTERISTICS OF PEACE CORPS VOLUNTEERS</b>   |   |
|---|---|
| <ol style="list-style-type: none"><li>1. Total commitment, determination and perseverance</li><li>2. Drive to achieve and grow</li><li>3. Opportunity and goal orientation</li><li>4. Taking initiative and personal responsibility</li><li>5. Persistent problem solving</li><li>6. Realism and sense of humor</li><li>7. Seeking and using feedback</li><li>8. Internal locus of control</li><li>9. Calculated risk taking and risk seeking</li><li>10. Low need for status and power</li><li>11. Integrity and reliability</li></ol> | <p>Each of these characteristics of entrepreneurs can be seen reflected in the behaviors of Peace Corps volunteers:</p> <ol style="list-style-type: none"><li>1. Volunteers make a two-year commitment to their communities and become assimilated into their communities by the time they leave.</li><li>2. They are often driven to see progress in their communities</li><li>3. Many volunteers are sensitive to opportunities, and set goals and strive to achieve them.</li><li>4. Volunteers work with community members, but often take responsibility for ultimate success or failure of their projects.</li><li>5. Peace Corps volunteers, more than most other professionals, are forced to find multifaceted solutions to problems every day.</li><li>6. Out of the myriad of problems facing the any site, volunteers must be able to decide which ones are viable and can be tackled, and they must try to maintain a sense of humor about it.</li><li>7. It is common and encouraged to seek feedback from volunteers and others regarding successes and failures and culturally appropriate solutions, as well.</li><li>8. Volunteers tend to self-recruit for characteristics of self-determination, and the belief that they can get things done successfully. Volunteers tend to be calculated risk takers, being able to see success in their mind's eye.</li><li>9. The life of a volunteer in the Peace Corps is unlikely to be high in status and power; motivation tends to be intrinsic rather than extrinsic.</li><li>10. Volunteers, having dedicated themselves to serving their communities for two years, must be people who act with integrity and do what they say they will do.</li></ol> |

**Table 2 – Hefstede’s Cultural Dimensions (Adapted from Deresky, 1994, pp. 82 – 84)**

| <b>HOFSTEDE’S CULTURAL DIMENSIONS</b> |  |
|---------------------------------------|--|
| <b>Individualism/Collectivism:</b>    | This dimension refers to the tendency of people to look after themselves first and see themselves as identified primarily by their individual attributes (individualism), versus seeing themselves first and foremost as members of an identifiable group. Hofstede’s findings suggest that countries higher in individualism tend to have higher GNP’s and more encouragement of individual initiative than more collectivist countries.  |
| <b>Power Distance:</b>                | This dimension represents the level of acceptance by a society of unequal distributions of wealth and power. It can be said that in high Power Distance cultures, empowerment opportunities are less likely to be perceived, as one’s station in life is already determined.   |
| <b>Uncertainty Avoidance:</b>         | Refers to the extent to which people in a culture feel threatened by situations that are ambiguous. People in high uncertainty avoidance societies tend to favor low-risk decisions.   |
| <b>Masculinity/Femininity:</b>        | This dimension refers to how heavily traditional Western Europeans and North American “masculine values” are espoused by a cultural group. These values include assertiveness, materialism, and lower levels of concern for others. Feminine values, in contrast, emphasize concern for others, valuing relationships, and attention to quality of life issues. In highly masculine societies, women are generally considered extensions of their men, and expected to maintain traditional roles of wives and homemakers. |

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**DO QUALITY AWARD MODELS HELP SMALL BUSINESS  
TO BE MORE SOCIALLY RESPONSIBLE?  
EXPERIENCES FROM TURKISH QUALITY AWARD SCHEME**

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# **DO QUALITY AWARD MODELS HELP SMALL BUSINESS TO BE MORE SOCIALLY RESPONSIBLE? EXPERIENCES FROM TURKISH QUALITY AWARD SCHEME**

**Semra Ascigil**

## **ABSTRACT**

Corporate social responsibility (CSR) is a theme that is integrated to quality management and quality award models with increasing emphasis in time. Although CSR is discussed as a strategy applied mostly by large firms, the award schemes for SMEs aim to disseminate use of model to smaller firms. Quality award models provide relevant guidance to SMEs whose development is argued as dependent on management of wider networks for innovation and formation of social capital. The paper investigates to what extent the EFQM model provides guidance in integrating CSR in quality management and then explores how the concept is operationalized by two quality award finalist SMEs in Turkey.

## **INTRODUCTION**

Corporations are under the scrutiny of diverse stakeholders that made them accountable to not only shareholders but also other internal and external stakeholders. The point reached is beyond what Friedman (1970) once defined with the statement “the only responsibility of business is to increase profits” pointing sole responsibility to shareholders. Carroll (1979) has provided the definition of the dimensions of corporate social responsibility (CSR) concept and operationalized the construct through economic, legal, ethical and discretionary activities of business organizations. Among the responsibilities that management is expected to adhere, economic responsibility was the most well known one due to the historical importance attached in discussions of managerial behavior. The thrust behind economic responsibility in business is simply producing goods or services that will bring profit. There are reservations as to whether this category can be considered a social responsibility, however, a reinterpretation such as “providing consumers goods or services at the lowest cost with highest quality and make reasonable level of profit” may help bring an inclusive perspective.

As the number of stakeholders management have to deal with increased depending on the issue at hand, companies realized that their borders are quite fluid. As a consequence, concepts like “boundaryless organizations” and “networks” became major topics for researchers (Carroll and Buchholtz, 2000). With changing relations, management of communication across the boundaries became crucial. However, such relationships have to be managed with a different understanding of the role of organizations in society. Social responsibility in business simply describes company relationships with stakeholders and in case effectively done contributes to learning and offer competitive advantage (Freeman, 1984; Freeman & Gilbert, 1988). Stakeholder model also provides a useful framework to evaluate CSR through social reporting activities. Social reporting processes are means for communicating the social and environmental effects of organizations to particular interest groups.

Although views has changed over time concerning the use of organizational resources for larger community, the need for revising corporate responsibilities is evident within academic research. Doing business with social responsibility outlines how stakeholder management should be embedded into company operations and whether companies will take responsibility

of social issues. Recently, Total Quality Management (TQM) is interpreted to include concepts like business ethics, social responsibility and governance. The enlightened view of quality management offers a more strategic perspective of quality where the focus is broadened to cover firms' relationships in a larger environment (Garvin, 1988).

The aim of the paper is to identify salient points of Excellence Model used by European Foundation for Quality Management (EFQM) regarding social responsibility and then see how Excellence Model is operationalized by SMEs applying the model successfully.

## **QUALITY MANAGEMENT AWARD MODELS FOR SME ASSESSMENT**

It is increasingly argued that efficient use of venture capital is no longer the sole determinant for gaining competitive advantage. The development and survival of SMEs are increasingly dependent on soft factors such as whether effective management policies are deployed to create a broader prosperity. Development towards a broader vision is a result of an interactive process not only within the SME, but also between the firm and some institutions in society. Growth of SMEs adopting social responsibility will also serve in building social capital through stakeholders relations. Therefore, partnerships established and policy tools promoted by various institutions in a given society are of great importance.

The interest of SMEs in award models is relatively new. SME categories have been added to Baldrige Award scheme in late 1980s. EFQM added the category in 1997 followed by Turkish Quality Association a year later. The recent issues in management are integrated into quality award models through periodical-revisions. EFQM Excellence Model, which is used in Europe, is based on stakeholder approach in managing organizations. The Foundation makes such adaptations by way of incremental changes in its annual revisions as well as big changes every 4 years with the help of expert committees. By revisions done in year 2000, the model made ethics and social responsibility related issues that were already existing, more visible. Quality Association (KalDer) in Turkey has been using EFQM Excellence Model since its foundation. During the award process KalDer is training the assessor pool with cases prepared by EFQM. At the same time some assessors in Turkish Award scheme are serving as assessors in European award scheme.

By giving a non-prescriptive framework for management the award models allow for management initiative in implementation. The models are also useful tools for self-assessment. Unlike Baldrige model, EFQM Excellence model is made up of nine major criteria (Figure 1). The first five (leadership; policy and strategy; management of people; management of resources and partnerships; management of processes) are labeled enablers describing the approaches. The last four criteria (people related results, consumer-related results, and impact on society and results) are labeled as outcomes. The major message given by way of the grouping of criteria into two is that in order to change the outcomes obtained today, you need to review and change the approaches adopted in the past. In other words, you can not change your present without changing the past approaches. Importance of stakeholder management is another highlight whereas successful implementation rests upon balanced emphasis on needs and legitimate claims of various stakeholders. In addition to stakeholder commitment, care for natural (e.g. pollution, packaging, waste management) and physical (e.g. safety, health, and ergonomic aspects) environment is also emphasized.

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Figure 1 about here

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## **METHODOLOGY AND FINDINGS**

### **Research Purpose**

Research associating quality management and corporate social responsibility in SMEs is rare. The research question is structured as:

What is the content of issues within stakeholder groups that quality award finalist SMEs are addressing regarding corporate social responsibility?

### **Methodology**

Past research on CSR activities of large firms used companies' self-presentations of their CSR activities on company websites (Snider, Hill and Martin, 2003). The lack of existing research on SME social responsibility led the author to conclude that qualitative research will be the most appropriate methodology for the study. In addition to this, since social responsibility is a concept penetrated to quality award schemes only recently, the related practices are supposed to be in their embryonic phase justifying an exploratory type of research. Therefore, analysis of award submission books followed the tenets of grounded theory and qualitative content analysis. The analysis designed by Glaser and Strauss (1967) focus on revealing patterns among information and give a meaning to data rather than imposing a framework from outside. The data used for this investigation is the quality management related assessments of finalist companies applying to the award scheme for SME category. In analysis, first, the data is scanned for explicit and implicit statements regarding firm's moral, ethical, legal and philanthropy related responsibilities to all internal and external constituencies. The information acquired is sorted secondly and then categorized by stakeholders. Thirdly, the data is reread to organize like information into separate groupings of issues. Fourth, possibilities of differences between two SMEs were explored among the issues and stakeholders.

SME category in the award scheme defines firm size based on the number of full-time employee and covers those firms with less than 250 employees. SMEs are further grouped as either dependent (at least 25% of its shares owned by a holding company or a group) or independent. Self-assessment reports prepared according to Excellence Model that are submitted to organizing association KalDer are used as self-reports of companies. The submission books of TQM champions provided in-depth cases to be used for the exploratory analysis. It is thought that because these companies have proven their performance in implementing the model, the way they interpret and operationalize the EFQM model is enriched enough to involve social responsibility related endeavors. Among the companies contacted, positive response of two is obtained. Each firm has been given a pseudonym that was in line with their market and sector. Thus, Service Domestic Firm (SDF) provides service to domestic market whereas Manufacture Global Firm (MGF) manufactures intermediate goods for global markets. In terms of size SDF is smaller than MGF.

### **Findings**

SDF is a dependent SME operating in service sector providing logistical services for a product. The mission is being the best service providing logistics center in Turkey. Their focus is more on distribution chain within the country and contributions to the happiness of ultimate customers achieved through responsiveness to their increasing expectations. The firm values are defined around "focus on human resources and customers," "technological

infrastructure," "openness to change" and "proactivity." SDF supplies products from foreign suppliers and acts as a facilitator between domestic and foreign suppliers in improving the parts, competitive pricing as well as dissemination and sharing of improvement related experiences.

MGF is characterized as a dependent SME with high technological competencies. The mission of the company highlights customer, shareholder and employee as primary stakeholders. The customer is viewed as partner and MGF aims to develop perception of a reliable firm delivering excellently performing products. Responsibility of MGF towards shareholders is defined as retaining competitive position and efficient use of resources. Additionally, the mission statement emphasizes creation of open, well functioning company in order to enhance involvement and teamwork while upgrading skills.

MGF's mission emphasizes worldwide recognition on excellence. Because it operates globally through supplying its product to firms in various countries, it is organized as a flexible company to produce many different types of its product demanded in markets. The organization has therefore a flat structure. Excellence Model is accepted as a tool for self-assessment and guide five years before being a finalist.

The results reveal that both firms concentrate their attention on a similar set of stakeholders imposed by the Excellence Model. Both firms consider input from all stakeholders in strategic planning. However, the emphasis varies depending on the business environment they are operating in. Social responsibility related activities are described below within appropriate categories.

Employee: Development of policies focusing mainly on safety, health and training of employees is commonly observed in both firms reflecting emphasis on proactivity with regard to fulfillment of responsibility towards employees. Monthly safety and health meetings, emergency planning in case of fire (alarm systems, covering floors with inflammable material) are some examples for such activities. In general, the training provided aims both personal development of employees as well as company success. The emphasis on the importance of human capital can be observed in processes developed to upgrade human capacity. Viewing leader training as a mean to serve the purpose of improving communication with employees concerning meaning and role of quality management, both companies vigorously utilize human resource management tools. Given such an aim whereby enriching the understanding of award model is the target, it can be said that a readiness for broader interpretations of quality management is in place in both firms. Both companies are sensitive in developing performance evaluation systems that helps establishing fair relationships with employees. In MGF, employee recognition scheme is developed addressing different accomplishment situations to enable fairness. Performance evaluation in both firms is linked to participation in continuous improvement activities enabling consistency with firm goals. These efforts are justified as leading to improvements in employee satisfaction and variety of other measures like lower turnover, sickness, and absenteeism. Both MGF and SDF manage information resources with the purpose of assuring equal opportunity in accessing appropriate and reliable information. Compliance to regulations is done by cross checks to meet legal responsibilities. Social activities provided aim to create a work-life balance as well as enhance the spirit essential for teamwork.

Customer: In both firms, customer is identified as one of major stakeholders. There are processes developed to hear their needs and handle their complaints. Measures concerning



complaints, satisfaction, and loyalty are used with the aim of fulfilling responsibilities to customers. The relationship with customers continues after sales in terms of training on recent changes or obtaining feedback for further improvement. In MGF customer relations are handled by dividing into commercial issues and technical issues each assigned to related divisions. The improvement related activities are varied taking the form of meetings, quality circle activities and improvement projects organized jointly. In MGF case, the aim is establishing the ideal of partnering with customer on business improvement. Improvement done concerning a particular customer is deployed to other customers showing a concern for equal treatment. Reciprocal relations are developed through training of customers and training received from customers which enables sharing of expertise and information for proactivity and innovation. Similarly, SDF receives training and exchanges market related information with suppliers in order to address customer right for a quality product. The customer relations are handled with a proactive orientation to prevent dissatisfaction from the supplied product/service in both firms.

**Suppliers:** As SDF is not a manufacturing firm, the relations with suppliers are limited in scope and do not involve monitoring by way of audits. However, SDF acted as a facilitator by organizing workshops during which domestic suppliers and foreign suppliers met to develop business relations and improve efficiency and quality of products. Whereas in MGF case, relations with suppliers are managed through a formal supplier evaluation system that provides input to identify priority areas for improvement. Innovative examples for joint improvement activities are planned and carried out together with supplier firms. MGF has systematically included environment-related issues in purchasing decisions, a challenging policy in terms of requirements for openness. Thus, the policy not only changes their own processes, but also changes the business behaviors of suppliers.

**Competitors:** Competitors in general are the forgotten stakeholder in any firm. Green (1994) argues that competitors are "corporate stakeholders with a claim for fair treatment." The cooperation and trust developed among competitors may help understand the reasons for mutual support and collaboration between SMEs. The relevant examples traced are few in both cases. In case of MGF where innovativeness is a prominent goal, process-benchmarking activities attended serves in building interactive relationships with other producers, thus enabling cooperative relations with competitor companies. In SDF case, firm is tracing competitors to make price related suggestions to suppliers.

**Society:** MGF shows visible effort to spread best practices within and outside the holding organization by way of seminars, team presentations, publications, and training. Philanthropy related activities are institutionalized through linkage to a Foundation within the holding company. SDF's approach focus more on maintaining safety in immediate environment through strengthening safety in case of fire. SDF is engaged in philanthropy as well, with major activity areas being education, health and cultural development of society. To ensure accountability for the process of creating a desirable impact on society, teams are designated to work on societal relations. "Societal Positive Impact Teams" are such examples formed to develop action plans and budgeting of these activities.

**Environmental Issues:** Environmental responsibility is another area where both firms are engaged in its development and thereby found under various stakeholder categories. However, the reasons for involvement differ. High stakeholder pressure and inherent potential in production for harming environment seems to be the reason leading MGF to deal with the issue by developing formal processes. MGF questions environmental profile by

surveys (Total Environmental Care Survey) supported by energy saving projects, environment-related publishing and participation in environment focused NGOs. Additionally, the supplier audits are performed by Quality and Environment Control Section Manager pointing to the availability of socially-responsible buying practices. On the other hand, the major examples of sensitivity in environmental issues implemented by SDF are water distillation and recycling projects. Other projects relate to paper waste prevention project replacing cardboard packaging with steel cages, use of centralized air-conditioning working with ozone layer friendly gases, saving of electricity, using LPG in heating to prevent pollution.

Intellectual Property: Examples for the care shown in protecting intellectual property rights can be seen in both firms.

## **DISCUSSION**

The above findings point to the fact that CSR is not at the monopoly of large firms with an organizational structure where maintaining reputation by way of CSR is the exclusive preserve of PR or communications departments. When utilized vigorously, Excellence model may provide a systematic perspective in establishing social responsibility in an SME. The fact that the model is based on stakeholder mentality is an advantage to be exploited in CSR related implementation. Because issues that are concerns of stakeholders are addressed in CSR, Excellence model helps to handle these issues in a more systematic manner. Another advantage provided by Excellence Model is that it encourages firms to make an impact analysis in the first place and then prioritize social responsibility areas. The model brings much comprehensive approach to CSR by preventing reductionist perspectives where social responsibility is equated with corporate philanthropy.

SMEs may not have individual resources to consider the impact of their activities on various stakeholders proactively. The more proactive the strategy, the more formal processes need to be employed where greater stakeholder involvement becomes essential in these processes. Therefore, employing structures (alliances, networking) that enable interaction with stakeholders becomes key success factor for SMEs in implementing CSR. Partnerships established are recent examples of such structures enabling exchange of information and experience. Success is attained by letting partnering stakeholder organization to give feedback as to company's impact on stakeholders which otherwise may not be recognized at all. The examples for improvements in the above cases are mostly the outcomes of joint improvement projects allowing the firms to consider stakeholder claims proactively.

Successful implementation of CSR requires partnerships with numerous stakeholders in variety of issues. The examples in the two cases are performed with organizational stakeholders involving primary stakeholders; i.e. customers, employees, shareholders, and suppliers. No major examples for partnerships with regulatory stakeholders (including local and national government, professional organizations, and competitors), community stakeholders (environmental and human rights groups, consumer advocates) and media are found in the two cases. Turkish Quality Association, in fact, was a sort of hidden partner in both cases that contributed organizational learning and growth. Considering the above two success stories, it is evident that providing support in developing management systems are equally important for SMEs as provision of financing in being sustainable.

The availability of benchmarks on CSR is another factor for innovative CSR implementation. For example use of minority suppliers, which is an issue most prevalent in U.S. designates preference of diversity of suppliers in terms of gender, size, racial background. Employment of such criteria is not yet observed in firms of any size in Turkey. However, just like learning as a result of interactions with foreign partners, the pressures of urgent needs may be the reason for creative solutions in the way CSR is operationalized in SMEs.

The above cases also reveal the importance of three factors in launching CSR in SMEs; stakeholder pressures, broader perceptions of quality, and support in the process of implementation. Stakeholder pressure is more prominent in MGF than SDF in showing sensitivity to environmental issues. In the absence of stakeholder pressure, firms' engagement in CSR may not be formalized through audits, social reporting, etc. In other words, those efforts will be individualized responses rather than collaborative responses involving partnering stakeholders. The values embracing excellence, social duty, human rights themes are also driving forces for integrating social responsibility to quality management concept. An enlightened quality notion should eventually involve social responsibility concept. The benefits to be derived from CSR are integrity, continuous work relations and growth.

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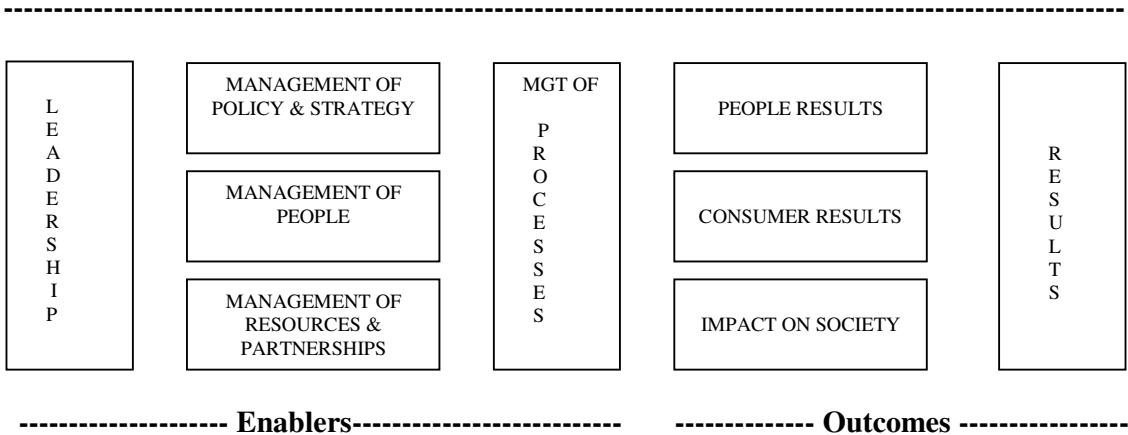
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**EXCELLENCE MODEL**  
**Figure 1**

# **Venture Capitalists, Insider Ownership and Firm Performance around IPOs: Small Firm Evidence** by

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## **Abstract**

This study examines the potential substitution between insider ownership and external monitoring, and the role of venture capitalists in IPOs with sales less than \$35 million, the median level of all firm-commitment IPOs over the 1980-1998 period. We find that majority-owned small firms have lower profit margins yet are more efficient before the IPO, and that the presence of venture capitalists reinforces these characteristics. However, they are valued less after the IPO, though this may be ameliorated by VC presence and higher inside ownership retention after the IPO. We observe that VC-backed IPOs are valued more after the IPO and that they tend to do better in the aftermarket. Our results suggest that higher insider ownership retention and VC involvement in small firms provide signals of quality for newly listed firms.

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## **1. INTRODUCTION**

This study investigates the relationship between insider ownership and firm performance around IPOs (Initial Public Offerings). Our primary goal is to assess the relationship between insider ownership and venture capitalists and performance. To do this, we compare and contrast the characteristics and performance of firms that are majority-owned *vis a vis* non-majority-owned both before and after the IPO. This study examines IPOs that occurred over the period of 1980-1998 by firms with less than \$35 million in sales, the median level of all firm-commitment IPOs over the period. This group of IPOs occupies the so-called "Middle Market," which represents a large swath of businesses in the United States and, therefore, provides important information relevant to scholars as well as advisors to small firms.

This study focuses on small IPOs for three reasons. First, small firms tend to be less liquid, are more vulnerable to information asymmetries, and are more likely to be majority-owned than large firms. Therefore, they may not be valued as highly in the market. Second, small majority-owned firms are less likely to have "professional management," since the founding family or owner group, with such a large stake, is likely to be actively involved in managing the firm. Therefore, these firms are less likely to possess the managerial depth needed to navigate the rough waters of the public markets. Finally, the influence of VCs may become more significant since the management may be less sophisticated and suffer from entrenchment.

Insider ownership, because of the incentives it provides, may be related to company performance (Jensen and Meckling 1976, Stulz 1988, Morck et al. 1988, McConnell and Servaes 1990, and Nagar and Wolfenzon 2000.) With respect to IPOs, insider ownership retention may also provide information about a firm's quality. Insiders, who have better information than outside investors, will be more willing to hold shares if

they expect the company to have good future prospects (Leland and Pyle 1977, and Downes and Heinkel 1982.)

Similarly, the presence of venture capital investors in a firm may provide a signal of quality. VCs are sophisticated and well-informed investors; so the fact that they have made investments in a company serves to certify company quality, much like bank loans are a signal of quality because of the due diligence analysis a bank undertakes before lending (James, 1987). Further, VCs often provide managerial, financial and strategic expertise, which adds value to the firms in which they invest (Megginson and Weiss 1991, Brav and Gompers 1997, Astrachan and McConaughy 2001.)

The literature suggests that VCs are associated with higher performance in IPOs, though this may not be the case for small manufacturing firms. Further, the literature with respect to insider ownership suggests that higher insider ownership retention after the IPO is a signal of quality and is associated with better performance. This study extends the research on small firm IPOs by looking at a larger sample of small IPOs over a longer period of time and across industries.

## **2. HYPOTHESES AND METHODOLOGY**

We intend to test the following hypotheses:

H1: Venture capitalists are associated with better performance in small firms.

H2: Higher insider retention of shares after the IPO is associated with better stock market performance in small firms.

To test the hypotheses, we employ both univariate and multivariate analyses because univariate methods alone are inadequate. Since majority-owned firms are generally smaller and may differ systematically from non-majority-owned firms, a multivariate analysis provides a clearer profile of majority-owned firms versus their more diffusely-held counterparts. The analyses are in terms of event time. In other words, for each IPO issue, the zero time is the IPO date.

## **3. DATA**

The sample, drawn from the SDC New Issues database, includes firm-commitment IPOs over the 1980 – 1998 period for firms with less than \$35 million in sales, which was the median level of sales among IPOs over this period. We eliminated closed end funds, unit investment trusts, firms without sales and IPOs whose shares sold for less than \$5.00.

In order to get a broad view of the performance of IPOs in the sample and specifically majority-owned IPOs and the role of venture capitalists, we examine the firm characteristics both before and after the IPO, the offering characteristics of the IPO firms, the insider ownership characteristics, and the stock market performance. We also employ some of these characteristics as control variables in order to ascertain the special characteristics of majority-owned IPOs and the role of VCs. We describe the sample firms as majority-owned if insider ownership before the IPO was 50% or greater and non-majority owned if the insider ownership before the IPO was less than 50%.

### **3.1 Company Characteristics**

*Sales* is reported in millions of dollars as reported for the year before the IPO. Size is an important measure due to scale and scope effects as well as being a measure of success. It is an important control variable. *Assets*, an alternative control variable for size effects, is measured in millions of dollars as reported for the year before the IPO. *Total Asset Turnover* is calculated as sales divided by assets. It is a measure of asset use efficiency. Generally, higher turnover ratios, other things equal, indicate a better utilization of a firm's assets.

*Profit Margin* is Net Income as a percent of Sales the year before the IPO. Higher values indicate a higher quality company. *ROE* is the return on equity before the IPO. *ROE pro forma* is the Return on pro-forma Book Equity after the IPO. Higher values indicate a higher quality company. *Price-to-Earnings* is calculated as IPO price to earnings the year before the IPO. It is a measure of relative value and may be related to quality. *Debt-to-Assets* is Total Debt to Total Assets at the time just before the IPO. High levels may indicate that the firm is capital constrained and must go to the equity market to get funds.

*Price-to-Sales* is calculated as IPO price to sales the year before the IPO. It is a measure of relative value and may be related to quality. *Market-to-Book Equity* is calculated as IPO market value of equity to pro-forma Book Equity at the IPO. It is a measure of relative value. Higher quality firms or those with more growth opportunities, are expected to have higher values.

### 3.2 Offering Characteristics

*Proceeds* is the amount of money that went to the company after the underwriter's discount. This is reported in \$millions. *Over allotment (% Shares)* is the percent of shares sold through the over allotment option as a percent of total shares sold. The over allotment option, the Green Shoe Option, is a common feature in IPOs. It allows the underwriter to sell more shares at the market price and yet pay the issuing firm the offering price. If the issue does well, the over allotment option is exercised. It indicates quality in that it signals to the market that the underwriters have an incentive to price the issue to do well so that they can sell over allotment shares into the market and make a profit, possibly a large profit.

*Priced above High* is a dummy variable taking the value of one when the IPO price was above the high end of the range in the prospectus, 0 otherwise. Offers that are priced above the high end of the range are ones where demand was greater. Thus, this variable is an indicator of company quality. *Priced below Low* is a dummy variable taking the value of 1 when the IPO price was below the low end of the range in the prospectus, 0 otherwise. Offers that are priced below the low end of the range are ones where demand was low. Thus, this variable is a proxy for market expectation.????

*Syndicated Offers* is a variable that takes the value of one when the IPO was underwritten by a syndicate of underwriters, zero otherwise. *VC-backed Offer* is a dummy variable taking the value of one when venture capitalists were involved, zero otherwise. VC-backed firms may be viewed as higher quality firms due to the certification that comes from having informed investors. *Lockup Duration* refers to the number of days that insiders' shares were restricted. Longer lockups may indicate a

higher quality issue since the insiders are bonded to the firm more closely. *Lockup* is a dummy variable taking the value of one when there was a lockup of insider shares, 0 otherwise.

*Underwriters' Spread (%)* is calculated as the ratio of the underwriter discount as a percent of total offering amount before payouts. This is a measure of the total direct costs of going public. Generally, due to the many fixed costs associated with going public, the percentage spread is higher for smaller issues. Lower spreads, other things equal, indicate more of the proceeds go to the company.

### 3.3 Ownership Characteristics and Stock Market Performance

*Pre-IPO Shareholdings (%)* is the percentage of insider ownership before the IPO. *Post-IPO Shareholdings (%)* is the percentage of insider ownership after the IPO. Higher quality IPOs would be expected to have higher values. *Holdings Divested (%)* is the percentage of insider shares sold as a proportion of those held before the IPO. One would expect that higher quality companies would have lower rates of divestiture since there is less risk for the insiders.

*Stock Market Returns* are expressed in percent for the time periods indicated. *NASDAQ-Adjusted Stock Returns* are calculated as the difference between the company's return over the specified period less the return on the NASDAQ stock market index over the same time period. This gives a relative, market-adjusted performance measure that will show the firm's own returns in a more meaningful context.

## 4. RESULTS AND DISCUSSION

Univariate comparisons may not reliably indicate differences between the two groups if other factors associated with majority-owned are related to the variable in interest. Controlling for multiple variables simultaneously with majority-owned allows us to estimate the relations in the presence of other influence factors. To further investigate important factors associated with offering characteristics for majority-owned and non-majority-owned IPOs, we employ binomial probit analysis for our indicator variables and the Ordinary Least Squares (OLS) regressions for others. Table 1, Panel A shows the binomial probit results. We find that majority-owned firms are less likely to be VC-backed, but firms with higher sales are more likely to be VC-backed. This suggests that venture capitalists might avoid majority-owned firms and smaller firms with lesser growth opportunities. In addition, VC-backed firms are more likely to be priced above the range and less likely to be priced below the expected price range. We also find that larger firms and VC-backed firms are more likely to have a lock-up provision.

Panel B presents OLS analysis on other offering characteristics. Our results show that lockup duration is positively related to majority-owned, but it is negatively related to VC-backed. The longer lockup for majority-owned firms suggests that a greater commitment from the insiders is needed to assure the market of the quality of the firm. However, venture capitalists do not favor IPOs with long lockup duration, which reduces the liquidity of their investments. We also find that % spread is negatively related to Sales and VC-backed. In other words, these are economies of scale. The presence of VCs is associated with lower underwriting costs, perhaps because they are better able to

negotiate with investment bankers. However, the % spread is not significantly related to majority-owned. We do not find a significant relation between the % shares offered by the over-allotment option and either majority-owned IPOs or VC-backed IPOs. An over-allotment option is essentially a call option with a strike price equal to the issue price. The over-allotment option can be viewed as a signal of quality since the underwriters cannot exercise it unless the issue remains above the offer price long enough for them to exercise. The better the IPO does in the aftermarket, the higher the gains to the underwriters. The insignificant relations suggest that the majority-owned IPOs and VC-backed IPOs do not use this option any more than the others.

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Table 1 Panels A and B about here

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Table 1, Panel C shows that size is not related to the percentage of shares owned before and after the IPO. However, the majority-owned IPOs are positively related to the percentage of shares owned after the IPO. Our finding of a positive relation between % holdings divested and majority-owned IPOs suggests that the insiders of small firms may find it less desirable to retain ownership, perhaps because they are riskier. Alternatively, majority owners have more capacity to divest and retain control.

Panel D shows results on Pre-IPO firm characteristics. We find that debt is negatively related to size, but is insignificant related to majority-owned IPOs. Before the IPO, majority-owned and VC-backed companies are more efficient. Both ROE and Total Assets Turnover are positively related to majority-owned IPOs and VC-backed IPOs.

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Table 1 Panels C and D about here

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Panel E presents results on Post-IPO firm characteristics. ROE proforma (after the IPO) is positively related to VC-backed IPOs but insignificantly related to majority-owned IPOs. The negative relations between majority-owned IPOs and the ratios of Market-to-book and Price-to-Earnings *pro forma* suggest that majority-owned IPOs were priced at lower levels. This is somewhat clarified by the stock market performance reported in Panel F, which reports a consistent negative relation for majority-owned IPOs. However, a positive relation is found for VC-backed IPOs. The results suggest that there may be an entrenchment effect in majority-owned IPOs that can be ameliorated by the presence of VCs.

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Table 1 Panels E and F about here

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To further investigate the factors contributing to the negative relation between majority-owned IPOs and stock market performance reported in Table 1, we run another set of regressions specifically on the post-IPO majority-owned firms and report our results in Table 2. Panel A shows that the presence of VCs does help mitigate the lower valuations associated with majority ownership. More importantly, the positive relation between the post-IPO insider ownership and stock market returns suggest that a more concentrated post-IPO insider ownership is desirable for the majority-owned IPOs.

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Table 2 Panel A about here

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We report in Panel B, similar results for insider ownership for majority-owned IPOs with a lockup greater than or equal to 180 days. However, no significant result is found for VC-backed. As we pointed out above, VCs may try to avoid IPOs that have longer lockup durations, or they may negotiate shorter ones. Using *Pro Forma* Price-to-Earnings and Market-to-Book ratios (Panel C), we find that market response positively to a higher post-IPO insider ownership for majority-owned IPOs. Overall, our results suggest that insider retention of shares and VC involvement in smaller, majority-owned firms provide signals of quality for newly listed firms.

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Table 2 Panels B and C about here

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## 5. CONCLUSION

The results of this study support Stulz's (1988) contention that majority-owned companies are not as valuable or perform as well in the stock market in spite of their higher ROA before the IPO. This may reflect market concerns regarding insider entrenchment, since the market for corporate control is ineffective in firms controlled by insiders holding a majority of the shares. However, our finding that the *% Owned After* is positively related to value and stock market performance is consistent with the signaling hypothesis of Leland and Pyle (1977). Further, the positive impact of VCs on performance and value is consistent with Brav and Gompers (1997) and Megginson and Weiss (1999), who hypothesize that VCs provide a certification of quality. Our findings based on a larger sample of more uniformly small IPOs drawn from more industries over a longer period of time are very different from those reported by Brau et al (2004).

Majority-owned firms would do well to consider engaging venture capitalists well in advance of a contemplated public offering. Though majority-owned firms tend to have higher ROA and Asset Turnover, they do not sell at a premium and their stock returns are lower than those that are not majority-owned. However, the impact of venture capitalists may serve to increase the value of the firm. Their contributions come in the form of experience to better groom the firm for sale.

Our results have implications not only for middle market firms in general, which no IPO study has really addressed but also for family-controlled firms, a significant holder of 'middle-market' firms. The main reason for this is because the determination of family control is difficult, time-consuming, and somewhat subjective. (Objective measures, such as McConaughy et al. (1999) used, tend to be incomplete. The difficulty creates a bias against finding results, which, however, would strengthen any significant finding.) Related to the issue of majority-owned IPOs, is the observation of Shanker and Astrachan (1996), who estimate that about 61% of majority-owned corporations are family controlled. Thus, majority-owned IPOs may proxy for family control. If so, the results are relevant to family controlled firms.

An important strategic issue in closely-held, 'middle-market' firms is that of liquidity. Liquidity needs among these firms extend beyond the need for growth capital. These firms also deal with the liquidity needs of senior owners to 'cash out' at retirement and needs associated with estate taxes. Family controlled firms with multiple generations of family members also face the problem that some other family members may not be as interested in holding shares in a private company and therefore desire liquidity. Since a public offering is one way to obtain liquidity, the factors we examined may help closely held firms focus on what matters and contribute to more successful IPOs, enhancing the wealth and liquidity of their owners.

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**Table 1 Analysis of Factors Associated with Offering Characteristics****Panel A: Offering Characteristics**

|                        | <i>Priced above High</i> | <i>Priced below Low</i> | <i>Lockup</i> | <i>Venture-backed</i> |
|------------------------|--------------------------|-------------------------|---------------|-----------------------|
| Constant               | -0.998(.000)             | -0.558(.000)            | 0.762(.000)   | -1.698(.000)          |
| Pre-IPO Majority-owned | --                       | --                      | --            | -0.584(.000)          |
| Venture-backed         | 0.213(.05)               | -0.136(.17)             | 0.468(.008)   | --                    |
| Sales                  | 0.035(.83)               | --                      | 0.534(.003)   | 1.355(.000)           |
| N                      | 830                      | 830                     | 830           | 830                   |
| Chi-Sq. p-value        | .10                      | .17                     | .000          | .000                  |

**Panel B: Offering Characteristics**

|                         | <i>Lockup Duration (days)</i> | <i>% Spread</i> | <i>Over allotment (% Shares)</i> |
|-------------------------|-------------------------------|-----------------|----------------------------------|
| Constant                | 536.71 (.000)                 | 9.91 (.000)     | 0.070 (.000)                     |
| Pre-IPO Majority-owned  | 82.15 (.000)                  | 0.178 (.135)    | 0.000 (.961)                     |
| Venture-backed          | -84.26 (.000)                 | -0.624 (.000)   | 0.001 (.502)                     |
| Sales                   | -185.33 (.000)                | -2.00 (.000)    | 0.015 (.000)                     |
| N                       | 768                           | 830             | 566                              |
| Adjusted R <sup>2</sup> | .22                           | .33             | .46                              |

**Panel C: Insider Ownership Characteristics**

|                         | <i>Pre-IPO Shareholdings (%)</i> | <i>Post-IPO Shareholdings (%)</i> | <i>Holdings Divested (%)</i> |
|-------------------------|----------------------------------|-----------------------------------|------------------------------|
| Constant                | 42.31 (.000)                     | 22.36 (.000)                      | 0.42 (.000)                  |
| Pre-IPO Majority-owned  | 45.39 (.000)                     | 27.82 (.000)                      | 0.035 (.001)                 |
| Venture-backed          | -2.90 (.011)                     | 1.83 (.104)                       | -0.054 (.000)                |
| Sales                   | 0.87 (.580)                      | 1.99 (.198)                       | -0.032 (.032)                |
| N                       | 804                              | 804                               | 804                          |
| Adjusted R <sup>2</sup> | .72                              | .49                               | .09                          |

**Panel D: Firm Characteristics Prior to IPO**

|                         | <i>Profit Margin</i> | <i>Total Asset Turnover</i> | <i>Return on Equity</i> | <i>Total Debt to Total Assets</i> |
|-------------------------|----------------------|-----------------------------|-------------------------|-----------------------------------|
| Constant                | 2.71 (.000)          | -0.414 (.004)               | 2.324 (.000)            | -1.076 (.000)                     |
| Pre-IPO Majority-owned  | -0.103 (.111)        | 0.448 (.000)                | 0.337 (.000)            | -0.014 (.908)                     |
| Venture-backed          | -0.074 (.292)        | 0.327 (.000)                | 0.282 (.002)            | -1.036 (.000)                     |
| Sales                   | -0.495 (.000)        | 0.162 (.165)                | -0.368 (.003)           | -0.599 (.002)                     |
| N                       | 830                  | 804                         | 804                     | 550                               |
| Adjusted R <sup>2</sup> | .04                  | .05                         | .03                     | .14                               |

Panel E: Firm Characteristics after Offer

|                         | <i>ROE pro forma</i> | <i>Price-to-Earnings pro forma</i> | <i>Price-to-Sales</i> | <i>Market-to-Book Equity</i> |
|-------------------------|----------------------|------------------------------------|-----------------------|------------------------------|
| Constant                | 1.045 (.000)         | 3.533 (.000)                       | 1.814 (.000)          | 1.258 (.000)                 |
| Pre-IPO Majority-owned  | 0.019 (.831)         | -0.425 (.000)                      | 0.160 (.273)          | -0.285 (.000)                |
| Venture-backed          | 0.255 (.000)         | 0.389 (.000)                       | -0.443 (.000)         | -0.022 (.721)                |
| Sales                   | 0.595 (.000)         | -0.336 (.002)                      | --                    | -0.582 (.000)                |
| N                       | 830                  | 705                                | 830                   | 830                          |
| Adjusted R <sup>2</sup> | .07                  | .07                                | .02                   | .15                          |

Panel F: Stock Market Performance

|                         | <i>1 Day Return</i> | <i>2 Weeks Return</i> | <i>1 Year Return</i> | <i>2 Weeks Return NASDAQ-Adjusted</i> | <i>1 Year Return NASDAQ-Adjusted</i> |
|-------------------------|---------------------|-----------------------|----------------------|---------------------------------------|--------------------------------------|
| Constant                | 22.14 (.000)        | 19.808 (.000)         | 62.10 (.001)         | 16.20 (.001)                          | 46.46 (.016)                         |
| Pre-IPO Majority-owned  | -3.70 (.187)        | -6.90 (.041)          | -26.92 (.018)        | -7.47 (.008)                          | -20.66 (.064)                        |
| Venture-backed          | 5.09 (.017)         | 8.50 (.000)           | 28.38 (.001)         | 8.78 (.000)                           | 28.79 (.001)                         |
| Sales                   | -8.80 (.009)        | -6.39 (.050)          | -24.33 (.065)        | 6.19 (.067)                           | -24.44 (.060)                        |
| N                       | 399                 | 695                   | 544                  | 695                                   | 543                                  |
| Adjusted R <sup>2</sup> | .03                 | .04                   | .04                  | .04                                   | .03                                  |

**Table 6 Factors Associated with the Performance of Majority-owned IPOs**

## Panel A: Stock Market Performance

|                         | <i>1 Day<br/>Return</i> | <i>2 Weeks<br/>Return</i> | <i>1 Year<br/>Return</i> | <i>2 Weeks<br/>Return<br/>NASDAQ-<br/>Adjusted</i> | <i>1 Year<br/>Return<br/>NASDAQ-<br/>Adjusted</i> |
|-------------------------|-------------------------|---------------------------|--------------------------|--|---|
| Constant                | 19.03<br>(.004)         | 24.24 (.000)              | 58.06 (.019)             | 20.48 (.002)                                       | 49.17 (.047)                                      |
| Sales                   | -3.98<br>(.328)         | -7.03 (.105)              | -35.15 (.025)            | -6.73 (.121)                                       | -35.46 (.024)                                     |
| Venture-<br>backed      | 1.49 (.564)             | 4.96 (.074)               | 19.67 (.056)             | 5.19 (.062)  | 21.46 (.037)                                      |
| Post-IPO<br>holding     | .108 (.165)             | 0.165 (.040)              | 0.927 (.003)             | 0.172 (.033)                                       | 0.79 (.010)                                       |
| ROA                     | 3.63 (.002)             | 3.71 (.006)               | 4.90 (.300)              | 4.19 (.002)  | 4.40 (.352)                                       |
| ROE                     | -5.55<br>(.001)         | -6.88 (.000)              | -10.98 (.089)            | -7.24 (.000)                                       | -11.32 (.079)                                     |
| N                       | 237                     | 408                       | 310                      | 408  | 309   |
| Adjusted R <sup>2</sup> | .063                    | .058                      | .053                     | .065   | .049  |

## Panel B: Stock Market Performance of Majority-owned Firms with a Lockup Greater than or Equal to 180 Days

|                         | <i>1 Day<br/>Return</i> | <i>2 Weeks<br/>Return</i> | <i>1 Year<br/>Return</i> | <i>2 Weeks<br/>Return<br/>NASDAQ-<br/>Adjusted</i> | <i>1 Year<br/>Return<br/>NASDAQ-<br/>Adjusted</i> |
|-------------------------|-------------------------|---------------------------|--------------------------|--|---|
| Constant                | 9.56 (.306)             | 13.96 (.158)              | 121.87<br>(.001)         | 9.66 (.331)  | 112.09<br>(.002)                                  |
| Sales                   | -0.369<br>(.939)        | -3.72 (.487)              | -58.59 (.003)            | 3.00 (.579)  | -57.63 (.003)                                     |
| Venture-<br>backed      | 1.929<br>(.482)         | 5.98 (.052)               | 10.98 (.345)             | 6.22 (.045)  | 11.51 (.320)                                      |
| Post-IPO<br>holding     | 0.107<br>(.228)         | 0.177 (.062)              | 0.769 (.040)             | 0.179 (.060)                                       | 0.613 (.101)                                      |
| ROA                     | 6.15 (.000)             | 5.58 (.001)               | 3.517 (.561)             | 6.11 (.000)  | 3.88 (.519)                                       |
| ROE                     | -7.19<br>(.000)         | -8.49 (.000)              | -9.035 (.228)            | -9.01 (.000)                                       | -9.87 (.187)                                      |
| Lockup<br>Duration      | 0.009<br>(.311)         | 0.016 (.074)              | -0.085 (.010)            | 0.018 (.046)                                       | -0.085 (.010)                                     |
| N                       | 208                     | 356                       | 267                      | 356  | 266   |
| Adjusted R <sup>2</sup> | .10                     | .07                       | .07                      | .08  | .06   |

## Panel C: Price Multiples

|                | <i>Price-to-Earnings pro<br/>forma</i> | <i>Market-to-Book Equity</i> |
|----------------|--|------------------------------|
| Constant       | 3.78 (.000)                            | 0.939 (.000)                 |
| Sales          | -0.338 (.014)                          | -0.695 (.000)                |
| Venture-backed | 0.437 (.000)                           | -0.040 (.631)                |

|                         |               |              |
|-------------------------|---------------|--------------|
| Post-IPO holding        | 0.009 (.005)  | 0.016 (.000) |
| ROA                     | -0.239 (.000) | 0.112 (.003) |
| ROE                     | -7.19 (.000)  | -8.49 (.000) |
| N                       | 357           | 414          |
| Adjusted R <sup>2</sup> | .11           | .18          |

# **TEACHING ENTREPRENEURSHIP, RISK TAKING, AND CHANGE, “ACROSS” THE CURRICULUM**

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Abstract: Entrepreneurship course offerings should not “only” seek to attract students majoring in business or engineering. Agreed? This paper describes a course: Entrepreneurship, Leadership, and Team Building: Identifying and Applying Best Practices that was developed and taught in each of the last two years for a University Honors Program. (530 official Honors Program exist in the U.S.) In addition to providing background information relevant to professors interested in offering a similar course, deliverables, outcomes, and a course syllabus is shared.

## “So What Issue”

There are 530 official Honors Programs in the U.S. (National Collegiate Honors Council—[www.nchchonors.org](http://www.nchchonors.org)) and all attract top academic students. Perhaps your university has or will soon have an Honors Program. At our university, 550 students are enrolled in the Honors Program and 95 percent represent majors “other than” business. The majority >90 percent of these bright students will never enroll in a business class nor will they take any course in entrepreneurship or small business. The author believes “this experience” is typical as to what occurs on most college campuses where Majors, Concentrations, and Minors in Entrepreneurship are offered but never taken by the majority of students attending and graduating from our universities.

The goal of this presentation/paper is to encourage and guide USASBE members as they expand entrepreneur course offerings to students across the university.

## Introduction



Is entrepreneurship "more than" starting and running businesses? Do entrepreneurs exist in private AND public arenas? Are students on all campuses, in all majors, inherently focused on success, long to make a difference, and interested in entrepreneurship?

This paper provides strategy and details as to how courses in entrepreneurship may be “modified” and targeted to non-business majors on any campus.

Specifically, a successful Studies in Entrepreneurship course, (Mgmt. 4350) housed in the College of Business Administration, was modified by changing the course deliverable from writing a business plan to “effecting and instituting” change on campus. Further, a University Honors Program (550 students are enrolled in this program) offered and promoted the course, which was “targeted” to non-business freshmen and sophomores. The course was first taught\* in spring 2003 and is being repeated in fall, 2004.

*\*Note: On our campus, the Honors Program reimburses the college/department \$2,500 to encourage/allow faculty to get a course reduction and to provide funding to cover the cost of hiring a per-course adjunct instructor. This instructor, however, “volunteers” to teach this course “out-of-load” and the Department uses the \$2,500 to partially fund the campus chapter of CEO.*

Before describing the actual course in entrepreneurship that was modified, here is a brief description of the Honors Course.

### Honors 3393

The “modified” course required students to work in groups and create campus-based projects that required the group/team to identify something (a process, program, or system) that was not being done or was but could be done better, and then to work to develop a plan and strategy designed to turn their proposed change(s) into reality.

Student teams pilot-tested their plans and prepared written reports identifying what they did, why they did it, where and when they did it, how they did it, what “worked” and what didn’t, as well as what they would do differently in the future to improve the strategy and plan. Student teams also presented the contents of these reports to the class as oral presentations.

Before the USASBE 2005 Conference begins, the course will have been taught twice for the University Honors Program (Spring 2003 and Fall 2004) and enrolled students from pre-med, psychology, advertising, government, mass communication, nursing, and biology majors among others.

The results from 2003 and 2004 were impressive, as the students became “intrapreneurs” and actually changed processes and policies and created new programs at the university. Samples of changes included:

- Adding a student crises and suicide hotline on campus.

- Linking all computer labs on campus to “allow” only duplex (two-sided) printing and saving an estimated \$9,000 in printing costs each semester. Further, this change was also supported and legislation passed by the Student Senate at the University.
- Creating a Tutor Program sponsored by the Honors College.
- Creating Employment Assistance for Honors College students.
- Modifying the campus Recreation Centers’ policy for outdoor exercise.
- Working to create “themed” honors housing in the dorms.
- Sponsoring an “all campus” beautification program where students from campus organizations work together to clean and “spiff-up” the campus each semester.
- Creating an “Honors Coffee House” to be operated by an outside vendor with a percentage of sales going to support the Honors Program.

Further, three students from the course had their competitive paper accepted and presented “findings” and “change/creations” at the National Collegiate Honors Council Conference held in Chicago in fall 2003. In Chicago they shared their “entrepreneurial” experiences and distributed copies of the class syllabus.

As noted previously, rather than ‘create’ a new course, an entrepreneurship course, Studies in Entrepreneurship (Mgmt. 4350) was modified and taught to students enrolled in our University Honors Program. The next segment describes the entrepreneurship course that was modified, details the changes/modifications made; includes a detailed syllabus for Honors 3393S, and provides outcomes, recommendations, and conclusions.

#### Studies in Entrepreneurship (Mgmt. 4350) Course Background.

Management 4350, Studies in Entrepreneurship was first offered on our campus in 1999 and has been taught to more than 600 students—99% being business majors. The course structure provides presentations by entrepreneurs on Tuesday and work on business plans, of the students’ choosing on Thursday. For more information on the course, refer to this web link: <http://www.business.swt.edu/users/jb15/MGT4350/default.htm>.

Since 1999, more than 100 successful entrepreneurs representing the public and private sectors, big and small enterprises, young and old, men and women, minority and non-minority, have spoken at Texas State University (formerly Southwest Texas State University).

Just a few of the “tutors for enterprise success” have been:

- Herb Kelleher, President Southwest Airlines;
- Peter Holt, President Holt Enterprises, Caterpillar and the San Antonio Spurs;
- Stacy Bishkin, President BBH Exhibits, Inc.;
- Tom Meredith, CFO Dell Computer;
- Red McCombs, CEO McCombs Enterprises (includes Clear Channel Communications and the Minnesota Vikings);
- Alex Sheshunoff, President Sheshunoff Management Services; and’
- Bob Marbut, President and CEO Hearst-Argyle Television, Inc.
- Mike Levy, Founder and Publisher, *Texas Monthly*;

- Admiral Bobby Inman, former Director of the CIA and founder of MCC;

The names of many of the speakers are household words. Others are success stories known only in their industry. They represent big business, small business, non-profit and captive entrepreneurship (i.e. entrepreneurial activity within a business structure).

Cable TV and a Textbook. Tapes have been made of all presentations and all have been edited to fit a 55-minute time frame. Since fall 2002, more than 60 selected videotapes have been shown on local Cable Television. Further, because of the class, twenty-nine “entrepreneurial stories” now appear in a recently published book and CD entitled, Profiles in Entrepreneurship: Leaving More Than Footprints, Southwestern/Thompson Publishers (available on Amazon).

In addition, although only one day each week is devoted to writing and presenting business plans, students enrolled in the Studies in Entrepreneurship class have placed second in 2002 and again in 2003 and won \$7,000 for two different business plans at the Ernst Young/Nasdaq New Enterprise Creation Competition sponsored by Ball State University.

Although the course could be labeled successful, as previously noted, 99% of students that enrolled were majoring in business. The instructor was interested in teaching entrepreneurship to students other than business majors.

### Entrepreneurship Across the Curriculum

In fall, 2002, working with the Director of the University Honors Program, an honors course entitled, *Entrepreneurship, Leadership, and Team Building: Identifying and Applying Best Practices* was created. Although the course was modeled after the Studies in Entrepreneurship course described previously, this honors course was different in that it targeted non-business students who were freshman and sophomore level honors students. In addition, “creating change on campus” was to be the course focus rather than creating business plans.

This honors course was designed to spark genuine interest in creating and identifying opportunities for change on campus, but especially for “turning ideas into substance and into tangibles.” Finally, instead of having “real” guest speakers, the course used selected stories, videotapes, and a CD all taken from the Profiles in Entrepreneurship: Leaving More Than Footprints, book as well as a CD highlighting key concepts such as leadership, risk taking, decision making, etc., delivered by entrepreneurs who previously spoke on campus.

### Honors Course Structure

This course sought to identify characteristics needed to become an entrepreneur or intrapreneur (someone who works within a large enterprise). The course also examined how to build a team, how to effect change, how to build and sustain a guiding coalition,

and explored leadership principles necessary for team initiated and directed projects to prosper and succeed.

Using selected videotapes and entrepreneurial stories, students were introduced to how creativity and idea generating is necessary for change, growth, and improvement.

### Course Syllabus

Course: Honors 3393S -- Entrepreneurship, Leadership, and Team Building:  
Identifying and Applying Best Practices

#### Course Description:

This writing intensive seminar examines the “life stories” of selected entrepreneurs, identifies leadership qualities that may have contributed to success, and explores research based principles necessary for groups to become teams and for teams to become high performing. The course output/tangible is for students to work in teams, identify potential needed/necessary “changes” that might be implemented, and work to effect and initiate these changes.

#### Course Outcomes, Goals, and Objectives:

After completing, Entrepreneurship, Leadership, and Team Building: Identifying and Applying Best Practices, students will have:

- Identified idea generating strategies and opportunities available in the university, local, and regional communities
- Identified and categorized leadership qualities needed to attract followers and to build a guiding coalition
- Identified how individual leadership qualities possessed by class/seminar participants compares with leadership qualities possessed by successful entrepreneurs and leaders
- Created an individual and team-based action plan designed to improve and build upon leadership qualities already possessed
- Worked in groups and created campus-based projects which required the group to become a team and to have moved through specific stages necessary for the team to become high performing
- Completed an action-based, tangible change project

#### Semester Course Outline:

##### Weeks 1-2

View select video portions of the entrepreneur speaker cd and read select transcripts of successful entrepreneurs to identify sources of ideas as well as idea generating techniques necessary to stay current.

Assignment: Students form groups/teams and individually and collectively begin to list strategies for identifying opportunities and/or for improving self-selected, campus/community-based existing practices. Teams select their preliminary project related to a campus-based innovation or improvement of existing practice.

##### Weeks 2-6

Review research-based techniques and principles designed to assist a group to become a team and to progress through team stages. Introduce leadership and team member skills and activities required in high performing teams.

Assignment: Students work individually and collectively to create listings of team or group necessities and problems as well as identify leadership characteristics necessary for success. Students evaluate their past performance and contributions while being a member of a group or team and then identify task or maintenance functions where improvements are sought and needed. In addition, student groups create vision and mission statements, identify their project “target,” develop specific goals, break goals into tasks and delegate the work to individual team members, as well as create project time-lines and milestones.

Weeks 6-9

Continue to introduce leadership and team-based research intended to educate and challenge team members to develop and further refine skills possessed. Students initiate and continue working on their team-based projects.

Assignment: Teams submit their preliminary project related to a campus-based innovation or improvement of existing practice.

Weeks 9-12

Students discuss project successes and impediments and receive constructive feedback from all class teams.

Weeks 12-15

Students submit a team-prepared written report documenting their campus/community project and focusing on the six helpers—who, what, when, where, how, and why as well as describe outcomes. Students also orally present the results of their project, receive feedback from the other teams, and prepare a “what was learned analysis” of the experience.

Textbook and/or Learning Resources:

Profiles in Entrepreneurship: Leaving More Than Footprints w/ cd, David Nelson, James Bell, Southwestern/Thompson Publishers, 2004.

Packet of materials developed by the instructor and available for purchase at the University Bookstore. (Materials have previously been used to deliver in-house education and professional development for for-profit and not-for-profit businesses and organizations.) Expected cost not to exceed \$20.

Major Course Project

Students work in groups and create a campus-based project which will requires the group/team identify something that is not being done or is but could be done better, and work to develop a plan and strategy to turn ideas, recommendations for implementation and/or improvements into a reality. Student teams will pilot-test their plan and prepare a written report identifying what they did, why they did it, where, with whom and when they did it, how they did it, what “worked” and what didn’t, as well as what they would do differently in the future to improve the strategy and plan. Student teams will also present the contents of this report to the class as an oral presentation.

#### Assessment of Student Learning

1. Attendance and informed participation at seminar sessions (10%)
2. Preliminary Written Group Project Report (due week 8) (15%)
3. Individual assessment as to the quantity and quality of contributions and attitude of team members. (10%--5% week 8; 5% week 14)
4. Written Group Project Report (due week 14) (50%)
5. Team Oral Presentation (weeks 13 and 14) (15%)

Course Grading: 90+ =A; 80 to 89=B; 70 to 79=C; 60 to 69=D; <60=F

#### Course Bibliography:

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Marcus Buckingham and Curt Coffman, First, Break All the Rules: What the World's Greatest Managers Do Differently, Simon & Schuster, 1999.

#### Summary, Outcome, Recommendations, and Conclusion

As previously noted, the course has been taught twice for the University Honors Program (Spring 2003 and Fall 2004) and enrolled students from pre-med, psychology, advertising, nursing, and biology majors among others. The results were impressive, as the students became “intrapreneurs” and actually changed processes and policies and created new programs at the university (Please refer to the listing of “changes.”)

Across campuses, modules of this course may exist, but by using real-life role models and research based principles, this Honors Course examined and combined entrepreneurial principles and techniques, and worked with a “non-traditional audience” and did so early-on in the university experience with the goal of giving the student his or her junior and senior years to further apply and refine skills.

The author intends to “track” students who completed this Honors Course to learn if the students continued applying entrepreneurial traits and characteristics both while students and later as graduates.

Expanding the reach of entrepreneurship throughout the university provides benefits to students and can impact an entire campus community. Honors Programs are currently offered at 530 campuses in the U.S. Professors are encouraged to modify and to “share” entrepreneurship across the university curriculum!

BUILDING BUISNESS EDUCATION AROUND A MODEL OF  
ENTREPRENEURIAL PROCESSES

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## Abstract / Executive Summary

In this paper, we discuss how changes in the business environment have made necessary changes in the business education process. Greater use of industry experienced teachers, current supporting materials, a group process-based learning model, relevant use of computing technology, emphasis on skills modules rather than content categories, and closer ties with the local entrepreneurial business community are proposed to develop graduates with marketable skills, ability to deal with ambiguous environments, and the capability to contribute more immediately to the success of the hiring organization.



In our university's School of Business, the faculty and staff work very closely with the local Entrepreneurial Community, the Dean's Advisory Board (local business leaders), and the Placement Office (which brings firms to campus to hire students). In our interactions with the local business community, and in our research within industry and academic publications, we have discovered that university-level business education, as routinely conducted in American universities, falls far short of the expectations of industry leaders in several key areas:

1. Graduates are poorly prepared in the areas of writing, oral communication, working in groups, critical thinking, and dealing with ambiguous circumstances.
2. Graduates of business programs may have memorized vocabulary for their courses, but the students have long since forgotten meanings.
3. Business graduates, having had a program of classes specializing in functional areas (marketing, management, economics, finance, etc.) are unable to integrate the functional knowledge to solve realistic business challenges.
4. Business graduates, trained by business academics, lack the experience base to contribute meaningfully to the business immediately.
5. Business graduates, educated in large sized courses, have leaned upon textbooks written by academic (not industry) experts, whose theoretical bases and research programs have necessarily focused on *Fortune 500*-sized firms. The challenges facing new ventures and small business are systematically ignored

Many of these shortcomings reported by recruiters are systemic to the large-scale American research institution. Consolidation of students into large classes, the tenure system driven by academic publishing, the utilization of graduate students as evaluators of undergraduate work, and the compensation/rewards system providing the context for undergraduate and graduate education, make these problems relatively intractable across a large university.

However, business programs have several elements which provide them the potential to become proactive in changing the educational experiences of their students. Many business programs make extensive use of evening adjunct professors who are working in industry by day. The business professorate is increasingly made up of “second-career” professors, who went into the academy after a decade or more of industry experience. Business professors are more able, and more likely, to understand and actively forge symbiotic linkages with the local business community, than professors in other fields. Finally, students attracted to the study of business are more likely to accept alternative learning models, especially if the new learning model can demonstrably be linked to creating and grooming skills that are useful in the workplace.

#### FORMATION OF A NEW BUSINESS LEARNING MODEL

The academic business community is just beginning to understand, at the institution/journal level, the lack of results delivered by the traditional business education model, and the opportunities for change and improvement available through more

effective and efficient use of resources available. This recognition is additionally energized by three environmental changes:

1. The prolific spread of computer competency means that current students have been exposed to the computer learning tool for the past eight to ten years. Earlier students viewed Management Information Systems and Computing Power as akin to content areas, worthy of study in and of themselves. Currently, both students and professors have a more reasonable view of the computer as a tool, not as an Oracle of Knowledge (no pun intended).
2. The loss of power and prestige previously controlled by *Fortune 1000* firms has shaken the business education considerably. Students, as well as professors, know that the *Fortune 1000* are net job losers; thus, a renewed interest and energy for learning about small business in general, and Entrepreneurship in particular.
3. The rise and fall of the Internet-based stock market has shown the irrationality of many of the newest management education fads. The Dow 30 runup of 1998-1999 spurred interest in New Ventures; the subsequent crash of Internet-based stocks spurred interest in rediscovering basic business principles and skills.

Contributing to this change in the educational model is the rise of Entrepreneurship as a free-standing discipline in the business-academic community. For many years, academics interested in entrepreneurship had to justify their existence by publishing and teaching in some other content area more traditionally accepted in the research community. However, since the mid-1990s,

Entrepreneurship has gained acceptance both as a class offering and as a research field. The earlier “undercover” status of entrepreneurship allowed professors to integrate entrepreneurship into other academic disciplines; the subsequent “justified” period has allowed for the formation of a critical mass of professors interested in small and new ventures, just at the time that students, consciously turning away from the “corporate ladder”, have increasingly demanded education in entrepreneurship.

As both job-seekers (students) and job creators (employers and organizations) have become more cognizant of the disparity between traditional business education and current business practice, both have begun to demand relevance and applicability from the providers of business education – the university-based business program. Increasingly, the parents of undergraduate students are asking how the business major will prepare their children for industry, rather than asking about the nature and quality of the liberal arts and general education programs.

In our university, the answer is that we employ frequent and content-rich interactions with our Dean’s Advisory Board to help us design curriculum which develops marketable skills in our business graduates. In addition, the members of the Dean’s Advisory Board help deliver the content by acting as guest speakers and clinical professors in our business courses. These industry leaders thus have the opportunity to design and deliver learning which addresses their own immediate employment needs, and the vehicle for ongoing and in-depth interaction with students who may one day join their organizations as employees!

In addition to the content changes driven by interaction with the Dean’s Advisory Board, the delivery method contrasts to the typical lecture-regurgitate model. In

many of our courses, faculty lecture about 30% of the available contact time in class. The balance of the time is spent in threaded discussion, group projects, and presentations. Students really learn a skill only when they have to put it into use to solve a problem, and when they have to teach somebody else how to do so. Thus, many of our courses force students to apply tools to ambiguous, messy problems. The student is a junior partner, the teacher as senior partner, and the team of four or five people moves the process along to fruition.

The materials supporting this process have moved away from the traditional college textbook. We are far more likely to use a combination of trade books, internet hotlinks, academic journal articles, and business periodical content to surround the learning process than using the traditional college textbook. The students benefit by using more current examples, fighting through greater ambiguity, and integrating disparate material for themselves. In addition, this combination saves the student money, forces professors to be more aware of current applications and trends, and provides greater stimulus for group learning, than can be found through using traditional textbooks.

This holistic approach to business education is further defined by using a “processes approach” to curriculum organization, creation and delivery. This approach provides several benefits:

- For the students, a consistent learning model or style for all materials and topics regardless of content, thus patterning student learning.

- A structure format for the discipline, within which all topics can be defined and related, and
- A format easily translated between academic and practitioner.

The “processes approach” provides the vehicle to

- Introduce the plethora of new entrepreneurial materials
- Integrate traditional business content, and
- Provide a format for non-traditional business topics from the soft sciences into a cohesive body of content-rich learning opportunities.

Topics new to business, those instigated by the entrepreneurial awakening include

- the process of obtaining money (understanding the various sources of capital at the startup level)
- the process of protecting ideas while promoting innovation
- the IPO process
- the franchising process
- the business valuation process (including the perception of financial need).

Those integrating traditional business content might include

- the Mergers & Acquisitions process
- considerations in the International Sales process
- the regulatory compliance process
- the process of Strategic alliances.

Those non-traditional business topics integrating soft sciences might include

- the process of team characteristics and selection
- the learning / training process
- the process of creating and maintaining a corporate culture
- incorporating moral / ethical values in all processes

While the choice of where to place each topic can be debated, the obvious accommodation of all topics, regardless of origin, to the “processes approach” is striking. Two points become clear. Learning / teaching can follow a common format, topics can be clearly delineated. The clear delineations provide easy visibility of the commonalities and overlaps. While the “processes approach” may appear to again be creating the “silo effect” of academia, it provides clear visibility of the inter-relationships between processes and at the same time allows clear definition and integration of new and existing processes.

All entrepreneurial content is structured using the traditional “who, what, when, why and how” logic of business practices. For example when dealing with the process of Innovation one provides both historical and future perspectives of the topic, motivates through discussions of significant innovations, categorizes levels of innovation, and provides motion to young entrepreneurs for creation and innovation as roads to personal success. Innovation is an excellent example of application of the processes approach, innovation can be learned by using processes. And, innovation represents one of those areas of traditional business interest, well grounded in soft-sciences and integral to the wonderful opportunities of entrepreneurship.

Much further developing is needed in structuring the many entrepreneurial topics in the processes format. The “processes approach” structure and definition provide a vehicle for the advancement of our discipline and for the general achievement of our educational objectives, passing on valuable content while providing tools for implementation.

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# RISING ABOVE PRINCIPLE: A TEACHING CASE

By

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## ABSTRACT

This is a case about overcoming obstacles to the sale of a small family business. The aging patriarch still maintains tight control over events. As the prospects for a sale grow more probable the employees become ever more concerned for their own futures and the owners learn that they have maneuvered themselves into a position that is strategically strong but ethically questionable. This case study describes the ethical and practical problems faced by the sons of the patriarch as they try to prevent the machinations of the employees from leading to a failure of the deal. Will they "rise above principle" in order to help get the deal done?

## INTRODUCTION

It is a most felicitous situation when one can prosper while helping others at the same time. Such is often the case in business, but it is also true that at times business transactions are, or are molded into, zero-sum games. In the case that follows, brothers Georg and Micah are faced with a business and moral dilemma concerning the sale of the family business known here as the Davir Corporation (all names are fictitious) because what should have been a win-win situation was turned into a win-lose proposition.

## BACKGROUND

The year is 2003. The father, Dov, an old school, hard-nosed businessman, owns the controlling shares of the firm which is located on the East Coast. Neither of his sons works full time in the firm anymore. In fact, Micah is primarily a writer and lives out in California while Georg is a teacher in the mid-west. To a great degree Micah is financially dependent on the firm. For Georg, the income he earns is important for his lifestyle but not critical. Another sibling who struggles with substance abuse and the care of a retarded child are also dependent on the firm. So too is Dov's estranged wife who is now in the early stages of senility and requires around-the-clock care.

A small staff consisting of Newell, Gus, Cammie and Ham oversees business operations. Newell is an attorney who has worked for the firm since 1991 after a period of working in large law firms "downtown." Gus and Cammie were hired in the 1980s and Ham dates back to the 1970s. Gus is blue collar, the operations manager/supervisor of work crews, Cammie is a secretary and Ham is the bookkeeper who emigrated from a central-American country many years ago.

In the mid-1990s Dov, then in the eightieth decade of his life, decided that he no longer wished to run the operations day-to-day. Actually, he had felt that way for some time but now was desperate enough to get "out from under" it all that he was seriously contemplating a move. The change was facilitated by the fact that an old and trusted friend, an executive in another industry, was retiring from that job and might be available. In the eyes of many, either Micah or Georg could have led the firm, but according to Dov Micah wanted to stay on the West Coast too

much of the time and could not run things properly from there. As for Georg, Dov stated that Georg was happy where he was and it would be wrong to ask him to relocate. For their parts both Georg and Micah felt that between them they could fashion a viable leadership system for the firm if given the opportunity. After all, they were both college graduates with graduate business education to their credit and many years of experience in the firm. In any event, Dov's old friend, Forest, agreed to assume the presidency. An affable former railroad man, he was readily accepted by all concerned and it was felt that with his experience and network he could be very helpful.

Davir Corporation owned and operated various types of real estate including a public parking lot adjacent to a professional sports stadium. It was the policy of Davir (or practically speaking, Dov) to avoid the nuts and bolts of operations insofar as possible. Thus the parking, like maintenance and repair, was leased out to others. Every three years or so bids would be solicited from various parking operators. Bids were basically based on the Davir Corporation getting a certain percentage of the gross receipts, somewhere around 30 to 35 per cent. The balance would go to the operator who would be responsible for licenses and fees, insurance, payroll and maintenance and all other related expenses, if any.

### **SLIPPERY SLOPE**

At this point in time, soon after Forest joined the firm, Gus and Newell began advancing a proposition that they be allowed to operate the parking directly as one of their duties in Davir, with a small raise. Raises had been meager lately, their families were growing, and they needed some extra income. They were convinced that they could oversee the parking as efficiently as any outsider could and it would be a win-win situation for all. But Dov would have none of it. He was concerned that the "boy's" focus would shift from the primary business to this other operation, and he didn't want the direct liability and payroll issues to impact the firm. The boys then proposed to create their own firm, staffed with an outside professional manager whom they would only oversee after hours (most stadium events were at night and on weekends anyway), and they would pay Davir fifty per cent of the proceeds. Neither Dov nor Forest liked the idea of the boys moonlighting or the possible conflict of interest. But on the other hand they could not ignore either the higher percentage to the firm or the argument that subcontracting the opportunity to a stranger would be unjust when Newell and Gus were ready to step in. Thus it was with some misgivings that they agreed finally to give the boys a chance with the understanding that if the parking began to interfere with their other work they would give it up. And so the Newgus Parking Company was formed.

Almost from the start the new arrangement exceeded expectations. Revenue to Davir almost doubled to nearly \$100,000 per year net of taxes, a significant figure for the family business whose total gross revenue was between two and three million dollars a year. At the same time the boys were doing much better. Their share covered their leased cars, cellular telephones and provided additional income as well, though they were very cagey about the amount. Dov became angry when he sensed that their income might be excessive, and when they began using hourly company employees (on their own time) to help with the parking. He complained that Gus and Newell had an undeserved windfall because the operation essentially managed itself while they skimmed the profits. When Gus and Newell began asking for raises again after several years Georg sat down with them and laid out Dov's concerns about the parking, hoping to get a good accounting of their actual income so he could intercede with Dov and get them a raise. Georg felt that once the air was cleared Dov would be more reasonable. However, Newell and Gus became very defensive, Gus even raising his voice before storming

out of the room. When he calmed down Gus approached Georg and volunteered to go over the income and expenses of Newgus with him.

### **DISSEMBLING**

Georg was relieved and eager to sit with the boys. Gus claimed not to have exact figures with him (which Georg took to be true) but could give Georg a rough accounting. Georg took notes as Gus began to roughly estimate the income and expenses for the last several years but unexpectedly stopped after about a half hour and exclaimed, "This is silly. We'll give a full accounting at the right time." Georg didn't understand this turn of events but in any event he felt he had enough data to work with. His MBA training had taught him that he didn't need perfect information to get a satisfactory understanding of a situation, and he was shocked when his analysis showed that the "boys" together were earning an extra one hundred fifty to two hundred thousand dollars annually from the parking, far more than the modest amount they were claiming. Georg still hoped to be able to keep the peace between Dov and the boys and did not begrudge them their profits (after all, the parent company was doing very well too), but he could no longer in good conscience fight for their raises.

The situation continued to fester for several more years, and then Georg had another shock related to the parking. Because of a certain other situation that arose, Newell, the lawyer, entered into discussions with Micah unknown to Georg or Dov about revising the Davir-Newgus parking contract to give them a virtually uncancellable lease with no expiration date. The rationale was that if something happened to disenfranchise Davir with respect to their other assets, at least the lease of the parking to a third party would survive. Newgus would then turn the lease over to the family at some point. When Micah asked Newell for a side letter about that, Newell convinced him as the company attorney that it was not a good idea as it could jeopardize the survival of the agreement if the letter ever came to light. To make matters even worse, Micah had apparently agreed to modify the lease at some point so that the area it encompassed was greatly expanded and covered virtually every piece of vacant land on the parcel near the stadium. Nothing further could be built on the land without the cooperation of Newgus.

### **CONFLICT OF INTEREST**

The way this all came to light was that a real estate developer became interested in buying out the Davir shareholders with plans to develop the property. In the course of their due diligence the existence of the Davir-Newgus agreement was exposed in its entirety. Dov was furious when he learned of the non-cancellation clause and apoplectic when he learned that the lease now covered all of the vacant land on the now very valuable twenty-plus acre parcel. He demanded that the boys give up their lease immediately so that negotiations could go forward, because as long as the property was encumbered by the parking lease the developers would not be interested in its purchase. But the boys were hesitant.

By now Dov had moved away and so Micah handled the direct discussions with Newell and Gus though the latter two continued to discuss other matters long distance with Dov. At this point Newell and Gus did not deny the verbal agreement in their discussions with Micah and promised that they would cancel the lease when the time came but, inasmuch as there was a chance that the buyers might pay them to get the lease it would be foolish to simply walk away. On the contrary, the buyers put Dov on notice that he would have to deliver the property free and clear and that any sums paid to get Newgus out of the picture would reduce the price they paid to Dov and the other shareholders. In a further act of duplicity, the income from the parking operation that Newell and Gus claimed to the prospective buyers was far greater the amount they had communicated to Micah and Georg.

Micah and Georg were at their wits end. The "boys" were going back on their promise to cancel when necessary. They said they had their families to think of, they had no company pensions, when the business was sold they would not even have health insurance, they had had no raises in years (they did not mention the yearly bonuses). Dov screamed to Micah and Georg that he would fire Newell and Gus if they did not cancel. But even if that were to happen the lease would still be in effect. Yes, the company could sue for breach of contract and might or might not win, the boys might sue for wrongful termination, and the only sure consequence would be that the property would be tied up in court for years and there would be no sale. Micah and Georg were eager for a buyout. It would change forever the fortunes of the family. Although there were other negotiating points, the parking was without question the biggest obstacle to the deal.

In order to keep things moving along Micah gave Dov assurances that the boys would sign over the lease "soon." But privately he knew that they were stonewalling. Micah and Georg "knew" that Dov would never pay the boys for the lease he thought they should not have had in the first place; his sons had seen Dov burden the company with too many expensive litigations in the past based on "principle." They saw a train wreck about to happen because Newell and Gus refused to accept Micah's and Georg's verbal promise of "just compensation" after the deal was consummated. They demanded severance packages in writing.

Micah and Georg began discussing between themselves and with the boys a secret severance package that they would guaranty from their own funds. Based on what Micah and Georg stood to earn, Gus and Newell would receive about 25% of their share, but as a percentage of the full deal it would have been only a couple of percent.. They all knew if Dov found out before the sale it would all fall apart. If he found out after the fact it would be too late for him to do anything about it but he would lose all respect for his sons. They did not want that, nor did they like the idea of being "blackmailed" or deceiving their father.

### **CONCLUSION**

Georg and Micah found themselves on the horns of a moral and a business dilemma. It was in the best interests of everyone in the family to sell the business and move on with their lives. If the sale fell through the business might not survive for long and Dov would spend his few remaining years struggling with it instead of enjoying himself. The same situation existed to a greater or lesser extent for all the family members. Besides that, Gus and Newell had been invaluable to the firm many times over the years, sometimes even courageous. They had been abused verbally and emotionally by Dov. But they had also been slackers, often working far under their potential. At one time Georg had to resort to disabling a computer game they were playing during business hours to get them to focus on their work. Georg and Micah harbored ambivalent feelings about Gus and Newell and about the personal "hit" they would have to take.

### **QUESTIONS**

1. What should Micah and Georg do? Should they "rise above principle" and agree to the "blackmail" of Gus and Newell for everyone's sake including Dov's? In doing so Micah and Georg know they will be going against their father's wishes even if it was in his best interest. But Dov was not the only stakeholder -- other family members are counting on the sale going through. And it is easy to rationalize that Newell and Gus deserve something after all these years. On the other hand, they were deceitful and disingenuous in their dealings with Micah and deserve to be punished. Besides, they could be only bluffing.
2. Should Micah and Georg tell Dov what is really going on? It will probably kill the deal if he finds out. Yet Dov has lots of negotiating experience and it is, after all, his business. He

founded it, and he built it. One moral right is the right to informed consent. Does Dov have the right to know about this private deal between his sons and the "boys"? Perhaps not, after all, Micah and Georg will pay with their money, not Dov's.

### **EPILOGUE**

Micah and Dov decided to meet Newell and Gus's demands. They had their lawyer draw up the papers and worked with their accountants as well to try to minimize the tax consequences. One stipulation was that the money would have to be returned if Dov learned of the deal because of something Gus or Newell did. Dov gave each of the boys a bonus of fifty thousand dollars, a miniscule fraction of the family's gain from the sale of the firm. He continued to resent the "games" they played related to the parking deal. Newell called Micah to thank him after the money was wired to his attorney and praised his honor and "menschlichkeit." He tried calling Georg and left word twice. The calls were never returned.

# FELT FAIR PAY OF SMALL TO MEDIUM SIZED ENTERPRISE (SME) OWNERS IN FINLAND AND LATVIA: AN EXAMINATION OF JAMES' EQUITY CONSTRUCT

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This study tests a portion of James' theory of equitable payment, using two samples of small to medium sized business owners in Finland and Latvia. Results support James' proposition about who would be satisfied with their pay level and who would be dissatisfied.

## INTRODUCTION

Compensation has long been a topic of interest to employees and employers alike. In fact, the use of compensation as a motivator has been traced to antiquity (Peach & Wren, 1992). The concept of an employment relationship implies that employees work in exchange for some reward, and this reward is often monetary compensation (Brockner, 2002). Thus, pay satisfaction has emerged as a popular variable for use in organizational research (for reviews, see Carraher, Buckley, & Carraher, 2002; Heneman, 1985; Heneman & Schwab, 1979; Lawler, 1971, 1981; Miceli & Lane, 1991; Rynes & Gerhart, 2003). Pay satisfaction exhibits significant relationships with organizationally important outcomes such as absenteeism (Weiner, 1980), turnover intentions (Griffeth & Gaertner, 2001), perceived organizational attractiveness for job seekers (Heneman & Berkley, 1999) organizational citizenship behaviors (Lambert, 2000), and job performance (Mulvey, LeBlanc, Heneman, & McInerney, 2002; Werner & Mero, 1999).

As noted by Rice, Phillips, and McFarlin (1990), one of the most intriguing findings with respect to pay satisfaction is the modest strength of the relationship between how much an individual is actually paid and that individual's pay satisfaction. Although this relationship typically has been positive and statistically significant, it has generally explained well under 25% of the variance in pay satisfaction. These findings have led others to examine the prediction of pay satisfaction based upon multiple discrepancies or multiple monetary standards of comparison for the individual employee (Law & Wong, 1998), and demographic and psychological variables (Berkowitz, Fraser, Treasure, & Cochran, 1987; Carraher & Buckley, 1995).

Scholars have noted that comparatively little research advances models of pay and their predictors (Cox, 2000; Heneman, 1985; Miceli & Lane, 1991; Rynes & Gerhart, 2003; Shaw & Gupta, 2001; Williams & Brower, 1996). This could be due to the assertions of some researchers that it is clearly "too early to offer a precise theoretical model of the determinants of income satisfaction" (Berkowitz et al., 1987, p. 546), yet such model development is still needed (Shaw & Gupta, 2001). Heneman's (1985) review of the pay-satisfaction literature discussed two major models of pay satisfaction: the equity model of Adams (1965) and the discrepancy model of Lawler (1971). A third model, the theory of equitable payment developed by James (1961, 1964) in the United Kingdom, has generally been overlooked by theorists due to difficulties in measuring some of its concepts (Belcher, 1974; Hellriegel & French, 1969) but is making a comeback (Allison & Morfitt, 1996; Brookes, 1994; Carraher, Carraher, & Whitely, 2003; Lip-Bluman & Leavitt, 1999) and it may be useful in the examination of the antecedents of satisfaction with pay. Both Adams (1965) and Lawler (1971) also cited James' work in their own.



Jaques' theory of equitable payment (1961, 1964) postulates that individuals have an intuitive knowledge of: (1) their capacity for work, (2) the level of their work in terms of responsibility and performance, and (3) the appropriateness of their pay. Further, with respect to individual capacity to work, Jaques has hypothesized that capacities for work develop in regular and predictable patterns over time; that it is necessary that one work in a role equivalent to one's capacity for work in order for him or her to experience psychological equilibrium in their job and with their pay; and that employees seek jobs that will match their level of work with their current capacity for work. He also postulates that one's level of work can be measured by determining an individual's time-span of discretion with respect to decision making on the job, and that an individual's perception of being fairly paid for a certain level of work can be successfully measured either directly or by examining their time-span of discretion and current capacity for work (Jaques, 1964). Unfortunately, although Jaques (1961, 1962; 1964; 1968; 1970), Richardson (1971), and Allison and Morfitt (1996) have reported success at measuring both time-span of discretion and felt fair pay, others have not found these concepts easy to measure (Hellriegel & French, 1969) and, therefore, the application of Jaques' work has been limited (Belcher, 1974). Most of the work on, and problems encountered with, Jaques' theory have focused on the time-span of discretion construct (for examples, see Brookes, 1994; Bushe & Havlovic, 1996; Gordon, 1969; Milkovich & Campbell, 1972; Nystrom, 1973; Wintermans, 1994) while in the current study felt fair pay is assessed directly.

When addressing issues of equity, particularly felt fair pay, Jaques (1961) believed that unrecognized norms of fair pay existed for any given level of work and therefore he postulated that if actual salary were not less than 90% or greater than 120% of deserved salary (as perceived by the individual), then equity would be experienced. As with Adams equity theory, Jaques believed that the greater the discrepancy between felt fair pay and actual pay, the stronger would be the psychological disequilibrium. Richardson (1971) reported high correlations between time-span of discretion and felt fair pay ( $r = .86$ ,  $n = 180$ ).

The present study addresses the question: 1. Does Jaques' equity construct accurately predict who will be satisfied and who will be dissatisfied with their pay levels among business owners in Finland and Latvia?

## **Method**

### Measures

Pay Satisfaction. The measure of pay satisfaction used was the "pay level" sub-scale of the Pay Satisfaction Questionnaire that contains four items (Heneman & Schwab, 1985). These items are rated on a 5-point Likert-like scale with scale anchor points from 1 (very dissatisfied) to 5 (very satisfied). Ash, Dreher, and Bretz (1987) report a one-month test-retest reliability estimate of .73 for this scale. The coefficient alphas for these two samples indicate high levels of internal consistency with alphas equal to .978 for sample 1 and .982 for sample 2.

Equity. The measure of Jaques' equity construct of felt fair pay comes from Jaques (1961) - although it has been adapted for assessment by survey questionnaire rather than assessment through face-to-face interview as has generally been done by Jaques and his associates. The actual measure is the fraction of (actual salary - deserved salary) / deserved salary. Jaques does agree that this is a good measure of his felt fair pay construct (personal communications, Sept. 1996; August 2002). Dividing the discrepancy by deserved salary serves to standardize the

measure, which was suggested by Jaques (1961) and Katzell (1964) and was based on Weber's Law. It is important that the information for Jaques' felt fair pay construct be collected within a social-analytic relationship (Amado, 1995; Jaques, 1962; 1961). In other words, information should be kept confidential, no executive action should be taken as a result of the data collection, and the participants should not be pressured to participate in the assessments. The violation of any of these requirements can result in respondents not providing accurate information (Jaques, 1962).

### Samples

This article reports on data from two samples. The first sample consisted of 182 owners of small to medium sized businesses in Finland; 119 (65.4%) were males. On average, they were 41.2 years of age and received an annual income of \$88,802 from their organization. The second sample consisted of 210 owners of small to medium sized businesses in Latvia; 138 (65.7%) were males. On average, they were 34.07 years of age and received an average annual salary of \$77,410 from their organization.

### **Results**

In order to ascertain whether Jaques' equity proposition concerning who will be satisfied and who will be dissatisfied is correct, the samples were each split into two groups. One group consisted of those people who believed that they were paid between 90% and 120% of what they actually deserved (the "satisfied" group) whereas the other group consisted of those people who were paid less than 90% or more than 120% of what they thought they deserved (the "dissatisfied" group). No person in these samples felt that they were overpaid according to the 120% parameter, so all "dissatisfied" individuals felt underpaid here. Two  $t$  tests were then performed between the two groups, yielding the results of  $t$  values of 17.96 for Finland and 17.07 for Latvia. Results from both samples are significant beyond the .0000001 level, so it appears that Jaques' proposition does accurately predict different degrees of satisfaction with pay levels. Additionally, in order to examine the likelihood that these findings were due to common method bias, Harman's one-factor (1967) test was performed on the full, 18-item PSQ for each of the samples and found that in no case was a one-factor solution deemed to be optimal. With Harman's one-factor test all variables under examination are entered in to an exploratory factor analysis. It is assumed that if only one factor emerges from the unrotated factor solution that it is reasonably likely that common method bias may be the primary source of systematic variance observed within a data set. Conversely, the greater the number of dimensions extracted, the less likely that common method bias is the source of systematic variance within a data set (Podsakoff & Organ, 1986). The eigenvalue greater than one criterion indicated that three to four dimensions were appropriate for each sample, thus indicating that it is unlikely that common method bias is causing the observed results.

To examine the predictive ability of the measure, two hierarchical multiple-regression analyses were performed using the data. Three steps were involved in each of the multiple regressions. The first step entered the demographic variables of gender and age as suggested by Rice et al. (1990). The second step entered actual salary, as Heneman (1985) has prescribed that actual salary should always be controlled when testing models of pay satisfaction. The third step entered felt fair pay. Results of these analyses appear in the table.

Table

Multiple Regressions Comparing Felt Fair Pay in Finland and Latvia as Predictors of Pay Satisfaction (PSQ)

| Predictor |                    | $R^2$ | $\Delta R^2$ |
|-----------|--------------------|-------|--------------|
| Step 1    | Demographics       | .117  | .117***      |
| Step 2    | Actual salary      | .203  | .086**       |
| Step 3    | Workplace-referent | .639  | .436***      |
| Step 1    | Demographics       | .144  | .144***      |
| Step 2    | Actual salary      | .235  | .091***      |
| Step 3    | Workplace-referent | .584  | .349***      |

\*\*  $p < .01$ .      \*\*\*  $p < .001$ .

N's = 182 Business Owners from Finland and 210 from Latvia.

In general, these findings provide strong support for the assertion that felt fair pay does an excellent job of predicting pay satisfaction in both Finland and Latvia with the owners of small to medium sized businesses, with the contribution of each being significant beyond the .001 level.

### Discussion

Results from two samples of the owners of small to medium sized businesses indicate that Jaques' (1961, 1964) construct of felt fair pay deserves more attention from researchers. Jaques' construct accurately predicted who would be satisfied and who would be dissatisfied with their pay levels. Jaques' construct appears to be an excellent predictor of pay satisfaction. Past thinking about pay satisfaction (for instance, Heneman, 1985; Rice et al., 1990) might lead one to expect that actual salary would serve as a strong predictor of pay satisfaction. However, multivariate analyses revealed that Jaques' measure explained more of the variance in pay satisfaction than did their actual salaries.

The findings of this study suggest at least three veins for future research. The first vein could examine what variables might influence the relationship between salary and pay satisfaction. For

instance Rice et al found that salary level could explain 25% of the variance in pay satisfaction while in the current samples salary levels could explain 17 to 19 % of the variance in pay satisfaction and Carraher and Buckley (1996) found no relationship between salary and pay satisfaction (  $r$ 's = .01, .00, & .01). Some possible variables to examine include the use of family income rather than personal salary, reasons for working (economic vs. non-economic; Carraher et al. 2003), number of levels of organizational hierarchy included in the sample (Jaques, 1962; 1996), and various demographic differences within samples, such as gender composition, age, and educational attainment (Carraher & Buckley, 1995; Miceli & Mulvey, 2000). The relationships may also differ between owners and employees of small to medium sized employees.

A second vein for research would focus on examining how similar or different the results found here might be across cultures (Carraher, 2003; Carraher et al. 2003). For instance in the current study the two samples were carefully chosen so that they be from similar cultures with the business owners doing similar work. How might the results be different - or similar - if Chinese, South Korean, Japanese, or Mexican samples were added (Eshima, 2003; Zapalska & Edwards, 2001)?

A third vein for research could involve examining Jaques' equity construct in other domains. Initially, this study should be replicated with other samples. Next, Jaques' general theory could be tested for applicability with dependent variables such as general job satisfaction, satisfaction with benefits, and perceptions of the fairness of organizational pay systems. Finally, it might be possible to extend Jaques' theories beyond felt fair pay and examine the concepts of felt fair benefits and felt fair raises (Carraher, Hart, & Carraher, 2003; Heneman & Schwab, 1985).

In summary, this study has used two samples of business owners in order to examine the efficacy of Jaques' felt fair pay construct as it relates to pay satisfaction. It appears that felt fair pay is strongly related to pay satisfaction for these samples from Austria and Germany. Based upon these findings it appears that Jaques' construct of felt fair pay merits inclusion in future studies of pay satisfaction among business owners and additional research is suggested.

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# **The Venture Development Processes of “Sustainable” Entrepreneurs**

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## **ABSTRACT**

This paper examines the venture development processes of “sustainable” entrepreneurs, i.e., entrepreneurs who create and build profitable companies that also pursue environmental or social causes. We identified 21 successful sustainable entrepreneurs in various industries ranging from food, apparel to biotechnology and analyzed their strategies and decisions in key stages of their companies’ development. Our research finds that sustainable entrepreneurs approach business differently, from venture initiation through their eventual exit. We learn that most of our sustainable entrepreneurs are an unusual breed with unconventional backgrounds, strategically obtain financing from non-professional sources and employ unorthodox, yet sound human resource management practices. They are also shrewd in their marketing strategies and effective in running efficient, environmentally sound operations. Finally, we observe that our sustainable entrepreneurs steadily find innovative means for balancing their financial goals against their objectives of making a difference in their environment and society.



## INTRODUCTION

This study examines the venture development processes of “sustainable” entrepreneurs, i.e., entrepreneurs renowned for their efforts and achievements toward “sustainability”. Sustainable development was initially defined as “development that meets the needs of the present without compromising the ability of the future generation to meet their needs” (World Commission on Environment and Development, 1987). Over time, sustainability, as it has come to be called, has become a multidimensional concept that encompasses not just environmental protection but also extends to economic development and social equity (Gladwin, et. al., 1995). In our view, successful sustainable entrepreneurs not only create profitable enterprises but also achieve certain social and/or environmental objectives. They balance multiple objectives effectively and are successful in meeting the “triple bottom-line”, i.e., their economic, environmental and social objectives.

Most academics and practioners would suggest that balancing multiple objectives is forbiddingly difficult because of the harsh realities of the marketplace. Evidence shows otherwise. We have identified 21 such high-profiled entrepreneurs in various industries, ranging from food and personal products to biotechnology, who had delivered strong triple bottom-line results year after year. These include such reputable companies such as Patagonia, The Body Shop, Stonyfield Farm, Interface Carpets, and many other entities illustrated in this research. They show that it is possible to meet multiple objectives simultaneously when they employ the right strategies and processes. In some cases, sustainable identity provided companies with a competitive advantage.

Very little formal research has been conducted in the area of sustainable entrepreneurship. One exception is the area of “social entrepreneurship”, being examined in the non-profit management or public sector management publications. Most of this literature, however, deals with the initiation of non-profit organizations and agencies to handle the problems of social welfare. Exceptions are some case studies and books on a particular entrepreneur or entrepreneurial business. These include Cohen, Greenfield and Maran (1997) who write about their own venture Ben & Jerry’s and Roddick (2001) who wrote about her entrepreneurial experiences with The Body Shop. We are only aware of Gray & Balmer (2004) that attempts to generalize findings from multiple entrepreneurs. It identifies 12 commonalities from an examination of 5 sustainable companies.

Our research brings to light the accomplishments of numerous sustainable entrepreneurs who offer a different model of entrepreneurial pursuits. We develop useful insights into their venture development process by rigorously studying the methods by which the founders initiated, grew and built their companies. We specifically examine how they:

- Identified and evaluated their business opportunities
- Arranged the financing of their unconventional ventures
- Launched and grew their businesses in the face of harsh market realities
- Established cultures that reflected their values and strengthened their organizations
- Leveraged their social identity to create a strong brand and a profitable operation
- Balanced their idealism with issues of growth (and other business requirements)
- Harvested their successes in financial and social terms

## METHODOLOGY

Through various literature searches and personal referrals, we were able to collect a list of small and large companies that were exemplary in their pursuit for sustainability. These were companies that were effective or showed significant progress toward meeting *triple* (economic, environment, and social) or at least *dual* (economic and environment, or economic and social) bottom-lines.

Specifically, we looked for companies that were

- Profitable or had several years of profitability
- Effective in making progress toward their social or environmental causes
- Founded and operated by entrepreneurs who either had sustainable values from the very beginning or adopted them while being leaders of their companies
- Diverse, i.e., different in size, stage of development, and nature of business (industry)

We narrowed down our list to 21 entrepreneurial companies that were effective in their pursuit for sustainability. Our list shown in Table 1 includes some of the most widely recognized companies, such as The Body Shop, as well as other smaller but equally innovative ventures, e.g., Chris King Precision Components and Iggy's Bread of the World. Our list is by no means comprehensive. We have attempted to collect a diverse group of interesting companies that we could learn from.

TABLE 1: SUSTAINABLE COMPANIES

| Company                   | Main Business Area              | HQ Location |
|---------------------------|---------------------------------|-------------|
| AgraQuest                 | Natural pest management         | CA          |
| Ben & Jerry's             | Ice cream                       | VT          |
| The Body Shop             | Natural skin care product       | UK          |
| Berkeley Mills            | Furniture                       | CA          |
| Chris King                | Bicycle components              | OR          |
| Eileen Fisher Clothing    | Comfortable clothing            | NY          |
| Explore Inc.              | After-school day care           | MD          |
| Green Mountain Energy     | Cleaner energy                  | VT          |
| Iggy's Bread of the World | Bakery                          | MA          |
| Interface Carpets         | Floor covering                  | GA          |
| Just Desserts             | Desserts                        | CA          |
| Magic Johnson Enterprises | Real estate                     | CA          |
| Migros                    | Food retail                     | CH          |
| Newman's Own              | Salad dressing                  | CT          |
| Patagonia                 | Outdoor clothing                | CA          |
| Rhythm & Hues             | Entertainment (Special effects) | CA          |
| Seventh Generation        | Household products              | VT          |
| Stonyfield Farm           | Organic yogurt                  | NH          |
| Tom's of Maine            | Personal care products          | ME          |
| White Dog Cafe            | Restaurant                      | PA          |

In an effort to understand how our sustainable entrepreneurs initiated, grew and built their companies, we examined their key decisions and activities in their “entrepreneurial processes”, as described in Baron & Shane (2003) and Morris et al. (2001). We customized the framework slightly to better address the special nature of sustainable ventures. As shown in Figure 1, we organized the entrepreneurial processes in 5 major stages (and 11 activities, e.g., financing), starting with Recognition of an Opportunity and ending with Harvesting the Business.

We collected most of the relevant information from published materials such as printed case studies and books on the companies in addition to newspaper articles and company websites. A number of the case studies had been developed by the authors for use in their courses. Whenever feasible, we interviewed the entrepreneurs and their employees to supplement our research. The next section summarizes our findings for each of the 5 major stages.

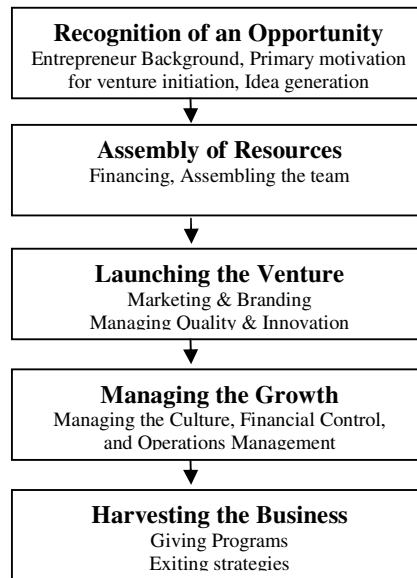


Figure 1. Venture Development Process (Entrepreneurial Process)

## RESULTS

In this abbreviated version, we discuss several of the most interesting commonalities only.

### *A. Recognition of an Opportunity*

Backgrounds of entrepreneurs: Table 2 describes the backgrounds of several entrepreneurs representative of our larger sample. We find that most entrepreneurs in our sample had little relevant business experience or formal business education. Paul Newman, whose company Newman's Own now has annual revenues over \$100 million, was an (Oscar-winning) actor. Gary Hirschberg of Stonyfield Farm with over \$50 million annual revenue was an educator and environmental activist before founding his company. Anita Roddick of The Body Shop had no business or cosmetics experience before founding The Body Shop. Most, though not all, exhibited some sense of social or environmental consciousness before pursuing their entrepreneurial business careers. Anita Roddick had been interested in issues of Third World women's rights and had worked for the United Nations International Labor Organization. Elliot Hoffman and Gail Horvath of Just Desserts were self-claimed hippies.

TABLE 2: SAMPLE BACKGROUNDS OF ENTREPRENEURS

| Company   | Backgrounds |          |       | Professional Backgrounds                         |
|---|-------------|----------|-------|--|
|   | Business    | Activist | Other |  |
| Ben & Jerry's<br>(Ben Cohen, Jerry Greenfield)  |             |          | X     | Potter (Ben), medical doctor<br>drop-out (Jerry) |
| The Body Shop<br>(Anita Roddick)                |             | X        | X     | Library researcher, housewife                    |
| Just Desserts<br>(Elliot Hoffman, Gail Horvath) |             | x        | x     | Hippies from the Haight-Ashbury<br>Scene         |
| Magic Johnson Enterprises<br>(Earvin Johnson)   |             |          | X     | Professional basketball player                   |
| Newman's Own<br>(Paul Newman)                   |             | x        | X     | Actor , racer                                    |

|                                      |   |                        |
|--------------------------------------|---|------------------------|
| Stoneyfield Farm<br>(Gary Hirshberg) | X | Environmental activist |
|--------------------------------------|---|------------------------|

X: Strong background   x: some background

Primary reason for venture initiation: For the majority of our sustainable entrepreneurs the primary motivation for starting their companies was rather modest – to make a living – not necessarily to generate great wealth or change the world. As described in Table 3, Anita Roddick started her retail shop after her husband decided to travel across the Americas on a horse back. Pamela Marrone of Agraquest found herself without a job when her employer was acquired, which motivated her to consider entrepreneurship. Judy Wicks started her restaurant out of her home primarily to make a living after the restaurant she worked for had closed.

TABLE 3: SAMPLE PRIMARY REASONS FOR VENTURE INITIATION

| Company  | Motivation |        |       | Description   |
|--|------------|--------|-------|---|
|  | Income     | Wealth | Cause |   |
| Ben & Jerry's<br>(Ben Cohen, Jerry Greenfield) | X          |        | x     | Being a potter had not worked out for Ben and being a doctor had not worked out for Jerry. So they wanted to go into a food business. |
| The Body Shop<br>(Anita Roddick)               | X          |        | x     | Opened retail shop to support the family while her husband went to ride a horse for 2 years.  |
| Newman's Own<br>(Paul Newman)                  |            |        | X     | Wanted to sell a healthy product and give the entire profits to charity.  |
| Stoneyfield Farm<br>(Samuel Kaymen)            | x          |        | X     | Began the company primarily as a vehicle to help fund Kaymen's Rural Education Center.  |
| White Dog Café<br>(Judy Wicks)                 | X          |        |       | Started the business primarily to make a living after the restaurant she worked for had closed.                                       |

X: Strong motivation   x: some motivation

It is noteworthy that some business ideas originated from the founders' drive to make a difference. The idea for Berkeley Mills began from a vision to forge a realistic harmony between a woodworker's livelihood and forest preservation. John Hughes founded Rhythm & Hues to offer a unique work environment for entertainment professionals – very unusual for a very harsh industry. Earvin Johnson wanted to revitalize the inner cities through his venture.

*B. Assembling the Resources - Financing sources:* We examine the means by which the sustainable entrepreneurs obtained their initial financial resources. The source or method of financing is particularly important for sustainable companies it can have a big impact on how the companies are managed and controlled. Table 4 describes the financing sources of a sample of our companies. We find that most of the companies bootstrapped, i.e., started with very little seed financing and managed through tight cost control. For example, Tom's of Maine started with a loan of \$5,000 from a friend, while Just Desserts founders sold off their VW Bug to purchase a mixer. Most obtained some financial assistance from family and friends, and very few received equity financing from professional investors.

TABLE 4: SAMPLE FINANCING SOURCES

| Company       | Sources    |                 |      |          | Description                 |
|---------------|------------|-----------------|------|----------|-----------------------------|
|               | Boot-strap | Friend & Family | Bank | Investor |                             |
| The Body Shop | X          |                 | X    |          | £ 4,000 loan from the bank. |

|                           |   |   |  |
|---------------------------|---|---|--|
| Eileen Fisher Clothing    | X | X | Borrowed from friends to buy fabric, often at 2% interest per month. |
| Encore, Inc.              |   |   | X \$5 M from private individuals.                                    |
| Just Desserts             | X |   | Sold their VW Bug to buy a mixer.                                    |
| Magic Johnson Enterprises |   |   | X Convinced Sony to co-invest.                                       |
| Tom's of Maine            | X | X | \$5,000 loan from a friend.  |
| White Dog Cafe            | X | X | \$75,000 loan from a friend.   |

*C. Launching the Venture - Marketing and branding:* From early on, our sustainable entrepreneurs developed a sound marketing strategy leveraging the high quality of their products and their stance on the environment and social issues. All of the companies in our list positioned themselves as producers of high quality products or services. Customers, however, bought the companies' products not only because of their quality, but also because they liked what the companies stood for. Newman's Own admitted to "shamelessly exploiting" their celebrity status and its social message for a greater good (Newman & Hotchner, 2003). White Dog Café also learned that combining entertainment with social message could be good business. Judy Wicks of White Dog Café noted, "The more I get into expressing what I believe in and care about, the more popular we have been" (Hollender & Fenichell, 2004). See Table 5 for sample marketing and branding strategies.

TABLE 5: SAMPLE MARKETING & BRANDING STRATEGIES

| Companies          | Marketing & Branding Strategies   |
|--------------------|---|
| Ben & Jerry's      | Used their ice cream containers as protest ads against nuclear energy and the cold war.   |
| Newman's Own       | Decided to "shamelessly exploit" their celebrity status for a greater good.   |
| Seventh Generation | Provided information for consumers to make informed choices. Packaging explained the difference between post and pre-consumer materials, e.g., why avoiding chlorine is critical etc. |
| Tom's of Maine     | Always listed all ingredients on the packaging along with the source of the ingredients and an explanation of their purpose.  |
| White Dog Cafe     | Combined entertainment with a social message.   |

*D. Managing the Growth- Building the culture:*

Most of the sustainable entrepreneurs we analyzed prided themselves for having created a strong organizational culture that in return supported the growth of their companies. Most organizations reflected the entrepreneurs' unconventionally strong, genuine concern for the well-being of their employees. Many offered employee benefits that far exceed their industry standard. Rhythm & Hues offered its artists 9 weeks of paid time off per year, unheard of in the entertainment industry. In a dramatic move, Chris King relocated his entire company from California to Portland, Oregon, when he realized that his employees could not afford to live near work and were driving long distances everyday. Its corporate cafeteria, staffed by a professional chef, offered some of the best food in the area, thereby encouraging employees to spend time together over meals (Choi, 2004a). Tom's of Maine eliminated elongated conference tables to emphasize equality and encourage everyone to contribute ideas. Table 6 lists several examples of such efforts.

TABLE 6: SAMPLE CULTURE BUILDING EFFORTS

| Companies  | Sample Practices for Building the Culture  |
|------------|--|
| Chris King | Relocated to Portland, Oregon so that its employees could afford housing.<br>Offers café credit for every day they ride their bicycle, carpool or walk to work.<br>The café serves some of the best food in the area, providing a chance for |

|                           |   |
|---------------------------|---|
|                           | employees to all hang around together.  |
| Iggy's Bread of the World | Offers English classes to foreign employees, free acupuncture for employees who quit smoking, and free massages to all employees. Brings workers together through soccer matches. |
| Patagonia                 | A pioneer in on-site childcare program, opening its Great Pacific Child Development Center in 1984.   |
| Rhythm & Hues             | Offers its artists 9 weeks of Paid Time Off per year. All employees are eligible for a 2 months sabbatical after 5 years of employment.   |

#### *D. Harvesting the Business*

**Exit Strategies:** Sustainable entrepreneurs employed a different thought process when it came to harvesting their businesses, as described in Table 7. They took into consideration not just their financial gain, but how their exit would impact their businesses, stakeholders, and their long-fought causes. Patagonia founder Yvon Chouinard considered selling the company and setting up a foundation to give away money to environmental causes (Gray, 2003b). After months of soul searching, he decided to keep running the company and not to exit. He concluded that the money barely made a dent in the world's problems and that the greatest good he could do was to develop Patagonia as an exemplar for other companies to emulate. Stonyfield Farm founders sold their business to Danone with the objective to "infect the conglomerate with organic bug".

TABLE 7: SAMPLE EXIT STRATEGIES

| Company            | Sample Exit Strategies  |
|--------------------|---|
| Ben & Jerry's      | Sold to Unilever in 2000 with conditions of how the company would be operated.                                      |
| Patagonia          | Founder has retired from the company daily operations but still owns majority of the company.                       |
| Stonyfield Farm    | Sold 40% to Danone, a socially responsible company, with the objective to infect Group Danone with the organic bug. |
| Tom's of Maine     | Founders felt that they could not sell their business without compromising their own values.                        |
| Seventh Generation | IPO'd in 1994 and then became private in 1995.  |

**Giving Programs:** Another form of harvesting that sustainable companies engaged in was their institutional giving programs as shown in Table 8. As early as 1985, Ben & Jerry's established a foundation to formalize the company's donation processes; the firm's annual contribution to the foundation was 7.5% pre-tax profits. Stonyfield Farm created a "Profits for the Planet" program under which the company donated 10% of pretax profits annually to organizations and projects that served to protect and restore the environment. Newman's Own, organized as a non-profit company, has given away more than \$150 million. Magic Johnson Foundation raised more than \$20 million for charity and helped send more than 3,000 students to college.

TABLE 8: SAMPLE GIVING PROGRAMS

| Companies                 | Description of Sample Giving Programs  |
|---------------------------|--|
| Magic Johnson Enterprises | Has raised more than \$20 million for charity and helped send more than 3,000 students to college.                                   |
| Newman's Own              | Has given more than \$150 million to charities, such as the Cystic Fibrosis Foundation as well as many obscure little organizations. |
| Patagonia                 | Funds its programs through its "Earth Tax" a yearly levy of 1% on sales or 10% of pre-tax profit, whichever is greater.              |
| Tom's of Maine            | Gives 10% of its pre-tax to non-profit organizations. Awards 40-50 grants  |

## CONCLUSION

This research should demystify and educate aspiring entrepreneurs about how ventures can simultaneously meet economic, social and environmental objectives. The objective of our research is to inspire as well as provide useful management guidelines. Our hope is that more values-driven individuals in the future will choose entrepreneurship as a vehicle for self-expression and social contribution. We believe that our finding can serve as a preliminary model – that hopefully can be refined and improved – that aspiring sustainability-oriented entrepreneurs can use as a partial guide in the development of their companies.

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# **GENDER DIFFERENCE AND THE FORMATION OF ENTREPRENEURIAL SELF-EFFICACY**

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## **ABSTRACT**

Data from participants of a computer venture strategy simulation indicate that men report significantly higher levels of entrepreneurial self-efficacy versus women. Perceived financial knowledge exerts a significant, positive impact on entrepreneurial self-efficacy for all subjects. However, the level of education interacts with gender in affecting entrepreneurial self-efficacy. For women, the level of education exerts a significant positive effect of self-efficacy to act entrepreneurially. This relationship was not present in men. Implications of the research, limitations and suggestions for future research are offered.

## **INTRODUCTION**

Women-owned ventures are increasingly becoming significant for the US economy, yet studies regarding factors relevant for the growth and success of these businesses are rare. Women entrepreneurs are generally suggested to have characteristics somewhat different from their male counterparts. Besides several unique individual characteristics, researchers propose that women's self-confidence of being an entrepreneur is less than men's.

Self-efficacy is one's confidence in performing a specific task is an important topic for entrepreneurship. Research suggests that self-efficacy helps develop both entrepreneurial intentions and actions. In addition, individual perception of business knowledge and financial knowledge help build entrepreneurial self-confidence.

Hence, the contribution of this study is based on the tenet that self-efficacy is vital in nurturing entrepreneurial motivation among prospective entrepreneurs. Data from 67 undergraduate and graduate students were used to examine gender difference of forming entrepreneurial self-efficacy formation. We then provide a discussion of the findings and implications for future research and practice.

### **Women in Entrepreneurship and Self-efficacy**

In today's business environment, the entrepreneurship sector is viewed as a significant for economic growth. However, the history of entrepreneurship research is mainly based on



evidence of male entrepreneurs (Birley, 1989). In reality, women entrepreneurs are increasingly becoming significant contributors to the entrepreneurial growth around the world. Hisrich and his associates (2004) point out the latest data of the Census Bureau and the Small Business Administration's office of Advocacy to show the growth and importance of women owned businesses. While women entrepreneurial activities play an important role, research suggest that women entrepreneurs have less self-confidence than their male counterparts (Hisrich, 1986).

Research also suggests that self-efficacy play a significant role in entrepreneurship (Boyd and Vozikis, 1994; Markman, Balkin, and Baron, 2002). Self-efficacy is defined as one's level of confidence in performing a specific task and is the central cognitive motivator predicting behavior (Bandura, 1997). Many empirical studies have found a positive relationship between self-efficacy and entrepreneurial action (Chen, Green, and Crick, 1998; Markman, et al., 2002; Bradley and Roberts, 2004).

Given the above discussion, the current study contributes to the entrepreneurship literature by studying gender difference in self-efficacy formation. While there are many similarities between male and female entrepreneurs, previous research has suggested some important differences. Specifically, female entrepreneurs are suggested to be different from their male counterpart in terms of age, educational background, financial skills, and more importantly in terms of self-efficacy. Hence, this study intends to test the following hypotheses:

Hypothesis 1: Aspiring businessmen and businesswomen differ in terms of age, education, financial skills, and entrepreneurial self-efficacy.

Hypothesis 2: Level of education is positively related to the entrepreneurial self-efficacy.

Hypothesis 3: Perceived financial knowledge is positively related to the entrepreneurial self-efficacy.

Hypothesis 4: The relationship between education level and entrepreneurial self-efficacy differ based on gender.

## **METHOD**

### **Sample and Data Collection**

Undergraduate and graduate business students in their final semester before graduating were used as subjects for data collection. These students were enrolled in the undergraduate and graduate capstone courses that required participation in a business simulation. Students were required make decisions as entrepreneurs to start and grow a business. This simulation was major a project requiring students to work throughout the semester (sixteen weeks) and contributed heavily towards their grade. A total of sixty seven students were involved in the study. After students had spent three weeks practicing the simulation, a survey was administered to collect data on individual background and entrepreneurial self-efficacy measures.

#### **Measures**

The variables in this study were operationalized based on the current literature using established measurement instruments. Based on Bandura's (1982; 1997) suggestion, self-efficacy was

measured by assessing each individual's level of confidence of being successful entrepreneur. A five point scale was used to measure each respondent's level of confidence.

The study also collected data on individual background variables such as education, age, and gender. Education was measured as graduate and undergraduate, age was measured in terms of years, and gender was measured as 0 and 1 where 0 is male and 1 is female. Data on age, education, and gender were also collected from enrollment information and used to check the responses. In case of a discrepancy, the secondary information was used.

Finally, financial knowledge measure used here is a four item questionnaire, in which respondents were asked to mark, using a 5 point Likert scale, the extent to which they agree or disagree to various financial skills. The specific items used are: I know how to achieve high overall growth in my portfolio of investments; I know how to achieve a balanced portfolio of investments with appropriate risk levels; I know how to manage my investments appropriately; and I know how to take calculated financial risks. This instrument produced a reliability score of .91. Responses across the four items were averaged to create the final perceived financial knowledge score.

## **DATA ANALYSIS & RESULTS**

### **Descriptive Statistics and Correlations**

Using descriptive statistics and bivariate correlations the study assessed the nature of data on each variable and initial correlation between them. Table 1 provides descriptive statistics and zero order correlation coefficients for all variables used in this study. The extent of entrepreneurial self-efficacy correlated positively with financial knowledge ( $r = .55, p < .01$ ) and negatively with gender ( $r = -.31, p < .01$ ). In addition, several other variables show significant correlations. Although none of these correlations is stronger than .45, they raise the issue of multicollinearity. However, each relationship produced a variance inflation factor score well below 10, suggesting no multicollinearity problem. The strong correlation between financial knowledge and entrepreneurial self-efficacy may also create a concern about problems of multicollinearity. However, these two variables did not produce similar correlation with all study variables. For instance, age was significantly correlated to financial knowledge and insignificantly correlated with self-efficacy.

### **Hypotheses Testing**

To test Hypothesis 1 that suggest a gender difference in terms of age, education, financial skills, and entrepreneurial self-efficacy, four one-way ANOVA procedures were used. Each model used here is a simple one factor ANOVA, where the dependent variable is a one of the four characteristics on which men and women are suggested to be different and the independent variable (factor) is gender (taking the numerical codes 0 and 1 for male and female respectively). The results of the ANOVA showed significant difference on the levels of entrepreneurial self-efficacy and perceived financial knowledge. Men and women did not significantly differ in terms of age and the level of education.

Moderated multiple regression analysis was used to test the remaining hypothesized relationships (hypothesis 2 through 4). First age and gender were introduced into the regression equation to run the regression. Next, the independent variables, level of education and perceived financial knowledge, were introduced into the regression equation to run the regression for the main effects. Finally, the hypothesized interaction between education and gender was added to the regression analysis.

In the above analysis, the  $R^2$  changes reflect the amount of variance explained by the entry of variable sets in step 1, step 2, and step 3 of the hierarchical regression. According to the step 2 results, after controlling for the effects of age and gender, the main effect of the independent variables (education and perceived financial knowledge) contributed to the explanation of a significant amount of variance in entrepreneurial self-efficacy ( $\Delta R^2 = .249$ ,  $p < .01$ ). However, the level of education does not produce significant influence on self-efficacy as the standardized coefficient for education is positive but not significant ( $b = .13$ ,  $p > .1$ ). Thus, hypothesis 2 receives no support. The financial knowledge produces a significant influence on self-efficacy (the coefficient for perceived financial knowledge is positive and significant,  $b = .48$ ,  $p < .01$ ). Thus, data supports Hypothesis 3.

Results of step 3 tested the hypothesized moderated relationships (Hypotheses 4). The interaction terms introduced in step 3 enabled testing of whether the influence of education level on entrepreneurial self-efficacy varied with the difference in gender as predicted. Results in step 3 show that the interaction term explained a significant amount of variance in entrepreneurial self-efficacy ( $\Delta R^2 = .07$ ,  $p < .01$ ). Results show a significant beta for the interaction term ( $b = 1.21$ ,  $p < .01$ ). Therefore, Hypothesis 4 is supported.

To gain further insights into the moderated relationships and to clearly examine Hypothesis 4, the interaction effect was plotted (Figure 1). As shown, while female respondents of this study show a significant positive relationship between level of education and entrepreneurial self-efficacy, male respondents show a slightly negative relation between level of education and such self-efficacy. However, compared to women, men show higher levels self-efficacy at all education levels.

-----  
Insert Figure 1 about here  
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## DISCUSSION

The results of this study, while by no means definitive, support both the general thrust of the arguments developed in the earlier part of this paper and the specific hypotheses that were derived from these arguments. Examination of the data revealed that men and women differ significantly in terms of perceived financial knowledge and entrepreneurial self-efficacy. However, they did not differ in relation to the level of education and age. While, women and men produced similar result in terms of age and education level, women are found to have significantly lower levels of entrepreneurial self-efficacy as well as perceived financial

knowledge. Findings of these important differences support the previous suggestions that gender difference has significant influence on entrepreneurial intention and action.

The findings also support the suggestion of self-efficacy literature that perceived knowledge positively influence self-efficacy formation. Results show that higher perceived financial knowledge positively influences entrepreneurial self-efficacy. Therefore, by developing perceived financial knowledge among individuals entrepreneurial intentionality and action can be improved.

The notion of gender difference in forming entrepreneurial self-efficacy is further supported by the findings with regard to the gender and education interaction term. Result show, while men form higher level of self-efficacy when they are about to complete an undergraduate degree, women form higher level of self-efficacy when they are about to complete a graduate degree. Thus graduate education is more important for female entrepreneurial intentions and actions and is less important for male entrepreneurial intentions and actions.

As self-efficacy is closely related to self-beliefs about personal capabilities, business education must focus on influencing individuals' self-belief, which is an important requirement for achieving entrepreneurship. Results of this study show that women with same level of education as male, lack self-perceived knowledge. Therefore, to improve women entrepreneurial intention and action entrepreneurship education must focus on improving not only the actual knowledge gained by female students but also their perception of knowledge gained.

While the results of this study should make valuable contributions to both research and practice of entrepreneurship, the study is not free from limitations. Possible limitations revolve around the data used for this study. Specifically, these limitations include generalizability problems and common method variance in testing hypotheses. The following discussion addresses the nature of these limitations and steps taken to minimize them and suggestions for future research.

Caution must be applied when generalizing the findings of this study as it used data collected from students. However, researchers have found that the use of students is appropriate when studying behavioral concepts (Krughanski, 1975) because they often exhibit various attitudes of the society in general (Gordon, Slade, & Schmitt, 1986). In future this study should be conducted on practicing entrepreneurs to reexamine the relationships proposed here.

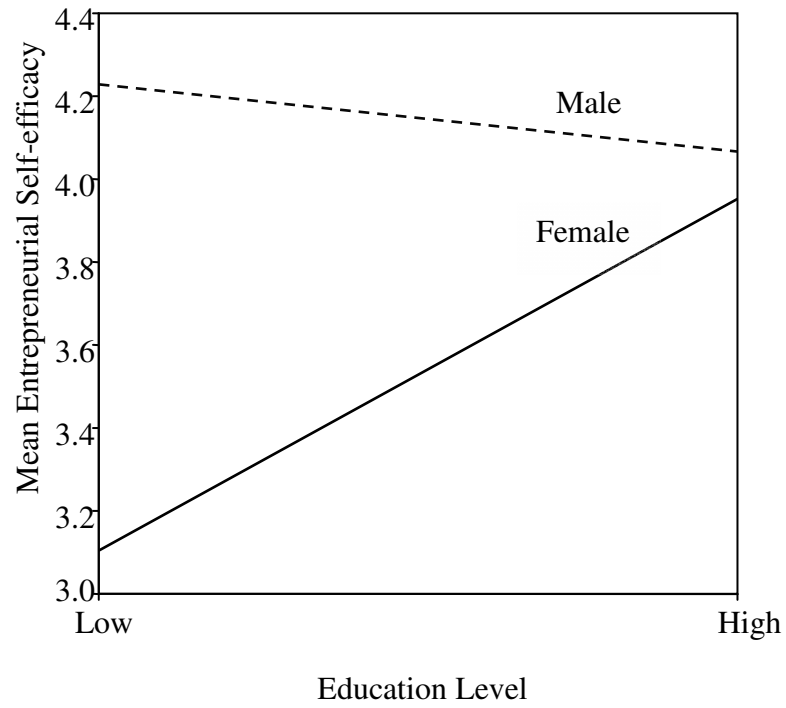
Another limitation is the use of self-reported measures where students provided data on both independent and dependent variables. It is possible that the relationships among the independent and dependent variables were inflated due to common method variance. Since the variables used in this study were attitudinal and perceptual, it was necessary to assess the perceptions of the respondents. In addition, not all independent variables were perceptual data, for example data on age, gender and level of education are recorded as objective data. A secondary source (enrollment data) was used to validate this information. In case of discrepancies, data from the secondary source was used for this study. The use of two sources of data might suggest that common method variance is not operating at such a level that invalidates the findings of this study. However, future research could use different sources for measuring financial knowledge and self-efficacy variables.

Finally, small sample size is a significant limitation of this study. However, the significant statistical test results indicate a high effect-size and power. Hence the small sample size seems to be adequate for the statistical analyses (Cohen, 1988). Although the findings of this study are generally strong, these findings should not be seen as refuting other explanation of development of entrepreneurial self-efficacy in men and women. The small sample size made the relationship found in this research vulnerable to alternate explanations that might provide a fertile ground for future research.

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FIGURE 1. Education and Entrepreneurial Self-efficacy Relationships for Male and Female



# **CORPORATE VENTURING AND STRATEGIC RENEWAL FROM THE PERSPECTIVE OF PROSPECT THEORY<sup>1</sup>**

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## **ABSTRACT**

This paper explains why strategic renewal and corporate venturing are different and why that difference is theoretically and practically significant. Strategic renewal is seen as a top-down process whereas corporate venturing is seen as a bottom-up process. Consequently, managers who initiate an entrepreneurial initiative are more likely to view its prospects from a reference point of loss avoidance than gain enhancement and therefore should be willing to *accept* more risk than other managers. Entrepreneurs are also more likely to *perceive* lower risk in a given initiative. Behavioral and performance implications for organizations are suggested.

## **INTRODUCTION**

As the two primary components of corporate entrepreneurship, corporate venturing and strategic renewal have received considerable attention in the literature (e.g., Birkinshaw, 1997, 1999; Burgelman, 1983a, 1983b; Covin & Miles, 1999; Zahra, 1993) The distinction between the two concepts can be traced back to Guth and Ginsberg (1990: 5) who refer to corporate venturing as “the birth of new businesses within existing organizations” and strategic renewal as the “transformation of organizations through renewal of the key ideas on which they are built.” Sharma and Chrisman (1999) further clarify these definitions when they suggest that corporate venturing leads to the creation of new businesses within a company and strategic renewal involves the reconfiguration of the strategies and/or structures of existing ones.

Theoretical advances have been made to distinguish forms of corporate entrepreneurship related to strategic renewal (Covin & Miles, 1999) and corporate venturing (Miles & Covin, 2002; Sharma & Chrisman, 1999). However, these advances do not provide a theory to justify the distinction between these two components of corporate entrepreneurship. Others have considered the problem as a matter of focused or dispersed corporate entrepreneurship without explicitly distinguishing efforts at renewal and venturing (Birkinshaw, 1997, 1999). The only empirical study that has directly compared corporate venturing and strategic renewal suggests that “companies in different environments emphasize different corporate entrepreneurship activities, and that these activities are associated differently with indicators of financial performance” (Zahra, 1993: 335). Thus, despite the paucity of studies that compare strategic renewal and corporate venturing, there is some limited evidence that these two forms of corporate entrepreneurship have fundamental differences.

The purpose of this article is to provide a theoretical justification for distinguishing between strategic renewal and autonomous internal corporate venturing (Sharma & Chrisman, 1999). The distinctions are based on the position in the organizational hierarchy of the corporate entrepreneur who conceives and promotes the initiative, and the differences in risk perceptions

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<sup>1</sup> The authors thank Franz Kellermanns for his comments on an earlier draft of this paper.



and reference points between those entrepreneurs and other managers (non-entrepreneurs) who are not involved in the proposal to engage in entrepreneurial behavior but may be asked to fund or implement the initiative. These factors may lead to fundamental differences in the manner in which corporate entrepreneurship initiatives are evaluated and implemented. These differences may also have an influence over the success or failure of these initiatives.

We contribute to the corporate entrepreneurship literature by addressing the issue of why corporate venturing and strategic renewal are different from a theoretical perspective and why these differences matter from a managerial perspective. From these distinctions, we also develop propositions on the organizational behavior that should be observable in strategic renewal and corporate venturing efforts. In the discussion part, we also speculate on some of the performance outcomes to be expected in light of those behaviors. By setting these foundations, we provide a basis for further theoretical and empirical investigation, as well as a framework to help orient managers on how to evaluate and anticipate corporate entrepreneurship initiatives.

To keep the presentation manageable, we shall focus on internal corporate venturing efforts that occurs solely through the autonomous activities of managers and employees at lower levels in an organization. Our focus will also be limited to acts of voluntary strategic renewal. We will not attempt to deal with the risk orientations of managers faced with situations of imminent bankruptcy where all efforts to achieve operational solutions have been exhausted and more severe strategic remedies are the only remaining alternatives (c.f. Hofer, 1980). Finally, we shall concentrate on renewal and venturing efforts initiated by single-business organizations. This will allow us to minimize the levels of organizational hierarchy we need to consider, thereby simplifying our fundamental arguments. However, in our conclusions we will address the implications of our theoretical framework for multi-divisional and multi-national firms so that the reader can better appreciate the dynamics that might occur in these settings.

## **CORPORATE VENTURING AND STRATEGIC RENEWAL**

Because a corporate entrepreneurship initiative starts with an opportunity (or threat) that ends with an organizational commitment to allocate resources (Birkinshaw, 1997), the processes of autonomous internal corporate venturing (hereafter referred to simply as corporate venturing or venturing) and strategic renewal are complex, involving multiple interactions between managers at various organizational levels (e.g. Burgelman, 1983a, 1983b). Although both types of corporate entrepreneurship are viable means to promote, sustain, or develop competitive advantages (Covin & Miles, 1999), venturing and strategic renewal efforts represent dissimilar approaches that require special attention.

Burgelman (1983a) argued that some autonomous strategic activities fall outside the scope of the current concept of strategy. In our terminology, corporate venturing is an autonomous strategic behavior characterized by lower and middle level managers' attempts to search for areas of new business activities and convince top management to support them (Burgelman, 1983b). Corporate venturing is therefore a bottom-up process. It represents an option for growth and diversification that involves risk and uncertainty in pursuit of an unexploited opportunity that alters the corporate strategy of an organization (Block & MacMillan, 1993; Burgelman, 1983a).

In contrast, strategic renewal changes the pattern of an organization's existing resource deployments to avoid or overcome stagnation (Grinyer & McKiernan, 1990) or to manage discontinuous change in the environment (Lant & Mezias, 1990; Meyer, Brooks, & Goes, 1990). Consequently, strategic renewal typically occurs as a response to an internal or external opportunity or threat to an organization that significantly alters the nature of its pre-existing business (Sharma & Chrisman, 1999). Strategic renewal might involve a shift from differentiation to a cost leadership strategy or from narrow to a broad segment scope (Bauerschmidt & Chrisman, 1993). Thus, strategic renewal primarily deals with changes to a company's business strategy within the corporate context. It is a top-down process instigated by top management who select and enact different initiatives to promote changes across the organization.

These basic distinctions identify the location of the entrepreneurs who formulate and promote the different types corporate entrepreneurship initiatives in an organization. Corporate venturing emerges through autonomous processes originating at lower managerial levels. Therefore, the entrepreneurs for a specific corporate venturing initiative are the individuals or teams at lower managerial levels who promote and implement the ventures. In contrast, strategic renewal occurs when top management introduces major changes in the strategy or structure of an existing business to create or sustain competitive advantages (Covin & Miles, 1999). In that case, top managers are the ones who act as the entrepreneurs. However, unlike corporate venturing, strategic renewal initiatives are not implemented by the entrepreneurs themselves but rather by managers and employees at lower levels in an organization who may not have had input into the idea that led to the entrepreneurial effort. In other words, strategic renewal implies an entrepreneurial process that distances the entrepreneurs who originated the effort from the managers who carry it out.

The distinction between the location of the entrepreneur and the roles the entrepreneurs play in the process are important because they help identify the different tensions that occur in corporate venturing versus strategic renewal. In terms of corporate venturing, the promoters may attempt to implement initiatives quickly so top management does not become discouraged and withdraw its support (Burgelman & Sayles, 1986). Unfortunately, such forcing often occurs at the expense of the development of an administrative infrastructure that can cause negative consequences for the venture (Burgelman & Sayles, 1986). By contrast, strategic renewal initiatives may experience organizational resistance if the managers who did not contribute to the original idea, but are responsible for its implementation, do not fully share the vision, commitment, and understanding of the need for the change. Also, the entrepreneurial *orientations* (Covin & Slevin, 1991) of top and lower level managers may vary and this will affect the way they perceive a venturing or renewal initiative. Because of a high entrepreneurial orientation, managers who did not conceive an initiative may still be enthusiastic about the idea but not to the same level as the entrepreneurs from which the idea sprung. Therefore, the entrepreneurial orientations of the managers who did not conceive the initiative will determine the extent to which their perceptions of a particular initiative will diverge from the promoters.

### **The Distinction of Prospects**

In the previous section, we argued that a fundamental difference between corporate venturing and strategic renewal is the location in the organizational hierarchy of the entrepreneur. This

difference leads to a different set of problems and tensions in implementing the two types of initiatives. In this section, we use prospect theory to explain why the difference matters or, in other words, why the different problems in implementing the initiatives occur.

In simple terms, prospect theory proposes that individuals are usually risk averse when faced with a choice of gains and risk seeking when faced with a choice of losses (Kahneman & Tversky, 1979). To avoid confusion, we refer to the former situation as prospects for gain enhancement and to the latter as prospects for loss avoidance. Prospect theory also suggests that individuals will normally evaluate possible outcomes as gains or losses relative to some reference point rather than evaluating them according to the expected values of the alternatives (Tversky & Kahneman, 1992). Empirical work has supported these risk-return relationships (Fiegenbaum & Thomas, 1988). Research has also suggested that prospect theory helps explain why managers escalate commitments on projects with a history of losses; sunk costs cause such decisions to be framed as choices among losses rather than as an assessment of the overall expected values of alternatives (Whyte, 1986). Baron (1998) has been suggested that entrepreneurs may be more susceptible to escalating commitments than non-entrepreneurs.

Managers will base their decisions concerning corporate venturing or strategic renewal according to strategic reference points such as internal capability, external conditions, and time (Fiegenbaum, Hart, & Schendel, 1996). Moreover, reference points such as outcome history and domain familiarity can affect the risk behavior of decision makers (Sitkin & Pablo, 1992). Because individuals do not maintain a comprehensive view of consequences (Whyte, 1986), an initiative can be either perceived from the perspective of gain enhancement or loss avoidance (Tversky & Kahneman, 1992). We argue that the views of the promoters, evaluators, and implementers are likely to diverge in this respect. Thus, strategic renewal and corporate venturing efforts will differ in terms of the reference points in which top management and managers at lower organizational levels evaluate them. Because of divergent reference points, the view of top and lower level managers with regard to the two types of initiatives is also expected to diverge.

Top management will be enticed to engage in strategic renewal when it perceives the failure to pursue the initiative will lead to a certain loss (or a certain loss of an opportunity). Being the creators and promoters of the initiative (i.e., the entrepreneurs), they will tend to be risk seekers who perceive that the organization will lose if the initiative is not implemented. However, top management may perceive the opportunities for corporate venturing brought from lower levels of the organization as a risky chance of gain enhancement relative to the certain gain of the status quo. As a result, top management will tend to be risk averse in their evaluation of corporate venturing efforts. The proposed differences, reflected in the following propositions, are consistent with the arguments of Baron (1998).

*P1. Top management will tend to view strategic renewal from the perspective of loss avoidance and consequently will be risk seeking in their evaluation of such initiatives. This will increase the probability that a given strategic renewal effort will be pursued.*

*P2. Top management will tend to view corporate venturing from the perspective of gain enhancement and consequently will be risk adverse in their evaluation of such initiative. This will reduce the probability that a given corporate venturing opportunity will be pursued.*

The reverse situation regarding risk perceptions obtains from the reference point of the managers and employees at lower organizational levels who are responsible for implementing an initiative. Here, the focus of our attention is exclusively on the managers who are responsible for implementing a plan for strategic renewal or corporate venturing. Similar to the above argument, the corporate entrepreneurs who promote a venturing initiative will perceive a certain loss of opportunity to the organization if the initiative is not implemented. The entrepreneurs will tend to be risk seekers committed to making the initiative work. In contrast, managers at lower organizational levels will be more risk averse toward strategic renewal initiatives induced by top management. Relative to top management, they lack ownership of the idea so they may not see the need for change or may feel threatened by the change. They will compare the risky gain of renewal against the more certain gain of the initiatives that they themselves favor. The commitment to strategic renewal among the managers responsible for implementing the changes when they are not the entrepreneurs is expected to be lower than the entrepreneurs who proposed the effort. Thus:

*P3. Lower level management will view strategic renewal from the perspective of gain enhancement and consequently will be risk adverse in their evaluation of such initiatives. This will decrease the probability that they will be committed to the initiative.*

*P4. Lower level management will view corporate venturing from the perspective of loss avoidance and consequently will be risk seeking in their evaluation of such initiatives. This will increase the probability that they will be committed to the initiative.*

### **Risk Probabilities**

Aside from the differences in reference points of entrepreneurs and non-entrepreneurs, cognitive theory suggests that differences in risk perceptions may lead to divergent assessments of risk probabilities (Kahneman, 1992). Entrepreneurs may be especially susceptible to cognitive biases due to the ambiguity and stress consonant with the decisions to engage in corporate venturing or strategic renewal (Busenitz & Barney, 1997; Simon, Houghton, & Aquino, 1999). Thus, entrepreneurs may perceive a lower probability of failure than non-entrepreneurs. Combined with the opposing reference points and perspectives, the divergence in perceptions is likely to exacerbate the differences in the evaluation of the efficacy of the initiative. Recent research findings support the premise that entrepreneurs perceive business situations more positively than other individuals (Palich & Bagby, 1995). Simon et al.'s (1999) study yielded similar conclusions: entrepreneurs were significantly more likely to succumb to illusions of self-control and belief in the law of small numbers than non-entrepreneurs. They concluded that entrepreneurs appear to be more likely to perceive lower levels of risk in their initiatives. In sum, one would expect that top management would perceive the probability of failure of corporate venturing initiatives to be higher than the entrepreneurs at lower levels in the organization who propose the initiatives. In the case of strategic renewal, top managers, acting as the entrepreneurs, should perceive a lower probability of failure or downside risk than the managers

who will be responsible for implementing such initiative. This leads to the following propositions:

*P5. Top management will perceive lower downside risk in strategic renewal than lower level management. These perceptions of risk probabilities will increase the probability that the initiative will be pursued and decrease the organizational commitment to the initiative.*

*P6. Top management will perceive higher downside risk in corporate venturing than lower level management. These perceptions of risk probabilities will decrease the probability that the initiative will be pursued and increase the organizational commitment to the initiative (should it be pursued).*

## **DISCUSSION AND IMPLICATIONS**

To summarize, we argue that strategic renewal is theoretically distinct from corporate venturing due to the two characteristics of risk assessments that come into play during their formulation, evaluation, and implementation: (1) differences in the reference points of evaluation which determine if the initiative is viewed as a mechanism for gain enhancement or loss avoidance, and consequently whether managers are risk averse or risk seeking; and (2) differences in perceptions of risk probabilities of corporate entrepreneurs and non-entrepreneurs. We have also suggested that these differences can be traced back to the location in the organizational hierarchy of the entrepreneur and the type of strategic change being contemplated. More specifically, we noted that entrepreneurs and non-entrepreneurs might assess entrepreneurial initiatives from different reference points and assign different probabilities to downside risks.

These conclusions lead to implications that are important from a theoretical and practical perspective. First, top managers will possess biases when evaluating the prospects for strategic renewal and corporate venturing. All things being equal, we have suggested that at any given level of risk top management is more likely to engage in strategic renewal and less likely to engage in corporate venturing. This means that many promising ventures proposed by lower and middle level management will not proceed. Furthermore, as specified by Burgelman and Sayles (1986), those that do make it through the corporate evaluation process are likely to be subject to perverse selection pressures that may diminish their ability to provide the returns expected of them in the long term. Thus, it is not surprising that so many corporate ventures fail to meet expectations (Sykes, 1986) and that independent ventures outperform corporate ventures (Weiss, 1981). Second, the bias in evaluation is perhaps more troubling with respect to strategic renewal efforts. Since those responsible for implementing the new strategy and/or structure are likely to possess different reference points and make different assessments of the probabilities of success, their commitments to the initiative is expected to be lower. As we explained, lower commitment might engender resistance, slowing down the process of implementation and further reducing the probabilities of success. That prospect theory and other related risk concepts explain such behavior so well is encouraging. A better understanding of risk and risk perceptions may yield better answers to the problems we have enumerated than have been available heretofore.

As noted above, for the sake of simplicity we limited our discussion to companies following a single-business corporate strategy in a domestic setting. When one considers the situation of a

company that competes in more than one industry with multiple product divisions or even multiple groups, the situation becomes much more complex and much more interesting. The same is true for companies competing internationally using global or multi-domestic structures. In such situations there are multiple reference points and multiple risk probability assessments. One might expect, for instance, that the challenge of strategic renewal in multi-divisional or multi-national corporations would be even greater than in single-business corporations. Divisional managers recognizing the need to engage in renewal efforts would not only need to rally their subordinate managers to the cause but may also need to gain the approval of managers at corporate headquarters, who would be likely to view those efforts from the standpoint of gain enhancement rather than loss avoidance and might also see higher downside risk as well. Although this might put a brake on ill-conceived efforts, it might also stop ones that were more carefully thought out. Likewise, corporate venturing efforts might be rare in companies where their approval is dependent upon the assessments of corporate as well as divisional management. Clearly, there is wide scope for investigating corporate entrepreneurship from a risk orientation, and such investigations may yield many important insights. For example, the potential impediments to corporate entrepreneurship may be especially great in situations where strategic coordination across business units needs to be high, such as when a multi-national firm follows a global strategy. In such cases even corporate managers with strong entrepreneurial orientations may view subsidiary initiatives from a perspective of gain enhancement.

In conclusion, we contribute to the literature by providing a theoretical explanation for how and why corporate venturing and strategic renewal are distinct phenomena. As shown, these distinctions have important managerial implications. We encourage further empirical and theoretical work along the lines taken in this paper.

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## **LINKING ART TO SCIENCE: DIGITAL MEDIA AS A TECHNOLOGY TRANSLATION TOOL**

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### **Abstract**

Technology translation can be achieved through the blending of the sciences and arts in the form of digital imagery. Digital animation and video can be utilized to portray molecular events where the mechanism of action is known but the process occurs at a sub-microscopic level. There needs to be a strong collaboration between scientific advisors and digital artists when creating the animation such that the artistic interpretation of the molecular event conforms to the known and accepted confines of science. The finished animation may be used for information, education or persuasion as entrepreneurial biotechnical companies attempt to find markets, customers and investors interested in their inventions. Educational institutions with programs in the sciences, arts, digital media and medicine need to promote the interaction of students from these disciplines through cross-functional teams and courses. Solutions to problems developed by these teams tend to be broader and more comprehensive than more homogeneous teams.

### **Executive Summary**

Technology is becoming more complex and difficult to understand as new fields or applications of science and medicine are discovered or invented. There is a need to develop new communication forums that simplify the science to a level that can be understood by individuals wanting to use the technology and/or by entities wanting to invest in the newly developing business venture.

Digital imagery can be used as a tool to help facilitate a type of technology translation through the use of digital animation and video. As new discoveries are made in biotechnical, biochemical, medical and bio-analytical fields of science the mechanism of action of the technologies while known is many times at a sub-microscopic level. In order to visualize what is happening at the cellular level, digital media experts in collaboration with scientific advisors create animations demonstrating the mechanism of action through an artistic interpretation of the science that conforms to known and accepted confines of science. These animations can be used as sales tools, educational pieces or used to help persuade equity partners to invest in their newly formed companies. The key to success for these entrepreneurial biotechnology companies is to assist any interested party, regardless of their scientific background, in understanding why the technology being promoted is unique and marketable.

Institutions with programs of study in science, medicine, technology and digital media need to develop coursework or opportunities for interaction between these diverse fields



of study. Our experience has been that diverse cross-functional student teams generate solution sets to problems that are more comprehensive and diverse than teams comprised of members from a more homogeneous background. As the technology revolution continues to evolve the need to explain the technology to non-experts will become critical for the success of newly formed entrepreneurial technology-based companies. The combination of arts and sciences through digital imagery is one technique to help facilitate this technology translation.

### **Introduction**

New technology and scientific breakthroughs, especially those in the medical, pharmaceutical and biotechnology fields, have become so complex that the explanation and comprehension of the technology by scientists in a different field of study is difficult and to a non-scientific individual it can be virtually impossible. As companies commercializing these technologies bring products to market there is an urgent need to find new channels of communication that facilitate the translation of highly technical concepts to the common language of the general population. In many cases the new technologies may be the result of disruptive rather than incremental research and the resulting products may significantly alter an existing market or create an entirely new market that has no competition, recognition or boundaries in place. This paper will discuss the use of digital media as an art form to assist in the technology translation process as products move from prototype to commercial availability and in the relevant pedagogical issues that facilitate the linkage of art and science to a common purpose.

### **Background**

Traditional research protocol for Universities and Federal Research Laboratories have been to conduct basic research that contributes to the underlying scientific understanding but leaves the process of conversion of basic research to commercial products to the private sector. Recently, university and federal research laboratories have seen the limitations of licensing technologies to private industry and are favoring the formation of private corporations from technology developed in their own laboratories by allowing professors/researchers needed release time to commercialize their intellectual property. The emergence of regional technology-based business incubators has generated the necessary infrastructure and cost structure needed for emerging high-technology business ventures from Universities and Federal Laboratories. The location of these technology-based business incubators adjacent to universities and federal laboratories provide a diverse consulting base to address the difficulties encountered in technology transfer from the laboratory bench to the commercial realm. In addition, the existence of these incubators in close proximity to the university provides a self-renewing source of embryonic technology-based businesses for our graduate students to interact with through the course of their study in technology driven entrepreneurial innovation (Clark and Czuchry, 2004).

Through involvement with embryonic technology-based businesses formed through technology transfer from universities and/or federal laboratories we have noted several critical observations. The technical complexity of these businesses is increasing over time and this is especially true in the biotechnology based entrepreneurial firms. In most

cases, the technical focus of the business is narrow in scope and theoretical in nature as the science concept moves from the laboratory to the fledgling business. In addition, the founders of the newly formed corporations, in general, are experts in their respective field of study but have limited to no business experience. Many of these businesses gain initial funding through federal SBIR (Small Business Innovation and Research) grants that foster the further development of the technology to a commercial product.

As the technology moves past the SBIR funding phase and a prototype product is formulated, the founders of the company will require substantial capital for continued development of their product and growth of their corporate entity. Funding sources typically come through commercial channels such as venture capital, small business administration loans, angel investors, initial public offerings and other. We have observed difficulty in communication as cutting-edge scientists attempt to translate “science speak” into a language that can be understood by the financial non-science speaking community. The necessity to communicate the significance of the invention to the financial community and their recognition of potential market significance is becoming more difficult as the complexity of technologies is increasing at an exponential rate. The use of cross-functional student consulting teams has proven invaluable as business, technology and digital media students come together to assist these companies in bringing their product to market through market research, marketing strategy development, advertising forms and forums, competitor analysis and other needed information or assistance. This process of using student teams to assist embryonic technology-based businesses domiciled in regional business incubators has been previously reported (Clark and Czuchry, 2004). One significant learning has been the incorporation of digital visual formats as a tool to assist in the translation of complex technology to potential investors or customers through animation and digital imagery.

### **Digital Media**

Students entering our digital media program envision themselves post-graduation as animators employed in studios in the creation of the next “blockbuster” movie or in creating the next generation of interactive videogames. The reality is that opportunities to work in these premier settings is limited, however there are numerous other outlets for creative capabilities in the design of new and innovative uses for digital technology beyond the scope of entertainment industry. Miller (1999) described an incident where 3D animators were given eight days to create a video animation, to be shown to a group of venture capitalists, describing the mechanism of action of a new matrix metalloprotease (MMP) inhibitor, invented by Agouron Pharmaceuticals, for the treatment of non-small-cell lung cancer. The primary author of this 3D animation, Marie Dauenheimer, was quoted in this article stating “A few years ago, we wouldn’t have had the computer resources or capability to create something of this ilk that quickly. Yet today we were able to design rather elegant animation that showed the drug traveling through the blood stream, into the epithelial layers and eventually stopping the blood supply to the tumor”. In the case of Agouron Pharmaceuticals, the animation was used to describe the molecular process for illustrative purposes, however the use of 3D modeling is becoming more common in designing molecules through structure-based design. This process and was described accurately by Werth (1994) in his description of the process

used by Vertex Pharmaceutical to custom synthesize a molecule that would have the appropriate structure and conformation to combat the AIDS virus.

Other examples of using digital imagery are evident and can be found in the literature illustrating the utility of computer animation for molecular biology educational purposes (Amerongen, 2000, Skweres, 2004) or assisting in the analysis of medical images (Berlage et al., 1966). In reviewing the websites of new biotechnology pharmaceutical companies there is a prevalent use of digital animation to visually describe the proposed mechanism of action of new pharmaceutical entities at the molecular level. This translation of “science-speak” into easily understood visual imagery can be applied to numerous scientific applications and becomes a significant alternative career path for digital media students. The Digital Media Program, however attracts students who view themselves as artists that are experimenting with the new art medium of electrons and many have little to no interest in business and commercial applications of their skill set. We have undertaken education program steps that seek to bridge the arts and sciences by providing students with technical knowledge, an understanding of aesthetics, and practical experience in digital media. With a core emphasis on learning how to develop and express ideas, solve problems and create digital media content, this program leads students through problem, project and process-based learning experiences that teach them how to define, design and develop digital media content, computer graphics and interactive medias. The program endeavors to bring together students, faculty and industry professionals to realize interdisciplinary initiatives that prepare students for the professional challenges of linking the arts to the sciences. These new 21<sup>st</sup> century careers include employment utilizing Web media design, 3D visualization (modeling for data, product, architectural, and other needs), interactive design (for education, entertainment and business applications), communication design, digital video production and special effects and animation. Mark Meadows (2003), author of the text, *Pause and Effect, The Art of Interactive Narrative*, gives an excellent example of the utility of digital animation. He states: “The best learning would occur hands on with the physical subject matter. If you’re studying a rock, the best way to comprehend a rock is to hold it in your hands, look at it, smell it, weigh it – physical interaction. With 3D where you are using 3D, photorealism and motion, we can approach reality far closer than any other media. In this medium, learning is going to be facilitated.” In biotechnology, the process of molecular action although known in many cases, is sub-microscopic and not visible and the use of 3D animation created with scientific direction helps in the understanding of how the body and the molecule interact.

### **The Process**

Our experience of linking digital media and the sciences together is truly in its infancy at our university. Currently students have the opportunity to interact with scientists and create animation that is used to help explain some complex functions in two different manners. For our graduate students, this opportunity is offered in a course entitled “Strategic Experience” which is a culminating experience course for students obtaining a masters degree in business administration, technology and digital media. These students are grouped in consulting teams based on their education, experience and needs and most importantly the consulting teams feature members with diverse educational disciplines.

We have found that by creating cross-functional teams, through bringing many different disciplines together, we create consulting teams that develop solution sets that are broader and more comprehensive than teams with more homogeneous members. We have described the difficulties and positive aspects of managing and directing cross-functional teams in a previous paper (Clark, Johnson and Turner, 2004). When students serve as consultants to emerging businesses at regional technology-based business incubators, they are faced with numerous problems ranging from the need to develop a brand identity, defining their market niche, developing a comprehensive website and communication forum and in finding a way to describe their complex technical process to consumers or individuals that might be interested in investing in their company. In fact, working with these emerging biotechnology companies is a true challenge for our students since many of the companies are dealing with newly emerging or not yet defined market niches.

The second opportunity developed to intentionally link the arts and sciences together is through the Honors Program Thesis Project within the digital media department. In this case a student or teams of students work with a scientific mentor with the end result being an animation of a biochemical, physiological or biomedical process that may be combined with an interactive web or CD interface. In each case, the process for developing the animation is similar (Figure 1). The team meets with the scientist (content advisor) to discuss the technical problem that needs to be described through animation. This part of the process may require multiple meetings until the problem is well defined and there is a significant understanding of the technology and how it works. This is not a simple process since animating events that cannot be seen through a microscope requires some artistic interpretation that must conform to the confines of the known science. In the case of cross-functional teams this process can be accelerated since technology students can assist in the translation of “science speak” to the digital media student team members. Once the problem is defined, the team develops a sketches and a storyboard defining how the animation will be developed and what will be emphasized and highlighted in the completed animation. This part of the process may take several more meetings with the scientific advisor as iterations of the animation process are developed and matched to known or perceived mechanism of action at the cellular level. The prototype animation (timing test) or parts of the animation are developed in animatic format and meetings with the team and scientific advisor are again held to confirm the accuracy and authenticity of the artistic interpretation of the biological event. At this point the final voice-overs are added and the finished 3D models created with color, texture and lighting schemes identified. If there is a strong working relationship between the team members and the scientific advisors and the necessary time has been spent to ensure the scientific accuracy of the animation, the final result is an excellent educational, promotional, information and sales tool for the newly emerging technology. This merging of art and science appears to be an excellent new employment opportunity for digital media students/artists who have successfully learned to interact with the scientific community.

### **Our Experience**

Our experience to date in linking science to the arts has been rewarding and enlightening. The use of digital imagery as a translation tool has allowed our classroom to expand to regional technology-based business incubators, federal laboratories and departments on campus where previously we have not had much interaction, such as the medical school and most recently a newly formed linkage to artists located in our community. Examples of projects completed may provide a basis for understanding the utility of digital imagery in the biotechnology field and the wealth of new educational opportunities it provides.

One embryonic biotechnology company wanted assistance in illustrating how unesterified tocopherols and tocotrienols, when formulated into a hydrolipid cream base, would migrate into the skin layers (epidermis, dermis, subdermis) rather than remaining on the skin surface until the ester bond could be broken (requires the presence of an esterase). The significance of the molecules migrating into the dermis layers is that the tocopherols and tocotrienols act to neutralize free radicals that are formed through exposure to UV radiation, environmental toxins and/or other pollutants. Free radicals can serve as a stimulus for cell mutation and the formation of skin cancers. In this case, a digital cartoon was created showing migration of the molecules and the resulting neutralization of the free radical. It allows the company the opportunity to differentiate its product from others using esterified tocopherols and tocotrienols in their formulation and allows for premium pricing in a commodity driven marketplace.

Our graduate students worked with a new startup bio-analytical company that had developed a new piece of laboratory equipment designed to perform two-dimensional gel electrophoresis of blood proteins based on their hydrophobicity and pH. Although our team never had the opportunity to create the actual digital animation of how the proteins would migrate in this two-dimensional field, they did collaborate with scientists at the company to develop a detailed storyboard of how the final animation would be created to show the proteins movement in the gel. The significance of this technology is that it allows scientist to differentiate proteins from normal and abnormal cells. If protein segments identified from abnormal cells are isolated, the amino acid sequence determined and the conformational structure of the protein identified then companies can work to develop new chemical or biological entities to inactivate the expression of that protein from the cellular DNA. In this case, digital animation will give the company a technology translation that will be understood and appreciated by the investment community helping to move the company to the next level.

A third example was a project entitled: "Visualized Surgical Solutions: Female Incontinence," an interactive walk-through of the surgical procedure for correcting female incontinence. A Professor of Surgery (content provider) and a five-member student team developed an anatomical explanation of the procedure using 3D models of the female pelvis. The project included a series of videos using 3D models to identify the various structural anatomy involved and an interactive, rotatable model of the female pelvis. Also included in the application are a series of video clips of the surgical techniques that could be viewed in pieces, or as a complete video of the entire surgery. This digital imagery used in concert with actual surgical footage provides the physician an excellent platform to describe the process to potential patients. In this case the digital

imagery is used to illustrate a macromolecular process rather than sub-microscopic as discussed in the previous examples.

A fourth example was the subject of a two student's Honors project and was entitled "Visualizing the Human Knee." In this project the students used a combination of digital video in addition to animated 3D models of the bones. What is interesting about this particular case is that by using digital video the students were able to take the video and "clean up" and enhance the images giving the surgery a more aesthetic representation of the actual procedure. Patients considering the surgery can view the operation without having to endure the more graphic scenes typically seen in an operating theatre. In this case the students collaborated with a research physician who was the content and scientific advisor.

Our last example also used a content and scientific advisor from the medical school and was entitled "A 3D Visualization of the Sacroiliac Joint." In this case the animation was used to assist in determining how much room for play there actually is in the sacroiliac joint under in vivo conditions. The student worked with scans of the joint to create a negative image (the inverse of the joint—basically a model of the interior surfaces), to be able to visualize how smooth or rough the surface was, and evaluate the effects of the surface topography on actual motion ability of the joint.

### **Conclusions**

The linkage of arts and sciences generates tremendous benefits where digital imagery can be utilized to facilitate imaging of medical, biotechnical, biochemical and bioanalytical processes. Since many of the processes occur at the sub-microscopic level, the use of digital animation, created under the direction of scientists and maintaining scientific integrity within the known and accepted bounds, provides the opportunity for complex molecular events to be understood by the non-scientific community. This technology translation becomes important for emerging new companies promoting these technologies as they seek customers, markets and the influx of capital to support growth. Institutions with strong science, medical and digital media/imaging departments need to intentionally develop projects and coursework promoting the blending of these diverse technologies through cross-functional teams and classes.

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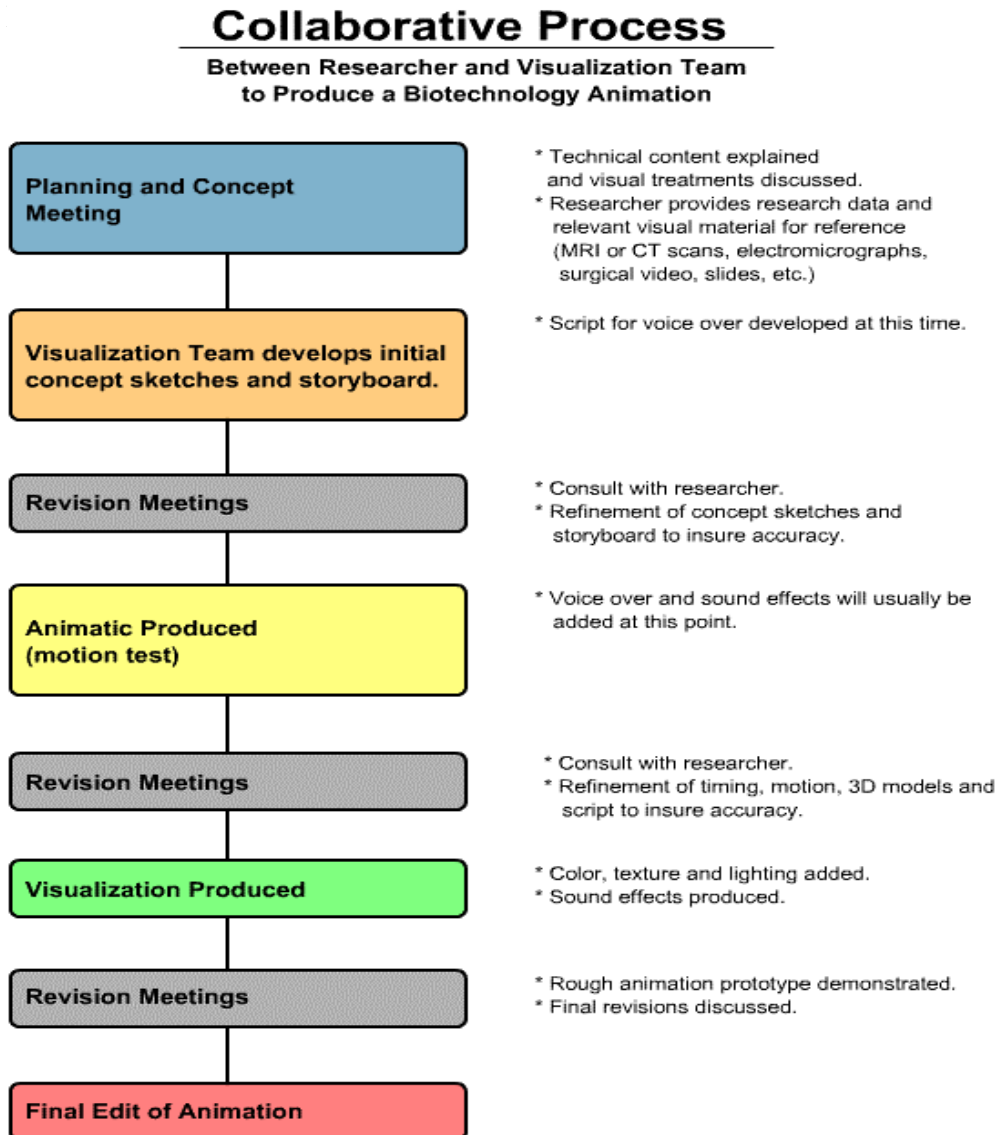
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Figure 1.





# FRANCHISING AS A STATE ECONOMIC DEVELOPMENT TOOL: SOME PRELIMINARY ANALYSIS AND SUGGESTIONS FOR FUTURE RESEARCH

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## ABSTRACT

The purpose of this paper is to explore the potential benefits of using franchising as a state economic development tool. We examined the relationship between concentrations of franchisors and the economic development environment of the state in which the franchise firms were headquartered. Using firms listed in Entrepreneur Magazine's Franchise 500<sup>®</sup>, we identified states with the greatest concentration of ranked firms. To measure the impact on each state's economy, we used a traditional economic development metric, the number of corporate employees. To examine possible factors that might be associated with higher concentrations of franchise headquarters in any given state, we used the Corporation for Enterprise Development (CFED) annual state's economic development Report Card.

As expected, large states such as California, Texas, and Florida were found to be headquarters to a large number of franchisors. The analysis also revealed that several smaller states, such as Minnesota and Ohio had substantially higher numbers of franchisors than states of comparable population. Next, using data from Source Book Publication's Worldfranchising website, we obtained the number of headquarters staff for each firm in the Franchise 500.<sup>®</sup> Analysis revealed that many of the top ranked firms have large headquarters staffs, an indicator of substantial economic impact in the states in which they are located. This study raises questions about whether a state's economic development policy and associated economic incentives may be appropriately targeted to encourage franchise formation and/or growth in order to reap its associated economic benefits. Implications for practitioners and policy makers as well as future research directions are discussed.

## INTRODUCTION

Although entrepreneurs have been studied for their personality (e.g., (Chell, 1984)), their behaviors (e.g., (Gartner, 1988)), and their ability to transform their attributes into business success (e.g., (Shaver, Gartner et al., 1996)), researchers have frequently focused on entrepreneurs because of their economic contributions. Whether viewed as creative destruction ((Schumpeter, 1934)) or entrepreneurial opportunity (von Mises, 1949), economists were among the first to study entrepreneurs primarily because of the value created by their innovations (Stevenson, Roberts et al., 1985). More recently, the study of

entrepreneurship has been expanded in scope to encompass the creation of new business ventures (e.g., (Carter, Gartner et al., 1995)) as well as entrepreneurship within organizations (Jarillo, 1988). This line of research has led to studies of entrepreneurial activities within major corporations (e.g., (Kanter, 1996)) and within hybrid organizations, such as franchise firms (Kaufmann and Dant, 1998). Franchising's economic impact has been a topic of interest to academics, practitioners, and policy makers for many years (e.g., (Bucklin, 1971); (Stanworth and Dandridge, 1993); (Trutko, Trutko et al., 1993)). Viewed from a domestic perspective, franchising is an integral part of the small business and entrepreneurial landscape (Elango and Fried, 1997). Franchising has also had an increasingly visible international presence, especially in developing economies where it has contributed to poverty reduction and wealth creation by stimulating new firm creation and through transfer of expertise through licensing (anonymous, 2004).

Although insightful, studies of franchising's economic impact have primarily centered on the development of franchised outlets. Similar to other large, non-franchised businesses, the headquarters of a franchise is likely to employ a number of professional workers. Additionally, economic benefits from increased travel, conventions, and supply-chain linkages are likely to be realized in regions where a franchise establishes its headquarters. Similar to non-franchised businesses, a franchise is likely to locate in a state where economic development conditions are favorable, such as those areas with a talented labor force, high quality of life, and other factors that support business growth. Despite the number of studies of franchise firms, very little attention has been paid to the economic contributions made by a franchise headquarters on its state and local economy. More specifically, where franchise organizations form and grow remains largely unexplained.

In an effort to address this topic, this paper explores two primary research questions. First, what is the economic impact of a franchise headquarters? Using the number of headquarters employees as a measure, we look at the level of employment of some of North America's top franchise firms. Second, is there a relationship between the headquarters locations of top franchises and those states with favorable economic development conditions? To explore this relationship we analyzed the headquarters locations of Entrepreneur Magazine's Franchise 500<sup>®</sup> firms and the Center for Enterprise Development (CEFD) report card for the states. In this preliminary analysis, we looked at states with the highest and lowest concentrations of franchise headquarters.

## **LITERATURE ON FRANCHISING AND ECONOMIC DEVELOPMENT**

### **Background**

In one of the earlier studies of economic impact, Caves and Murphy revealed that franchise firms were responsible for 38 percent of all retail sales in the United States, and nearly 12 percent of the gross national product (Caves and Murphy, 1976). Although much of the growth in franchising has been through expansion in its traditional industries, such as fast-food, quick printing, and janitorial services (Trutko, Trutko et al., 1993), it is also expanding its impact by penetrating new industries, now accounting for nearly 50 percent of all domestic retail sales, a figure estimated at \$1 trillion (Grunhagen, 2001). A recent study by the

International Franchise Association (IFA) and Pricewaterhouse Coopers claimed that franchising in the U.S. created more than 18 million jobs, and accounts for 9.5 percent of the private sector economic output (anonymous, 2004). Because of its substantial economic impact and far-reaching international expansion, franchising is increasingly considered and important and global phenomenon (Teegen, 2000), and one worthy of study.

### **An International Economic Development Tool**

The ubiquity of franchised outlets is evidenced throughout the world (Swartz, 2001). The United States has been considered as the source of innovation behind many successful international franchise concepts (Fernie and Fernie, 1997). For many U.S. franchisors, international expansion has been growing at a rate that exceeds their domestic growth (Preble and Hoffman, 1995), although not all franchisors choose to expand in this manner (Clarkin, 2002). One measure of the impact of international operations by U.S. franchisors is reflected in the receipt of franchise fees from overseas operations, a figure that exceeded \$569 million in 1999 (Clarkin, 2002). In developed economies, globalization has created opportunities for U.S. franchisors (Shane, 1996), and, albeit to a lesser extent, for European and other international concepts to expand into the U.S. market (Muniz-Martinez, 1998). In developing economies, franchising has been considered a valuable contributor to an emerging small- and medium-sized enterprise sector (Sanghavi, 2001), as well as valuable technology transfer mechanism (Stanworth, Price et al., 2001), helping to build a nation's economic base while offering a tested method of privatization with comparatively low failure rates (Preble and Hoffman, 1995).

### **A Domestic Economic Development Tool**

In similar fashion to the innovators and creators of non-franchised businesses, franchisors have been studied by entrepreneurship researchers. Entrepreneurs are considered to be essential to economic development (Schumpeter, 1934), serving as "protagonist(s) of economic activity" (p. 18) (Stevenson and Jarillo, 1990). According to the U.S. Small Business Administration (SBA), franchised businesses, together with non-franchised small businesses, are considered to be the "building blocks of sustainable economic growth...and they must be the cornerstones of inner city and rural communities" (p.1) (anonymous, 1999). Supporting this effort, the SBA has backed more than 18,600 loans to franchisees totaling more than \$5 billion in the five-year period of 1993 through 1998 (anonymous, 1999).

Bingham and Bowen observed that economic development had become a major priority for state agencies, employing three primary strategies: 1) maintaining existing firms and technologies; 2) recruiting firms from other states, or encouraging opening of branch plants; and 3) creating new industries and enterprises (p. 501) (Bingham and Bowen, 1994). Most economic development initiatives related to franchising have been focused on encouraging the opening of branch outlets by supporting and training prospective franchisees. Franchising has received a great deal of attention among economic development agencies and researchers, in part because of the widespread belief that franchised businesses have overall lower failure rates than non-franchised businesses (e.g., (Barrow, 1989); (Burke, 1996)). Much of this attention, however, has been directed toward the "micro" impact of franchised outlets in rural or urban economic development, both in the U.S. and abroad.

To address gaps in the literature, this study explores the economic impact of franchisors, and potential links between the locations of franchise headquarters and the state's economic development conditions. To accomplish this study, data from three sources were utilized, each of which is described in the following section.

## **DATASET DESCRIPTIONS**

### **Entrepreneur Magazine Franchise 500®**

Data were collected from the January 2004 edition of *Entrepreneur Magazine* for this study. Published annually since 1980, Entrepreneur Magazine's Franchise 500® has been widely used by practitioners and potential franchisees to compare franchise opportunities. In addition to its use by practitioners, Entrepreneur's Franchise 500® dataset has been used, albeit in different capacities, in several academic studies. Authors of previous studies concluded that the Franchise 500® dataset was a reliable source of data for studies of franchising (Lafontaine and Slade, 1996); (Shane and Spell, 1998). Table 1 presents the criteria used by the magazine in its ranking.

[Table 1 about here]

The Franchise 500® ranking is based on pre-determined, weighted criteria, those considered by the magazine to be essential for evaluating and comparing franchises. Although it does not disclose individual weightings assigned to specific criterion, the magazine differentiates between criteria it considers most important and important. The magazine collects data from franchisors through a survey, and requires respondents to submit a UFOC and/or other supporting documentation before inclusion in the ranking.

### **Source Book Publications "Worldfranchising" website**

Source Book Publications provides franchise information through books, databases, consulting, and through a number of websites. Among the books published by Source Book are "Bond's Franchise Guide" and "The International Herald Tribune Franchise Guide." Its websites include [www.worldfranchising.com](http://www.worldfranchising.com), promoted as "the Internet's most comprehensive and up-to-date portal on franchising," and [www.franchisingconsultant.com](http://www.franchisingconsultant.com), a database containing detailed profiles of leading North American franchise consultants and service providers. Source Book's "Worldfranchising" website contains a database of more than 1,100 franchise concepts, with data gathered through a survey of North American franchisors.

### **Corporation for Enterprise Development (CFED)**

For 17 years, the Corporation for Enterprise Development (CFED) has published its "Development Report Card for the States." (available at <http://drc.cfed.org/grades/>) In its report card, states are graded on three composite indices, "Performance," "Business Vitality," and "Development Capacity," each of which is comprised of a series of sub-indexes. The *Performance* index measures how a state's economy is providing opportunities for employment, income, and an improving quality of life. The *Business Vitality* index looks at the degree to which a state's large and small businesses are dynamic and competitive, while *Development Capacity* examines each state's capacity for future development. To calculate

grades for its report cards, CFED collects data on 68 separate measures, and then ranks each state from best to worst on each measure. Overall index scores are calculated by taking the sum of the sub-index scores. Once the scores are compiled, states are rank-ordered, with those that rank from 1-10 given a grade of “A,” those from 11-20 earn “B,” and so on until those states ranked 46-50 receive a grade of “F” in each of the three indexes.

### **Preliminary analysis of states with firms in the Franchise 500®**

Preliminary analysis of the Franchise 500® data was performed using SPSS for Windows V10.5. The frequency of each state was calculated in order to determine which states had the highest and lowest concentration of ranked firms. The District of Columbia and Canada were also assigned unique numbers, making a total of 52 possible headquarters locations.

[INSERT TABLE 2 ABOUT HERE]

As presented in Table 2, the frequency analysis revealed highest concentrations of franchise headquarters among ranked firms in three of the four most populous states: California (33.8 million), Texas (20.8 million), and Florida (15.9 million). Interestingly, the comparatively smaller state of Minnesota (4.9 million) accounted for what appears to be a disproportionate number of franchise headquarters. Conversely, Idaho, Montana, North and South Dakota, and Vermont had only two ranked firms domiciled in their respective states, while Wyoming, West Virginia, and Alabama accounted for only one each.

### **Preliminary analysis of Franchise 500® and headquarters employment**

As presented earlier, one way to measure the economic development impact of a franchise firm is to examine its headquarters employment. Using the top-ranked franchises in the Franchise 500®, this section of the analysis focused on the number of corporate employees in each firm. Source Book Publication’s “Worldfranchising” website was used to determine the size of each firm’s corporate staff.

[INSERT TABLE 3 ABOUT HERE]

Table 3 presents the top-ranked franchises in the Franchise 500®, with the size of their firm’s corporate staff. The table reveals that the top-ranked franchises represent sources of substantial employment, such as 7-Eleven (1,000), Subway (700), and Quizno’s (485). Although Source Book Publication’s survey asked each franchisor to note the size of their corporate staff, they were not required to disclose the location of the employees. In other words, some corporate employees may not be located in the state in which their headquarters exists.

### **Preliminary analysis of headquarters location and the state’s economic development report card**

To explore the relationship between states with higher concentrations of top-ranked franchises and their economic climate, we used each state’s economic development report card, as reported by the CEFD. We assigned a numeric value to the letter grade given in the report card, from an “A” which was assigned a value of “1” to an “F” which was assigned a value of “5” for each of the three indices described earlier in Table 2. In addition to the three indices, a composite was entered, representing the sum of the three. Using this method, states with all “As” would receive a composite score of three, while those receiving all “Fs” on the report card would receive a score of fifteen.

Although a relationship between a state's population and the number of franchise headquarters was evident, it appears that population is not the sole determinant. For example, Minnesota and Alabama have similar populations, 4.9 million and 4.5 million respectively. Despite similar populations, Minnesota serves as the headquarters of 27 of the top-ranked franchises in North America, while Alabama is home to only one of the Franchise 500<sup>®</sup> firms. Georgia (8.2 million), with twice the population of its neighbor South Carolina (4.0 million) has more than six times the number of headquarters among ranked firms.

### **Conclusions and suggestions for further research**

Preliminary analysis using only 2004 data from the Franchise 500<sup>®</sup> indicates that there is value to continuing this line of research. Based on the number of corporate employees found in many franchise headquarters, there can be little doubt that there is economic value associated with employment and associated payrolls. This conclusion does not consider additional indirect benefits that may accrue to these locations through training centers, and their transient economic impacts, such as national meetings and conventions. Also not considered is the flow of franchise or royalty fees to corporate headquarters, the value of creating an innovative and growing organization on the local real estate market and the community at large, and the potential impact on growing a network of local suppliers. These represent potential paths for further research on this topic.

A second potential avenue for research could be more focused on specific economic development conditions, weighing their impact on supporting or constraining franchise formation and development. Issues such as infrastructure, taxes, and employment tax credits have potentially meaningful effects on franchise development. Third, it would appear that franchising could be more than just a tool for expansion of entrepreneurial ventures, but could also be viewed as a state economic development tool, one that may have been overlooked for some time. Properly crafted, economic development incentives and targeted marketing strategies could become powerful and effective tools for developing and recruiting franchise headquarters.

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| Table 1<br>Franchise 500 <sup>®</sup> Ranking Criteria |                                |
|--|--------------------------------|
|  | Criterion                      |
| Most Important   | Franchisor Financial Strength  |
|  | Franchisor Stability           |
|  | Size of System                 |
|  | Growth Rate                    |
| Important  | Number of Years in Business    |
|  | Experience in Franchising      |
|  | Start-up costs                 |
|  | Amount of litigation           |
|  | Percentage of terminations     |
|  | Franchisor financing available |

| Table 2: States with highest and lowest concentration of ranked firms |                  |            |                                   |                      |                  |             |                                   |
|---|------------------|------------|-----------------------------------|----------------------|------------------|-------------|-----------------------------------|
| Highest concentration   |                  |            |                                   | Lowest concentration |                  |             |                                   |
| No. Ranked Firms  | Percent of Total | State      | Population <sup>a</sup> (million) | No. Ranked Firms     | Percent of Total | State       | Population <sup>a</sup> (million) |
| 59  | 11.8             | California | 33.8                              | 2                    | .4               | Vermont     | .61                               |
| 44  | 8.8              | Texas      | 20.8                              | 2                    | .4               | S. Dakota   | .75                               |
| 42  | 8.4              | Florida    | 15.9                              | 2                    | .4               | N. Dakota   | .64                               |
| 27  | 5.4              | Minnesota  | 4.9                               | 2                    | .4               | Montana     | .90                               |
| 27  | 5.4              | Ohio       | 11.3                              | 2                    | .4               | Idaho       | 1.3                               |
|   |                  |            |                                   | 1                    | .2               | Alabama     | 4.5                               |
|   |                  |            |                                   | 1                    | .2               | W. Virginia | 1.8                               |
|   |                  |            |                                   | 1                    | .2               | Wyoming     | .49                               |

<sup>a</sup> U.S. population by state: Population Reference Bureau, available at [http://www.classbrain.com/artstate/publish/article\\_661.shtml](http://www.classbrain.com/artstate/publish/article_661.shtml)

| Table 3: Top-Ranked Firms and Their Headquarters Staff |                |                    |                    |
|--|----------------|--------------------|--------------------|
| Rank   | Name           | Headquarters State | Headquarters Staff |
| 1  | Subway         | Connecticut        | 700                |
| 2  | Curves         | Texas              | 50                 |
| 3  | Quizno's       | Colorado           | 485                |
| 4  | 7-Eleven       | Texas              | 1,000              |
| 5  | Jackson Hewitt | New Jersey         | 235                |



# THE IMPACT OF HUMAN CAPITAL MEASURES ON THE PERFORMANCE OF SMALL, WOMEN-OWNED FIRMS

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## ABSTRACT

A growing number of women are starting and operating small firms. Prior research has often indicated, however, that women-owned businesses tend to under-perform firms owned by men in measures of size, growth, and profitability. This article compares the performance of women- and men-owned small firms in the service and retail industries in an attempt to determine if higher levels of human capital close the supposed performance gap between them. Results reveal that women-owned firms were smaller than men-owned firms, even controlling for industry sector and various measures of human capital. Contrary to prior research, however, women-owned firms were significantly more profitable and exhibited a significantly higher year to year growth rate in sales.

## INTRODUCTION

Small firms are a vital part of the United States economy. The U.S. Small Business Administration defines a small firm as one that has 500 or fewer employees. Using this definition, ninety-nine percent of all firms in the U.S. would be categorized as small businesses. Data compiled by the SBA indicate that there were 22.9 million small firms in this country in 2002 (Small Business by the Numbers, 2003). These firms generated over half of gross domestic product and employed more than half of the work force. In fact, small firms have been responsible for sixty to eighty percent of net new jobs. They are also an important source of innovation in the creation of new products, services, and technologies.

Within the larger category of small businesses, women-owned small businesses are a special sub-set. In spite of their growing numbers, however, women-owned firms continue to lag men-owned firms in a number of performance measures. Typically, women-owned firms are smaller than men-owned firms in terms of assets, revenues, and profits. Overall, women-owned firms tend to be very small and concentrated in highly competitive and less profitable service businesses (Brush, 1992; Chaganti, 1986; Loscocco & Robinson, 1991). These performance discrepancies could be partially due to different lifestyle choices on the part of women small business owners, but they could also be due to differences in the array of skills and experiences that women bring to small business ownership. This research will examine the effect of human capital variables including education and prior business experience on the performance of small women-owned firms to determine if higher levels of human capital are associated with higher levels of firm performance.

## DESCRIPTION OF THE DATA

Data for this study are drawn from the 1998 Survey of Small Business Finances (SSBF) conducted every five years by the Federal Reserve Board. The 1998 Survey is the most recent for which data are publicly available. It includes balance sheet and income statement data on 3,561 U.S. small firms defined as firms having 500 or fewer employees. Survey firms represent a random sample stratified by size, geographic location, gender, and the racial or ethnic identity of the firm owner. Sample weights are provided in order to make it possible to construct population estimates from the sample data. In addition to demographic data, the SSBF provides a wealth of information on the sample firms' use of financial products and services as well as on their use of financial service providers. It is the largest and most comprehensive data set of its type.

## MULTIVARIATE ANALYSIS

In order to explore the relationship between gender, human capital, and various measures of performance, a series of multivariate models were developed. The first of these examined the relationship between various measures of firm size, gender, and independent variables representing various aspects of human capital. The model took the following form:

Model 1:

$$\text{Logsales (or Logassts)} = a + b_1\text{ed2} + b_2\text{ed3} + b_3\text{ed4} + b_4\text{soleprop} + b_5\text{family} + b_6\text{inherit} + b_7\text{ownage} + b_8\text{firmage} + b_9\text{exp} + b_{10}\text{female} + e$$

The dependent variable, Logsales, represents the log of 1998 sales and is a measure of firm size. In a second iteration of the model, the log of total assets (Logassts), also a measure of firm size, was substituted as the dependent variable. The logged form of both variables was used because both values were highly skewed.

Independent variables represent firm or owner characteristics that could be expected to contribute to human capital. The variables Ed2, Ed3, and Ed4 represent various educational levels. Prior research has suggested that more highly educated firm owners tend to operate more successful firms (Kangasharju & Pekkala, 2002; Pena, 2002; Schiller & Crewson, 1997). The lowest educational level, Ed1 (did not graduate from high school), was omitted as the reference variable.

The variable Soleprop identifies firms that are organized as sole proprietorships and thus do not have the benefit of the education or experience that could be provided by partners. The variable Family indicates those firms that are defined by the firm owner as being family-owned, while the variable Inherit indicates those firms that were inherited. The owners of family-owned firms should be able to benefit from the human capital provided by other family members. Similarly, owners who have inherited their firms should benefit not only from the accumulated experience of prior generations but also from the experience of growing up in the business. Ownage and Firmage were included as

independent variables, because one would anticipate that older firm owners would have accumulated a greater amount of life experience, judgment, and maturity, while older firms would have weathered the shocks typically experienced by early stage firms.

The variable Exp indicates the firm owner's number of years of prior business experience. One would anticipate that more experienced owners would be better equipped for firm survival and success. Finally, Female is a dichotomous variable indicating whether or not the firm was owned by a woman.

A considerable amount of prior research has revealed that women-owned firms tend to be more heavily concentrated in the less growth oriented and less profitable sectors of service and retail. Since the intent of this paper is to compare the performance of women-owned firms to comparable men-owned firms, the multivariate analyses are confined to firms in the service and retail sectors. This will eliminate the potentially confounding effect of having a larger number of men-owned firms operating in sectors such as manufacturing and construction which are characterized by larger and more profitable firms. The results of Model 1 are included in Table 1 which reveals that, even controlling for various types of human capital, women-owned firms were still significantly smaller than men-owned firms in terms of total sales and total assets.

A second size model was constructed having total employees (Totemp) as the dependent variable. Since the number of employees is typically a function of firm size, logsales was added to this model as an independent variable. This model had the following form:

Model 2:

$$\text{Totemp} = a + b_1\text{ed2} + b_2\text{ed3} + b_3\text{ed4} + b_4\text{soleprop} + b_5\text{family} + b_6\text{inherit} + b_7\text{ownage} + b_8\text{firmage} + b_9\text{exp} + b_{10}\text{female} + b_{11}\text{logsales} + e$$

In this model, the variable Female was not significant, indicating that when we control for firm size, industry, and measures of human capital, women-owned firms were no smaller than men-owned firms in terms of total employees. This is an important finding, because it suggests that women-owned firms have the same willingness and potential to create jobs as firms owned by men.

A second set of models examined the relationship between various measures of profitability and independent variables representing human capital characteristics. In the first of these, return of sales (ROS) was used as the dependent variable:

Model 3:

$$\text{ROS (or Growth)} = a + b_1\text{ed2} + b_2\text{ed3} + b_3\text{ed4} + b_4\text{soleprop} + b_5\text{family} + b_6\text{inherit} + b_7\text{ownage} + b_8\text{firmage} + b_9\text{exp} + b_{10}\text{female} + b_{11}\text{logsales} + e$$

Return on sales was used as the dependent variable rather than return on assets or return of equity, because prior research has indicated that women-owned firms are smaller in

terms of assets. Thus, their ROA or ROE ratios might be unusually high because of the low denominator. Return of sales, on the other hand, is a measure of operating efficiency. It provides an indication of the firm owner's ability to manage expenses relative to revenues. In this model Tobit analysis was used, because the dependent variable, ROS, was truncated at a lower boundary of zero.

The results of Model 3 (Table 2) reveal that women-owned firms were significantly more profitable than men-owned firms in terms of return on assets. This finding supports prior research which has found that, although women-owned firms are smaller than men-owned firms, they are no less profitable. .

The Tobit model was repeated with a second independent variable representing year to year growth in sales (Growth). The results of this model are also provided in Table 2 which reveals that women-owned firms were significantly more likely to have experienced growth in sales from 1997 to 1998

As a final measure, two additional models were constructed to examine profitability and growth. In this instance, the dependent variable was a dichotomous variable indicating whether or not the firm achieved positive versus zero or negative profits (or growth). The model took the following form.

Model 4:

$$\text{Someprof (or Somegrow)} = a + b_1\text{ed2} + b_2\text{ed3} + b_3\text{ed4} + b_4\text{soleprop} + b_5\text{family} + b_6\text{inherit} + b_7\text{ownage} + b_8\text{firmage} + b_9\text{exp} + b_{10}\text{female} + b_{11}\text{logsales} + e$$

The variable representing gender was not significant indicating that women were no more likely than men to operate firms having positive profits. Women were, however, significantly more likely to operate positive growth firms than men.

## SUMMARY AND CONCLUSIONS

Prior research has been inconclusive regarding the performance of women-owned firms relative to firms owned by men. In general, however, it seems to suggest that women-owned firms are smaller and less growth oriented, though not necessarily less profitable. These results, using data from the 1998 Survey of Small Business Finances, sheds some additional light on those findings. Multivariate analysis reveals that women-owned firms were significantly smaller than men-owned firms in terms of total sales and total assets. Controlling for sales level and industry sector, however, women-owned firms had no fewer employees than men-owned firms suggesting that women-owned firms are just as willing and able to generate jobs as businesses operated by men. Further, these findings reveal that women-owned firms were significantly more profitable than men-owned firms in terms of return on sales. They also demonstrated a significantly higher year to year growth rate in sales. Women-owned firms were no more likely to demonstrate zero or negative profitability than men-owned firms, and they were significantly less likely to demonstrate zero or negative growth. Overall, these results seem to indicate that,

although women-owned firms under-perform men-owned firms in terms of firm size, they do not under-perform in measures of either profitability or growth.

Table 1  
Multivariate Analysis: Measures of Firm Size (Regression Analysis)  
Parameter Estimates

| Variables | Logsales     | Logassts     | Totemp      |
|-----------|--------------|--------------|-------------|
| Intercept | 13.85826**   | 12.13153**   | -75.61242** |
| Ed2       | -0.00564     | 0.46945      | 3.07499     |
| Ed3       | 0.17839      | 0.57058*     | 3.09457     |
| Ed4       | 0.56279*     | 0.92928**    | 7.23753     |
| Soleprop  | -2.07129**   | -1.73072**   | -6.63427**  |
| Family    | -0.54263**   | -0.60414**   | -12.91668** |
| Inherit   | 0.81282**    | 0.77297**    | 11.62575**  |
| Ownage    | -0.03370**   | -0.02645**   | 0.16007     |
| Firmage   | 0.03240**    | 0.02907**    | 0.36310**   |
| Exp       | 0.04151**    | 0.04121**    | 0.00431     |
| Female    | -0.54001**   | -0.54594**   | 2.74327     |
| Logsales  | not included | not included | 7.47572**   |
| R-square  | 0.3196       | 0.3227       | 0.2759      |
| Pr>F      | 0.0001       | 0.0001       | 0.0001      |

\*results significant at the .05 level

\*\*results significant at the .01 level

Table 2  
Multivariate Analysis: Measures of Firm Profitability and Growth (Tobit Analysis)  
Parameter Estimates

| Variables | ROS      | Growth    |
|-----------|----------|-----------|
| Intercept | 0.0898   | -0.2490*  |
| Ed2       | -0.0043  | -0.0114   |
| Ed3       | -0.0123  | 0.0290    |
| Ed4       | -0.0165  | 0.0244    |
| Soleprop  | 0.1763** | 0.0578**  |
| Family    | -0.0044  | 0.0013    |
| Inherit   | 0.0645*  | -0.1238** |
| Ownage    | -0.0010  | -0.0002   |
| Firmage   | 0.0014   | -0.0052** |
| Exp       | 0.0010   | -0.0039** |
| Female    | 0.0330*  | 0.0585**  |
| Logsales  | 0.0056   | 0.0328**  |

\*results significant at the .05 level

\*\*results significant at the .01 level

Table 3  
Multivariate Analysis: Measures of Firm Profitability and Growth  
(Logistic Regression Analysis)  
Parameter Estimates

| Variables | Someprof  | Somegrow  |
|-----------|-----------|-----------|
| Intercept | -3.2837** | -3.1494** |
| Ed2       | 0.5658    | 0.4077    |
| Ed3       | 0.3526    | 0.5162*   |
| Ed4       | 0.2267    | 0.4683    |
| Soleprop  | 1.0077**  | 0.2643**  |
| Family    | -0.0521   | 0.2134    |
| Inherit   | 0.4141    | -0.5372*  |
| Ownage    | -0.0119   | 0.0003    |
| Firmage   | 0.0138    | -0.0072   |
| Exp       | 0.0111    | -0.0134*  |
| Female    | 0.0992    | 0.1968*   |
| Logsales  | 0.3578**  | 0.2615**  |

\*results significant at the .05 level

\*\*results significant at the .01 level

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## **SAGE: AN INTERNATIONAL EDUCATION PROGRAM BASED ON ENTREPRENEURSHIP AND COMMUNITY SERVICE**

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Students for the Advancement of Global Entrepreneurship—SAGE—is a groundbreaking education program that links secondary school student organizations to “consultants/mentors” from local universities and businesses using an interscholastic structure similar to athletic competitions. Its mission: to advance entrepreneurship education and community service-learning across the world, emphasizing ethical business practices, social-responsibility, civic engagement and environmental awareness. SAGE provides a new avenue for teens to become actively involved in creating small businesses and contributing to the community.

During an academic year, a high school SAGE team is challenged to complete real-world projects. Near the end of the year, each team showcases its projects in a competitive “tournament” whose “referees” are local leaders business, civic and education communities. The team that wins its regional or state competition advances to the national competition; the national champion advances to the “SAGE World Cup.” SAGE has been operating as a pilot program for the past two years, and has grown to include approximately 100 high schools—16 high schools in California—and over 80 high schools in 10 other countries. This program is innovative and ambitious, for three reasons. First, SAGE students do not compete for grades; rather, they compete for the same type of recognition that comes with interscholastic sports. Second, SAGE cuts across boundaries between secondary education and higher education; between education and business; and, just as importantly, among countries. One of SAGE’s goals is to give all participants a global perspective along with local insight. Third, SAGE integrates entrepreneurship and community service-learning.

### **INTRODUCTION**

Students for the Advancement of Global Entrepreneurship—SAGE—addresses a global problem: access to educational resources that increase the capacity of young people to become self-reliant and employable in today’s global marketplace. It also addresses additional problems connected to secondary and postsecondary education, including: (1) the need for better collaboration among colleges, K-12, and local businesses to prepare students for life after graduation; (2) resistance to using alternative pedagogies, such as community service-learning (CSL) and problem-based learning (PBL), as a means of reforming curriculum and instruction in settings other than traditional classrooms (e.g., co-curricular student organizations), and (3) the lack of role models and mentors for high school students from nearby universities and businesses.

SAGE's mission is to advance entrepreneurship education and community service-learning across the world, emphasizing ethical business practices, social-responsibility, civic engagement and environmental awareness. This mission is accomplished by linking secondary school student organizations to "consultants/mentors" from local universities and businesses using an interscholastic structure similar to athletic competitions. During an academic year, a high school SAGE team is challenged to complete real-world projects. Near the end of the year, each team showcases its projects in a competitive "tournament" whose "referees" are local leaders recruited from the business, civic and education communities. The team that wins its regional or state competition advances to the national competition; the national champion advances to the "SAGE World Cup."

This paper contributes to the entrepreneurship education literature by describing the SAGE program and offering suggestions as to how this program is related to alternative pedagogies, community development and outreach. The remainder of this paper is organized as follows:

- I. History and background
- II. Description of how SAGE is an innovative learning project grounded in community service-learning (CSL) and problem-based learning (PBL); this description will also include the key features of the program
- III. SAGE's goals and structure
- IV. How SAGE's goals are linked to the new AACSB standards
- V. A description of how SAGE is a unique model for assessing the quality of CSL and PBL projects
- VI. So what?

## **HISTORY AND BACKGROUND**

The SAGE concept was created nine years ago under the name "Cal-High Students in Free Enterprise (SIFE)." A team of students and faculty from California State University, Chico (CSUC), a comprehensive four-year public university in California, started Cal-High SIFE in fall 1995. This program matched college business students with underserved and/or economically disadvantaged high schools. The college students became coaches and mentors in helping high school students develop entrepreneurship projects and hone skills needed to enter the workforce or go on to college.

Two years ago, the program was re-named from Cal-High SIFE to SAGE, for several reasons. First, high school SAGE teams focus on *entrepreneurship* rather than corporate careers as one of their main goals. Instead of merely "teaching others how free markets work in a global economy" and "teaching others how entrepreneurs succeed" (which are the main goals of collegiate SIFE chapters (<http://sife.org>), we wanted students to actually do something entrepreneurial.

Second, we wanted to reflect the *global scope* of the program. In 2003-2004, 16 high schools participated in the California competition, and over 200 high school students came to the CSUC campus at the end of March. This program has been so successful that collegiate teams from China, Kazakhstan, Mexico, Philippines, Poland, Tajikistan, Russia, South Africa and the

Ukraine started similar high school mentoring programs under the guidance and direction of CSUC students and faculty.

A third reason we re-named the project to SAGE was to reflect SAGE's more holistic set of judging criteria that include a component on civic engagement and another on environmental awareness, based on the philosophy of businessman and author Paul Hawken [1993, p. 1]:

*"The ultimate purpose of business is not, or should not be, simply to make money. Nor is it merely a system of making and selling things. The promise of business is to increase the general well-being of humankind through service, a creative invention and ethical philosophy."*

These two judging criteria ensure that SAGE teams include these topics as part of their projects. Exhibit 1 contains the SAGE judging criteria.

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Insert Exhibit 1 about here

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A fourth reason is that the name SAGE more accurately captures our vision and mission. *Sage* is defined in Webster's Dictionary as "wise; proceeding from wisdom; well-judged; grave; serious." This definition, we believe, more appropriately captures our vision of creating better futures through entrepreneurship and community service, with secondary students working collaboratively with older, more experienced consultants from nearby universities and the private sector.

### **SAGE—A COMMUNITY SERVICE-LEARNING (CSL) AND PROBLEM-BASED LEARNING (PBL) PROGRAM**

Experiential education encompasses a wide range of teaching and learning methods which engage the learner actively in whatever is being learned, whether it happens in the classroom, workplace, or community. CSL is one form of experiential learning. CSL is defined as: "A method under which students or participants learn and develop through active participation in thoughtfully organized service that is conducted in and meets the needs of a community, and is coordinated with the community and with an elementary school, secondary school, institution of higher education, or community service program" (National and Community Service Trust Act of 1993). One of the leading campus organizations in this area is the CSUC SIFE team. The mission of collegiate SIFE teams is to make a difference in their communities by learning, practicing, and teaching the principles of free enterprise. While completing community outreach projects, the students develop teamwork, leadership, and communication skills.

One of SAGE's unique features is that university business students are trained to become consultants, mentors and coaches for teams of secondary school students in their region. The university students, who can earn course credit as part of their CSL experience, aid the participating secondary school teacher and his/her SAGE students by helping them identify, deliver and assess outreach activities (readers can find a sample syllabus by going to the following website: <http://www.csuchico.edu/sage>). A pedagogy related to CSL is PBL, defined as

“an instructional method that challenges students to ‘learn to learn,’ working cooperatively in groups to seek solutions to real world problems. These problems are used to engage students' curiosity and to initiate learning the subject matter. PBL prepares students to think critically and analytically, and to find and use appropriate learning resources.” (<http://www.udel.edu/pbl/>). SAGE allows secondary school students to seek solutions to real world problems by working cooperatively on projects that they identify, deliver and assess, with input from their college mentors, their business advisory board (BAB) members and their teacher.

It should be noted that the PBL projects completed by the secondary school students can be integrated into their regular coursework or as a co-curricular activity after school or on weekends, depending on the school's infrastructure.

### **SAGE'S GOALS AND STRUCTURE**

SAGE has three main goals:

- To establish new linkages between secondary schools and universities in North America and abroad, furthering entrepreneurship education and community service for high school educators and their students; the high school students will be assisted by their college consultants.
- To contribute to the learning of business, entrepreneurship, civic engagement and environmental awareness at the secondary school level by creating an infrastructure that relies on CSL and PBL.
- To involve the business community by enlisting business managers, executives and entrepreneurs to participate as guest speakers, consultants and business advisers for SAGE high schools. Further, in the role as SAGE competition judges, they serve as evaluators and graders to determine which educational projects are doing the most to enhance business understanding and economic enterprise.

As for SAGE's structure, a high school teacher organizes a SAGE team at the beginning of an academic year. The adviser also seeks out assistance from a nearby college or university to recruit older mentors/consultants to help the SAGE students. Working with their college mentor, the high school students identify, deliver and assess activities related to entrepreneurship and community service. Near the end of the year, the SAGE teams in the area come together—usually at a university that “hosts” the competition—to showcase their projects in an oral and written presentation to judges. The competitive element incorporated into SAGE is very important. At the SAGE competition each high school is placed into a competitive league, much like athletic competitions.

This structure also allows teams to “benchmark” their best projects against other secondary schools. Unquestionably, one of the strongest motivators for a young person is peer pressure, and the SAGE structure, in a subtle yet powerful manner, has incorporated this motivational technique into a tournament-like setting. Any high school with an active business class is welcome to participate, as are student organizations like Future Business Leaders of America (FBLA), DECA (an association for students and teachers of marketing, management and

entrepreneurship), Junior Achievement, Virtual Enterprise, Future Farmers of America, SkillsUSA or the Technology Student Association (TSA).

Advisors serving on a SAGE high school team's BAB can participate in a second way. These entrepreneurs, business leaders and civic leaders can serve as official SAGE judges at a state, national or global SAGE competition. State and national competitions take place between February and July each year, followed by the "SAGE World Cup" (note: the third annual SAGE World Cup will take place on August 11-14, 2005, in San Francisco. The Second Annual SAGE World Cup took place on May 20-23, 2004 in San Francisco; seven countries participated. Results: Philippines, 1<sup>st</sup> place; Tajikistan, 2<sup>nd</sup> place; China, 3<sup>rd</sup> place; USA and Poland, tie for 4<sup>th</sup> place; South Africa, 6<sup>th</sup> place; Mexico, 7<sup>th</sup> place).

### **SAGE AND AACSB STANDARDS**

On April 25, 2003, the AACSB International (Association to Advance Collegiate Schools of Business) passed its new accreditation procedures and standards for business school accreditation. The AACSB assures quality and promotes excellence and continuous improvement in undergraduate and graduate education for business administration and accounting. The new standards require business colleges wanting accreditation to incorporate a stronger global emphasis into their curriculum. For example:

- "Every graduate should be prepared to pursue a business or management career in a global context. That is, students should be exposed to cultural practices different from their own. The learning experiences should foster sensitivity and flexibility toward cultural differences. For the benefit of all, active support of a number of perspectives is desirable." (AACSB, p. 12)
- "The curriculum management process will result in an undergraduate degree program that includes learning experiences in such general knowledge and skill areas as multicultural and diversity understanding, and such management-specific knowledge and skills areas as domestic and global economic environments of organizations." (AACSB, p. 19)

SAGE addresses these standards by involving university students in a consulting role that includes a global dimension. Exhibit 1 shows the third judging criterion by which high school students are evaluated. This criterion is intentionally broad in scope and vague in specifics. In order to be successful in today's business world, it is important that students interested in pursuing entrepreneurial ventures (or careers in business) be exposed to cultural practices different from their own. Also, it is important that they are aware of key policymaking organizations, such as the NAFTA, ASEAN, IMF, the World Bank, the WTO and the European Union.

It is vital for university students and high school SAGE students to have ample opportunity to learn entrepreneurial skills, while at the same time learning how international trade directly affects many aspects of their lives (e.g., from purchasing decisions to career choices). SAGE builds international linkages between education and business that currently do not exist.

SAGE teams from different states or countries are encouraged to work with each other in determining if there is a potential market for import/export products. Other types of projects might be a study of how free markets work in an economy other than one's own, or an in-depth study of the roles and responsibilities of various policymakers in a global economy. By including a judging criterion with a global dimension, SAGE provides secondary students with an international perspective and, for the most outstanding students, a unique cultural exchange program when they travel to the SAGE World Cup in August each year.

### **SAGE: A UNIQUE ASSESSMENT MODEL**

Another unique feature of SAGE is that accountability is built in as one of the nine judging criteria by which SAGE teams are evaluated. The last criterion reads: "In their projects, how effective were the students in measuring the results of their projects (e.g., pre- and post-test results)?" It is very important that a SAGE team measures the results of its projects. SAGE teams are urged to include an assessment component for each project, and the college mentors make them aware that "what gets measured gets managed." When SAGE teams compete against one another at national and international competitions they have the opportunity to learn how to improve their projects based on judges comments and ratings; they also have the opportunity to see the best projects completed by other teams. This is an example of how the judges' ratings are also used as a formative assessment tool.

Most assessment data currently used to evaluate service-learning projects lie in the area of authentic assessment (Hart, 1994). Examples of SAGE authentic assessment data included the number of organizations in the community who have benefited from SAGE projects. Other data include the annual summary written report and an oral presentation to a critical panel of judges.

Taken together, the SAGE judging criteria provide another form of assessment by offering a feedback mechanism for communicating project outcomes to students and thus represent the equivalent of a syllabus in a course. The judging criteria also help students understand how the judges assess student skills and thus play a role similar to grading policies/exams in a course. Menlo (1993) and Honett and Poulsen (1989) have shown that performance feedback is an effective development tool for students involved in CSL and PBL activities.

As for the university students, they must keep an activity log describing what they did during the semester (the log must show at least 35 hours of service in order to earn one unit of credit). At the end of the semester, the students must also write a reflection essay describe their experience, explain what they learned, offer recommendations to improve the project, and indicate whether or not they plan to continue with the project after the semester is over.

### **HOW TO START A SAGE PROGRAM**

There are three important "legs on the stool" that must exist for SAGE to succeed as a viable program in one's area. First, it is vital that there is a committed, entrepreneurial high school teacher who will serve as a SAGE adviser. Second, one needs a community college or university in the area with business students who have the motivation and incentive to become SAGE

consultants. Third, the community needs to be aware that a SAGE program exists, with business, civic and education leaders willing to participate, both in terms of time and financial support.

1. Entrepreneurial High School Teacher – The typical SAGE adviser is a high school teacher who currently teaches a business class such as “Virtual Enterprise,” is part of a business academy, or is an adviser to a high school business organization like FBLA or DECA (an association for students and teachers of marketing, management and entrepreneurship). In most cases students are already completing entrepreneurship projects or projects related to entrepreneurship, and the teachers are proud of their accomplishments. SAGE provides an additional, public venue for their students to achieve recognition and reward for their accomplishments.

2. Community College/University – Higher education is involved mainly through business departments and colleges, and the dean sees that SAGE has a fit with his/her academic unit. SAGE provides an avenue for entrepreneurship students to obtain hands-on learning; it offers a mechanism by which business departments can offer any business student CSL course credit; and if the campus has a SIFE program SAGE is an outstanding community service project which can help the team excel at the collegiate competitions. Under all three scenarios, SAGE offers the business unit an avenue to gain goodwill from the community at large through positive press and image building. Just like the first leg of the stool, however, for SAGE to take root on a college campus, one needs an entrepreneurial faculty member to champion the cause. This may require release time or overload compensation.

3. Business and Civic Leaders – Community leaders have a vested interest in making sure that today’s youth are educated in entrepreneurship, financial concepts and international trade. SAGE provides a model to help high school students accomplish their dreams through entrepreneurship and community service. Most of these students will enter the work force directly after graduation, go on to college and become a college mentor or start their own business.

Any business or civic leader can participate, once a high school and college in the community has started a SAGE program. Furthermore, any private foundation that supports youth development, service learning, leadership, and innovative K-12 and university partnerships is invited to join our SAGE network. If no SAGE program exists in an area, a business or civic leader can take steps to create one. They can:

1. Urge local high school principals or superintendent to launch a high school SAGE team.
2. Encourage high school teachers who teach economics, social studies, technology, civics, accounting or general business to become a SAGE adviser
3. Arrange for a presentation of the SAGE program to school boards, Rotary Clubs, Chamber of Commerce, etc. (sample templates are available from the author or at the SAGE web site at <http://www.csuchico.edu/sage>).

Once a SAGE program exists, one can:

1. Serve on the BAB of a high school SAGE team.
2. Serve on the BAB of the university working with a local high school SAGE team.
3. Be a guest speaker at periodic meetings.

4. Provide financial support to help fund outstanding projects. This may mean writing a letter of support to the community affairs division or to the non-profit foundation affiliated with your for-profit company.
5. Hire the high school or college students as interns.
6. Volunteer to judge at a High School SAGE Regional Competition.
7. Volunteer to judge at the USA SAGE or World Cup Competitions.

One business leader who supports SAGE is Rieva Lesonsky, Editor-in-Chief, *Entrepreneur* Magazine. She said:

"I want to issue a challenge. If California State University, Chico can create the hugely successful California SAGE program, why can't this happen in Arizona, Texas, Utah, or Nebraska? Why can't there be a nationwide high school SAGE competition? Why can't SAGE be global?"

### **FUTURE PLANS FOR SAGE**

As of October, 2004, CSUC has secured funding to finance the 2004-2005 California SAGE program from the Allstate Foundation, and has also secured funding to expand USA SAGE, thanks to a grant from the Walgreens Foundation (grant proposal copies available upon request). Five states have committed so far: Idaho, Nevada, New York, Pennsylvania and Texas. Moreover, discussions are underway with Colorado, Iowa and Tennessee. Internationally, several more countries are planning to join the SAGE network. We are currently seeking sponsorship for Global SAGE, so that Australia, Chile, Kyrgyzstan and Uzbekistan will be able to join existing SAGE programs. Proposals are currently pending with Ernst & Young, UBS, and the Bank of America Foundation.

### **SO WHAT?**

SAGE enhances international business education programs in 10 countries, and actively engages the business community in activities that promote an understanding of business, entrepreneurship and economics. The activities completed by the institutions of higher education and secondary schools, with input from leaders in the private and public sectors, are contributing not only to a better understanding of entrepreneurship and community service, but also brings the most outstanding teams together to showcase their best projects at the SAGE World Cup. At the World Cup, all participants learn from one another based on the common goals; U.S. participants learn more about the cultural norms, attitudes and entrepreneurship environments in each of the countries in the SAGE network; and just as importantly participants from these countries learn about the entrepreneurship and cultural environments in the U.S.

SAGE can be implemented by universities as a community service-learning program (e.g., integrated into existing coursework, added as a new course, or included as a self-standing, co-curricular program completed by a business student organization). Moreover, secondary schools can implement SAGE using a problem-based learning approach. Toward this end, the projects completed within the SAGE network can be integrated into the curricula of both the secondary schools and higher educational institutions, consistent with the missions, goals and structures in place at each home institution.



## EXHIBIT 1: SAGE JUDGING CRITERIA

|  |
|--|
| <i>In their annual report and verbal presentation, how effective were the students in demonstrating that they:</i>   |
| (1) Completed at least one entrepreneurship project and/or one business-related project (e.g., a “virtual business”)? In completing such project(s), the students show that they have <i>learned</i> about entrepreneurship and business, and have been able to <i>apply</i> their knowledge and skills to plan and implement their project(s).  |
| (2) Completed at least one community outreach project(s)? In completing such project(s), the students have shown that they understand the importance of social responsibility, and the ethic of “giving back.” An example would be a significant teaching project, whereby students have taught financial management skills to others, such as younger students or senior citizens (e.g., budgeting, time value of money, accounting, saving and investing)? |
| (3) Included at least one type of “global” component in their activities during the year (e.g., did students work with students or businesses from another country to import/export products; did they study how free markets work in an economy other than their own; did they study who are the key policymakers in a global economy?).  |
| (4) Understand the importance of civic engagement in a democratic society, and that each citizen can exercise their freedom by registering to vote and participating in public elections?  |
| (5) Understand the importance of being responsible stewards of the environment in a free market economy?   |
| <i>In their projects, how effective were the students in:</i>  |
| (6) Utilizing at least one or two college “consultants/mentors” from a nearby college or university to help them identify, deliver, assess and present their projects?   |
| (7) Utilizing a Business Advisory Board (each team should have at least three active BAB members, at least two of whom come from the private sector)?  |
| (8) Utilizing mass media (e.g., newspapers, TV, radio, billboards, and newsletters)? Attach newspaper articles to the annual report.   |
| (9) Measuring the results of their projects (e.g., pre- and post-test results; financial statements)?  |

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# Response to Michael Porter: An Alternative Model for Supporting Inner City Firms

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## Abstract

Small businesses are an essential part of the United State economy. According to the U.S. Small Business Administration, small firms employ 53 percent of the workforce and contribute 47 percent of sales. They are responsible for 51 percent of gross domestic product and account for the vast majority of net new jobs (The Facts About Small Business, 1999). Small firms are also a major source of innovation, producing twice as many new product and service innovations as larger firms.

Firms owned by minority business owners represent a special subset of small firms that are growing even more rapidly than small firms in general. The number of black-owned

firms increased by 26 percent from 1992 to 1997 to a total of 823,499 firms. This compares to a 4 percent growth rate for non-minority owned firms for the same timeframe. Simultaneously, revenues for black-owned firms increased by 120 percent to a total of \$71 billion (Minorities in Business, 2001). The numbers for Hispanic-owned firms are equally impressive. In 1997, Hispanic-owned firms totaled 1.4 million firms representing an increase of 80 percent from 1992. During that same timeframe revenues more than doubled to a level of \$184 billion.

Minority-owned firms are worthy of study in and of themselves for several important reasons. First, firm ownership provides a path to economic empowerment for entrepreneurs and their families. Prior research indicates that, on average, the level of household wealth for black and Hispanic families falls well below of that of white families (Badu et al., 1999; Blau & Graham, 1990; Smith, 1995). Simultaneously, however, research reveals that individuals who own their own firms have higher household income and wealth than the population in general (Haynes, 2001). Thus, owning and operating a successful small business can be a strategy for minority families to achieve the “American Dream”.

Second, a vibrant small business sector is key to the economic revitalization of many inner city communities. Since minority families tend to represent a higher percentage of the inner city population, it is important to have a range of flourishing small businesses to serve their needs as well as those of the larger community. In his article entitled “The Competitive Advantage of the Inner City”, Michael Porter (1995) presents a convincing

case for the economic role played by urban small businesses. Although Porter argues for a relatively free market approach to the development of urban small businesses, others contend that this will not happen without government intervention and additional sources of support (Dymski, 1996; Rogers et al., 2001). This article will describe one such program conducted by the University of Hartford, the Upper Albany Program, which combines resources from both the public and private sector to support small and emerging businesses in one of Hartford's neighborhoods.

The University of Hartford, in partnership with the Upper Albany Main Street Program, launched a few years ago (and currently manages) a successful community-based service learning initiative centered on creating relationships and building the capability of our culturally diverse area entrepreneurs. By empowering the community and by focusing on developing self sufficiency and skill advancement, the area is showing signs of economic growth. This article describes how a private university with a public mission can champion and follow-through on a plan to revitalize and support a commercial district leading to clear and measurable outcomes.

This articles highlights that minority-owned businesses have enjoyed a significantly higher growth rate over the past few years compared to their counterparts; it emphasizes that entrepreneurship can be an alternative to unemployment or underemployment in culturally diverse neighborhood historically plagued with crime and unemployment; it shows that minority-owned businesses are uniquely knowledgeable in identifying and providing products and services to the rapidly growing minority segment of the economy;

it shows how a community based program can be the vehicle for economic development and be at the center of urban intern cities growth; and lastly, this article highlights that little is know about what drives the success of minority-owned businesses.

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# **SELF-ASSESSED LEADERSHIP TRAITS OF FRANCHISEES VS. MANAGERS: IS THERE HOPE?**

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## **ABSTRACT**

Organizational leadership traits, hope level, organizational commitment, and service quality perceptions of franchised managers and franchisees are differentiated in the current study in order to add to the current understanding of the role of franchising in entrepreneurship and to help franchise systems improve efficiency. For scholars, the dynamic relationship between entrepreneurship, franchisees, and management is an important and developing triangle in the organizational behavior literature which merits further investigation. For practitioners, the role of leadership styles in franchising and entrepreneurship presents a valuable recruiting imperative. The current research proposes a study for better understanding of the variations between these roles in organizations.

## **INTRODUCTION**

Franchising has been one of the fastest growing methods of doing business in the U.S. and abroad for the last half century. It is a less expensive, less risky form of doing business than developing a start up company (Taylor, 2000). Because of the dominance of this form of doing business, the exploration of franchisees' perceptions as well as the perceptions of the managers that work with them is needed to investigate the differences between franchising and other types of entrepreneurship, but also in order to increase the effectiveness of franchised organizations.

## **BACKGROUND LITERATURE**

### *Entrepreneurship Theory and the Resource-Based View of the Firm*

There is extensive literature on the role of entrepreneurship in economic development. The work of Schumpeter (1934) is a key building block in the argument that new firms are essential to a revitalized economic order. In this view, entrepreneurs destroy the existing economic order by introducing new products and services, by creating new forms of organization, or by exploiting new raw materials. Opportunity recognition and subsequent action are essential to entrepreneurship. The importance of acquiring resources for new venture formation and growth

is a long-standing theme in the entrepreneurship literature (Gartner, 1985; Covin & Slevin, 1991; Stevenson & Gumpert, 1985; Timmons, 2004). Alvarez and Busenitz (2001) have linked entrepreneurship theory and the Resource-Based View (RBV) of the firm by identifying resources as the central focus of the two theoretical models. In entrepreneurship, opportunities are recognized because individuals have heterogeneous views of resources while RBV views heterogeneous resources across firms as the basis for sustainable competitive advantage.

Resource-Based View theory addresses one of the central issues in management - the identification of the factors that make firms different and are responsible for above average performance (Rumelt, Schendel, & Teece, 1994). In this perspective, resources of the firm, both tangible and intangible, and their combinations are employed by managers to provide competitive advantage (Amit & Schoemaker, 1993; Barney, 1986; Conner, 1991; Penrose, 1959; Prahalad & Hamel, 1990; Wernerfelt, 1984). The sustainability of the competitive advantage of resources, capabilities and core competencies depends on factors such as the rate of environmental change, degree of imitation and the availability of substitutes (Hitt, Ireland, & Hoskisson, 1999). The challenge for managers is how to develop and use resources under conditions of uncertainty, complexity and intra-organizational conflicts (Amit & Schoemaker, 1993).

The acquisition of financial resources and human resources in the form of a management team are cited as particularly important (Timmons, 2004). The RBV of the firm has more typically dealt with the deployment of resources in established firms. Recent research provides an expanded definition of human resources (capital) and social capital that take into account the personal characteristics and connections of the entrepreneur (Brush & Greene, 1996). This work can provide a link between the RBV and the extensive research on the individual entrepreneur (Shaver & Scott, 1991). Some of the personal characteristics that have received attention in the literature include need for achievement (McClelland, 1961), locus of control (Rotter, 1966), propensity for risk (Slevin & Covin, 1992), and vision (Falbe & Larwood, 1995).

The resource based view of the firm provides an explanation for the functioning of the franchisor-franchisee relationship. The franchisor obtains capital, managerial expertise and knowledge of local markets from the franchisee. In turn, the franchisee depends on the franchisor for a business system including strategies and tactics, policies and procedures, operating experience, technology, advertising, and a valuable brand name. Each contributes a bundle of complementary resources which provide the firm a competitive advantage. However, an important difference is that franchisees are not managers in their business, rather they are the owners and as such franchisees, for the most part, tend to put much more into the effort of running their business, yet this RBV of the firm could be extended to the relationship between the franchisee who brings resources and managers who deploy those resources.

#### *Franchising as a Form of Entrepreneurship*

The franchisor, or founder of the unique business format system, fits clearly into the definitions of entrepreneurship found in the literature as reviewed by Low and MacMillan (1988), such as carrying out new combinations (Schumpeter, 1934); driven by the perception of opportunity (Stevenson, Roberts, & Grousbeck, 1989); and the creation of new ventures (Gartner, 1985). Franchising encompasses entrepreneurial characteristics such as the introduction of new products

and services, innovative marketing, openness to change, outrunning the competition and fast growth (Aldrich & Auster, 1986; Gartner, 1985).

While franchisees differ from the traditional entrepreneurs in that they are buying a license from an organization that has a market tested concept and a structured set of operating procedures, usually decreasing their risk substantially relative to a traditional start up business, they are still business owners, which classify them as a particular type of entrepreneur. Entrepreneurship entails: innovativeness, risk taking, and proactiveness (Burgelman, 1983; Morrison, 2000). Despite the control of the franchisor, a franchisee still must commit to a certain amount of risk taking and proactiveness in the running their business successfully.

### *Current Research*

Young, McIntyre, and Green (2000) conducted a content analysis of the first thirteen volumes of the International Society of Franchising (ISOF) Proceedings (1986, 1988-1999). Twelve major topics of research were identified. Entrepreneurship and franchising encompassed twelve papers out of 285 papers and ranked eighth in frequency. No papers on leadership per se were presented; however, six papers on power and influence were presented. Overall, ISOF members' research interests primarily reflect the results provided by Elango and Fried's (1997) review of franchising research published in journals. They identified an absence of research involving training, control systems, cooperative advertising, and communication. Leadership was not mentioned.

The managers and franchisees of a business must work together in a system that maximizes the performance of the business. The franchised organization, the franchisee, the managers and the hourly employees makes up a diverse set of interactions when operating a business. As such, this study will hone in on the relationship between self-assessed leadership traits (organizational leadership traits, hope level, organizational commitment, and service quality perceptions) of franchisees and the managers in the organizations, which seem to be missing from the franchising literature.

### *Organizational Leadership Traits*

In a pilot research study done by Welsh et al (2001), it was determined that the perceptions of the vision, leadership, and operations of franchise systems were different depending on whether you were a franchisee or a franchisor in the system. Franchisors viewed themselves as much more likely to recognize rapid change in the industry and company, focus more on research and development, and be more innovative than the perspective of the franchisee regarding the same franchisor. Franchisors also viewed themselves as more long-term and strategic than the franchisees in the system. By using the same organizational leadership traits analyzed in that initial pilot study, the current study intends to analyze the similarity and differences between the perspectives of franchisees and managers in franchise systems, rather than the differences between franchisees and franchisors.

### *Proposition 1*

The leadership style of franchisees will differ from the leadership styles of manager

### *Hope in Franchisees and Managers*



A theory measuring hope and the usefulness of hope was developed by Snyder et al (1991). Snyder determined that hope, beyond wishful thinking, is represented by a person's ability to use their willpower or desire (agency) to get something (goal) accomplished, and their ability to create various paths to get the goal accomplished (pathways). These two components (agency and pathways) help determine how successful someone will be at achieving their goals. Hope has been a construct that has been researched in academics, athletics, and physical and mental health areas and has been positively correlated to positive performance outcomes, but has lacked empirical research in business settings to date beyond Peterson and Luthans' (2003) exploratory study using "state" hope with managers in a single fast food restaurant chain, and Adams, et al. (2002) who examined some emerging concepts of hope in the workplace. The concept of hope has not been fully explored relative to business leadership and performance.

In current management and business literature, the trend has been to start looking at the positive traits that people have and not as much at the negative traits that have been prevalent in the literature regarding work performance. Luthans (2001, 2002) introduced the term positive organizational behavior (POB) and positive approach to leadership (PAL) (Luthans, et al., 2002) to describe the construct of trying to encourage managers and leaders to support people in developing their strengths instead of reprimanding and criticizing people for their weaknesses. The traditional positive organizational behavior constructs most related to hope are: self-efficacy and optimism.

Self-efficacy (confidence) theory is similar to hope theory (Bandura, 1977). The theories are related in that agency or willpower is similar to efficacy expectancies and pathways or waypower is similar to outcome expectancies. The concept of hope is different in that Snyder (2002) has determined that agency and pathways are equally important to goal accomplishment and operate in a combined, iterative manner, while Bandura (1977) posits that efficacy expectancies are the most critical component of self-efficacy.

Hope is different from optimism because hope is initiated and determined through oneself rather than by external forces. Optimism theory tends to make external attributions for negative outcomes, rather than making internal attributions (Seligman, 1998). Optimism uses the agency component of having drive or motivation to get goals accomplished, but not necessarily the ability to find various pathways to get goals accomplished. In measuring hope, the pathways and agency are both equally important (Snyder, 2002). In the literature on franchising, the personality of individuals that chose to go into franchising is more "adventuresome, risk taking and aggressive" than those not in a franchisee position.

#### Proposition 2

Franchisees will have higher levels of hope than managers.

#### *Organizational Commitment*

Organizational commitment has been defined as the magnitude of an employee's relationship with a company. Many times, it is related to various factors such as the employee's belief in the organization's goals and values, the employee's attitude in giving effort for the company and the desire to remain with the company (Mowday, Steers, and Porter, 1981). Hunt, Chonko, and

Wood (1985) viewed organizational commitment as having the strong need to stay with the company when given opportunities to leave.

Empirical work regarding organizational commitment exists within the business and hospitality research that underscores the importance of this concept to franchised organizations. Many earlier studies linked the organizational commitment variable with its relationship to role ambiguity, role conflict, work-family conflict, job satisfaction and intentions to stay (Good, Sisler, and Gentry, 1988; Johnston et al, 1990; Michaels et al, 1988). Recently, a study of organizational commitment in hotel managers supported past literature claiming that work overload, conflict and job ambiguity can all reduce organizational commitment and that a feeling of importance, expectations of pay, social involvements and organizational dependence lead to increased levels of commitment (Maxwell & Steele, 2003). Understanding the differences between managers and owners of franchised businesses and being realistic about their various levels of commitment can aid franchise organizations in setting policies and procedures which are realistic, fair and improve upon the performance of the organization.

#### Proposition 3

Franchisees will have more organizational commitment than managers.

#### *Service Quality*

Service quality as defined by Zeithaml, Parasuraman, and Berry (1991) is made up of five attributes. These attributes include tangibles, reliability, empathy, assurance, and responsiveness. Tangibles refer to the physical appearance of the actual organization. Reliability is the ability to do for the guest what the business said they were going to do. Empathy refers to the ability of the staff to put themselves in the shoes of the customer. Assurance refers to the delivery of the service while making the customer feel like you are trustworthy. Responsiveness refers to the speed of the delivery and the speed at which the business responds to customer needs. These five attributes represent a good assessment of the service quality expected by the consumer.

From the inside of a franchised business, understanding the perceptions and the differences in perceptions of service quality between the managers and the franchisees is critical in order to better employ service training systems that are realistic and effective. The current survey instrument was created in order to determine the perception of franchisees and managers regarding the service provided by the organizations to the customer. In aligning company policies, it is important that both franchisees and managers understand the service they are delivering to the guest. Further we may surmise that hopeful individuals will have a higher perception of the service being delivered and that more committed individuals will perceive higher levels of service delivered and finally this may vary by leadership trait.

#### Proposition 4

Franchisees will have a higher perception of service quality than managers.

### **OBJECTIVES OF STUDY**

Since both franchisees and the managers in the franchised organizations play a key role in the success of the business, it is important to understand the inter-relationships and perceptions of

these inter-relationships between franchisees and managers. Specifically, the variables investigated in this study include perceived organizational leadership traits, hope levels, organizational commitment and service quality perceptions of the individuals.

### **SURVEY ITEMS**

*Organizational Leadership-* The first hypothesis was tested by the use of the Organizational Leadership/Entrepreneurship items on the survey. These 15 items were taken from a pilot survey distributed to a random sample of members of the British Franchise Association and the International Franchise Association developed by Welsh et al (2001). Through this pilot study, it was determined that franchisors and franchisees did not view the vision, leadership, and operations of the franchise system the same.

*Hope-* The dispositional hope items were developed and validated by Snyder, et al. (1991). The 12 items consist of four items measuring agency, four measuring pathways, and four distracter items. The instrument demonstrates both internal reliability (alphas ranging from .74-.88 for the overall scale, and alphas of .70-.84 for the agency and .63-.86 for the pathways subscales) and temporal reliability (test-retests range from .85 for three weeks to .82 for 10 weeks). The agency and pathways subscales were related, but not identical (Snyder, 2002; Babyak, Snyder, & Yoshinobu, 1993). The hope scale has also received extensive concurrent and discriminant validation support, as well as experimental manipulation-based convergent validation (Snyder et al., 1991).

*Organizational Commitment-* Items used to measure organizational commitment were adapted from Mowday, Steers and Porter (1981). For a review of the use of this scale, see Zajac and Mathieu (1990). Reliability estimates for Michaels et al (1988) reported an alpha of .90 for the items, while Good et al (1988) sampled 595 department stores and arrived at an alpha of .91, thus all studies proving consistent in reliability estimates.

*Service Quality-* Using a modified version of SERVQUAL (Parasuraman et al, 1986), the managers' and franchisees' perceptions of quality delivered to guests were evaluated. The perceptions tell us what the manager feels the company is delivering at the current moment on all of the attributes of the service quality instrument. The SERVQUAL questionnaire has been used extensively with all validities and reliabilities confirmed across and within service industries. There are five items measuring reliability, with four items measuring empathy, assurance, responsiveness, and tangibles. Most past studies have reported reliability alpha estimates of .87 and .90 across the multiple dimensions of tangibles, reliability, empathy, assurance, and responsiveness, again, acceptable in terms of reliability (Parasuraman et al., 1986).

### **IMPLICATIONS FOR PRACTICE**

Franchising is an essential method of doing business in the U.S. and globally. Increasing the understanding of the leadership styles of franchisees and the managers working for them will help to discern the effectiveness of these various leadership styles with the positions held in the organizations. The current study will determine if there is a difference between the franchisees of today and their managers. The current study will help to fill a void in the entrepreneurship and franchising literature regarding self-assessed leadership traits and the hope that could lead to improved performance and success in franchised systems.

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## EXPECTATIONS: THE CHALLENGES OF CREATING A BUSINESS INCUBATOR IN RESPONSE TO STATE AND LOCAL INITIATIVES

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The Center for Emerging Technologies and Entrepreneurial Studies (CETES) was created at Cameron University in Lawton Oklahoma in response to initiatives by the State Regents for Higher Education and an economic development study conducted by leaders within the city of Lawton. From the recommendations and challenges put forth by these efforts, the concept for an economic development program was created. CETES has five components: a business incubator, a networking conference center, a center for regional economic development, an entrepreneurial studies program, and a small business institute. The mission of CETES is to promote the creation and growth of new technology companies, create skilled employment opportunities, and prepare people to be effective contributors to the 21<sup>st</sup> century economy of southwest Oklahoma.

The emphasis of this paper is on the issues surrounding the operational planning and initial start-up of the business incubator. Going through this process, it became clear that the expectations of how the center will operate and what it will achieve were divergent among the four major constituencies involved: the university, the community, the region, and the state. Funding comes directly from two of these groups and support is necessary from all four in order for the incubator to be effective. Each, however, has its own definition of success and its own vision of where they see the incubator fitting within their realm. The focus of this paper is to identify the various expectations and potential land mines along with the response to them as the incubator creates its service network, markets itself, and prepares to open for business.

# **A COMPARISON OF STUDENT BUSINESS PLANS WITH ACTUAL ENTREPRENEURIAL NEW VENTURES**

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## **ABSTRACT**

Using historical data collected over a 5-year period, this study compared student team business plan projects to actual new business ventures created during the same period in a small college-town community. The results support the proposition put forth by previous studies that experiential-based entrepreneurial education can increase the perceptive abilities of young people in isolating attractive business opportunities in their environment. Implications are discussed.

## **INTRODUCTION**

Although much has been published on the perceived benefits of entrepreneurial education (Peterman & Kennedy, 2003; Wang Wong, 2004; Gorman, Hanlon & King 1997; Young, 1997) there has been limited vigorous research on its effects (Henry, Hill & Leitch, 2004; Storey, 2000). Many believe that advancing the research in this direction will move the field beyond its exploratory stage (Alberti, 1999; Curran, 2000; McMullan, Chrisman & Vesper, 2001; Rosa, 2003), thus enhance the credibility and value of entrepreneurial education and training programs at all levels – secondary, college and graduate. Creating a successful enterprise begins with an idea - what service or product your business will provide and what needs it will fill. Successful entrepreneur are adept at finding new market opportunities that satisfy real customer needs. University-based entrepreneurship programs and initiatives are aimed at developing students' skills and knowledge at identifying such opportunities. They also teach students the importance of business plans and how to develop them. According to the SBA, the business plan is a necessary and critical document for anyone who wants to start a small business (SBA, 2004). Some programs provide funding for student ideas to move beyond the business plan phase to implementation (Rosa, 2003), while others end at the business plan development phase. The purpose of this paper is to address a specific question: how closely related are students' business plan ideas to actual new business ventures created in the market environment. This study has implications for university administrators, government funding agencies and the business community.

## **BACKGROUND**

Increasing complexity and dynamism in the economic environment has led to a growing research interest in the role that small and new businesses can play in economic development (Curran,



2000). This awareness has led to an upsurge in research in entrepreneurship. Early research on factors that influence entrepreneurial behavioral centered on trait or personality characteristics of individuals (Brockhaus, 1980; 1982 McClelland, 1961). More recently, there has been growing interest in the role education and training can have on the desire to become an entrepreneur (Peterman & Kennedy, 2003; Henry et al., 2004). University-based entrepreneurship curricula have attracted the bulk of research in the field of entrepreneurship education (Gorman et al., 1997; Young, 1997). The debate in academic circles is whether or not individuals can be educated or trained for the purposes of new business creation and entrepreneurship (Henry et al., 2004). The growth in the number and types of college-based entrepreneurship programs would seem to suggest a causal relationship between entrepreneurship education and entrepreneurial behavior; a relationship supported by research (Gorman et al; 1997).

Despite the recognition that education and training programs influence people's perceptions of the desirability and feasibility of starting a business, there has been little empirical research directed towards evaluating the effectiveness of such programs (Peterson & Kennedy, 2003; Henry et al 2004; Storey, 2000). Scholars have argued that assessment is important because it highlights program benefits rather than just costs (McMullan et al., 2001). This has both funding and administrative support implications.

### **THE SENIOR SEMINAR COURSE**

This research is based on a college senior seminar project whereby business majors in their last semester are required to formulate a comprehensive business plan for a small business venture, to be launched in the community. At the college, the department of business administration is organized into three majors - accounting, business administration, and economics.

#### **Background**

Five years ago, the department underwent a major curriculum review. One of the outcomes of the review was the decision to refocus the senior seminar course on entrepreneurship because of the changing economic environment of the area. For a long time, the local economy was coal dependent. As the demand for coal steadily declined in the 1980's to 1990's, the area suffered significantly. Coal mines and coal related businesses closed, creating double-digit unemployment rates. The key, according to most experts, was to focus on bringing in new industries or creating new businesses. Encouraging small business creation seemed to be a more viable option than bringing in new industries because of the area's remote location and inherent infrastructural weaknesses.

It is against this backdrop that the business department decided to focus on entrepreneurship. The belief was that students represent potential entrepreneurs who through educational training and preparation, can begin to see entrepreneurship as a career choice. The hope was that after the senior seminar experience, more students would show interest in creating their own businesses rather than waiting for a job. This view is consistent with the literature and reflects the growing popularity of entrepreneurship education programs nationwide. According to one study, entrepreneurship education in America's major universities has grown at an incredible rate over the

past 20 years. This is evidence by the increase number of endowed positions, academic programs, journals and other publication (Robinson & Haynes, 1991).

## **Course Design**

The course syllabus starts with a purpose statement stating that the project will help students understand the importance of developing a business plan prior to starting a business. The business idea and resulting plan is evaluated on its accurate and realistic reflection of local market conditions. Each team is required to conduct a comprehensive environmental and industry analysis; target market needs assessment; competitor, location and logistics analysis. Also, the plan must describe the pricing, product/service, and promotion strategies.

Each semester, we form student teams. Each team consists of students from different majors - accounting, economics, and business administration. The multi-disciplinary make up of the teams, coupled with the many functional aspects of the standard business plan, means that students have to collaborate and apply knowledge from just about every part of the curriculum. It is an integrative project where success depends on applying concepts from marketing, finance, accounting, HR, operations, management, strategy and many other disciplines. The project presents students with learning opportunities to develop teamwork skills, effective communication, problem solving, conflict management and leadership.

The class is designed as a totally hands-on experience, with no lectures, readings, quizzes, examinations, or required textbooks. The class is student-centered, with few regular class meetings. Experiential learning involves high levels of active student involvement. Requiring that students envision themselves as entrepreneurs and carry out a comprehensive business plan development project using accurate secondary and primary information, is experiential. There is research to support the use of the experiential learning model (Angelidis, 2004).

## **Course Structure**

Class meets regularly for two to three weeks from the start of the semester. These organizational meetings are designed to accomplish the following: (a) introductions and course review, (b) team foundation, and (c) presentations/workshops to refresh students' knowledge in select topics (such as running effective meetings, conflict management, goal setting, teamwork, effective communication, etc.).

After three weeks, the teams are sent off to start the project. Group members are instructed to formulate group goals, norms, meeting times, and assign individual responsibilities. To keep the project and teams on track, the project is broken-up into specific activities with deadlines. An overview of major activities and due dates for the spring 2004 class is provided in Table 1 below. All groups are required to come to class on these dates. Representatives from each group get a chance to present the group's progress.

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place table 1 about here

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## METHODS

The participants in this study included past student business plans and small business startups in the community. All 58 student business plan projects developed over the past five years were retrieved and organized by year, industry sector and business type. To get information on small business ventures created during the past five years in the community, we contacted the County Administration's Economic Development Office to get data on small businesses launched within the past five years–1998-2003. This information was then organized in the same way as the student business plans–year, industry sector and business type. Frequency analysis was then used to compare the two groups.

## RESULTS

From 1998 to 2004, a total of 58 business plans have been cataloged. The business plans were grouped into 8 major business sectors. These sectors are based on SIC classifications of business types by the government. See below for the 8 business sectors and the number of business plans under each sector.

| Manufac-<br>ture | Apt.<br>Rental | Entertainment | Service | Recreation | Restaurants | Fitness | Retail |
|------------------|----------------|---------------|---------|------------|-------------|---------|--------|
| 2                | 2              | 8             | 7       | 11         | 12          | 3       | 13     |

In the same period of time, new businesses created in the area revealed the following distribution by business sectors.

| Manufacture | Apt. Rental | Entertainment | Service | Recreation | Restaurants | Fitness | Retail |
|-------------|-------------|---------------|---------|------------|-------------|---------|--------|
| 3           | 2           | 2             | 32      | 3          | 10          | 4       | 24     |

Over the past 5 years, students seemed to perceive more opportunities in 5 of the 8 business sectors: entertainment, service, recreation, restaurant, and retail. Three sectors dominate in terms of the number of business plan projects focused on them: retail, restaurant and recreation. In Table 3, the actual businesses launched dominated in three sectors: retail, service and restaurants with the service sector leading in numbers.

It would appear that student have similar entrepreneurial instincts as entrepreneurs when it comes to identifying attractive new business opportunities. An analysis by specific business types reveals a closer similarity between some of the students' business plan descriptions and actual new business ventures. In at least six cases, the new business venture closely matched the type of business that students' business plans had depicted in past years, see Table 2.

It should be noted that, in many cases, the business plans were published long before the actual businesses were ever launched. Also, students are instructed at the beginning of the project to avoid focusing business plan ideas on existing businesses; rather, they are to locate new niches or target markets.

## IMPLICATIONS

This study has public policy implications as 99.7% of all businesses are classified as small business, they employ half of all private sector employees, and they generate 60% to 80% of net new jobs annually (Bounds, 2004). It also has policy implications for university administrators. The fact that students perceive attractive business opportunities in the same sectors as entrepreneurs would indicate to some extent that the entrepreneurship education program is effective at getting students to think like entrepreneurs. This could allow for close collaboration between the college/university business program and the community. Student business plans could be cataloged and made available to prospective entrepreneurs who are ready to go into business for themselves but don't know what areas are attractive. Much of the research and analysis would have been done, shortening the time to prepare and launch a business. Two-thirds of new ventures survive two years and about half survive at least four years. Last year there were over half a million new venture, but about the same number of firms closed their doors (Bounds, 2004). One of the many reasons accounting for this high failure rate is the lack of adequate planning and research. The senior seminar class could market itself as a resource for prospective entrepreneurs. This type of community outreach by a student entrepreneurship program will encourage federal, state or local government support. Support could be in the form of grants and/or loans to graduates with promising ideas. Also, college administrators are more likely to support such programs with resources.

## CONCLUSION

The feedback gathered from this course reveals overwhelmingly that students feel challenged by the course because it forces them to review and integrate knowledge learned from other courses (marketing, management, strategy, finance, accounting, economics, etc.) and also, to work in terms.

The oral team presentations at the end of the course require teams to model and simulate much of their business plan. We have observed the classroom turned into a live restaurant, daycare, sports bar, or laser-tag entertainment center during team presentations. Students learn effective presentation skills and the competitive nature of business. Each team strives to out-present the other by bringing as much of their business idea to life as possible. It is usually the most exciting part of the course.

Follow-up studies to see how many students have carried their classroom ideas to the market place by creating start-up ventures are still lacking. This is a critical area that future research should address because simply having the right idea is not enough. What distinguishes the entrepreneur from the non or potential entrepreneur is the initiative of turning an idea into a business venture – taking the risk.

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**Table 1 Assignment Schedule**

|          |  |
|----------|--|
| 01/24    | Submit three possible business idea topics   |
| 2/3      | Firm up choice of business idea after some preliminary research.   |
| 2/7      | List of activities the group intends to undertake prior to settling down to writing the business plan. This is really the research and information collection phase of the project. This list should document each member's responsibilities and deadline – who, what, when, how, where. |
| 2/21     | An outline of the Business Plan with all the key areas identified. I will like to see evidence that each section of the plan is supported with external data – secondary or primary.   |
| 3/7      | Draft copy of the full Business Plan adequately describing each section identified in the outline of 2/21.   |
| 3/28     | Second draft copy with all deficiencies from first draft address.  |
| 4/2-4/11 | Prepare oral group presentations. Use all necessary steps to make your presentation creative, entertaining, informative, engaging and professional.  |
| 4/14     | Turn in final copy of Business Plan.   |
| 4/21-28  | Group Presentations  |

**Table 2 Comparison of Student Business Plans to New Ventures**

| <b><u>Actual Business Venture</u></b>                   | <b><u>Business Plan Project</u></b>  |
|---|--|
| Bonterra (2004) [Upscale Restaurant]                    | The Warehouse (1998)<br>Carlotta's (1999)<br>Damon's Grill (2000)          |
| Harvest Coffee Shop (2003)                              | The Gray Possum Café (1998)<br>24-7 Café (1999)<br>Wise Choice Café (2002) |
| Bright Beginnings Daycare (2003)                        | Future Kids (2001)   |
| Landmark Financial Service (2002)                       | Taylor-Stanley Tax & Planning (2000)                                       |
| Dyna Body Health & Fitness (2003)                       | World of Fitness (2002)<br>Fantastic Shapes (2001)                         |
| New Apartment Complex (2003) [near the college No Name] | Cavalier Heights Apt. Complex (2002)                                       |

# FINDING COMPETITIVE ADVANTAGE IN MANAGING WORKPLACE ETHICS

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## Abstract

The many breaches of ethical conduct and violation of laws involving high profile executives in recent years have focused attention on the way firms manage business ethics and company values. This paper identifies some of the bottom line benefits and other benefits of actively managing the business ethics process and recommends practical approaches for developing a program for the management of the process. It is especially important for small and medium enterprises to become active in this area.

The management of business ethics and company values have received increased emphasis with the recent incidents of unethical and unlawful behavior on the part of some high profile executives. Many firms have revisited their programs to ensure proper compliance. The Sarbanes-Oxley Act of 2002 now requires that each public company disclose annually its code of ethics for the company's CEO and senior financial officers. Compliance is one matter, but there are other very practical and rewarding aspects to the process of actively managing ethics in the workplace. These are the benefits to the firm's bottom line because the practice of good business ethics makes the firm a desirable one with which to do business and the community image of the firm is enhanced. This paper identifies some of these benefits and proposes a method by which firms can become actively engaged in the management of company values.

## Introduction

The great attention in recent months to violations of ethics and laws by the leaders of such firms as Tyco, Enron, Martha Stewart, Worldcom, and many others have caused a number of companies to review their ethics programs. Customer complaints about improper trading and commission structures by financial institutions are resulting in settlements in sums ranging in the hundreds of millions of dollars. High profile events such as these are causing many to question the worth of formal codes of ethics because the firms involved in untoward business activities had codes of ethics in place. However, a recent informal survey of approximately fifty MBA students, who are employed full time in small and medium enterprises, about the role of formal codes of ethics in their organizations revealed the following:

1. Ethics codes are seen as devices that place the same behavioral expectations on all levels of the organization.
2. Ethics codes enable the employees to understand what is expected of them in the workplace.

3. Ethics codes provide a device for enabling the employees to communicate to customers and suppliers about the expectations of their firm in business dealings.
4. Ethics codes provide a mechanism for handling peer pressure.
5. Ethics codes provide a formal “outside the chain of command” way to communicate upwardly in the organization without fear of reprisal.

These findings provide the basis for exploring some of the benefits of actively managing ethics in the workplace. It should be noted that some are now using the phrase “managing company values” to denote the process of managing business ethics.

## Business Ethics

Discussions of ethics usually involve a concept of moral behavior. Moral refers to a set of principles or values that guide behavior. Ethics, then, is the behavior that conforms to those principles. Placing this in the concept of a business, business ethics is the discipline of developing and practicing business relationships that conform to the moral principles. Sherwin(1983) wrote about what he called “The ethical roots of the business system. Sherwin maintained that to act ethically a manager must ensure that the owners, employees, and customers all share fairly in the business’s gain.

A primary premise of this paper is that all members of the firm have significant roles to play in the active and effective management of ethics in the workplace that will accrue benefits to the firm and its stakeholders. This is illustrated by point 1 above which indicates that codes of ethics place the same behavioral requirements on all members of the organization. The motivations to conduct business in an ethical manner and the positive results will be discussed below.

## Codes of Ethics

Businesses develop formal ethics programs for reasons that range from programs designed to comply with the law to programs that provide for both compliance and conducting business on a higher level of trust between the stakeholders. Recent research indicates that some larger firms have developed formal codes of ethics and appointed a Vice President for Ethics in order to avoid the financial penalties imposed for ethics violations. The rationale is that a firm will likely receive a lighter penalty for ethics violations if it has a strong code and ethics education program in place than if it does not. This approach is merely a tradeoff between the cost of developing an ethics program and the projected cost of possible violations. It neglects some very positive and powerful incentives to actively manage ethics in the workplace.

Whether a code of ethics is formally called a *Code of Ethics*, a *Code of Conduct*, *Corporate Code of Ethics*, or *Values Based Management*, some companies had codes of ethics as early as the beginning of the 20<sup>th</sup> century(Newberg, 2004). Newberg focuses on Section 406 of the Sarbanes-Oxley Act of 2002 that now requires each public company to disclose annually its code of ethics for the company’s CEO and senior financial officers. He maintains that an unexpected result of the code requirement is that the ethical commitments of the codes act as a signal to potential investors, employees, and customers that these are good firms with which to do business.



## Managing the Ethics Process

Business ethics is now considered a management discipline (McNamara, 1999). Some consider this to have been driven by the social responsibility movement that began in the 60's. Archie Carroll (1979) addressed this with his proposal for a definition of corporate social responsibility. Carroll held that corporations had four responsibilities to fulfill to society: economic, legal, ethical, and discretionary. The term "stockholders" was changed to the term "stakeholders" by many firms to recognize that employees, customers, suppliers, and communities and countries in which a firm operates are also impacted by the operations of the firm. The stakeholder concept has been extended to include "primary stakeholders," those directly impacted by a proposed action and "other stakeholders," those for whom there may be some indirect impact. It is common knowledge that environmentalists have included spotted owls, spotted snail darters, and other species of wildlife in their classification of stakeholders in a business action to which they were opposed.

The consideration of these broader implications of the firm's activities led to the emergence of business ethics as a management discipline. The formalization or the management of business ethics has taken the path of many management disciplines on the evolutionary path of the management disciplines. It has been the response to a recognized need, just as the disciplines of strategic management, human resources management, quality management, and other management disciplines have evolved.

## Strategic Benefits of Managing the Ethics Process

A continuing stream of research identifies the strategic benefits to businesses of having actively managed ethics programs. The term Value Based Management is also used to describe what typically has been known as actively managed ethics programs. Some of these will be described below. The research goes beyond the benefits reported from the informal survey described in the introduction, but does support the benefits observed by the MBA students in their companies.

Amie Devero (2003) cites reports on how firms are using corporate values management not only to avoid penalties, fines, lawsuits, and criminal penalties. They are also finding that the programs

- Build employee loyalty, reducing hiring and training costs
- Reduce theft and other anti-company activity
- Drive sales and build customer loyalty
- Create community good will that can lend support for tax advantages and strategic alliances
- Attract quality applicants with minimum investment in recruitment
- Maintain loyal vendor relationships, reducing loss of suppliers and unexpected cost increases

More reports are emerging which support the idea that firms can gain competitive advantage through proper management of business ethics or managing company values as some call the process. Carter McNamara's (1999) research provides insight into some benefits which expand or are broader based than those of Devero.

McNamara's benefits include:

- Attention to business ethics has substantially improved society.
- Ethics programs help maintain a moral course in turbulent times.
- Ethics programs are an insurance policy – they help ensure that policies are legal.
- Ethics programs help avoid criminal “acts of omission” and can lower fines.
- Ethics programs help manage values associated with quality management, strategic planning and diversity management.

### Topics Covered in A Code of Ethics

The topics or areas of emphasis in a code will, of course, depend to some degree upon the industry in which a firm predominately operates. The pressure to develop codes of ethics with certain content can be driven by the fact that the firm has government contracts, the level of required reporting of financial matters and disclosures, and whether a major customer or supplier requires that you develop a code to be sure you are in compliance with their requirements. The Sarbanes-Oxley Law must be used by publicly held firms as one source of guidance. There are industry specific codes which can be used by many firms to guide their efforts. These are recommended for review as the starting point for developing programs. The industry codes are usually more general than what the individual firm will need. Also, the firm as a member of an industry group, such as The National Association of Realtors, has agreed to abide by that code. So, the firm must also ensure that its on code is in agreement with the industry code.

### Suggested Outline for A Code of Ethics

The code of ethics should be a formal statement of the firm’s values concerning ethics and social issues. Lockheed Martin (<http://www.lockheedmartin.com>) has long been recognized as having a thorough and effective code of ethics. Their code evolves from behavior guided by six virtues:

1. Honesty: to be truthful in all our endeavors; to be honest and forthright with one another and with our customers, communities, suppliers, and shareholders.
2. Integrity: to say what we mean, to deliver what we promise, and to stand for what is right.
3. Respect: to treat one another with dignity and fairness, appreciating the diversity of our workforce and the uniqueness of each employee.
4. Trust: to build confidence through teamwork and open, candid communication.
5. Responsibility: to speak up – without fear of retribution – and report concerns in the workplace, including violations of laws, regulations, and company policies, and seek clarification and guidance whenever there is doubt.
6. Citizenship: to obey all laws of the countries in which we do business and to do our part to make the communities in which we live and work better.

One fairly inclusive outline is presented below. This outline came from the work of two MBA students who developed a code of ethics in the Spring of 2003 for their employer. The firm had rapidly grown from a small firm with about 80 employees to 600 employees. They felt that the rapid expansion had created conditions which called for the formalization of company business values. The effort was welcomed by the

management, reviewed by the Corporate Attorney, and is being implemented in the company.

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## 1. THE PERFECT CODE OF ETHICS

- I. Purpose
- II. Policy
- III. Procedures(with examples of behaviors)
  - a. Particularly Sensitive Issues to the Company
    - i. Honesty and Fairness
    - ii. Conflicts of Interest
    - iii. Purchasing and Selling Goods and Services
    - iv. Discrimination, Harassment, and Professional Work Environment
    - v. Confidentiality of Compensation Information
    - vi. Labor and Employee Relations Matters
    - vii. Confidentiality and Insider Trading
    - viii. Intellectual Property
    - ix. Immigration Law
    - x. Compliance with Antitrust Laws
  - b. Foreign Corrupt Practices Act
  - c. Corporate Political Contributions
  - d. Environmental
  - e. Accurate and Complete Records
  - f. Document Retention
  - g. Workplace Safety
  - h. Bidding, Negotiation, and Performance on Contracts
- IV. Reporting
  - a. Reporting Suspected Violations
    - i. General Policy
    - ii. List of Designated Personnel
    - iii. Complaint Procedures
  - b. Discipline for Violations
- V. Training
- VI. Review Procedures
  - a. Employee Input
  - b. Timeline

The ethics program will be a part of each employee's new employee orientation packet and program. Management will discuss the importance of ethical behavior at the company and the intolerance of unethical or criminal behavior.

Training courses will be administered to employees yearly; most likely an online training program, giving examples of situations and "what would you do?" multiple choice answers. All employees will be required to take this training.

The code of ethics and the training program will be reviewed annually to incorporate any new issues that may have recently become important to the company. More frequent

revisions will be allowed if new laws are passed, if the company takes on a new type of work, or if the company shifts its focus.

A committee will be formed with the responsibility of enforcing the code of ethics, guiding employees on the correct course of action to take in questionable situations, and answering employees' questions in regard to the code. Names and phone numbers of these committee members will be provided to employee.

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## Developing Programs for Managing Business Ethics

There are two basic approaches to developing formal ethics or values management programs. First is the do-it-yourself method. The second is to hire a consultant to help develop the program or possibly approach a local college or university to see if students could undertake such a project under the supervision of a faculty member. The small and medium enterprises have some obvious advantages and disadvantages in developing programs for the effective management of business ethics and company values. Some disadvantages are seen as a lack of staff to dedicate to such efforts, lack of money for additional formal programs, and lack of time because of the press of day-to-day business and lack of knowledge of the process. Several small business owners have informed the author that having a formal code of conduct or ethics and actively managing it was high on the list of items in the startup phase of the business. However, the urgency of running the business caused the ethics programs to slip lower and lower on the list of priorities. Some small business owners feel that because of their short communications chains and fewer people it should not be necessary to formalize ethics and values programs. programs. One clear advantage for the smaller firms lie in the fact that there are fewer people both inside and outside the company with which to deal, the lines of communication are shorter, therefore, it should take less time and effort to formalize programs than in a large organization. Employees can be easily involved in the development of programs.

There are some common sense guidelines that should be followed in the whether a firms does its own development or uses the steps to review proposals from consultants.

The steps are:

1. Recognize the need for a formal ethics or values management program.
2. Ask the employees what should be included.
3. Decide whether to develop the program in house, hire a consultant, or ask a college or university for support. Assign an in house person the accountability for the program even if a consultant is hired.
4. Establish a timetable for development of each segment of the program.
5. Establish dates for review and update of the program.

This paper was written in an effort to raise the awareness of the business and social benefits which can be gained by the development of programs for active management of business ethics and company values.

*References available upon request.*

# **CONCEPTS TO PROFITS: HELPING SBI STUDENT CONSULTING TEAMS AND CLIENTS TO UNDERSTAND AND CONTROL SUCCESS**

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## **ABSTRACT**

This paper revisits a core SBI challenge – helping SBI student consulting teams and clients to understand and control business success. Six related Figures describe a useful framework that shows students and clients how to construct pathways to a successful business. The framework is a practical blend of concepts from diverse business specialties.

## **EXECUTIVE SUMMARY**

Most small businesses don't work. "What to do about it" is a popular theme in the business literature, and a continuing challenge for Small Business Institute directors and their student consulting teams. Many novice SBI clients think that small business success is essentially an entrepreneurial sales challenge in a chaotic marketplace. To the experienced, business success is multifaceted and market dynamics become more predictable.

Success is multifaceted, but how does one explain the elements, interactions and predictable consequences to undergraduate student consulting teams, and how do the teams pass such insights on to their clients? After all, most consulting teams are composed of students with diverse business majors -- most of whom only take one capstone strategy class and specialize in one field – only enrolling in basic core business courses in other areas. And, most SBI consulting clients do not have business degrees.

This paper revisits a core SBI challenge – helping SBI student consulting teams and clients to understand and control business success. Six related Figures describe a useful framework that shows students and clients how to construct pathways to a successful business. The framework is a practical blend of concepts from diverse business specialties.

## **INTRODUCTION**

Most small businesses don't work. "What to do about it" is a popular theme in the business literature, and a continuing challenge for Small Business Institute directors and their student consulting teams. (Gerber, 1995) Many small business clients think that small business success is essentially a entrepreneurial sales challenge in chaotic market environment. (Levinson, 1998) Hence, they believe that progress to success is difficult to plan, execute efficiently and track (read: an opportunistic, seat- of- the- pants approach is the only way). More likely, success is multi-faceted and observed market dynamics (economic drivers, sales cycles, and network relationships) are more predictable and controllable by experienced hands than by novice small business owners. (Miller & Sanchez, 1998; Moore, 2002)

For example, the typical SBI small business client is trying to fit products and services into an established supply chain and distribution network. Even if the product or service is highly innovative (read: disruptive to established ways of doing things) it can be professionally marketed and sold to mainstream customers. ( McKnight 2004; Moore, 2002) Marketing is only part of the challenge. Small businesses success is multifaceted. How the company operates its input-transformation-output processes constrains its business model. ( Bossidy & Charan, 2002; Rasiel and Friga, 2002 ; Schonberger, 1990; Walton, 1986; ) So does the firms ability to control needed resources. ( Gladstone & Gladstone, 2004; Nicholas, 1993) However, said business model is amenable to disciplined plans for achieving dramatic, long-term growth in both profits and revenues .(Timmons & Spinelli, 2004; Collins, 2001; Kuratko and Welsch, 2001; Hanon, 1979)

Success is multifaceted, but how does one explain the elements, interactions and predictable consequences to undergraduate student consulting teams, and how do the teams pass such insights on to their clients? After all, most consulting teams are composed of students with diverse business majors -- most of whom only take one capstone strategy class and specialize in one functional area – only enrolling in basic core business courses in other areas. And, most SBI consulting clients do not have business degrees.

This paper revisits a core SBI challenge – helping SBI student consulting teams and clients to understand and control business success. Five related Figures describe components of a useful success framework that students can learn and share with clients to create a common understanding of what it will take for the client’s business to succeed. The framework is a practical blend of concepts from diverse business specialities. Using the framework as a guide, student consulting teams can identify the SBI client’s starting point, identify what the client must do to succeed, and help the client prepare realistic action plans.

## **SUCCESS FRAMEWORK**

Figure I describes the core of the success framework. As shown at the top of Figure 1, small

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Figure 1 about here

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business processes are aptly described by the Input-Transformation-Output (ITO) model. However, achievement efficient transformation is not the whole success story. No business can succeed on its own. The typical SBI client has concurrent marketing challenges as it struggles to fit its products and services into established supply chain and distribution networks. Two basic marketing ideas apply – the marketing concept and branding. The marketing concept argues that a business should sell what its customers want, and charge prices that produce profits. Branding is accomplished by the selling of exceptional customer benefits and creation of the perception that the firm’s products and services have a value that exceeds their price and also exceeds the value of its competitor’s products and services.

Success amounts to both doing the right thing and doing things right. For example, if the small business offers a pivotal transformation to established networks, with no close substitutes from

competitors, the chance of adoption increases (more benefits to customers relative to competition). Also, it is easier to brand the business's offerings (offers exceptional value to the customer relative to competition). If the small business exploits the situation by pricing its offerings to make them bargains relative to their value in use, the business will earn respectable gross margins and rapidly gain much market and operations experience. If the small business learns quickly from its experience, it can also become the most efficient producer in its category, despite its relatively small size. Comparative advantage can result, where the business' prices are set lower than projected costs of aspiring competitors, effectively forestalling new market entrants. Yet, return on equity is high, yielding working capital to sustain growth. (Schonberger, 1986) Using, Figure 1 as a benchmark, SBI student consulting teams explore how well their SBI client's business model measures up.

It takes an able business to exploit the success drivers presented in Figure 1. Figures 2 and 3 add twelve needed abilities to the success framework. To succeed, the business must control resources that have these abilities and, through disciplined application, hone each ability to a competitive edge. SBI student teams can identify which abilities a client lacks, and which need honing. Where can resources with needed abilities be found? How can the resources be enlisted to support the business? How can abilities best be honed?

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Figure 2 about here

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Figure 3 about here

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Within the success framework described in this paper, the transformational abilities listed in Figure 3 (Collins, 2001; Bossidy & Charan, 2002, seem necessary to hone the strategic abilities listed in Figure 2.( Rasiel & Friga, 2002; Moore, 2002). It is important to think of the right things, but *doing* things right is extremely difficult without transformational capability. Organizational effectiveness depends on balanced investment in the six transformational abilities.

In the author's view, the successful small business consistently achieves efficiency in task design and resource deployment to achieve project objectives and strategic goals. To do so, it must make balanced use of resources to support the network of work flows and interconnected projects that lead to timely business success. In other words, to be successful, no matter the business' line of work, its key people must be good project managers. Accordingly, Figure 4 adds the Project Model to the success framework. Student consulting teams often come up with many brilliant recommendations that the SBI client proves incapable of executing.(Ames, 1994; Kerzner, 2003; Rosenau, 1998) Use of the project model, helps the team to bridge the gap between recommendations and results. Each recommendation should be translated into realistic action plans that the client can follow, step-by-step to build profit momentum. Further, once recommendations are translated into project-model format (action plans with tasks, time lines and budgets) the team can more easily reconcile and prioritize the entire recommendation list based on the client's available and potential resources.

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**Figure 4 about here**

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Use of the project model in Figure 4, helps the SBI client make balanced use of resources to support the network of work flows and interconnected projects that lead to timely business success. The model translates diverse activities into common measures of performance, cost, and time, such as conformance to specifications, resource usage (budget) and on-time schedule. When compiled, these measures form an overall picture of the business' profit momentum and permit meaningful use of eight financial concepts to track progress and guide improvement actions. Figure 5 adds the eight financial concepts to complete the success framework.

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Figure 5 about here

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Profit momentum is the name of the game for small business success. Adroit use of the eight concepts in Figure 5 allow the small business client to track financial performance and to take actions to improve. To generate maximum profit to reinvest in growth, each business decision must include a marginal calculation (Figure 5, concept 1) – will the implied activities help profit momentum by bringing more money down to the bottom line?

Financial statements ( Figure 5, concept 2) should aid in the marginal analysis. Historic statements should reflect the work flow so that performance can be traced and pro-forma statements should reflect planned actions to improve rather than simply assume percentage increases. In order, for small business financial statements to best serve the SBI client, fixed and variable costs must be accurately portrayed (Figure 5, concept 3).

For each product or service, when variable cost is subtracted from sales price, what remains is contribution margin (Figure 5, concept 4). Variances between planned margins and maintained margins must be tracked by product/service and market, and used to rebalance product/service offerings.

Contribution margin is not the only tool that the SBI client can use to evaluate profit momentum. Profitability ratios, activity ratios and liquidity ratios give useful views of performance ( Figure 5, concept 5).

Understanding profit momentum also requires a understanding of how financial ratios interact. Formulations such as the Sustainable Sales Growth Rate aid understanding ( Figure 5, concept 6). Derived from Du Pont type systems that link profitability and leverage ratios, the sustainable sales growth rate is the rate at which a firm can grow based on the retention of its profits in the business.(Brigham & Daves, 2004; Leach & Melicher, 2003 )

Financial systems have limited use unless they are used (Figure 5, concept 7). Financial tracking– monitoring of profitability ratios and activity ratios in an ongoing, real-time manner– helps the business owner to keep track of growth and to assess its costs and rewards.

Financial summaries, while useful tools for evaluating small business performance are incomplete when it comes to accounting for development of transformational abilities ( investment in people, teams, work structures, mechanisms for improvement, and leadership). Hence it is valuable to assign responsibility for the collection of key data and the preparation of brief special reports that combine and update key financial data and key transformational data



(Figure 5, concept 8). (Donaldson, 1984); Nicholas, 1993)

## **SO WHAT? IMPLICATIONS FOR SBI STUDENT CONSULTING AND SBI CLIENTS**

SBI student consulting teams and clients must understand and control business success. The five related Figures presented above describe components of a useful success framework that students can learn and share with clients to create a common understanding of what it will take for the client's business to succeed. The framework is a practical blend of concepts from diverse business specialities. Using the framework as a guide, student consulting teams can identify the SBI client's starting point, identify what the client must do to succeed, and help the client to understand the challenges and to prepare realistic action plans.

## **CONCLUSION**

This paper revisits a core SBI challenge – helping SBI student consulting teams and clients to understand and control business success. It presents five related Figures that describe a useful framework that shows students and clients how to construct pathways to a successful business. The framework is a practical blend of concepts from diverse business specialities. Adapted from Mary Walton's description of the Deming chain reaction, Figure 6 summarizes how artful use of the framework components (Figures 1 through 5) leads to a chain reaction of success. (Walton, 1986)

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Figure 6 goes about here

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### Figure 1: Core of Success Framework: Input-Output Model With Success Drivers

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Input→Transformation→ Output (Added Value)

Success Drivers:

Marketing Concept (sell what is wanted, price to gain experience and reasonable profits)  
 Effectiveness ( Maximum Value Among Competitors)  
 => Branding  
 +  
 Efficiency (Minimum Cost for desired quality)  
 => Product/Service Success  
 +  
 Build Track Record (Max Profit/Min Cost For Entire Line)  
 => Achieve Comparative Advantage (Forestall Competition)  
 => Business Success

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### Figure 2: Six Necessary, Strategic Abilities

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**Brand** -- Ability to create perception of exceptional value, more than competition.

**Niche** -- Ability to identify revenue-significant clusters of potential customers, who have strong needs met inadequately by competitors, and who are willing and able to purchase solutions.

**Operate** -- Ability of present operating system to efficiently produce timely solutions for

targeted niches that conform to needed operational characteristics (timely need fulfillment =>quality).

**Reach** --Ability to efficiently present the brand value proposition to niche customers.

**Service** -- Ability to enhance value in use, and profitability, through technical support, maintenance, aftermarket upgrades, product/service bundling, and systems integration.

**Finance** – Ability to document financial results; predict funding requirements; and, when needed, obtain appropriate, affordable outside funding.

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### Figure 3: Six Interdependent, Transformational Abilities

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**Physical Assets** – The ability to cost-effectively design and build/acquire/control and deploy necessary and appropriate plant and equipment, and other durable or fixed assets, in support of timely achievement of business goals.

**People** - Ability to recruit, retain, and build relationships with people, both within and outside the business, and to deploy them so that they can cost-effectively contribute hard work and smart work to the business, and can learn and become increasingly useful to the business as the years pass.

**Teams** – Ability to form, nurture and delegate to effective teams, involving people and utilizing physical assets to yield business results.

**Work Structures** – The ability to cost effectively design, integrate, and train staff in the use of tooling, blue prints, decision aids, rules of thumb, formal procedures, and incentives that facilitate operations by maintaining consistency and predictability (i.e., model good practice and reward those who go by the book).

**Mechanisms for Improvement** – Ability to exploit a changing environment rather than be exploited by it, accomplished by continuously improving the transformation processes served by physical assets, people, teams and work structures (i.e., daily pursuit of improved quality and productivity).

**Leadership** – Ability to understand the survival requirements of the business in a changing world, and to convey what needs to be done and why to scale the business up or down in a balanced manner, while preserving top quality, profitable results (maximum value added in the eyes of stakeholders, both now and in the future, though balanced investment in all six transformational abilities).

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### Figure 4: How the Project Model Lends Itself to Building Profit Momentum

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Activity Based----->

Time Based----->

Set milestones and prepare budgets----->

Set control points----->

Track progress----->

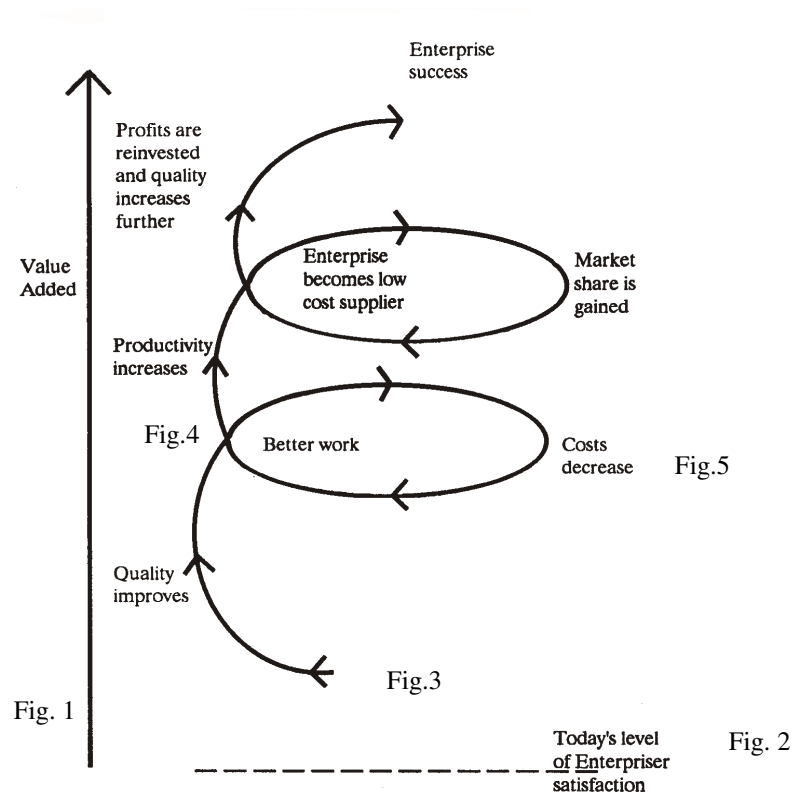
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PROFIT  
MOMENTUM

**Figure 5: Eight Financial Concepts That Underpin Successful Tracking and Action to Improve**

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1. Marginal Benefit vs. Marginal Cost (Maximum Benefit for Minimum Cost –Resource usage is a shadow of work and schedule, and cost is a shadow of resource usage.)
  2. Financial Statements (Balance Sheet, Income Statement, Cash Flow, Sources and Uses of Funds)
  3. Fixed vs.Variable Cost
  4. Contribution Margin
  5. Comparative Ratios and Bench Marking
  6. Sustainable Sales Growth Rate (Dupont System, Additional Funds Needed)
  7. Financial Tracking
  8. Special Reports
-

**Figure 6: Summary of How Five Success Framework Components Contribute To The Chain Reaction of Success**



## **PEACE CORPS EXPERIENCES IN CENTRAL AMERICA: COMMUNITY DEVELOPMENT AND ENTREPRENEURSHIP TRAINING**

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### **ABSTRACT**

The purpose of this paper is to demonstrate the impact of entrepreneurial efforts in the developing world by Peace Corps volunteers. These volunteers intuitively and intentionally foster this spirit within the communities that they serve. Although the USA is repeatedly described as the most entrepreneurial of societies, the Peace Corps and its cadre of innovative, highly-educated, and skilled volunteers has demonstrated that these efforts are alive and thriving around the world. The approach to encouraging and sustaining entrepreneurial efforts involves facilitating an environment where these activities, opportunities, and skills can be discovered and realized. Peace Corps volunteers are catalysts for this self-discovery process by facilitating community activities which promote active involvement in problem-solving and self-education. These activities must take into consideration the cultural context in which each community operates and slowly work to break down barriers which impede the self-realization process. This is particularly common with women who are marginalized within the "machismo" value system of Latin America. By training and using dedicated volunteers from an entrepreneurial society, and having them become instruments for change in their host countries, Peace Corps and other development organizations can overcome numerous barriers to entrepreneurship and the growth of an innovative perspective.

### **Introduction**

The USA is repeatedly described as the most entrepreneurial of societies (Global Entrepreneurship Monitor, 2004). In comparison, many other countries are said to suffer from cultural, structural, governmental, and other constraints not only upon entrepreneurial activity, but even entrepreneurial thinking and perspectives that espouse innovation. However, since 1963, the Peace Corps has contributed to improving conditions in the Third World through the service of a dedicated cadre of volunteers. This paper discusses the role of Peace Corps in rural community development and entrepreneurship training, with examples of programs that contribute to those outcomes specifically in Central America. Programs run by two Peace Corps volunteers, one in Honduras, and one in Costa Rica, are presented as illustrations of how Peace Corps contributes to the communities in which the volunteers serve. This paper briefly introduces the Peace Corps, and describes how Peace Corps volunteers are selected and trained for entrepreneurial characteristics. Cultural conditions in Central America are briefly discussed, and a framework is presented for viewing Peace Corps efforts to encourage entrepreneurial perspectives for community development and for small business projects. Finally, programs are

described to illustrate the outcomes of volunteers' efforts in community development and entrepreneurship training. The authors conclude that Peace Corps can overcome numerous barriers to entrepreneurship and contribute to community development and the growth of entrepreneurial perspective.

### **Peace Corps – An Overview**

The Peace Corps was formally established in March of 1961 under the presidency of John F. Kennedy. Since its inception, over 170,000 Peace Corps volunteers have served in 136 countries around the world. Currently, over 7,500 volunteers serve in 71 countries (peacecorps.gov, 2004). With a significant number of Peace Corps Volunteers assigned to community development and small business development projects, it should be no surprise that a number of volunteers' characteristics reflect archetypical characteristics of entrepreneurs (Table 1). As many volunteers maintain personal responsibility and authorship for their isolated projects, they must be entrepreneurial to succeed. As reported by the first author, Peace Corps trainers training encouraged him that “ideally, your job is to put yourself out of a job” by the successful implementation of his community projects.

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#### **Table 1 about here**

### **Entrepreneurship Training and Culture**

The United States enjoys a very strong culture of entrepreneurship, and as such, cultural models of successful entrepreneurs abound. With entrepreneurship salient in the national conscience, it is common, more so than in most other parts of the world, for Americans to consider making a career as an entrepreneur. Further, this attitude extends into other endeavors, as this cultural component and our freedoms encourage a sense of individual empowerment, not only for business start-ups, but in other dimensions as well. The components of the external environment can either encourage or inhibit entrepreneurial characteristics in people (Hall, 2001). Unlike the USA, many other countries do not enjoy such an encouraging environment for entrepreneurship.

Culture studies have borne out the intuitive conclusion that world cultures are different, and can inform differences in thinking by their participants (cf. Hofstede, 1991). Please see Table #2 below for a brief description of cultural dimensions as they relate to this discussion. Latin American culture has been characterized by collectivist values, high in power distance, high uncertainty avoidance, and quite masculine relative to other cultures. North American culture (U.S. and Canadian), in contrast, tends to be much more individualistic, low in power distance, medium in uncertainty avoidance, and also masculine, though not nearly to the extent of Latin American cultures (Hath, 1988).

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#### **Table 2 about here**

Among particular cultural challenges faced by Peace Corps volunteers in Central America is the strong culture of machismo, where women were generally subjugated into traditional roles and are not encouraged to pursue education or pursuits of their own interests. Another issue is the sense of predestination, or being at the mercy of some higher power. The common saying “*Si Dios Quiere*” (If God wills it) set some immediate barriers to moving forward with any project, idea, innovation, etc. Poverty seemed to magnify these attitudes.

Regardless of the cultural environment, but especially in cultures where entrepreneurial behaviors and values are not encouraged, individuals must be sensitive to opportunities. This may require training in the entrepreneurial perspective and learning entrepreneurial skills. Dr. Ulrich Braukmann and his workgroup at the Bergische Universitaet Wuppertal in Germany have developed the taxonomy of start-up relevant competencies, which can be seen as a roadmap for entrepreneurship training and education (Figure 1).

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**Figure 1 about here**

As shown schematically in the figure, working from bottom to top, the framework begins with Class I objectives at the stage of sensitizing people to the possibilities of entrepreneurship. In the context examined here, this specifically includes the ideas of growth and ability to continue the businesses or projects. Both Central American Peace Corps Volunteers stated that there was extensive interest in small businesses and projects in their host countries, but at very low levels. There were “always village women selling baked goods or foods they had prepared” but that these endeavors never were conceived to lead to any opportunities greater than simply relieving some of the problems of subsistence for poorer women and their families. Parenthetically, it was quite usual practice for women pursuing these low level business practices to turn most or all their profits over to their husbands, so frequently their efforts contributed more to recreational spending by the men rather than any significant bettering of living conditions for the families or for their villages. In contrast, some women hoarded their profits for the survival of their family members, as necessities might not be provided by their men-folk, who spent their money on themselves instead.

Following the framework further upward, Class II objectives are expressed as attitudes, comfort, maturity and perspective for considering entrepreneurial ventures or projects. Included here would be modeling possibilities, and in the case of Central America, the beginning of community and group consciousness of being able and poised to exploit opportunities for advancement. As the framework culminates in Class III objectives, non-business and business skill sets are taught or encouraged, to support the growing interest in exploiting opportunities. While the Peace Corps did not train the volunteers mentioned in this paper in this framework, it provides a natural pathway from naïve to formal thinking on the parts of the potential innovators – describing the process of moving from the untutored, subsistence level perspective of the “folk art of entrepreneurship” to the better-trained, higher level, opportunity-sensitive perspective of the “fine art of entrepreneurship.”

### **COMMUNITY DEVELOPMENT IN HONDURAS**

The first author was posted in the rural Yuscaran area of Honduras after a training program that included technical and practical training among other dimensions such as local language and culture. Community programs developed or extended by the first author were varied, but most revolved around the opportunities to encourage increased levels of tourism for the city and the region, with the objective of growing revenues for the city and for its local business community.

#### **Mango Festival**



Previous to this volunteer's posting, this had been a relatively small and very local festival. The volunteer worked with the local festival committee, encouraging them to take a more entrepreneurial attitude to the promotion of the festival. As a result, sponsors like Coca-Cola donated many more items to the festival, and the committee improved their self-promotion to media in the capital city. Further, new events were added to the Mango Festival, such as a "Donkey Polo" game that has become a popular national event, broadcast by national television and promoted in a new edition of a Honduras guide book. Outcomes from the increased promotion of the festival include: Increased tourism; more commitments for future sponsorship; vastly improved advertising of the festival at the national and regional level; and improved variety in the events offered.

### **International Bike Race**

During the second year of the volunteer's service, he realized that there was an opportunity for the community to exploit the region's justifiable reputation as a mountain biker's paradise. A local committee negotiated with Coca-Cola to persuade them to sponsor the race with publicity and trophies. As the event has grown, participants are now coming from all over Central America to compete in the race every year. The mountain bike race is also promoted in the Honduras guide book. Benefits accruing from the bike race include: Increased tourism and name recognition for Yuscaran; Improved opportunities for sponsorship of future races; Growing promotion of the city and the race due to building connections with media and advertisers.

### **Fundación Yuscarán**

A local non-profit organization had begun shortly before the arrival of the volunteer. With involvement of two other volunteers from the area, the group was able to increase tourism and began projects to save the natural cloud forest reserve in the mountains above the city. A number of seminars were developed to train members of the foundation in basic marketing, tourism, and computer skills, so they would be better able to promote their projects and exploit new opportunities. Benefits to the community of these projects include: Promoting and protecting natural resources and culture of the city; and the Fundacion Yuscaran has attained the status of a legal and recognized non-profit organization, thus improving the probability that it will continue its work in the community.

While the Peace Corps programs in Honduras concentrated more on community development opportunities, those in Costa Rica were more focused on local small business opportunities for citizens in more rural isolated locations.

### **EXPLOITING ENTREPRENEURSHIP OPPORTUNITIES IN COSTA RICA**

The second author of this paper was sent to Costa Rica as a Peace Corps volunteer, and posted in the Rio Celeste-Colonia Naranjena-La Florida area of the country (Cuerpo De paz, 1995). The volunteer assisted area businesses and project groups, assessing their business needs and planning and implementing new viable small enterprises. He organized, taught, and provided consulting to two women's associations, one indigenous cooperative, three agricultural organizations, and several small businesses during his years of service. In addition, he also provided ongoing training in business skills to about forty community business people. Through these training seminars, over 300 community members benefited from increased group and business efficiency and profitability.

### **Asociación de Mujeres Las Celestinas – Plantain Chip Factory**

A factory was planned, funded and built to buy plantains from local farmers, bolstering the local market for this produce and helping to create a product that could be sold nationally. Activities surrounding this project included:

- Formed the association, wrote the charter with members
- Taught business planning and business idea development
- Wrote a funding proposal resulting in \$20,000 for factory construction
- Liaised with department of agriculture to visit similar sites around Costa Rica
- Managed material purchases for the factory construction
- Managed factory construction
- Taught basic accounting, inventory and personnel management
- Marketed the end product
- Additionally developed a small dried spice and herbal medicine business

### **Asociación de Mujeres de Apacona – Dehydrated Produce**

With this local group, a viable small local business was investigated and implemented. Pineapple grown in the area could be marketed nationally after processing. Activities included:

- Assisted in formation of the association
- Taught business planning and accompanying skills
- Assisted with feasibility studies
- Taught basic computer skills
- Developed computer accounting worksheets
- Worked with the dept of agriculture for proper use of chemicals
- Began a composting program

### **Cooperativa Malecu – Native Reservation and Farmer's Cooperative**

Along with working in community development projects for this very small native reservation in the region, this volunteer worked with the reservation cooperative store to make it more efficient and profitable. Activities associated with this project included:

- Taught basic accounting and inventory skills for cooperative store employees
- Worked with the reservation developing an artisan crafts business to serve tourists
- Trained community leaders in assessing and determining strategies for the cooperative.

At the current time, a number of these programs are still in operation. While, as in many cases, the Peace Corps volunteer was the catalyst for training and innovations in entrepreneurial perspective, the volunteers only stay for two years. In Costa Rica, the *Centro Nacional de Aprendizaje* (the National Center of Learning) continues to build the entrepreneurial perspective for residents through ongoing training seminars in business skills and education opportunities, such as graduation equivalency courses. Over the years, the plantain drying factory the volunteer helped to finance and build has metamorphosed into a business incubator and training center for the women of the community. It has become a rich environment for start-ups of women's businesses. Further, it is a training center with classes in tailoring, clothing design, and baking.

For those learning baking, there is even a small bakery in the old factory, which produces goods for sale in the community.

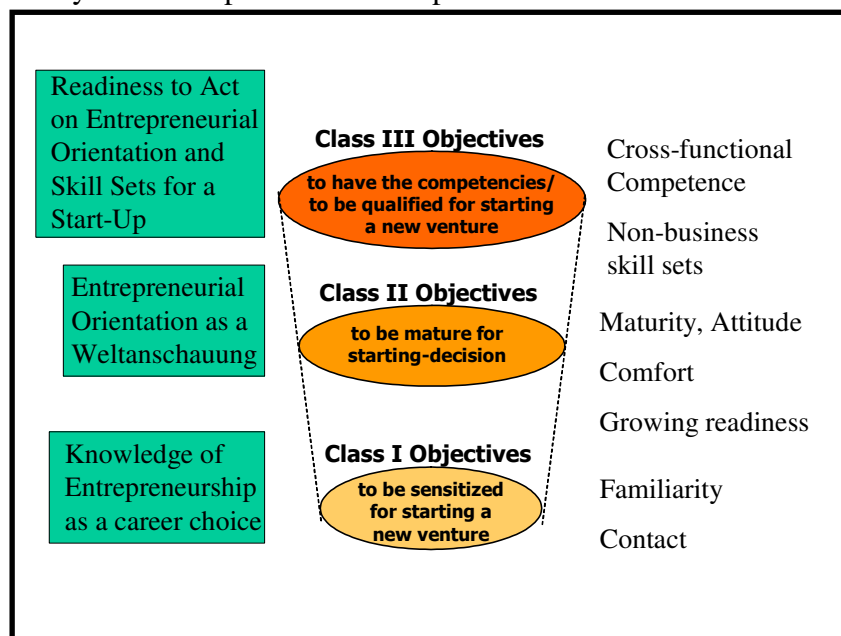
## Conclusion

The reach and impact of the Peace Corps since its inception in the early sixties have been extensive. This paper has examined how this organization capitalizes on the entrepreneurial characteristics of its volunteers to bring an entrepreneurial perspective to rural people in Central America. In spite of traditional, cultural, and structural inhibitions and limitations to entrepreneurial thinking, growth in these dimensions was seen. Through community development projects, business skills training, and encouraging small business start-ups by individuals, associations, and cooperative groups, Peace Corps contributed by helping to encourage innovation, recognition of opportunities, and actual business start-ups in rural areas where these would be unlikely to occur without some external help. The first author commented on the goal of the Peace Corps volunteers to "...do their job by putting themselves out of a job." In the words of the second author:

I believe the true economic impacts have and will come from the self-empowerment of some of the citizens in the small settlements where I worked. I am very proud to have been a part of this process (Toops, 2004).

To the extent that entrepreneurship and innovation depend on the empowerment of the community, Peace Corps volunteers can be seen as community facilitators who help others recognize and exploit opportunities for their own self-empowerment.

**Figure 1 - Taxonomy of Start-Up Relevant Competencies**



**Table 1 – Entrepreneurs and Peace Corps Volunteers (Adapted from Kao, 1991)**

| <b>COMMON CHARACTERISTICS OF ENTREPRENEURS WITH<br/>CORRESPONDING CHARACTERISTICS OF PEACE CORPS VOLUNTEERS</b>   |  |
|---|--|
| <ol style="list-style-type: none"><li>1. Total commitment, determination and perseverance</li><li>2. Drive to achieve and grow</li><li>3. Opportunity and goal orientation</li><li>4. Taking initiative and personal responsibility</li><li>5. Persistent problem solving</li><li>6. Realism and sense of humor</li><li>7. Seeking and using feedback</li><li>8. Internal locus of control</li><li>9. Calculated risk taking and risk seeking</li><li>10. Low need for status and power</li><li>11. Integrity and reliability</li></ol>   |  |
| <p>Each of these characteristics of entrepreneurs can be seen reflected in the behaviors of Peace Corps volunteers:</p> <ol style="list-style-type: none"><li>1. Volunteers make a two-year commitment to their communities and become assimilated into their communities by the time they leave.</li><li>2. They are often driven to see progress in their communities</li><li>3. Many volunteers are sensitive to opportunities, and set goals and strive to achieve them.</li><li>4. Volunteers work with community members, but often take responsibility for ultimate success or failure of their projects.</li><li>5. Peace Corps volunteers, more than most other professionals, are forced to find multifaceted solutions to problems every day.</li><li>6. Out of the myriad of problems facing the any site, volunteers must be able to decide which ones are viable and can be tackled, and they must try to maintain a sense of humor about it.</li><li>7. It is common and encouraged to seek feedback from volunteers and others regarding successes and failures and culturally appropriate solutions, as well.</li><li>8. Volunteers tend to self-recruit for characteristics of self-determination, and the belief that they can get things done successfully. Volunteers tend to be calculated risk takers, being able to see success in their mind's eye.</li><li>9. The life of a volunteer in the Peace Corps is unlikely to be high in status and power; motivation tends to be intrinsic rather than extrinsic.</li><li>10. Volunteers, having dedicated themselves to serving their communities for two years, must be people who act with integrity and do what they say they will do.</li></ol> |  |

**Table 2 – Hefstede’s Cultural Dimensions (Adapted from Deresky, 1994, pp. 82 – 84)**

| <b>HOFSTEDE’S CULTURAL DIMENSIONS</b> |  |
|---------------------------------------|--|
| <b>Individualism/Collectivism:</b>    | This dimension refers to the tendency of people to look after themselves first and see themselves as identified primarily by their individual attributes (individualism), versus seeing themselves first and foremost as members of an identifiable group. Hofstede’s findings suggest that countries higher in individualism tend to have higher GNP’s and more encouragement of individual initiative than more collectivist countries.  |
| <b>Power Distance:</b>                | This dimension represents the level of acceptance by a society of unequal distributions of wealth and power. It can be said that in high Power Distance cultures, empowerment opportunities are less likely to be perceived, as one’s station in life is already determined.   |
| <b>Uncertainty Avoidance:</b>         | Refers to the extent to which people in a culture feel threatened by situations that are ambiguous. People in high uncertainty avoidance societies tend to favor low-risk decisions.   |
| <b>Masculinity/Femininity:</b>        | This dimension refers to how heavily traditional Western Europeans and North American “masculine values” are espoused by a cultural group. These values include assertiveness, materialism, and lower levels of concern for others. Feminine values, in contrast, emphasize concern for others, valuing relationships, and attention to quality of life issues. In highly masculine societies, women are generally considered extensions of their men, and expected to maintain traditional roles of wives and homemakers. |

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**DO QUALITY AWARD MODELS HELP SMALL BUSINESS  
TO BE MORE SOCIALLY RESPONSIBLE?  
EXPERIENCES FROM TURKISH QUALITY AWARD SCHEME**

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# **DO QUALITY AWARD MODELS HELP SMALL BUSINESS TO BE MORE SOCIALLY RESPONSIBLE? EXPERIENCES FROM TURKISH QUALITY AWARD SCHEME**

**Semra Ascigil**

## **ABSTRACT**

Corporate social responsibility (CSR) is a theme that is integrated to quality management and quality award models with increasing emphasis in time. Although CSR is discussed as a strategy applied mostly by large firms, the award schemes for SMEs aim to disseminate use of model to smaller firms. Quality award models provide relevant guidance to SMEs whose development is argued as dependent on management of wider networks for innovation and formation of social capital. The paper investigates to what extent the EFQM model provides guidance in integrating CSR in quality management and then explores how the concept is operationalized by two quality award finalist SMEs in Turkey.

## **INTRODUCTION**

Corporations are under the scrutiny of diverse stakeholders that made them accountable to not only shareholders but also other internal and external stakeholders. The point reached is beyond what Friedman (1970) once defined with the statement “the only responsibility of business is to increase profits” pointing sole responsibility to shareholders. Carroll (1979) has provided the definition of the dimensions of corporate social responsibility (CSR) concept and operationalized the construct through economic, legal, ethical and discretionary activities of business organizations. Among the responsibilities that management is expected to adhere, economic responsibility was the most well known one due to the historical importance attached in discussions of managerial behavior. The thrust behind economic responsibility in business is simply producing goods or services that will bring profit. There are reservations as to whether this category can be considered a social responsibility, however, a reinterpretation such as “providing consumers goods or services at the lowest cost with highest quality and make reasonable level of profit” may help bring an inclusive perspective.

As the number of stakeholders management have to deal with increased depending on the issue at hand, companies realized that their borders are quite fluid. As a consequence, concepts like “boundaryless organizations” and “networks” became major topics for researchers (Carroll and Buchholtz, 2000). With changing relations, management of communication across the boundaries became crucial. However, such relationships have to be managed with a different understanding of the role of organizations in society. Social responsibility in business simply describes company relationships with stakeholders and in case effectively done contributes to learning and offer competitive advantage (Freeman, 1984; Freeman & Gilbert, 1988). Stakeholder model also provides a useful framework to evaluate CSR through social reporting activities. Social reporting processes are means for communicating the social and environmental effects of organizations to particular interest groups.

Although views has changed over time concerning the use of organizational resources for larger community, the need for revising corporate responsibilities is evident within academic research. Doing business with social responsibility outlines how stakeholder management should be embedded into company operations and whether companies will take responsibility

of social issues. Recently, Total Quality Management (TQM) is interpreted to include concepts like business ethics, social responsibility and governance. The enlightened view of quality management offers a more strategic perspective of quality where the focus is broadened to cover firms' relationships in a larger environment (Garvin, 1988).

The aim of the paper is to identify salient points of Excellence Model used by European Foundation for Quality Management (EFQM) regarding social responsibility and then see how Excellence Model is operationalized by SMEs applying the model successfully.

## **QUALITY MANAGEMENT AWARD MODELS FOR SME ASSESSMENT**

It is increasingly argued that efficient use of venture capital is no longer the sole determinant for gaining competitive advantage. The development and survival of SMEs are increasingly dependent on soft factors such as whether effective management policies are deployed to create a broader prosperity. Development towards a broader vision is a result of an interactive process not only within the SME, but also between the firm and some institutions in society. Growth of SMEs adopting social responsibility will also serve in building social capital through stakeholders relations. Therefore, partnerships established and policy tools promoted by various institutions in a given society are of great importance.

The interest of SMEs in award models is relatively new. SME categories have been added to Baldrige Award scheme in late 1980s. EFQM added the category in 1997 followed by Turkish Quality Association a year later. The recent issues in management are integrated into quality award models through periodical-revisions. EFQM Excellence Model, which is used in Europe, is based on stakeholder approach in managing organizations. The Foundation makes such adaptations by way of incremental changes in its annual revisions as well as big changes every 4 years with the help of expert committees. By revisions done in year 2000, the model made ethics and social responsibility related issues that were already existing, more visible. Quality Association (KalDer) in Turkey has been using EFQM Excellence Model since its foundation. During the award process KalDer is training the assessor pool with cases prepared by EFQM. At the same time some assessors in Turkish Award scheme are serving as assessors in European award scheme.

By giving a non-prescriptive framework for management the award models allow for management initiative in implementation. The models are also useful tools for self-assessment. Unlike Baldrige model, EFQM Excellence model is made up of nine major criteria (Figure 1). The first five (leadership; policy and strategy; management of people; management of resources and partnerships; management of processes) are labeled enablers describing the approaches. The last four criteria (people related results, consumer-related results, and impact on society and results) are labeled as outcomes. The major message given by way of the grouping of criteria into two is that in order to change the outcomes obtained today, you need to review and change the approaches adopted in the past. In other words, you can not change your present without changing the past approaches. Importance of stakeholder management is another highlight whereas successful implementation rests upon balanced emphasis on needs and legitimate claims of various stakeholders. In addition to stakeholder commitment, care for natural (e.g. pollution, packaging, waste management) and physical (e.g. safety, health, and ergonomic aspects) environment is also emphasized.

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Figure 1 about here

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## **METHODOLOGY AND FINDINGS**

### **Research Purpose**

Research associating quality management and corporate social responsibility in SMEs is rare. The research question is structured as:

What is the content of issues within stakeholder groups that quality award finalist SMEs are addressing regarding corporate social responsibility?

### **Methodology**

Past research on CSR activities of large firms used companies' self-presentations of their CSR activities on company websites (Snider, Hill and Martin, 2003). The lack of existing research on SME social responsibility led the author to conclude that qualitative research will be the most appropriate methodology for the study. In addition to this, since social responsibility is a concept penetrated to quality award schemes only recently, the related practices are supposed to be in their embryonic phase justifying an exploratory type of research. Therefore, analysis of award submission books followed the tenets of grounded theory and qualitative content analysis. The analysis designed by Glaser and Strauss (1967) focus on revealing patterns among information and give a meaning to data rather than imposing a framework from outside. The data used for this investigation is the quality management related assessments of finalist companies applying to the award scheme for SME category. In analysis, first, the data is scanned for explicit and implicit statements regarding firm's moral, ethical, legal and philanthropy related responsibilities to all internal and external constituencies. The information acquired is sorted secondly and then categorized by stakeholders. Thirdly, the data is reread to organize like information into separate groupings of issues. Fourth, possibilities of differences between two SMEs were explored among the issues and stakeholders.

SME category in the award scheme defines firm size based on the number of full-time employee and covers those firms with less than 250 employees. SMEs are further grouped as either dependent (at least 25% of its shares owned by a holding company or a group) or independent. Self-assessment reports prepared according to Excellence Model that are submitted to organizing association KalDer are used as self-reports of companies. The submission books of TQM champions provided in-depth cases to be used for the exploratory analysis. It is thought that because these companies have proven their performance in implementing the model, the way they interpret and operationalize the EFQM model is enriched enough to involve social responsibility related endeavors. Among the companies contacted, positive response of two is obtained. Each firm has been given a pseudonym that was in line with their market and sector. Thus, Service Domestic Firm (SDF) provides service to domestic market whereas Manufacture Global Firm (MGF) manufactures intermediate goods for global markets. In terms of size SDF is smaller than MGF.

### **Findings**

SDF is a dependent SME operating in service sector providing logistical services for a product. The mission is being the best service providing logistics center in Turkey. Their focus is more on distribution chain within the country and contributions to the happiness of ultimate customers achieved through responsiveness to their increasing expectations. The firm values are defined around "focus on human resources and customers," "technological

infrastructure," "openness to change" and "proactivity." SDF supplies products from foreign suppliers and acts as a facilitator between domestic and foreign suppliers in improving the parts, competitive pricing as well as dissemination and sharing of improvement related experiences.

MGF is characterized as a dependent SME with high technological competencies. The mission of the company highlights customer, shareholder and employee as primary stakeholders. The customer is viewed as partner and MGF aims to develop perception of a reliable firm delivering excellently performing products. Responsibility of MGF towards shareholders is defined as retaining competitive position and efficient use of resources. Additionally, the mission statement emphasizes creation of open, well functioning company in order to enhance involvement and teamwork while upgrading skills.

MGF's mission emphasizes worldwide recognition on excellence. Because it operates globally through supplying its product to firms in various countries, it is organized as a flexible company to produce many different types of its product demanded in markets. The organization has therefore a flat structure. Excellence Model is accepted as a tool for self-assessment and guide five years before being a finalist.

The results reveal that both firms concentrate their attention on a similar set of stakeholders imposed by the Excellence Model. Both firms consider input from all stakeholders in strategic planning. However, the emphasis varies depending on the business environment they are operating in. Social responsibility related activities are described below within appropriate categories.

Employee: Development of policies focusing mainly on safety, health and training of employees is commonly observed in both firms reflecting emphasis on proactivity with regard to fulfillment of responsibility towards employees. Monthly safety and health meetings, emergency planning in case of fire (alarm systems, covering floors with inflammable material) are some examples for such activities. In general, the training provided aims both personal development of employees as well as company success. The emphasis on the importance of human capital can be observed in processes developed to upgrade human capacity. Viewing leader training as a mean to serve the purpose of improving communication with employees concerning meaning and role of quality management, both companies vigorously utilize human resource management tools. Given such an aim whereby enriching the understanding of award model is the target, it can be said that a readiness for broader interpretations of quality management is in place in both firms. Both companies are sensitive in developing performance evaluation systems that helps establishing fair relationships with employees. In MGF, employee recognition scheme is developed addressing different accomplishment situations to enable fairness. Performance evaluation in both firms is linked to participation in continuous improvement activities enabling consistency with firm goals. These efforts are justified as leading to improvements in employee satisfaction and variety of other measures like lower turnover, sickness, and absenteeism. Both MGF and SDF manage information resources with the purpose of assuring equal opportunity in accessing appropriate and reliable information. Compliance to regulations is done by cross checks to meet legal responsibilities. Social activities provided aim to create a work-life balance as well as enhance the spirit essential for teamwork.

Customer: In both firms, customer is identified as one of major stakeholders. There are processes developed to hear their needs and handle their complaints. Measures concerning

complaints, satisfaction, and loyalty are used with the aim of fulfilling responsibilities to customers. The relationship with customers continues after sales in terms of training on recent changes or obtaining feedback for further improvement. In MGF customer relations are handled by dividing into commercial issues and technical issues each assigned to related divisions. The improvement related activities are varied taking the form of meetings, quality circle activities and improvement projects organized jointly. In MGF case, the aim is establishing the ideal of partnering with customer on business improvement. Improvement done concerning a particular customer is deployed to other customers showing a concern for equal treatment. Reciprocal relations are developed through training of customers and training received from customers which enables sharing of expertise and information for proactivity and innovation. Similarly, SDF receives training and exchanges market related information with suppliers in order to address customer right for a quality product. The customer relations are handled with a proactive orientation to prevent dissatisfaction from the supplied product/service in both firms.

**Suppliers:** As SDF is not a manufacturing firm, the relations with suppliers are limited in scope and do not involve monitoring by way of audits. However, SDF acted as a facilitator by organizing workshops during which domestic suppliers and foreign suppliers met to develop business relations and improve efficiency and quality of products. Whereas in MGF case, relations with suppliers are managed through a formal supplier evaluation system that provides input to identify priority areas for improvement. Innovative examples for joint improvement activities are planned and carried out together with supplier firms. MGF has systematically included environment-related issues in purchasing decisions, a challenging policy in terms of requirements for openness. Thus, the policy not only changes their own processes, but also changes the business behaviors of suppliers.

**Competitors:** Competitors in general are the forgotten stakeholder in any firm. Green (1994) argues that competitors are "corporate stakeholders with a claim for fair treatment." The cooperation and trust developed among competitors may help understand the reasons for mutual support and collaboration between SMEs. The relevant examples traced are few in both cases. In case of MGF where innovativeness is a prominent goal, process-benchmarking activities attended serves in building interactive relationships with other producers, thus enabling cooperative relations with competitor companies. In SDF case, firm is tracing competitors to make price related suggestions to suppliers.

**Society:** MGF shows visible effort to spread best practices within and outside the holding organization by way of seminars, team presentations, publications, and training. Philanthropy related activities are institutionalized through linkage to a Foundation within the holding company. SDF's approach focus more on maintaining safety in immediate environment through strengthening safety in case of fire. SDF is engaged in philanthropy as well, with major activity areas being education, health and cultural development of society. To ensure accountability for the process of creating a desirable impact on society, teams are designated to work on societal relations. "Societal Positive Impact Teams" are such examples formed to develop action plans and budgeting of these activities.

**Environmental Issues:** Environmental responsibility is another area where both firms are engaged in its development and thereby found under various stakeholder categories. However, the reasons for involvement differ. High stakeholder pressure and inherent potential in production for harming environment seems to be the reason leading MGF to deal with the issue by developing formal processes. MGF questions environmental profile by

surveys (Total Environmental Care Survey) supported by energy saving projects, environment-related publishing and participation in environment focused NGOs. Additionally, the supplier audits are performed by Quality and Environment Control Section Manager pointing to the availability of socially-responsible buying practices. On the other hand, the major examples of sensitivity in environmental issues implemented by SDF are water distillation and recycling projects. Other projects relate to paper waste prevention project replacing cardboard packaging with steel cages, use of centralized air-conditioning working with ozone layer friendly gases, saving of electricity, using LPG in heating to prevent pollution.

Intellectual Property: Examples for the care shown in protecting intellectual property rights can be seen in both firms.

## **DISCUSSION**

The above findings point to the fact that CSR is not at the monopoly of large firms with an organizational structure where maintaining reputation by way of CSR is the exclusive preserve of PR or communications departments. When utilized vigorously, Excellence model may provide a systematic perspective in establishing social responsibility in an SME. The fact that the model is based on stakeholder mentality is an advantage to be exploited in CSR related implementation. Because issues that are concerns of stakeholders are addressed in CSR, Excellence model helps to handle these issues in a more systematic manner. Another advantage provided by Excellence Model is that it encourages firms to make an impact analysis in the first place and then prioritize social responsibility areas. The model brings much comprehensive approach to CSR by preventing reductionist perspectives where social responsibility is equated with corporate philanthropy.

SMEs may not have individual resources to consider the impact of their activities on various stakeholders proactively. The more proactive the strategy, the more formal processes need to be employed where greater stakeholder involvement becomes essential in these processes. Therefore, employing structures (alliances, networking) that enable interaction with stakeholders becomes key success factor for SMEs in implementing CSR. Partnerships established are recent examples of such structures enabling exchange of information and experience. Success is attained by letting partnering stakeholder organization to give feedback as to company's impact on stakeholders which otherwise may not be recognized at all. The examples for improvements in the above cases are mostly the outcomes of joint improvement projects allowing the firms to consider stakeholder claims proactively.

Successful implementation of CSR requires partnerships with numerous stakeholders in variety of issues. The examples in the two cases are performed with organizational stakeholders involving primary stakeholders; i.e. customers, employees, shareholders, and suppliers. No major examples for partnerships with regulatory stakeholders (including local and national government, professional organizations, and competitors), community stakeholders (environmental and human rights groups, consumer advocates) and media are found in the two cases. Turkish Quality Association, in fact, was a sort of hidden partner in both cases that contributed organizational learning and growth. Considering the above two success stories, it is evident that providing support in developing management systems are equally important for SMEs as provision of financing in being sustainable.

The availability of benchmarks on CSR is another factor for innovative CSR implementation. For example use of minority suppliers, which is an issue most prevalent in U.S. designates preference of diversity of suppliers in terms of gender, size, racial background. Employment of such criteria is not yet observed in firms of any size in Turkey. However, just like learning as a result of interactions with foreign partners, the pressures of urgent needs may be the reason for creative solutions in the way CSR is operationalized in SMEs.

The above cases also reveal the importance of three factors in launching CSR in SMEs; stakeholder pressures, broader perceptions of quality, and support in the process of implementation. Stakeholder pressure is more prominent in MGF than SDF in showing sensitivity to environmental issues. In the absence of stakeholder pressure, firms' engagement in CSR may not be formalized through audits, social reporting, etc. In other words, those efforts will be individualized responses rather than collaborative responses involving partnering stakeholders. The values embracing excellence, social duty, human rights themes are also driving forces for integrating social responsibility to quality management concept. An enlightened quality notion should eventually involve social responsibility concept. The benefits to be derived from CSR are integrity, continuous work relations and growth.

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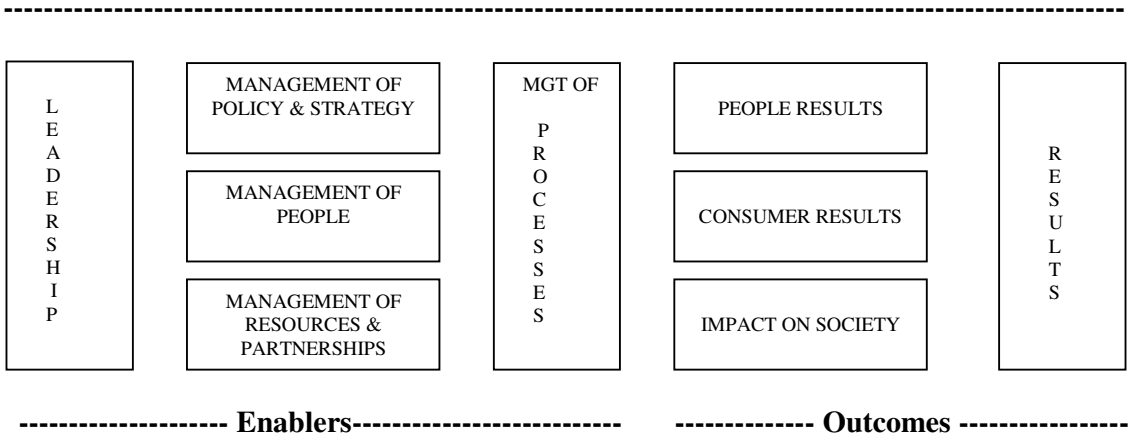
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**EXCELLENCE MODEL**  
**Figure 1**

# **Venture Capitalists, Insider Ownership and Firm Performance around IPOs: Small Firm Evidence by**

Joseph Astrachan, M. Monica Her, Daniel L. McConaughy\*

## **Abstract**

This study examines the potential substitution between insider ownership and external monitoring, and the role of venture capitalists in IPOs with sales less than \$35 million, the median level of all firm-commitment IPOs over the 1980-1998 period. We find that majority-owned small firms have lower profit margins yet are more efficient before the IPO, and that the presence of venture capitalists reinforces these characteristics. However, they are valued less after the IPO, though this may be ameliorated by VC presence and higher inside ownership retention after the IPO. We observe that VC-backed IPOs are valued more after the IPO and that they tend to do better in the aftermarket. Our results suggest that higher insider ownership retention and VC involvement in small firms provide signals of quality for newly listed firms.

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## **1. INTRODUCTION**

This study investigates the relationship between insider ownership and firm performance around IPOs (Initial Public Offerings). Our primary goal is to assess the relationship between insider ownership and venture capitalists and performance. To do this, we compare and contrast the characteristics and performance of firms that are majority-owned *vis a vis* non-majority-owned both before and after the IPO. This study examines IPOs that occurred over the period of 1980-1998 by firms with less than \$35 million in sales, the median level of all firm-commitment IPOs over the period. This group of IPOs occupies the so-called "Middle Market," which represents a large swath of businesses in the United States and, therefore, provides important information relevant to scholars as well as advisors to small firms.

This study focuses on small IPOs for three reasons. First, small firms tend to be less liquid, are more vulnerable to information asymmetries, and are more likely to be majority-owned than large firms. Therefore, they may not be valued as highly in the market. Second, small majority-owned firms are less likely to have "professional management," since the founding family or owner group, with such a large stake, is likely to be actively involved in managing the firm. Therefore, these firms are less likely to possess the managerial depth needed to navigate the rough waters of the public markets. Finally, the influence of VCs may become more significant since the management may be less sophisticated and suffer from entrenchment.

Insider ownership, because of the incentives it provides, may be related to company performance (Jensen and Meckling 1976, Stulz 1988, Morck et al. 1988, McConnell and Servaes 1990, and Nagar and Wolfenzon 2000.) With respect to IPOs, insider ownership retention may also provide information about a firm's quality. Insiders, who have better information than outside investors, will be more willing to hold shares if

they expect the company to have good future prospects (Leland and Pyle 1977, and Downes and Heinkel 1982.)

Similarly, the presence of venture capital investors in a firm may provide a signal of quality. VCs are sophisticated and well-informed investors; so the fact that they have made investments in a company serves to certify company quality, much like bank loans are a signal of quality because of the due diligence analysis a bank undertakes before lending (James, 1987). Further, VCs often provide managerial, financial and strategic expertise, which adds value to the firms in which they invest (Megginson and Weiss 1991, Brav and Gompers 1997, Astrachan and McConaughy 2001.)

The literature suggests that VCs are associated with higher performance in IPOs, though this may not be the case for small manufacturing firms. Further, the literature with respect to insider ownership suggests that higher insider ownership retention after the IPO is a signal of quality and is associated with better performance. This study extends the research on small firm IPOs by looking at a larger sample of small IPOs over a longer period of time and across industries.

## **2. HYPOTHESES AND METHODOLOGY**

We intend to test the following hypotheses:

H1: Venture capitalists are associated with better performance in small firms.

H2: Higher insider retention of shares after the IPO is associated with better stock market performance in small firms.

To test the hypotheses, we employ both univariate and multivariate analyses because univariate methods alone are inadequate. Since majority-owned firms are generally smaller and may differ systematically from non-majority-owned firms, a multivariate analysis provides a clearer profile of majority-owned firms versus their more diffusely-held counterparts. The analyses are in terms of event time. In other words, for each IPO issue, the zero time is the IPO date.

## **3. DATA**

The sample, drawn from the SDC New Issues database, includes firm-commitment IPOs over the 1980 – 1998 period for firms with less than \$35 million in sales, which was the median level of sales among IPOs over this period. We eliminated closed end funds, unit investment trusts, firms without sales and IPOs whose shares sold for less than \$5.00.

In order to get a broad view of the performance of IPOs in the sample and specifically majority-owned IPOs and the role of venture capitalists, we examine the firm characteristics both before and after the IPO, the offering characteristics of the IPO firms, the insider ownership characteristics, and the stock market performance. We also employ some of these characteristics as control variables in order to ascertain the special characteristics of majority-owned IPOs and the role of VCs. We describe the sample firms as majority-owned if insider ownership before the IPO was 50% or greater and non-majority owned if the insider ownership before the IPO was less than 50%.

### **3.1 Company Characteristics**

*Sales* is reported in millions of dollars as reported for the year before the IPO. Size is an important measure due to scale and scope effects as well as being a measure of success. It is an important control variable. *Assets*, an alternative control variable for size effects, is measured in millions of dollars as reported for the year before the IPO. *Total Asset Turnover* is calculated as sales divided by assets. It is a measure of asset use efficiency. Generally, higher turnover ratios, other things equal, indicate a better utilization of a firm's assets.

*Profit Margin* is Net Income as a percent of Sales the year before the IPO. Higher values indicate a higher quality company. *ROE* is the return on equity before the IPO. *ROE pro forma* is the Return on pro-forma Book Equity after the IPO. Higher values indicate a higher quality company. *Price-to-Earnings* is calculated as IPO price to earnings the year before the IPO. It is a measure of relative value and may be related to quality. *Debt-to-Assets* is Total Debt to Total Assets at the time just before the IPO. High levels may indicate that the firm is capital constrained and must go to the equity market to get funds.

*Price-to-Sales* is calculated as IPO price to sales the year before the IPO. It is a measure of relative value and may be related to quality. *Market-to-Book Equity* is calculated as IPO market value of equity to pro-forma Book Equity at the IPO. It is a measure of relative value. Higher quality firms or those with more growth opportunities, are expected to have higher values.

### 3.2 Offering Characteristics

*Proceeds* is the amount of money that went to the company after the underwriter's discount. This is reported in \$millions. *Over allotment (% Shares)* is the percent of shares sold through the over allotment option as a percent of total shares sold. The over allotment option, the Green Shoe Option, is a common feature in IPOs. It allows the underwriter to sell more shares at the market price and yet pay the issuing firm the offering price. If the issue does well, the over allotment option is exercised. It indicates quality in that it signals to the market that the underwriters have an incentive to price the issue to do well so that they can sell over allotment shares into the market and make a profit, possibly a large profit.

*Priced above High* is a dummy variable taking the value of one when the IPO price was above the high end of the range in the prospectus, 0 otherwise. Offers that are priced above the high end of the range are ones where demand was greater. Thus, this variable is an indicator of company quality. *Priced below Low* is a dummy variable taking the value of 1 when the IPO price was below the low end of the range in the prospectus, 0 otherwise. Offers that are priced below the low end of the range are ones where demand was low. Thus, this variable is a proxy for market expectation.????

*Syndicated Offers* is a variable that takes the value of one when the IPO was underwritten by a syndicate of underwriters, zero otherwise. *VC-backed Offer* is a dummy variable taking the value of one when venture capitalists were involved, zero otherwise. VC-backed firms may be viewed as higher quality firms due to the certification that comes from having informed investors. *Lockup Duration* refers to the number of days that insiders' shares were restricted. Longer lockups may indicate a



higher quality issue since the insiders are bonded to the firm more closely. *Lockup* is a dummy variable taking the value of one when there was a lockup of insider shares, 0 otherwise.

*Underwriters' Spread (%)* is calculated as the ratio of the underwriter discount as a percent of total offering amount before payouts. This is a measure of the total direct costs of going public. Generally, due to the many fixed costs associated with going public, the percentage spread is higher for smaller issues. Lower spreads, other things equal, indicate more of the proceeds go to the company.

### 3.3 Ownership Characteristics and Stock Market Performance

*Pre-IPO Shareholdings (%)* is the percentage of insider ownership before the IPO. *Post-IPO Shareholdings (%)* is the percentage of insider ownership after the IPO. Higher quality IPOs would be expected to have higher values. *Holdings Divested (%)* is the percentage of insider shares sold as a proportion of those held before the IPO. One would expect that higher quality companies would have lower rates of divestiture since there is less risk for the insiders.

*Stock Market Returns* are expressed in percent for the time periods indicated. *NASDAQ-Adjusted Stock Returns* are calculated as the difference between the company's return over the specified period less the return on the NASDAQ stock market index over the same time period. This gives a relative, market-adjusted performance measure that will show the firm's own returns in a more meaningful context.

## 4. RESULTS AND DISCUSSION

Univariate comparisons may not reliably indicate differences between the two groups if other factors associated with majority-owned are related to the variable in interest. Controlling for multiple variables simultaneously with majority-owned allows us to estimate the relations in the presence of other influence factors. To further investigate important factors associated with offering characteristics for majority-owned and non-majority-owned IPOs, we employ binomial probit analysis for our indicator variables and the Ordinary Least Squares (OLS) regressions for others. Table 1, Panel A shows the binomial probit results. We find that majority-owned firms are less likely to be VC-backed, but firms with higher sales are more likely to be VC-backed. This suggests that venture capitalists might avoid majority-owned firms and smaller firms with lesser growth opportunities. In addition, VC-backed firms are more likely to be priced above the range and less likely to be priced below the expected price range. We also find that larger firms and VC-backed firms are more likely to have a lock-up provision.

Panel B presents OLS analysis on other offering characteristics. Our results show that lockup duration is positively related to majority-owned, but it is negatively related to VC-backed. The longer lockup for majority-owned firms suggests that a greater commitment from the insiders is needed to assure the market of the quality of the firm. However, venture capitalists do not favor IPOs with long lockup duration, which reduces the liquidity of their investments. We also find that % spread is negatively related to Sales and VC-backed. In other words, these are economies of scale. The presence of VCs is associated with lower underwriting costs, perhaps because they are better able to

negotiate with investment bankers. However, the % spread is not significantly related to majority-owned. We do not find a significant relation between the % shares offered by the over-allotment option and either majority-owned IPOs or VC-backed IPOs. An over-allotment option is essentially a call option with a strike price equal to the issue price. The over-allotment option can be viewed as a signal of quality since the underwriters cannot exercise it unless the issue remains above the offer price long enough for them to exercise. The better the IPO does in the aftermarket, the higher the gains to the underwriters. The insignificant relations suggest that the majority-owned IPOs and VC-backed IPOs do not use this option any more than the others.

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Table 1 Panels A and B about here

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Table 1, Panel C shows that size is not related to the percentage of shares owned before and after the IPO. However, the majority-owned IPOs are positively related to the percentage of shares owned after the IPO. Our finding of a positive relation between % holdings divested and majority-owned IPOs suggests that the insiders of small firms may find it less desirable to retain ownership, perhaps because they are riskier. Alternatively, majority owners have more capacity to divest and retain control.

Panel D shows results on Pre-IPO firm characteristics. We find that debt is negatively related to size, but is insignificant related to majority-owned IPOs. Before the IPO, majority-owned and VC-backed companies are more efficient. Both ROE and Total Assets Turnover are positively related to majority-owned IPOs and VC-backed IPOs.

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Table 1 Panels C and D about here

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Panel E presents results on Post-IPO firm characteristics. ROE proforma (after the IPO) is positively related to VC-backed IPOs but insignificantly related to majority-owned IPOs. The negative relations between majority-owned IPOs and the ratios of Market-to-book and Price-to-Earnings *pro forma* suggest that majority-owned IPOs were priced at lower levels. This is somewhat clarified by the stock market performance reported in Panel F, which reports a consistent negative relation for majority-owned IPOs. However, a positive relation is found for VC-backed IPOs. The results suggest that there may be an entrenchment effect in majority-owned IPOs that can be ameliorated by the presence of VCs.

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Table 1 Panels E and F about here

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To further investigate the factors contributing to the negative relation between majority-owned IPOs and stock market performance reported in Table 1, we run another set of regressions specifically on the post-IPO majority-owned firms and report our results in Table 2. Panel A shows that the presence of VCs does help mitigate the lower valuations associated with majority ownership. More importantly, the positive relation between the post-IPO insider ownership and stock market returns suggest that a more concentrated post-IPO insider ownership is desirable for the majority-owned IPOs.

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Table 2 Panel A about here

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We report in Panel B, similar results for insider ownership for majority-owned IPOs with a lockup greater than or equal to 180 days. However, no significant result is found for VC-backed. As we pointed out above, VCs may try to avoid IPOs that have longer lockup durations, or they may negotiate shorter ones. Using *Pro Forma* Price-to-Earnings and Market-to-Book ratios (Panel C), we find that market response positively to a higher post-IPO insider ownership for majority-owned IPOs. Overall, our results suggest that insider retention of shares and VC involvement in smaller, majority-owned firms provide signals of quality for newly listed firms.

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Table 2 Panels B and C about here

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## 5. CONCLUSION

The results of this study support Stulz's (1988) contention that majority-owned companies are not as valuable or perform as well in the stock market in spite of their higher ROA before the IPO. This may reflect market concerns regarding insider entrenchment, since the market for corporate control is ineffective in firms controlled by insiders holding a majority of the shares. However, our finding that the *% Owned After* is positively related to value and stock market performance is consistent with the signaling hypothesis of Leland and Pyle (1977). Further, the positive impact of VCs on performance and value is consistent with Brav and Gompers (1997) and Megginson and Weiss (1999), who hypothesize that VCs provide a certification of quality. Our findings based on a larger sample of more uniformly small IPOs drawn from more industries over a longer period of time are very different from those reported by Brau et al (2004).

Majority-owned firms would do well to consider engaging venture capitalists well in advance of a contemplated public offering. Though majority-owned firms tend to have higher ROA and Asset Turnover, they do not sell at a premium and their stock returns are lower than those that are not majority-owned. However, the impact of venture capitalists may serve to increase the value of the firm. Their contributions come in the form of experience to better groom the firm for sale.

Our results have implications not only for middle market firms in general, which no IPO study has really addressed but also for family-controlled firms, a significant holder of 'middle-market' firms. The main reason for this is because the determination of family control is difficult, time-consuming, and somewhat subjective. (Objective measures, such as McConaughy et al. (1999) used, tend to be incomplete. The difficulty creates a bias against finding results, which, however, would strengthen any significant finding.) Related to the issue of majority-owned IPOs, is the observation of Shanker and Astrachan (1996), who estimate that about 61% of majority-owned corporations are family controlled. Thus, majority-owned IPOs may proxy for family control. If so, the results are relevant to family controlled firms.

An important strategic issue in closely-held, 'middle-market' firms is that of liquidity. Liquidity needs among these firms extend beyond the need for growth capital. These firms also deal with the liquidity needs of senior owners to 'cash out' at retirement and needs associated with estate taxes. Family controlled firms with multiple generations of family members also face the problem that some other family members may not be as interested in holding shares in a private company and therefore desire liquidity. Since a public offering is one way to obtain liquidity, the factors we examined may help closely held firms focus on what matters and contribute to more successful IPOs, enhancing the wealth and liquidity of their owners.

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**Table 1 Analysis of Factors Associated with Offering Characteristics****Panel A: Offering Characteristics**

|                        | <i>Priced above High</i> | <i>Priced below Low</i> | <i>Lockup</i> | <i>Venture-backed</i> |
|------------------------|--------------------------|-------------------------|---------------|-----------------------|
| Constant               | -0.998(.000)             | -0.558(.000)            | 0.762(.000)   | -1.698(.000)          |
| Pre-IPO Majority-owned | --                       | --                      | --            | -0.584(.000)          |
| Venture-backed         | 0.213(.05)               | -0.136(.17)             | 0.468(.008)   | --                    |
| Sales                  | 0.035(.83)               | --                      | 0.534(.003)   | 1.355(.000)           |
| N                      | 830                      | 830                     | 830           | 830                   |
| Chi-Sq. p-value        | .10                      | .17                     | .000          | .000                  |

**Panel B: Offering Characteristics**

|                         | <i>Lockup Duration (days)</i> | <i>% Spread</i> | <i>Over allotment (% Shares)</i> |
|-------------------------|-------------------------------|-----------------|----------------------------------|
| Constant                | 536.71 (.000)                 | 9.91 (.000)     | 0.070 (.000)                     |
| Pre-IPO Majority-owned  | 82.15 (.000)                  | 0.178 (.135)    | 0.000 (.961)                     |
| Venture-backed          | -84.26 (.000)                 | -0.624 (.000)   | 0.001 (.502)                     |
| Sales                   | -185.33 (.000)                | -2.00 (.000)    | 0.015 (.000)                     |
| N                       | 768                           | 830             | 566                              |
| Adjusted R <sup>2</sup> | .22                           | .33             | .46                              |

**Panel C: Insider Ownership Characteristics**

|                         | <i>Pre-IPO Shareholdings (%)</i> | <i>Post-IPO Shareholdings (%)</i> | <i>Holdings Divested (%)</i> |
|-------------------------|----------------------------------|-----------------------------------|------------------------------|
| Constant                | 42.31 (.000)                     | 22.36 (.000)                      | 0.42 (.000)                  |
| Pre-IPO Majority-owned  | 45.39 (.000)                     | 27.82 (.000)                      | 0.035 (.001)                 |
| Venture-backed          | -2.90 (.011)                     | 1.83 (.104)                       | -0.054 (.000)                |
| Sales                   | 0.87 (.580)                      | 1.99 (.198)                       | -0.032 (.032)                |
| N                       | 804                              | 804                               | 804                          |
| Adjusted R <sup>2</sup> | .72                              | .49                               | .09                          |

**Panel D: Firm Characteristics Prior to IPO**

|                         | <i>Profit Margin</i> | <i>Total Asset Turnover</i> | <i>Return on Equity</i> | <i>Total Debt to Total Assets</i> |
|-------------------------|----------------------|-----------------------------|-------------------------|-----------------------------------|
| Constant                | 2.71 (.000)          | -0.414 (.004)               | 2.324 (.000)            | -1.076 (.000)                     |
| Pre-IPO Majority-owned  | -0.103 (.111)        | 0.448 (.000)                | 0.337 (.000)            | -0.014 (.908)                     |
| Venture-backed          | -0.074 (.292)        | 0.327 (.000)                | 0.282 (.002)            | -1.036 (.000)                     |
| Sales                   | -0.495 (.000)        | 0.162 (.165)                | -0.368 (.003)           | -0.599 (.002)                     |
| N                       | 830                  | 804                         | 804                     | 550                               |
| Adjusted R <sup>2</sup> | .04                  | .05                         | .03                     | .14                               |

Panel E: Firm Characteristics after Offer

|                         | <i>ROE pro forma</i> | <i>Price-to-Earnings pro forma</i> | <i>Price-to-Sales</i> | <i>Market-to-Book Equity</i> |
|-------------------------|----------------------|------------------------------------|-----------------------|------------------------------|
| Constant                | 1.045 (.000)         | 3.533 (.000)                       | 1.814 (.000)          | 1.258 (.000)                 |
| Pre-IPO Majority-owned  | 0.019 (.831)         | -0.425 (.000)                      | 0.160 (.273)          | -0.285 (.000)                |
| Venture-backed          | 0.255 (.000)         | 0.389 (.000)                       | -0.443 (.000)         | -0.022 (.721)                |
| Sales                   | 0.595 (.000)         | -0.336 (.002)                      | --                    | -0.582 (.000)                |
| N                       | 830                  | 705                                | 830                   | 830                          |
| Adjusted R <sup>2</sup> | .07                  | .07                                | .02                   | .15                          |

Panel F: Stock Market Performance

|                         | <i>1 Day Return</i> | <i>2 Weeks Return</i> | <i>1 Year Return</i> | <i>2 Weeks Return NASDAQ-Adjusted</i> | <i>1 Year Return NASDAQ-Adjusted</i> |
|-------------------------|---------------------|-----------------------|----------------------|---------------------------------------|--------------------------------------|
| Constant                | 22.14 (.000)        | 19.808 (.000)         | 62.10 (.001)         | 16.20 (.001)                          | 46.46 (.016)                         |
| Pre-IPO Majority-owned  | -3.70 (.187)        | -6.90 (.041)          | -26.92 (.018)        | -7.47 (.008)                          | -20.66 (.064)                        |
| Venture-backed          | 5.09 (.017)         | 8.50 (.000)           | 28.38 (.001)         | 8.78 (.000)                           | 28.79 (.001)                         |
| Sales                   | -8.80 (.009)        | -6.39 (.050)          | -24.33 (.065)        | 6.19 (.067)                           | -24.44 (.060)                        |
| N                       | 399                 | 695                   | 544                  | 695                                   | 543                                  |
| Adjusted R <sup>2</sup> | .03                 | .04                   | .04                  | .04                                   | .03                                  |

**Table 6 Factors Associated with the Performance of Majority-owned IPOs****Panel A: Stock Market Performance**

|                         | <i>1 Day<br/>Return</i> | <i>2 Weeks<br/>Return</i> | <i>1 Year<br/>Return</i> | <i>2 Weeks<br/>Return<br/>NASDAQ-<br/>Adjusted</i> | <i>1 Year<br/>Return<br/>NASDAQ-<br/>Adjusted</i> |
|-------------------------|-------------------------|---------------------------|--------------------------|--|---|
| Constant                | 19.03<br>(.004)         | 24.24 (.000)              | 58.06 (.019)             | 20.48 (.002)                                       | 49.17 (.047)                                      |
| Sales                   | -3.98<br>(.328)         | -7.03 (.105)              | -35.15 (.025)            | -6.73 (.121)                                       | -35.46 (.024)                                     |
| Venture-<br>backed      | 1.49 (.564)             | 4.96 (.074)               | 19.67 (.056)             | 5.19 (.062)  | 21.46 (.037)                                      |
| Post-IPO<br>holding     | .108 (.165)             | 0.165 (.040)              | 0.927 (.003)             | 0.172 (.033)                                       | 0.79 (.010)                                       |
| ROA                     | 3.63 (.002)             | 3.71 (.006)               | 4.90 (.300)              | 4.19 (.002)  | 4.40 (.352)                                       |
| ROE                     | -5.55<br>(.001)         | -6.88 (.000)              | -10.98 (.089)            | -7.24 (.000)                                       | -11.32 (.079)                                     |
| N                       | 237                     | 408                       | 310                      | 408  | 309   |
| Adjusted R <sup>2</sup> | .063                    | .058                      | .053                     | .065   | .049  |

**Panel B: Stock Market Performance of Majority-owned Firms with a Lockup Greater than or Equal to 180 Days**

|                         | <i>1 Day<br/>Return</i> | <i>2 Weeks<br/>Return</i> | <i>1 Year<br/>Return</i> | <i>2 Weeks<br/>Return<br/>NASDAQ-<br/>Adjusted</i> | <i>1 Year<br/>Return<br/>NASDAQ-<br/>Adjusted</i> |
|-------------------------|-------------------------|---------------------------|--------------------------|--|---|
| Constant                | 9.56 (.306)             | 13.96 (.158)              | 121.87<br>(.001)         | 9.66 (.331)  | 112.09<br>(.002)                                  |
| Sales                   | -0.369<br>(.939)        | -3.72 (.487)              | -58.59 (.003)            | 3.00 (.579)  | -57.63 (.003)                                     |
| Venture-<br>backed      | 1.929<br>(.482)         | 5.98 (.052)               | 10.98 (.345)             | 6.22 (.045)  | 11.51 (.320)                                      |
| Post-IPO<br>holding     | 0.107<br>(.228)         | 0.177 (.062)              | 0.769 (.040)             | 0.179 (.060)                                       | 0.613 (.101)                                      |
| ROA                     | 6.15 (.000)             | 5.58 (.001)               | 3.517 (.561)             | 6.11 (.000)  | 3.88 (.519)                                       |
| ROE                     | -7.19<br>(.000)         | -8.49 (.000)              | -9.035 (.228)            | -9.01 (.000)                                       | -9.87 (.187)                                      |
| Lockup<br>Duration      | 0.009<br>(.311)         | 0.016 (.074)              | -0.085 (.010)            | 0.018 (.046)                                       | -0.085 (.010)                                     |
| N                       | 208                     | 356                       | 267                      | 356  | 266   |
| Adjusted R <sup>2</sup> | .10                     | .07                       | .07                      | .08  | .06   |

**Panel C: Price Multiples**

|                | <i>Price-to-Earnings pro<br/>forma</i> | <i>Market-to-Book Equity</i> |
|----------------|--|------------------------------|
| Constant       | 3.78 (.000)                            | 0.939 (.000)                 |
| Sales          | -0.338 (.014)                          | -0.695 (.000)                |
| Venture-backed | 0.437 (.000)                           | -0.040 (.631)                |



|                         |               |              |
|-------------------------|---------------|--------------|
| Post-IPO holding        | 0.009 (.005)  | 0.016 (.000) |
| ROA                     | -0.239 (.000) | 0.112 (.003) |
| ROE                     | -7.19 (.000)  | -8.49 (.000) |
| N                       | 357           | 414          |
| Adjusted R <sup>2</sup> | .11           | .18          |

# **TEACHING ENTREPRENEURSHIP, RISK TAKING, AND CHANGE, “ACROSS” THE CURRICULUM**

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Abstract: Entrepreneurship course offerings should not “only” seek to attract students majoring in business or engineering. Agreed? This paper describes a course: Entrepreneurship, Leadership, and Team Building: Identifying and Applying Best Practices that was developed and taught in each of the last two years for a University Honors Program. (530 official Honors Program exist in the U.S.) In addition to providing background information relevant to professors interested in offering a similar course, deliverables, outcomes, and a course syllabus is shared.

## “So What Issue”

There are 530 official Honors Programs in the U.S. (National Collegiate Honors Council—[www.nchchonors.org](http://www.nchchonors.org)) and all attract top academic students. Perhaps your university has or will soon have an Honors Program. At our university, 550 students are enrolled in the Honors Program and 95 percent represent majors “other than” business. The majority >90 percent of these bright students will never enroll in a business class nor will they take any course in entrepreneurship or small business. The author believes “this experience” is typical as to what occurs on most college campuses where Majors, Concentrations, and Minors in Entrepreneurship are offered but never taken by the majority of students attending and graduating from our universities.

The goal of this presentation/paper is to encourage and guide USASBE members as they expand entrepreneur course offerings to students across the university.

## Introduction

Is entrepreneurship "more than" starting and running businesses? Do entrepreneurs exist in private AND public arenas? Are students on all campuses, in all majors, inherently focused on success, long to make a difference, and interested in entrepreneurship?

This paper provides strategy and details as to how courses in entrepreneurship may be “modified” and targeted to non-business majors on any campus.

Specifically, a successful Studies in Entrepreneurship course, (Mgmt. 4350) housed in the College of Business Administration, was modified by changing the course deliverable from writing a business plan to “effecting and instituting” change on campus. Further, a University Honors Program (550 students are enrolled in this program) offered and promoted the course, which was “targeted” to non-business freshmen and sophomores. The course was first taught\* in spring 2003 and is being repeated in fall, 2004.

*\*Note: On our campus, the Honors Program reimburses the college/department \$2,500 to encourage/allow faculty to get a course reduction and to provide funding to cover the cost of hiring a per-course adjunct instructor. This instructor, however, “volunteers” to teach this course “out-of-load” and the Department uses the \$2,500 to partially fund the campus chapter of CEO.*

Before describing the actual course in entrepreneurship that was modified, here is a brief description of the Honors Course.

### Honors 3393

The “modified” course required students to work in groups and create campus-based projects that required the group/team to identify something (a process, program, or system) that was not being done or was but could be done better, and then to work to develop a plan and strategy designed to turn their proposed change(s) into reality.

Student teams pilot-tested their plans and prepared written reports identifying what they did, why they did it, where and when they did it, how they did it, what “worked” and what didn’t, as well as what they would do differently in the future to improve the strategy and plan. Student teams also presented the contents of these reports to the class as oral presentations.

Before the USASBE 2005 Conference begins, the course will have been taught twice for the University Honors Program (Spring 2003 and Fall 2004) and enrolled students from pre-med, psychology, advertising, government, mass communication, nursing, and biology majors among others.

The results from 2003 and 2004 were impressive, as the students became “intrapreneurs” and actually changed processes and policies and created new programs at the university. Samples of changes included:

- Adding a student crises and suicide hotline on campus.

- Linking all computer labs on campus to “allow” only duplex (two-sided) printing and saving an estimated \$9,000 in printing costs each semester. Further, this change was also supported and legislation passed by the Student Senate at the University.
- Creating a Tutor Program sponsored by the Honors College.
- Creating Employment Assistance for Honors College students.
- Modifying the campus Recreation Centers’ policy for outdoor exercise.
- Working to create “themed” honors housing in the dorms.
- Sponsoring an “all campus” beautification program where students from campus organizations work together to clean and “spiff-up” the campus each semester.
- Creating an “Honors Coffee House” to be operated by an outside vendor with a percentage of sales going to support the Honors Program.

Further, three students from the course had their competitive paper accepted and presented “findings” and “change/creations” at the National Collegiate Honors Council Conference held in Chicago in fall 2003. In Chicago they shared their “entrepreneurial” experiences and distributed copies of the class syllabus.

As noted previously, rather than ‘create’ a new course, an entrepreneurship course, Studies in Entrepreneurship (Mgmt. 4350) was modified and taught to students enrolled in our University Honors Program. The next segment describes the entrepreneurship course that was modified, details the changes/modifications made; includes a detailed syllabus for Honors 3393S, and provides outcomes, recommendations, and conclusions.

#### Studies in Entrepreneurship (Mgmt. 4350) Course Background.

Management 4350, Studies in Entrepreneurship was first offered on our campus in 1999 and has been taught to more than 600 students—99% being business majors. The course structure provides presentations by entrepreneurs on Tuesday and work on business plans, of the students’ choosing on Thursday. For more information on the course, refer to this web link: <http://www.business.swt.edu/users/jb15/MGT4350/default.htm>.

Since 1999, more than 100 successful entrepreneurs representing the public and private sectors, big and small enterprises, young and old, men and women, minority and non-minority, have spoken at Texas State University (formerly Southwest Texas State University).

Just a few of the “tutors for enterprise success” have been:

- Herb Kelleher, President Southwest Airlines;
- Peter Holt, President Holt Enterprises, Caterpillar and the San Antonio Spurs;
- Stacy Bishkin, President BBH Exhibits, Inc.;
- Tom Meredith, CFO Dell Computer;
- Red McCombs, CEO McCombs Enterprises (includes Clear Channel Communications and the Minnesota Vikings);
- Alex Sheshunoff, President Sheshunoff Management Services; and’
- Bob Marbut, President and CEO Hearst-Argyle Television, Inc.
- Mike Levy, Founder and Publisher, *Texas Monthly*;

- Admiral Bobby Inman, former Director of the CIA and founder of MCC;

The names of many of the speakers are household words. Others are success stories known only in their industry. They represent big business, small business, non-profit and captive entrepreneurship (i.e. entrepreneurial activity within a business structure).

Cable TV and a Textbook. Tapes have been made of all presentations and all have been edited to fit a 55-minute time frame. Since fall 2002, more than 60 selected videotapes have been shown on local Cable Television. Further, because of the class, twenty-nine “entrepreneurial stories” now appear in a recently published book and CD entitled, Profiles in Entrepreneurship: Leaving More Than Footprints, Southwestern/Thompson Publishers (available on Amazon).

In addition, although only one day each week is devoted to writing and presenting business plans, students enrolled in the Studies in Entrepreneurship class have placed second in 2002 and again in 2003 and won \$7,000 for two different business plans at the Ernst Young/Nasdaq New Enterprise Creation Competition sponsored by Ball State University.

Although the course could be labeled successful, as previously noted, 99% of students that enrolled were majoring in business. The instructor was interested in teaching entrepreneurship to students other than business majors.

### Entrepreneurship Across the Curriculum

In fall, 2002, working with the Director of the University Honors Program, an honors course entitled, *Entrepreneurship, Leadership, and Team Building: Identifying and Applying Best Practices* was created. Although the course was modeled after the Studies in Entrepreneurship course described previously, this honors course was different in that it targeted non-business students who were freshman and sophomore level honors students. In addition, “creating change on campus” was to be the course focus rather than creating business plans.

This honors course was designed to spark genuine interest in creating and identifying opportunities for change on campus, but especially for “turning ideas into substance and into tangibles.” Finally, instead of having “real” guest speakers, the course used selected stories, videotapes, and a CD all taken from the Profiles in Entrepreneurship: Leaving More Than Footprints, book as well as a CD highlighting key concepts such as leadership, risk taking, decision making, etc., delivered by entrepreneurs who previously spoke on campus.

### Honors Course Structure

This course sought to identify characteristics needed to become an entrepreneur or intrapreneur (someone who works within a large enterprise). The course also examined how to build a team, how to effect change, how to build and sustain a guiding coalition,

and explored leadership principles necessary for team initiated and directed projects to prosper and succeed.

Using selected videotapes and entrepreneurial stories, students were introduced to how creativity and idea generating is necessary for change, growth, and improvement.

### Course Syllabus

Course: Honors 3393S -- Entrepreneurship, Leadership, and Team Building:  
Identifying and Applying Best Practices

#### Course Description:

This writing intensive seminar examines the “life stories” of selected entrepreneurs, identifies leadership qualities that may have contributed to success, and explores research based principles necessary for groups to become teams and for teams to become high performing. The course output/tangible is for students to work in teams, identify potential needed/necessary “changes” that might be implemented, and work to effect and initiate these changes.

#### Course Outcomes, Goals, and Objectives:

After completing, Entrepreneurship, Leadership, and Team Building: Identifying and Applying Best Practices, students will have:

- Identified idea generating strategies and opportunities available in the university, local, and regional communities
- Identified and categorized leadership qualities needed to attract followers and to build a guiding coalition
- Identified how individual leadership qualities possessed by class/seminar participants compares with leadership qualities possessed by successful entrepreneurs and leaders
- Created an individual and team-based action plan designed to improve and build upon leadership qualities already possessed
- Worked in groups and created campus-based projects which required the group to become a team and to have moved through specific stages necessary for the team to become high performing
- Completed an action-based, tangible change project

#### Semester Course Outline:

##### Weeks 1-2

View select video portions of the entrepreneur speaker cd and read select transcripts of successful entrepreneurs to identify sources of ideas as well as idea generating techniques necessary to stay current.

Assignment: Students form groups/teams and individually and collectively begin to list strategies for identifying opportunities and/or for improving self-selected, campus/community-based existing practices. Teams select their preliminary project related to a campus-based innovation or improvement of existing practice.

##### Weeks 2-6

Review research-based techniques and principles designed to assist a group to become a team and to progress through team stages. Introduce leadership and team member skills and activities required in high performing teams.

Assignment: Students work individually and collectively to create listings of team or group necessities and problems as well as identify leadership characteristics necessary for success. Students evaluate their past performance and contributions while being a member of a group or team and then identify task or maintenance functions where improvements are sought and needed. In addition, student groups create vision and mission statements, identify their project “target,” develop specific goals, break goals into tasks and delegate the work to individual team members, as well as create project time-lines and milestones.

Weeks 6-9

Continue to introduce leadership and team-based research intended to educate and challenge team members to develop and further refine skills possessed. Students initiate and continue working on their team-based projects.

Assignment: Teams submit their preliminary project related to a campus-based innovation or improvement of existing practice.

Weeks 9-12

Students discuss project successes and impediments and receive constructive feedback from all class teams.

Weeks 12-15

Students submit a team-prepared written report documenting their campus/community project and focusing on the six helpers—who, what, when, where, how, and why as well as describe outcomes. Students also orally present the results of their project, receive feedback from the other teams, and prepare a “what was learned analysis” of the experience.

Textbook and/or Learning Resources:

Profiles in Entrepreneurship: Leaving More Than Footprints w/ cd, David Nelson, James Bell, Southwestern/Thompson Publishers, 2004.

Packet of materials developed by the instructor and available for purchase at the University Bookstore. (Materials have previously been used to deliver in-house education and professional development for for-profit and not-for-profit businesses and organizations.) Expected cost not to exceed \$20.

### Major Course Project

Students work in groups and create a campus-based project which will requires the group/team identify something that is not being done or is but could be done better, and work to develop a plan and strategy to turn ideas, recommendations for implementation and/or improvements into a reality. Student teams will pilot-test their plan and prepare a written report identifying what they did, why they did it, where, with whom and when they did it, how they did it, what “worked” and what didn’t, as well as what they would do differently in the future to improve the strategy and plan. Student teams will also present the contents of this report to the class as an oral presentation.

#### Assessment of Student Learning

1. Attendance and informed participation at seminar sessions (10%)
2. Preliminary Written Group Project Report (due week 8) (15%)
3. Individual assessment as to the quantity and quality of contributions and attitude of team members. (10%--5% week 8; 5% week 14)
4. Written Group Project Report (due week 14) (50%)
5. Team Oral Presentation (weeks 13 and 14) (15%)

Course Grading: 90+ =A; 80 to 89=B; 70 to 79=C; 60 to 69=D; <60=F

#### Course Bibliography:

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#### Summary, Outcome, Recommendations, and Conclusion

As previously noted, the course has been taught twice for the University Honors Program (Spring 2003 and Fall 2004) and enrolled students from pre-med, psychology, advertising, nursing, and biology majors among others. The results were impressive, as the students became “intrapreneurs” and actually changed processes and policies and created new programs at the university (Please refer to the listing of “changes.”)

Across campuses, modules of this course may exist, but by using real-life role models and research based principles, this Honors Course examined and combined entrepreneurial principles and techniques, and worked with a “non-traditional audience” and did so early-on in the university experience with the goal of giving the student his or her junior and senior years to further apply and refine skills.

The author intends to “track” students who completed this Honors Course to learn if the students continued applying entrepreneurial traits and characteristics both while students and later as graduates.

Expanding the reach of entrepreneurship throughout the university provides benefits to students and can impact an entire campus community. Honors Programs are currently offered at 530 campuses in the U.S. Professors are encouraged to modify and to “share” entrepreneurship across the university curriculum!



BUILDING BUISNESS EDUCATION AROUND A MODEL OF  
ENTREPRENEURIAL PROCESSES

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## Abstract / Executive Summary

In this paper, we discuss how changes in the business environment have made necessary changes in the business education process. Greater use of industry experienced teachers, current supporting materials, a group process-based learning model, relevant use of computing technology, emphasis on skills modules rather than content categories, and closer ties with the local entrepreneurial business community are proposed to develop graduates with marketable skills, ability to deal with ambiguous environments, and the capability to contribute more immediately to the success of the hiring organization.

In our university's School of Business, the faculty and staff work very closely with the local Entrepreneurial Community, the Dean's Advisory Board (local business leaders), and the Placement Office (which brings firms to campus to hire students). In our interactions with the local business community, and in our research within industry and academic publications, we have discovered that university-level business education, as routinely conducted in American universities, falls far short of the expectations of industry leaders in several key areas:

1. Graduates are poorly prepared in the areas of writing, oral communication, working in groups, critical thinking, and dealing with ambiguous circumstances.
2. Graduates of business programs may have memorized vocabulary for their courses, but the students have long since forgotten meanings.
3. Business graduates, having had a program of classes specializing in functional areas (marketing, management, economics, finance, etc.) are unable to integrate the functional knowledge to solve realistic business challenges.
4. Business graduates, trained by business academics, lack the experience base to contribute meaningfully to the business immediately.
5. Business graduates, educated in large sized courses, have leaned upon textbooks written by academic (not industry) experts, whose theoretical bases and research programs have necessarily focused on *Fortune 500*-sized firms. The challenges facing new ventures and small business are systematically ignored

Many of these shortcomings reported by recruiters are systemic to the large-scale American research institution. Consolidation of students into large classes, the tenure system driven by academic publishing, the utilization of graduate students as evaluators of undergraduate work, and the compensation/rewards system providing the context for undergraduate and graduate education, make these problems relatively intractable across a large university.

However, business programs have several elements which provide them the potential to become proactive in changing the educational experiences of their students. Many business programs make extensive use of evening adjunct professors who are working in industry by day. The business professorate is increasingly made up of “second-career” professors, who went into the academy after a decade or more of industry experience. Business professors are more able, and more likely, to understand and actively forge symbiotic linkages with the local business community, than professors in other fields. Finally, students attracted to the study of business are more likely to accept alternative learning models, especially if the new learning model can demonstrably be linked to creating and grooming skills that are useful in the workplace.

## FORMATION OF A NEW BUSINESS LEARNING MODEL

The academic business community is just beginning to understand, at the institution/journal level, the lack of results delivered by the traditional business education model, and the opportunities for change and improvement available through more

effective and efficient use of resources available. This recognition is additionally energized by three environmental changes:

1. The prolific spread of computer competency means that current students have been exposed to the computer learning tool for the past eight to ten years. Earlier students viewed Management Information Systems and Computing Power as akin to content areas, worthy of study in and of themselves. Currently, both students and professors have a more reasonable view of the computer as a tool, not as an Oracle of Knowledge (no pun intended).
2. The loss of power and prestige previously controlled by *Fortune 1000* firms has shaken the business education considerably. Students, as well as professors, know that the *Fortune 1000* are net job losers; thus, a renewed interest and energy for learning about small business in general, and Entrepreneurship in particular.
3. The rise and fall of the Internet-based stock market has shown the irrationality of many of the newest management education fads. The Dow 30 runup of 1998-1999 spurred interest in New Ventures; the subsequent crash of Internet-based stocks spurred interest in rediscovering basic business principles and skills.

Contributing to this change in the educational model is the rise of Entrepreneurship as a free-standing discipline in the business-academic community. For many years, academics interested in entrepreneurship had to justify their existence by publishing and teaching in some other content area more traditionally accepted in the research community. However, since the mid-1990s,

Entrepreneurship has gained acceptance both as a class offering and as a research field. The earlier “undercover” status of entrepreneurship allowed professors to integrate entrepreneurship into other academic disciplines; the subsequent “justified” period has allowed for the formation of a critical mass of professors interested in small and new ventures, just at the time that students, consciously turning away from the “corporate ladder”, have increasingly demanded education in entrepreneurship.

As both job-seekers (students) and job creators (employers and organizations) have become more cognizant of the disparity between traditional business education and current business practice, both have begun to demand relevance and applicability from the providers of business education – the university-based business program. Increasingly, the parents of undergraduate students are asking how the business major will prepare their children for industry, rather than asking about the nature and quality of the liberal arts and general education programs.

In our university, the answer is that we employ frequent and content-rich interactions with our Dean’s Advisory Board to help us design curriculum which develops marketable skills in our business graduates. In addition, the members of the Dean’s Advisory Board help deliver the content by acting as guest speakers and clinical professors in our business courses. These industry leaders thus have the opportunity to design and deliver learning which addresses their own immediate employment needs, and the vehicle for ongoing and in-depth interaction with students who may one day join their organizations as employees!

In addition to the content changes driven by interaction with the Dean’s Advisory Board, the delivery method contrasts to the typical lecture-regurgitate model. In

many of our courses, faculty lecture about 30% of the available contact time in class. The balance of the time is spent in threaded discussion, group projects, and presentations. Students really learn a skill only when they have to put it into use to solve a problem, and when they have to teach somebody else how to do so. Thus, many of our courses force students to apply tools to ambiguous, messy problems. The student is a junior partner, the teacher as senior partner, and the team of four or five people moves the process along to fruition.

The materials supporting this process have moved away from the traditional college textbook. We are far more likely to use a combination of trade books, internet hotlinks, academic journal articles, and business periodical content to surround the learning process than using the traditional college textbook. The students benefit by using more current examples, fighting through greater ambiguity, and integrating disparate material for themselves. In addition, this combination saves the student money, forces professors to be more aware of current applications and trends, and provides greater stimulus for group learning, than can be found through using traditional textbooks.

This holistic approach to business education is further defined by using a “processes approach” to curriculum organization, creation and delivery. This approach provides several benefits:

- For the students, a consistent learning model or style for all materials and topics regardless of content, thus patterning student learning.

- A structure format for the discipline, within which all topics can be defined and related, and
- A format easily translated between academic and practitioner.

The “processes approach” provides the vehicle to

- Introduce the plethora of new entrepreneurial materials
- Integrate traditional business content, and
- Provide a format for non-traditional business topics from the soft sciences into a cohesive body of content-rich learning opportunities.

Topics new to business, those instigated by the entrepreneurial awakening include

- the process of obtaining money (understanding the various sources of capital at the startup level)
- the process of protecting ideas while promoting innovation
- the IPO process
- the franchising process
- the business valuation process (including the perception of financial need).

Those integrating traditional business content might include

- the Mergers & Acquisitions process
- considerations in the International Sales process
- the regulatory compliance process
- the process of Strategic alliances.



Those non-traditional business topics integrating soft sciences might include

- the process of team characteristics and selection
- the learning / training process
- the process of creating and maintaining a corporate culture
- incorporating moral / ethical values in all processes

While the choice of where to place each topic can be debated, the obvious accommodation of all topics, regardless of origin, to the “processes approach” is striking. Two points become clear. Learning / teaching can follow a common format, topics can be clearly delineated. The clear delineations provide easy visibility of the commonalities and overlaps. While the “processes approach” may appear to again be creating the “silo effect” of academia, it provides clear visibility of the inter-relationships between processes and at the same time allows clear definition and integration of new and existing processes.

All entrepreneurial content is structured using the traditional “who, what, when, why and how” logic of business practices. For example when dealing with the process of Innovation one provides both historical and future perspectives of the topic, motivates through discussions of significant innovations, categorizes levels of innovation, and provides motion to young entrepreneurs for creation and innovation as roads to personal success. Innovation is an excellent example of application of the processes approach, innovation can be learned by using processes. And, innovation represents one of those areas of traditional business interest, well grounded in soft-sciences and integral to the wonderful opportunities of entrepreneurship.

Much further developing is needed in structuring the many entrepreneurial topics in the processes format. The “processes approach” structure and definition provide a vehicle for the advancement of our discipline and for the general achievement of our educational objectives, passing on valuable content while providing tools for implementation.

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# RISING ABOVE PRINCIPLE: A TEACHING CASE

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## ABSTRACT

This is a case about overcoming obstacles to the sale of a small family business. The aging patriarch still maintains tight control over events. As the prospects for a sale grow more probable the employees become ever more concerned for their own futures and the owners learn that they have maneuvered themselves into a position that is strategically strong but ethically questionable. This case study describes the ethical and practical problems faced by the sons of the patriarch as they try to prevent the machinations of the employees from leading to a failure of the deal. Will they "rise above principle" in order to help get the deal done?

## INTRODUCTION

It is a most felicitous situation when one can prosper while helping others at the same time. Such is often the case in business, but it is also true that at times business transactions are, or are molded into, zero-sum games. In the case that follows, brothers Georg and Micah are faced with a business and moral dilemma concerning the sale of the family business known here as the Davir Corporation (all names are fictitious) because what should have been a win-win situation was turned into a win-lose proposition.

## BACKGROUND

The year is 2003. The father, Dov, an old school, hard-nosed businessman, owns the controlling shares of the firm which is located on the East Coast. Neither of his sons works full time in the firm anymore. In fact, Micah is primarily a writer and lives out in California while Georg is a teacher in the mid-west. To a great degree Micah is financially dependent on the firm. For Georg, the income he earns is important for his lifestyle but not critical. Another sibling who struggles with substance abuse and the care of a retarded child are also dependent on the firm. So too is Dov's estranged wife who is now in the early stages of senility and requires around-the-clock care.

A small staff consisting of Newell, Gus, Cammie and Ham oversees business operations. Newell is an attorney who has worked for the firm since 1991 after a period of working in large law firms "downtown." Gus and Cammie were hired in the 1980s and Ham dates back to the 1970s. Gus is blue collar, the operations manager/supervisor of work crews, Cammie is a secretary and Ham is the bookkeeper who emigrated from a central-American country many years ago.

In the mid-1990s Dov, then in the eightieth decade of his life, decided that he no longer wished to run the operations day-to-day. Actually, he had felt that way for some time but now was desperate enough to get "out from under" it all that he was seriously contemplating a move. The change was facilitated by the fact that an old and trusted friend, an executive in another industry, was retiring from that job and might be available. In the eyes of many, either Micah or Georg could have led the firm, but according to Dov Micah wanted to stay on the West Coast too

much of the time and could not run things properly from there. As for Georg, Dov stated that Georg was happy where he was and it would be wrong to ask him to relocate. For their parts both Georg and Micah felt that between them they could fashion a viable leadership system for the firm if given the opportunity. After all, they were both college graduates with graduate business education to their credit and many years of experience in the firm. In any event, Dov's old friend, Forest, agreed to assume the presidency. An affable former railroad man, he was readily accepted by all concerned and it was felt that with his experience and network he could be very helpful.

Davir Corporation owned and operated various types of real estate including a public parking lot adjacent to a professional sports stadium. It was the policy of Davir (or practically speaking, Dov) to avoid the nuts and bolts of operations insofar as possible. Thus the parking, like maintenance and repair, was leased out to others. Every three years or so bids would be solicited from various parking operators. Bids were basically based on the Davir Corporation getting a certain percentage of the gross receipts, somewhere around 30 to 35 per cent. The balance would go to the operator who would be responsible for licenses and fees, insurance, payroll and maintenance and all other related expenses, if any.

### **SLIPPERY SLOPE**

At this point in time, soon after Forest joined the firm, Gus and Newell began advancing a proposition that they be allowed to operate the parking directly as one of their duties in Davir, with a small raise. Raises had been meager lately, their families were growing, and they needed some extra income. They were convinced that they could oversee the parking as efficiently as any outsider could and it would be a win-win situation for all. But Dov would have none of it. He was concerned that the "boy's" focus would shift from the primary business to this other operation, and he didn't want the direct liability and payroll issues to impact the firm. The boys then proposed to create their own firm, staffed with an outside professional manager whom they would only oversee after hours (most stadium events were at night and on weekends anyway), and they would pay Davir fifty per cent of the proceeds. Neither Dov nor Forest liked the idea of the boys moonlighting or the possible conflict of interest. But on the other hand they could not ignore either the higher percentage to the firm or the argument that subcontracting the opportunity to a stranger would be unjust when Newell and Gus were ready to step in. Thus it was with some misgivings that they agreed finally to give the boys a chance with the understanding that if the parking began to interfere with their other work they would give it up. And so the Newgus Parking Company was formed.

Almost from the start the new arrangement exceeded expectations. Revenue to Davir almost doubled to nearly \$100,000 per year net of taxes, a significant figure for the family business whose total gross revenue was between two and three million dollars a year. At the same time the boys were doing much better. Their share covered their leased cars, cellular telephones and provided additional income as well, though they were very cagey about the amount. Dov became angry when he sensed that their income might be excessive, and when they began using hourly company employees (on their own time) to help with the parking. He complained that Gus and Newell had an undeserved windfall because the operation essentially managed itself while they skimmed the profits. When Gus and Newell began asking for raises again after several years Georg sat down with them and laid out Dov's concerns about the parking, hoping to get a good accounting of their actual income so he could intercede with Dov and get them a raise. Georg felt that once the air was cleared Dov would be more reasonable. However, Newell and Gus became very defensive, Gus even raising his voice before storming

out of the room. When he calmed down Gus approached Georg and volunteered to go over the income and expenses of Newgus with him.

### **DISSEMBLING**

Georg was relieved and eager to sit with the boys. Gus claimed not to have exact figures with him (which Georg took to be true) but could give Georg a rough accounting. Georg took notes as Gus began to roughly estimate the income and expenses for the last several years but unexpectedly stopped after about a half hour and exclaimed, "This is silly. We'll give a full accounting at the right time." Georg didn't understand this turn of events but in any event he felt he had enough data to work with. His MBA training had taught him that he didn't need perfect information to get a satisfactory understanding of a situation, and he was shocked when his analysis showed that the "boys" together were earning an extra one hundred fifty to two hundred thousand dollars annually from the parking, far more than the modest amount they were claiming. Georg still hoped to be able to keep the peace between Dov and the boys and did not begrudge them their profits (after all, the parent company was doing very well too), but he could no longer in good conscience fight for their raises.

The situation continued to fester for several more years, and then Georg had another shock related to the parking. Because of a certain other situation that arose, Newell, the lawyer, entered into discussions with Micah unknown to Georg or Dov about revising the Davir-Newgus parking contract to give them a virtually uncancellable lease with no expiration date. The rationale was that if something happened to disenfranchise Davir with respect to their other assets, at least the lease of the parking to a third party would survive. Newgus would then turn the lease over to the family at some point. When Micah asked Newell for a side letter about that, Newell convinced him as the company attorney that it was not a good idea as it could jeopardize the survival of the agreement if the letter ever came to light. To make matters even worse, Micah had apparently agreed to modify the lease at some point so that the area it encompassed was greatly expanded and covered virtually every piece of vacant land on the parcel near the stadium. Nothing further could be built on the land without the cooperation of Newgus.

### **CONFLICT OF INTEREST**

The way this all came to light was that a real estate developer became interested in buying out the Davir shareholders with plans to develop the property. In the course of their due diligence the existence of the Davir-Newgus agreement was exposed in its entirety. Dov was furious when he learned of the non-cancellation clause and apoplectic when he learned that the lease now covered all of the vacant land on the now very valuable twenty-plus acre parcel. He demanded that the boys give up their lease immediately so that negotiations could go forward, because as long as the property was encumbered by the parking lease the developers would not be interested in its purchase. But the boys were hesitant.

By now Dov had moved away and so Micah handled the direct discussions with Newell and Gus though the latter two continued to discuss other matters long distance with Dov. At this point Newell and Gus did not deny the verbal agreement in their discussions with Micah and promised that they would cancel the lease when the time came but, inasmuch as there was a chance that the buyers might pay them to get the lease it would be foolish to simply walk away. On the contrary, the buyers put Dov on notice that he would have to deliver the property free and clear and that any sums paid to get Newgus out of the picture would reduce the price they paid to Dov and the other shareholders. In a further act of duplicity, the income from the parking operation that Newell and Gus claimed to the prospective buyers was far greater the amount they had communicated to Micah and Georg.

Micah and Georg were at their wits end. The "boys" were going back on their promise to cancel when necessary. They said they had their families to think of, they had no company pensions, when the business was sold they would not even have health insurance, they had had no raises in years (they did not mention the yearly bonuses). Dov screamed to Micah and Georg that he would fire Newell and Gus if they did not cancel. But even if that were to happen the lease would still be in effect. Yes, the company could sue for breach of contract and might or might not win, the boys might sue for wrongful termination, and the only sure consequence would be that the property would be tied up in court for years and there would be no sale. Micah and Georg were eager for a buyout. It would change forever the fortunes of the family. Although there were other negotiating points, the parking was without question the biggest obstacle to the deal.

In order to keep things moving along Micah gave Dov assurances that the boys would sign over the lease "soon." But privately he knew that they were stonewalling. Micah and Georg "knew" that Dov would never pay the boys for the lease he thought they should not have had in the first place; his sons had seen Dov burden the company with too many expensive litigations in the past based on "principle." They saw a train wreck about to happen because Newell and Gus refused to accept Micah's and Georg's verbal promise of "just compensation" after the deal was consummated. They demanded severance packages in writing.

Micah and Georg began discussing between themselves and with the boys a secret severance package that they would guaranty from their own funds. Based on what Micah and Georg stood to earn, Gus and Newell would receive about 25% of their share, but as a percentage of the full deal it would have been only a couple of percent.. They all knew if Dov found out before the sale it would all fall apart. If he found out after the fact it would be too late for him to do anything about it but he would lose all respect for his sons. They did not want that, nor did they like the idea of being "blackmailed" or deceiving their father.

### **CONCLUSION**

Georg and Micah found themselves on the horns of a moral and a business dilemma. It was in the best interests of everyone in the family to sell the business and move on with their lives. If the sale fell through the business might not survive for long and Dov would spend his few remaining years struggling with it instead of enjoying himself. The same situation existed to a greater or lesser extent for all the family members. Besides that, Gus and Newell had been invaluable to the firm many times over the years, sometimes even courageous. They had been abused verbally and emotionally by Dov. But they had also been slackers, often working far under their potential. At one time Georg had to resort to disabling a computer game they were playing during business hours to get them to focus on their work. Georg and Micah harbored ambivalent feelings about Gus and Newell and about the personal "hit" they would have to take.

### **QUESTIONS**

1. What should Micah and Georg do? Should they "rise above principle" and agree to the "blackmail" of Gus and Newell for everyone's sake including Dov's? In doing so Micah and Georg know they will be going against their father's wishes even if it was in his best interest. But Dov was not the only stakeholder -- other family members are counting on the sale going through. And it is easy to rationalize that Newell and Gus deserve something after all these years. On the other hand, they were deceitful and disingenuous in their dealings with Micah and deserve to be punished. Besides, they could be only bluffing.
2. Should Micah and Georg tell Dov what is really going on? It will probably kill the deal if he finds out. Yet Dov has lots of negotiating experience and it is, after all, his business. He



founded it, and he built it. One moral right is the right to informed consent. Does Dov have the right to know about this private deal between his sons and the "boys"? Perhaps not, after all, Micah and Georg will pay with their money, not Dov's.

### **EPILOGUE**

Micah and Dov decided to meet Newell and Gus's demands. They had their lawyer draw up the papers and worked with their accountants as well to try to minimize the tax consequences. One stipulation was that the money would have to be returned if Dov learned of the deal because of something Gus or Newell did. Dov gave each of the boys a bonus of fifty thousand dollars, a miniscule fraction of the family's gain from the sale of the firm. He continued to resent the "games" they played related to the parking deal. Newell called Micah to thank him after the money was wired to his attorney and praised his honor and "menschlichkeit." He tried calling Georg and left word twice. The calls were never returned.

# FELT FAIR PAY OF SMALL TO MEDIUM SIZED ENTERPRISE (SME) OWNERS IN FINLAND AND LATVIA: AN EXAMINATION OF JAKUES' EQUITY CONSTRUCT

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This study tests a portion of Jaques' theory of equitable payment, using two samples of small to medium sized business owners in Finland and Latvia. Results support Jaques' proposition about who would be satisfied with their pay level and who would be dissatisfied.

## INTRODUCTION

Compensation has long been a topic of interest to employees and employers alike. In fact, the use of compensation as a motivator has been traced to antiquity (Peach & Wren, 1992). The concept of an employment relationship implies that employees work in exchange for some reward, and this reward is often monetary compensation (Brockner, 2002). Thus, pay satisfaction has emerged as a popular variable for use in organizational research (for reviews, see Carraher, Buckley, & Carraher, 2002; Heneman, 1985; Heneman & Schwab, 1979; Lawler, 1971, 1981; Miceli & Lane, 1991; Rynes & Gerhart, 2003). Pay satisfaction exhibits significant relationships with organizationally important outcomes such as absenteeism (Weiner, 1980), turnover intentions (Griffeth & Gaertner, 2001), perceived organizational attractiveness for job seekers (Heneman & Berkley, 1999) organizational citizenship behaviors (Lambert, 2000), and job performance (Mulvey, LeBlanc, Heneman, & McInerney, 2002; Werner & Mero, 1999).

As noted by Rice, Phillips, and McFarlin (1990), one of the most intriguing findings with respect to pay satisfaction is the modest strength of the relationship between how much an individual is actually paid and that individual's pay satisfaction. Although this relationship typically has been positive and statistically significant, it has generally explained well under 25% of the variance in pay satisfaction. These findings have led others to examine the prediction of pay satisfaction based upon multiple discrepancies or multiple monetary standards of comparison for the individual employee (Law & Wong, 1998), and demographic and psychological variables (Berkowitz, Fraser, Treasure, & Cochran, 1987; Carraher & Buckley, 1995).

Scholars have noted that comparatively little research advances models of pay and their predictors (Cox, 2000; Heneman, 1985; Miceli & Lane, 1991; Rynes & Gerhart, 2003; Shaw & Gupta, 2001; Williams & Brower, 1996). This could be due to the assertions of some researchers that it is clearly "too early to offer a precise theoretical model of the determinants of income satisfaction" (Berkowitz et al., 1987, p. 546), yet such model development is still needed (Shaw & Gupta, 2001). Heneman's (1985) review of the pay-satisfaction literature discussed two major models of pay satisfaction: the equity model of Adams (1965) and the discrepancy model of Lawler (1971). A third model, the theory of equitable payment developed by Jaques (1961, 1964) in the United Kingdom, has generally been overlooked by theorists due to difficulties in measuring some of its concepts (Belcher, 1974; Hellriegel & French, 1969) but is making a comeback (Allison & Morfitt, 1996; Brookes, 1994; Carraher, Carraher, & Whitely, 2003; Lip-Bluman & Leavitt, 1999) and it may be useful in the examination of the antecedents of satisfaction with pay. Both Adams (1965) and Lawler (1971) also cited Jaques' work in their own.

Jaques' theory of equitable payment (1961, 1964) postulates that individuals have an intuitive knowledge of: (1) their capacity for work, (2) the level of their work in terms of responsibility and performance, and (3) the appropriateness of their pay. Further, with respect to individual capacity to work, Jaques has hypothesized that capacities for work develop in regular and predictable patterns over time; that it is necessary that one work in a role equivalent to one's capacity for work in order for him or her to experience psychological equilibrium in their job and with their pay; and that employees seek jobs that will match their level of work with their current capacity for work. He also postulates that one's level of work can be measured by determining an individual's time-span of discretion with respect to decision making on the job, and that an individual's perception of being fairly paid for a certain level of work can be successfully measured either directly or by examining their time-span of discretion and current capacity for work (Jaques, 1964). Unfortunately, although Jaques (1961, 1962; 1964; 1968; 1970), Richardson (1971), and Allison and Morfitt (1996) have reported success at measuring both time-span of discretion and felt fair pay, others have not found these concepts easy to measure (Hellriegel & French, 1969) and, therefore, the application of Jaques' work has been limited (Belcher, 1974). Most of the work on, and problems encountered with, Jaques' theory have focused on the time-span of discretion construct (for examples, see Brookes, 1994; Bushe & Havlovic, 1996; Gordon, 1969; Milkovich & Campbell, 1972; Nystrom, 1973; Wintermans, 1994) while in the current study felt fair pay is assessed directly.

When addressing issues of equity, particularly felt fair pay, Jaques (1961) believed that unrecognized norms of fair pay existed for any given level of work and therefore he postulated that if actual salary were not less than 90% or greater than 120% of deserved salary (as perceived by the individual), then equity would be experienced. As with Adams equity theory, Jaques believed that the greater the discrepancy between felt fair pay and actual pay, the stronger would be the psychological disequilibrium. Richardson (1971) reported high correlations between time-span of discretion and felt fair pay ( $r = .86$ ,  $n = 180$ ).

The present study addresses the question: 1. Does Jaques' equity construct accurately predict who will be satisfied and who will be dissatisfied with their pay levels among business owners in Finland and Latvia?

## **Method**

### Measures

Pay Satisfaction. The measure of pay satisfaction used was the "pay level" sub-scale of the Pay Satisfaction Questionnaire that contains four items (Heneman & Schwab, 1985). These items are rated on a 5-point Likert-like scale with scale anchor points from 1 (very dissatisfied) to 5 (very satisfied). Ash, Dreher, and Bretz (1987) report a one-month test-retest reliability estimate of .73 for this scale. The coefficient alphas for these two samples indicate high levels of internal consistency with alphas equal to .978 for sample 1 and .982 for sample 2.

Equity. The measure of Jaques' equity construct of felt fair pay comes from Jaques (1961) - although it has been adapted for assessment by survey questionnaire rather than assessment through face-to-face interview as has generally been done by Jaques and his associates. The actual measure is the fraction of (actual salary - deserved salary) / deserved salary. Jaques does agree that this is a good measure of his felt fair pay construct (personal communications, Sept. 1996; August 2002). Dividing the discrepancy by deserved salary serves to standardize the

measure, which was suggested by Jaques (1961) and Katzell (1964) and was based on Weber's Law. It is important that the information for Jaques' felt fair pay construct be collected within a social-analytic relationship (Amado, 1995; Jaques, 1962; 1961). In other words, information should be kept confidential, no executive action should be taken as a result of the data collection, and the participants should not be pressured to participate in the assessments. The violation of any of these requirements can result in respondents not providing accurate information (Jaques, 1962).

### Samples

This article reports on data from two samples. The first sample consisted of 182 owners of small to medium sized businesses in Finland; 119 (65.4%) were males. On average, they were 41.2 years of age and received an annual income of \$88,802 from their organization. The second sample consisted of 210 owners of small to medium sized businesses in Latvia; 138 (65.7%) were males. On average, they were 34.07 years of age and received an average annual salary of \$77,410 from their organization.

### **Results**

In order to ascertain whether Jaques' equity proposition concerning who will be satisfied and who will be dissatisfied is correct, the samples were each split into two groups. One group consisted of those people who believed that they were paid between 90% and 120% of what they actually deserved (the "satisfied" group) whereas the other group consisted of those people who were paid less than 90% or more than 120% of what they thought they deserved (the "dissatisfied" group). No person in these samples felt that they were overpaid according to the 120% parameter, so all "dissatisfied" individuals felt underpaid here. Two *t* tests were then performed between the two groups, yielding the results of *t* values of 17.96 for Finland and 17.07 for Latvia. Results from both samples are significant beyond the .0000001 level, so it appears that Jaques' proposition does accurately predict different degrees of satisfaction with pay levels. Additionally, in order to examine the likelihood that these findings were due to common method bias, Harman's one-factor (1967) test was performed on the full, 18-item PSQ for each of the samples and found that in no case was a one-factor solution deemed to be optimal. With Harman's one-factor test all variables under examination are entered in to an exploratory factor analysis. It is assumed that if only one factor emerges from the unrotated factor solution that it is reasonably likely that common method bias may be the primary source of systematic variance observed within a data set. Conversely, the greater the number of dimensions extracted, the less likely that common method bias is the source of systematic variance within a data set (Podsakoff & Organ, 1986). The eigenvalue greater than one criterion indicated that three to four dimensions were appropriate for each sample, thus indicating that it is unlikely that common method bias is causing the observed results.

To examine the predictive ability of the measure, two hierarchical multiple-regression analyses were performed using the data. Three steps were involved in each of the multiple regressions. The first step entered the demographic variables of gender and age as suggested by Rice et al. (1990). The second step entered actual salary, as Heneman (1985) has prescribed that actual salary should always be controlled when testing models of pay satisfaction. The third step entered felt fair pay. Results of these analyses appear in the table.

Table

Multiple Regressions Comparing Felt Fair Pay in Finland and Latvia as Predictors of Pay Satisfaction (PSQ)

| Predictor |                    | $R^2$ | $\Delta R^2$ |
|-----------|--------------------|-------|--------------|
| Step 1    | Demographics       | .117  | .117***      |
| Step 2    | Actual salary      | .203  | .086**       |
| Step 3    | Workplace-referent | .639  | .436***      |
| Step 1    | Demographics       | .144  | .144***      |
| Step 2    | Actual salary      | .235  | .091***      |
| Step 3    | Workplace-referent | .584  | .349***      |

\*\*  $p < .01$ .      \*\*\*  $p < .001$ .

N's = 182 Business Owners from Finland and 210 from Latvia.

In general, these findings provide strong support for the assertion that felt fair pay does an excellent job of predicting pay satisfaction in both Finland and Latvia with the owners of small to medium sized businesses, with the contribution of each being significant beyond the .001 level.

### Discussion

Results from two samples of the owners of small to medium sized businesses indicate that Jaques' (1961, 1964) construct of felt fair pay deserves more attention from researchers. Jaques' construct accurately predicted who would be satisfied and who would be dissatisfied with their pay levels. Jaques' construct appears to be an excellent predictor of pay satisfaction. Past thinking about pay satisfaction (for instance, Heneman, 1985; Rice et al., 1990) might lead one to expect that actual salary would serve as a strong predictor of pay satisfaction. However, multivariate analyses revealed that Jaques' measure explained more of the variance in pay satisfaction than did their actual salaries.

The findings of this study suggest at least three veins for future research. The first vein could examine what variables might influence the relationship between salary and pay satisfaction. For

instance Rice et al found that salary level could explain 25% of the variance in pay satisfaction while in the current samples salary levels could explain 17 to 19 % of the variance in pay satisfaction and Carraher and Buckley (1996) found no relationship between salary and pay satisfaction (  $r$ 's = .01, .00, & .01). Some possible variables to examine include the use of family income rather than personal salary, reasons for working (economic vs. non-economic; Carraher et al. 2003), number of levels of organizational hierarchy included in the sample (Jaques, 1962; 1996), and various demographic differences within samples, such as gender composition, age, and educational attainment (Carraher & Buckley, 1995; Miceli & Mulvey, 2000). The relationships may also differ between owners and employees of small to medium sized employees.

A second vein for research would focus on examining how similar or different the results found here might be across cultures (Carraher, 2003; Carraher et al. 2003). For instance in the current study the two samples were carefully chosen so that they be from similar cultures with the business owners doing similar work. How might the results be different - or similar - if Chinese, South Korean, Japanese, or Mexican samples were added (Eshima, 2003; Zapalska & Edwards, 2001)?

A third vein for research could involve examining Jaques' equity construct in other domains. Initially, this study should be replicated with other samples. Next, Jaques' general theory could be tested for applicability with dependent variables such as general job satisfaction, satisfaction with benefits, and perceptions of the fairness of organizational pay systems. Finally, it might be possible to extend Jaques' theories beyond felt fair pay and examine the concepts of felt fair benefits and felt fair raises (Carraher, Hart, & Carraher, 2003; Heneman & Schwab, 1985).

In summary, this study has used two samples of business owners in order to examine the efficacy of Jaques' felt fair pay construct as it relates to pay satisfaction. It appears that felt fair pay is strongly related to pay satisfaction for these samples from Austria and Germany. Based upon these findings it appears that Jaques' construct of felt fair pay merits inclusion in future studies of pay satisfaction among business owners and additional research is suggested.

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# **The Venture Development Processes of “Sustainable” Entrepreneurs**

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## **ABSTRACT**

This paper examines the venture development processes of “sustainable” entrepreneurs, i.e., entrepreneurs who create and build profitable companies that also pursue environmental or social causes. We identified 21 successful sustainable entrepreneurs in various industries ranging from food, apparel to biotechnology and analyzed their strategies and decisions in key stages of their companies’ development. Our research finds that sustainable entrepreneurs approach business differently, from venture initiation through their eventual exit. We learn that most of our sustainable entrepreneurs are an unusual breed with unconventional backgrounds, strategically obtain financing from non-professional sources and employ unorthodox, yet sound human resource management practices. They are also shrewd in their marketing strategies and effective in running efficient, environmentally sound operations. Finally, we observe that our sustainable entrepreneurs steadily find innovative means for balancing their financial goals against their objectives of making a difference in their environment and society.

## INTRODUCTION

This study examines the venture development processes of “sustainable” entrepreneurs, i.e., entrepreneurs renowned for their efforts and achievements toward “sustainability”. Sustainable development was initially defined as “development that meets the needs of the present without compromising the ability of the future generation to meet their needs” (World Commission on Environment and Development, 1987). Over time, sustainability, as it has come to be called, has become a multidimensional concept that encompasses not just environmental protection but also extends to economic development and social equity (Gladwin, et. al., 1995). In our view, successful sustainable entrepreneurs not only create profitable enterprises but also achieve certain social and/or environmental objectives. They balance multiple objectives effectively and are successful in meeting the “triple bottom-line”, i.e., their economic, environmental and social objectives.

Most academics and practioners would suggest that balancing multiple objectives is forbiddingly difficult because of the harsh realities of the marketplace. Evidence shows otherwise. We have identified 21 such high-profiled entrepreneurs in various industries, ranging from food and personal products to biotechnology, who had delivered strong triple bottom-line results year after year. These include such reputable companies such as Patagonia, The Body Shop, Stonyfield Farm, Interface Carpets, and many other entities illustrated in this research. They show that it is possible to meet multiple objectives simultaneously when they employ the right strategies and processes. In some cases, sustainable identity provided companies with a competitive advantage.

Very little formal research has been conducted in the area of sustainable entrepreneurship. One exception is the area of “social entrepreneurship”, being examined in the non-profit management or public sector management publications. Most of this literature, however, deals with the initiation of non-profit organizations and agencies to handle the problems of social welfare. Exceptions are some case studies and books on a particular entrepreneur or entrepreneurial business. These include Cohen, Greenfield and Maran (1997) who write about their own venture Ben & Jerry’s and Roddick (2001) who wrote about her entrepreneurial experiences with The Body Shop. We are only aware of Gray & Balmer (2004) that attempts to generalize findings from multiple entrepreneurs. It identifies 12 commonalities from an examination of 5 sustainable companies.

Our research brings to light the accomplishments of numerous sustainable entrepreneurs who offer a different model of entrepreneurial pursuits. We develop useful insights into their venture development process by rigorously studying the methods by which the founders initiated, grew and built their companies. We specifically examine how they:

- Identified and evaluated their business opportunities
- Arranged the financing of their unconventional ventures
- Launched and grew their businesses in the face of harsh market realities
- Established cultures that reflected their values and strengthened their organizations
- Leveraged their social identity to create a strong brand and a profitable operation
- Balanced their idealism with issues of growth (and other business requirements)
- Harvested their successes in financial and social terms

## METHODOLOGY

Through various literature searches and personal referrals, we were able to collect a list of small and large companies that were exemplary in their pursuit for sustainability. These were companies that were effective or showed significant progress toward meeting *triple* (economic, environment, and social) or at least *dual* (economic and environment, or economic and social) bottom-lines.

Specifically, we looked for companies that were

- Profitable or had several years of profitability
- Effective in making progress toward their social or environmental causes
- Founded and operated by entrepreneurs who either had sustainable values from the very beginning or adopted them while being leaders of their companies
- Diverse, i.e., different in size, stage of development, and nature of business (industry)

We narrowed down our list to 21 entrepreneurial companies that were effective in their pursuit for sustainability. Our list shown in Table 1 includes some of the most widely recognized companies, such as The Body Shop, as well as other smaller but equally innovative ventures, e.g., Chris King Precision Components and Iggy's Bread of the World. Our list is by no means comprehensive. We have attempted to collect a diverse group of interesting companies that we could learn from.

TABLE 1: SUSTAINABLE COMPANIES

| Company                   | Main Business Area              | HQ Location |
|---------------------------|---------------------------------|-------------|
| AgraQuest                 | Natural pest management         | CA          |
| Ben & Jerry's             | Ice cream                       | VT          |
| The Body Shop             | Natural skin care product       | UK          |
| Berkeley Mills            | Furniture                       | CA          |
| Chris King                | Bicycle components              | OR          |
| Eileen Fisher Clothing    | Comfortable clothing            | NY          |
| Explore Inc.              | After-school day care           | MD          |
| Green Mountain Energy     | Cleaner energy                  | VT          |
| Iggy's Bread of the World | Bakery                          | MA          |
| Interface Carpets         | Floor covering                  | GA          |
| Just Desserts             | Desserts                        | CA          |
| Magic Johnson Enterprises | Real estate                     | CA          |
| Migros                    | Food retail                     | CH          |
| Newman's Own              | Salad dressing                  | CT          |
| Patagonia                 | Outdoor clothing                | CA          |
| Rhythm & Hues             | Entertainment (Special effects) | CA          |
| Seventh Generation        | Household products              | VT          |
| Stonyfield Farm           | Organic yogurt                  | NH          |
| Tom's of Maine            | Personal care products          | ME          |
| White Dog Cafe            | Restaurant                      | PA          |

In an effort to understand how our sustainable entrepreneurs initiated, grew and built their companies, we examined their key decisions and activities in their “entrepreneurial processes”, as described in Baron & Shane (2003) and Morris et al. (2001). We customized the framework slightly to better address the special nature of sustainable ventures. As shown in Figure 1, we organized the entrepreneurial processes in 5 major stages (and 11 activities, e.g., financing), starting with Recognition of an Opportunity and ending with Harvesting the Business.

We collected most of the relevant information from published materials such as printed case studies and books on the companies in addition to newspaper articles and company websites. A number of the case studies had been developed by the authors for use in their courses. Whenever feasible, we interviewed the entrepreneurs and their employees to supplement our research. The next section summarizes our findings for each of the 5 major stages.



Figure 1. Venture Development Process (Entrepreneurial Process)

## RESULTS

In this abbreviated version, we discuss several of the most interesting commonalities only.

### *A. Recognition of an Opportunity*

Backgrounds of entrepreneurs: Table 2 describes the backgrounds of several entrepreneurs representative of our larger sample. We find that most entrepreneurs in our sample had little relevant business experience or formal business education. Paul Newman, whose company Newman's Own now has annual revenues over \$100 million, was an (Oscar-winning) actor. Gary Hirschberg of Stonyfield Farm with over \$50 million annual revenue was an educator and environmental activist before founding his company. Anita Roddick of The Body Shop had no business or cosmetics experience before founding The Body Shop. Most, though not all, exhibited some sense of social or environmental consciousness before pursuing their entrepreneurial business careers. Anita Roddick had been interested in issues of Third World women's rights and had worked for the United Nations International Labor Organization. Elliot Hoffman and Gail Horvath of Just Desserts were self-claimed hippies.

TABLE 2: SAMPLE BACKGROUNDS OF ENTREPRENEURS

| Company   | Backgrounds |          |       | Professional Backgrounds                         |
|---|-------------|----------|-------|--|
|   | Business    | Activist | Other |  |
| Ben & Jerry's<br>(Ben Cohen, Jerry Greenfield)  |             |          | X     | Potter (Ben), medical doctor<br>drop-out (Jerry) |
| The Body Shop<br>(Anita Roddick)                |             | X        | X     | Library researcher, housewife                    |
| Just Desserts<br>(Elliot Hoffman, Gail Horvath) |             | x        | x     | Hippies from the Haight-Ashbury<br>Scene         |
| Magic Johnson Enterprises<br>(Earvin Johnson)   |             |          | X     | Professional basketball player                   |
| Newman's Own<br>(Paul Newman)                   |             | x        | X     | Actor , racer                                    |

|                                      |   |                        |
|--------------------------------------|---|------------------------|
| Stoneyfield Farm<br>(Gary Hirshberg) | X | Environmental activist |
|--------------------------------------|---|------------------------|

X: Strong background x: some background

Primary reason for venture initiation: For the majority of our sustainable entrepreneurs the primary motivation for starting their companies was rather modest – to make a living – not necessarily to generate great wealth or change the world. As described in Table 3, Anita Roddick started her retail shop after her husband decided to travel across the Americas on a horse back. Pamela Marrone of Agraquest found herself without a job when her employer was acquired, which motivated her to consider entrepreneurship. Judy Wicks started her restaurant out of her home primarily to make a living after the restaurant she worked for had closed.

TABLE 3: SAMPLE PRIMARY REASONS FOR VENTURE INITIATION

| Company  | Motivation |        |       | Description   |
|--|------------|--------|-------|---|
|  | Income     | Wealth | Cause |   |
| Ben & Jerry's<br>(Ben Cohen, Jerry Greenfield) | X          |        | x     | Being a potter had not worked out for Ben and being a doctor had not worked out for Jerry. So they wanted to go into a food business. |
| The Body Shop<br>(Anita Roddick)               | X          |        | x     | Opened retail shop to support the family while her husband went to ride a horse for 2 years.  |
| Newman's Own<br>(Paul Newman)                  |            |        | X     | Wanted to sell a healthy product and give the entire profits to charity.  |
| Stoneyfield Farm<br>(Samuel Kaymen)            | x          |        | X     | Began the company primarily as a vehicle to help fund Kaymen's Rural Education Center.  |
| White Dog Café<br>(Judy Wicks)                 | X          |        |       | Started the business primarily to make a living after the restaurant she worked for had closed.                                       |

X: Strong motivation x: some motivation

It is noteworthy that some business ideas originated from the founders' drive to make a difference. The idea for Berkeley Mills began from a vision to forge a realistic harmony between a woodworker's livelihood and forest preservation. John Hughes founded Rhythm & Hues to offer a unique work environment for entertainment professionals – very unusual for a very harsh industry. Earvin Johnson wanted to revitalize the inner cities through his venture.

*B. Assembling the Resources - Financing sources:* We examine the means by which the sustainable entrepreneurs obtained their initial financial resources. The source or method of financing is particularly important for sustainable companies it can have a big impact on how the companies are managed and controlled. Table 4 describes the financing sources of a sample of our companies. We find that most of the companies bootstrapped, i.e., started with very little seed financing and managed through tight cost control. For example, Tom's of Maine started with a loan of \$5,000 from a friend, while Just Desserts founders sold off their VW Bug to purchase a mixer. Most obtained some financial assistance from family and friends, and very few received equity financing from professional investors.

TABLE 4: SAMPLE FINANCING SOURCES

| Company       | Sources    |                 |      |          | Description                 |
|---------------|------------|-----------------|------|----------|-----------------------------|
|               | Boot-strap | Friend & Family | Bank | Investor |                             |
| The Body Shop | X          |                 | X    |          | £ 4,000 loan from the bank. |

|                           |   |   |  |
|---------------------------|---|---|--|
| Eileen Fisher Clothing    | X | X | Borrowed from friends to buy fabric, often at 2% interest per month. |
| Encore, Inc.              |   |   | X \$5 M from private individuals.                                    |
| Just Desserts             | X |   | Sold their VW Bug to buy a mixer.                                    |
| Magic Johnson Enterprises |   |   | X Convinced Sony to co-invest.                                       |
| Tom's of Maine            | X | X | \$5,000 loan from a friend.  |
| White Dog Cafe            | X | X | \$75,000 loan from a friend.   |

*C. Launching the Venture - Marketing and branding:* From early on, our sustainable entrepreneurs developed a sound marketing strategy leveraging the high quality of their products and their stance on the environment and social issues. All of the companies in our list positioned themselves as producers of high quality products or services. Customers, however, bought the companies' products not only because of their quality, but also because they liked what the companies stood for. Newman's Own admitted to "shamelessly exploiting" their celebrity status and its social message for a greater good (Newman & Hotchner, 2003). White Dog Café also learned that combining entertainment with social message could be good business. Judy Wicks of White Dog Café noted, "The more I get into expressing what I believe in and care about, the more popular we have been" (Hollender & Fenichell, 2004). See Table 5 for sample marketing and branding strategies.

TABLE 5: SAMPLE MARKETING & BRANDING STRATEGIES

| Companies          | Marketing & Branding Strategies   |
|--------------------|---|
| Ben & Jerry's      | Used their ice cream containers as protest ads against nuclear energy and the cold war.   |
| Newman's Own       | Decided to "shamelessly exploit" their celebrity status for a greater good.   |
| Seventh Generation | Provided information for consumers to make informed choices. Packaging explained the difference between post and pre-consumer materials, e.g., why avoiding chlorine is critical etc. |
| Tom's of Maine     | Always listed all ingredients on the packaging along with the source of the ingredients and an explanation of their purpose.  |
| White Dog Cafe     | Combined entertainment with a social message.   |

*D. Managing the Growth- Building the culture:*

Most of the sustainable entrepreneurs we analyzed prided themselves for having created a strong organizational culture that in return supported the growth of their companies. Most organizations reflected the entrepreneurs' unconventionally strong, genuine concern for the well-being of their employees. Many offered employee benefits that far exceed their industry standard. Rhythm & Hues offered its artists 9 weeks of paid time off per year, unheard of in the entertainment industry. In a dramatic move, Chris King relocated his entire company from California to Portland, Oregon, when he realized that his employees could not afford to live near work and were driving long distances everyday. Its corporate cafeteria, staffed by a professional chef, offered some of the best food in the area, thereby encouraging employees to spend time together over meals (Choi, 2004a). Tom's of Maine eliminated elongated conference tables to emphasize equality and encourage everyone to contribute ideas. Table 6 lists several examples of such efforts.

TABLE 6: SAMPLE CULTURE BUILDING EFFORTS

| Companies  | Sample Practices for Building the Culture  |
|------------|--|
| Chris King | Relocated to Portland, Oregon so that its employees could afford housing.<br>Offers café credit for every day they ride their bicycle, carpool or walk to work.<br>The café serves some of the best food in the area, providing a chance for |

|                           |   |
|---------------------------|---|
|                           | employees to all hang around together.  |
| Iggy's Bread of the World | Offers English classes to foreign employees, free acupuncture for employees who quit smoking, and free massages to all employees. Brings workers together through soccer matches. |
| Patagonia                 | A pioneer in on-site childcare program, opening its Great Pacific Child Development Center in 1984.   |
| Rhythm & Hues             | Offers its artists 9 weeks of Paid Time Off per year. All employees are eligible for a 2 months sabbatical after 5 years of employment.   |

#### *D. Harvesting the Business*

**Exit Strategies:** Sustainable entrepreneurs employed a different thought process when it came to harvesting their businesses, as described in Table 7. They took into consideration not just their financial gain, but how their exit would impact their businesses, stakeholders, and their long-fought causes. Patagonia founder Yvon Chouinard considered selling the company and setting up a foundation to give away money to environmental causes (Gray, 2003b). After months of soul searching, he decided to keep running the company and not to exit. He concluded that the money barely made a dent in the world's problems and that the greatest good he could do was to develop Patagonia as an exemplar for other companies to emulate. Stonyfield Farm founders sold their business to Danone with the objective to "infect the conglomerate with organic bug".

TABLE 7: SAMPLE EXIT STRATEGIES

| Company            | Sample Exit Strategies  |
|--------------------|---|
| Ben & Jerry's      | Sold to Unilever in 2000 with conditions of how the company would be operated.                                      |
| Patagonia          | Founder has retired from the company daily operations but still owns majority of the company.                       |
| Stonyfield Farm    | Sold 40% to Danone, a socially responsible company, with the objective to infect Group Danone with the organic bug. |
| Tom's of Maine     | Founders felt that they could not sell their business without compromising their own values.                        |
| Seventh Generation | IPO'd in 1994 and then became private in 1995.  |

**Giving Programs:** Another form of harvesting that sustainable companies engaged in was their institutional giving programs as shown in Table 8. As early as 1985, Ben & Jerry's established a foundation to formalize the company's donation processes; the firm's annual contribution to the foundation was 7.5% pre-tax profits. Stonyfield Farm created a "Profits for the Planet" program under which the company donated 10% of pretax profits annually to organizations and projects that served to protect and restore the environment. Newman's Own, organized as a non-profit company, has given away more than \$150 million. Magic Johnson Foundation raised more than \$20 million for charity and helped send more than 3,000 students to college.

TABLE 8: SAMPLE GIVING PROGRAMS

| Companies                 | Description of Sample Giving Programs  |
|---------------------------|--|
| Magic Johnson Enterprises | Has raised more than \$20 million for charity and helped send more than 3,000 students to college.                                   |
| Newman's Own              | Has given more than \$150 million to charities, such as the Cystic Fibrosis Foundation as well as many obscure little organizations. |
| Patagonia                 | Funds its programs through its "Earth Tax" a yearly levy of 1% on sales or 10% of pre-tax profit, whichever is greater.              |
| Tom's of Maine            | Gives 10% of its pre-tax to non-profit organizations. Awards 40-50 grants  |



## CONCLUSION

This research should demystify and educate aspiring entrepreneurs about how ventures can simultaneously meet economic, social and environmental objectives. The objective of our research is to inspire as well as provide useful management guidelines. Our hope is that more values-driven individuals in the future will choose entrepreneurship as a vehicle for self-expression and social contribution. We believe that our finding can serve as a preliminary model – that hopefully can be refined and improved – that aspiring sustainability-oriented entrepreneurs can use as a partial guide in the development of their companies.

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# **GENDER DIFFERENCE AND THE FORMATION OF ENTREPRENEURIAL SELF-EFFICACY**

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## **ABSTRACT**

Data from participants of a computer venture strategy simulation indicate that men report significantly higher levels of entrepreneurial self-efficacy versus women. Perceived financial knowledge exerts a significant, positive impact on entrepreneurial self-efficacy for all subjects. However, the level of education interacts with gender in affecting entrepreneurial self-efficacy. For women, the level of education exerts a significant positive effect of self-efficacy to act entrepreneurially. This relationship was not present in men. Implications of the research, limitations and suggestions for future research are offered.

## **INTRODUCTION**

Women-owned ventures are increasingly becoming significant for the US economy, yet studies regarding factors relevant for the growth and success of these businesses are rare. Women entrepreneurs are generally suggested to have characteristics somewhat different from their male counterparts. Besides several unique individual characteristics, researchers propose that women's self-confidence of being an entrepreneur is less than men's.

Self-efficacy is one's confidence in performing a specific task is an important topic for entrepreneurship. Research suggests that self-efficacy helps develop both entrepreneurial intentions and actions. In addition, individual perception of business knowledge and financial knowledge help build entrepreneurial self-confidence.

Hence, the contribution of this study is based on the tenet that self-efficacy is vital in nurturing entrepreneurial motivation among prospective entrepreneurs. Data from 67 undergraduate and graduate students were used to examine gender difference of forming entrepreneurial self-efficacy formation. We then provide a discussion of the findings and implications for future research and practice.

### **Women in Entrepreneurship and Self-efficacy**

In today's business environment, the entrepreneurship sector is viewed as a significant for economic growth. However, the history of entrepreneurship research is mainly based on

evidence of male entrepreneurs (Birley, 1989). In reality, women entrepreneurs are increasingly becoming significant contributors to the entrepreneurial growth around the world. Hisrich and his associates (2004) point out the latest data of the Census Bureau and the Small Business Administration's office of Advocacy to show the growth and importance of women owned businesses. While women entrepreneurial activities play an important role, research suggest that women entrepreneurs have less self-confidence than their male counterparts (Hisrich, 1986).

Research also suggests that self-efficacy play a significant role in entrepreneurship (Boyd and Vozikis, 1994; Markman, Balkin, and Baron, 2002). Self-efficacy is defined as one's level of confidence in performing a specific task and is the central cognitive motivator predicting behavior (Bandura, 1997). Many empirical studies have found a positive relationship between self-efficacy and entrepreneurial action (Chen, Green, and Crick, 1998; Markman, et al., 2002; Bradley and Roberts, 2004).

Given the above discussion, the current study contributes to the entrepreneurship literature by studying gender difference in self-efficacy formation. While there are many similarities between male and female entrepreneurs, previous research has suggested some important differences. Specifically, female entrepreneurs are suggested to be different from their male counterpart in terms of age, educational background, financial skills, and more importantly in terms of self-efficacy. Hence, this study intends to test the following hypotheses:

Hypothesis 1: Aspiring businessmen and businesswomen differ in terms of age, education, financial skills, and entrepreneurial self-efficacy.

Hypothesis 2: Level of education is positively related to the entrepreneurial self-efficacy.

Hypothesis 3: Perceived financial knowledge is positively related to the entrepreneurial self-efficacy.

Hypothesis 4: The relationship between education level and entrepreneurial self-efficacy differ based on gender.

## **METHOD**

### **Sample and Data Collection**

Undergraduate and graduate business students in their final semester before graduating were used as subjects for data collection. These students were enrolled in the undergraduate and graduate capstone courses that required participation in a business simulation. Students were required make decisions as entrepreneurs to start and grow a business. This simulation was major a project requiring students to work throughout the semester (sixteen weeks) and contributed heavily towards their grade. A total of sixty seven students were involved in the study. After students had spent three weeks practicing the simulation, a survey was administered to collect data on individual background and entrepreneurial self-efficacy measures.

#### **Measures**

The variables in this study were operationalized based on the current literature using established measurement instruments. Based on Bandura's (1982; 1997) suggestion, self-efficacy was

measured by assessing each individual's level of confidence of being successful entrepreneur. A five point scale was used to measure each respondent's level of confidence.

The study also collected data on individual background variables such as education, age, and gender. Education was measured as graduate and undergraduate, age was measured in terms of years, and gender was measured as 0 and 1 where 0 is male and 1 is female. Data on age, education, and gender were also collected from enrollment information and used to check the responses. In case of a discrepancy, the secondary information was used.

Finally, financial knowledge measure used here is a four item questionnaire, in which respondents were asked to mark, using a 5 point Likert scale, the extent to which they agree or disagree to various financial skills. The specific items used are: I know how to achieve high overall growth in my portfolio of investments; I know how to achieve a balanced portfolio of investments with appropriate risk levels; I know how to manage my investments appropriately; and I know how to take calculated financial risks. This instrument produced a reliability score of .91. Responses across the four items were averaged to create the final perceived financial knowledge score.

## **DATA ANALYSIS & RESULTS**

### **Descriptive Statistics and Correlations**

Using descriptive statistics and bivariate correlations the study assessed the nature of data on each variable and initial correlation between them. Table 1 provides descriptive statistics and zero order correlation coefficients for all variables used in this study. The extent of entrepreneurial self-efficacy correlated positively with financial knowledge ( $r = .55, p < .01$ ) and negatively with gender ( $r = -.31, p < .01$ ). In addition, several other variables show significant correlations. Although none of these correlations is stronger than .45, they raise the issue of multicollinearity. However, each relationship produced a variance inflation factor score well below 10, suggesting no multicollinearity problem. The strong correlation between financial knowledge and entrepreneurial self-efficacy may also create a concern about problems of multicollinearity. However, these two variables did not produce similar correlation with all study variables. For instance, age was significantly correlated to financial knowledge and insignificantly correlated with self-efficacy.

### **Hypotheses Testing**

To test Hypothesis 1 that suggest a gender difference in terms of age, education, financial skills, and entrepreneurial self-efficacy, four one-way ANOVA procedures were used. Each model used here is a simple one factor ANOVA, where the dependent variable is a one of the four characteristics on which men and women are suggested to be different and the independent variable (factor) is gender (taking the numerical codes 0 and 1 for male and female respectively). The results of the ANOVA showed significant difference on the levels of entrepreneurial self-efficacy and perceived financial knowledge. Men and women did not significantly differ in terms of age and the level of education.

Moderated multiple regression analysis was used to test the remaining hypothesized relationships (hypothesis 2 through 4). First age and gender were introduced into the regression equation to run the regression. Next, the independent variables, level of education and perceived financial knowledge, were introduced into the regression equation to run the regression for the main effects. Finally, the hypothesized interaction between education and gender was added to the regression analysis.

In the above analysis, the  $R^2$  changes reflect the amount of variance explained by the entry of variable sets in step 1, step 2, and step 3 of the hierarchical regression. According to the step 2 results, after controlling for the effects of age and gender, the main effect of the independent variables (education and perceived financial knowledge) contributed to the explanation of a significant amount of variance in entrepreneurial self-efficacy ( $\Delta R^2 = .249, p < .01$ ). However, the level of education does not produce significant influence on self-efficacy as the standardized coefficient for education is positive but not significant ( $b = .13, p > .1$ ). Thus, hypothesis 2 receives no support. The financial knowledge produces a significant influence on self-efficacy (the coefficient for perceived financial knowledge is positive and significant,  $b = .48, p < .01$ ). Thus, data supports Hypothesis 3.

Results of step 3 tested the hypothesized moderated relationships (Hypotheses 4). The interaction terms introduced in step 3 enabled testing of whether the influence of education level on entrepreneurial self-efficacy varied with the difference in gender as predicted. Results in step 3 show that the interaction term explained a significant amount of variance in entrepreneurial self-efficacy ( $\Delta R^2 = .07, p < .01$ ). Results show a significant beta for the interaction term ( $b = 1.21, p < .01$ ). Therefore, Hypothesis 4 is supported.

To gain further insights into the moderated relationships and to clearly examine Hypothesis 4, the interaction effect was plotted (Figure 1). As shown, while female respondents of this study show a significant positive relationship between level of education and entrepreneurial self-efficacy, male respondents show a slightly negative relation between level of education and such self-efficacy. However, compared to women, men show higher levels self-efficacy at all education levels.

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Insert Figure 1 about here  
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## DISCUSSION

The results of this study, while by no means definitive, support both the general thrust of the arguments developed in the earlier part of this paper and the specific hypotheses that were derived from these arguments. Examination of the data revealed that men and women differ significantly in terms of perceived financial knowledge and entrepreneurial self-efficacy. However, they did not differ in relation to the level of education and age. While, women and men produced similar result in terms of age and education level, women are found to have significantly lower levels of entrepreneurial self-efficacy as well as perceived financial

knowledge. Findings of these important differences support the previous suggestions that gender difference has significant influence on entrepreneurial intention and action.

The findings also support the suggestion of self-efficacy literature that perceived knowledge positively influence self-efficacy formation. Results show that higher perceived financial knowledge positively influences entrepreneurial self-efficacy. Therefore, by developing perceived financial knowledge among individuals entrepreneurial intentionality and action can be improved.

The notion of gender difference in forming entrepreneurial self-efficacy is further supported by the findings with regard to the gender and education interaction term. Result show, while men form higher level of self-efficacy when they are about to complete an undergraduate degree, women form higher level of self-efficacy when they are about to complete a graduate degree. Thus graduate education is more important for female entrepreneurial intentions and actions and is less important for male entrepreneurial intentions and actions.

As self-efficacy is closely related to self-beliefs about personal capabilities, business education must focus on influencing individuals' self-belief, which is an important requirement for achieving entrepreneurship. Results of this study show that women with same level of education as male, lack self-perceived knowledge. Therefore, to improve women entrepreneurial intention and action entrepreneurship education must focus on improving not only the actual knowledge gained by female students but also their perception of knowledge gained.

While the results of this study should make valuable contributions to both research and practice of entrepreneurship, the study is not free from limitations. Possible limitations revolve around the data used for this study. Specifically, these limitations include generalizability problems and common method variance in testing hypotheses. The following discussion addresses the nature of these limitations and steps taken to minimize them and suggestions for future research.

Caution must be applied when generalizing the findings of this study as it used data collected from students. However, researchers have found that the use of students is appropriate when studying behavioral concepts (Krughanski, 1975) because they often exhibit various attitudes of the society in general (Gordon, Slade, & Schmitt, 1986). In future this study should be conducted on practicing entrepreneurs to reexamine the relationships proposed here.

Another limitation is the use of self-reported measures where students provided data on both independent and dependent variables. It is possible that the relationships among the independent and dependent variables were inflated due to common method variance. Since the variables used in this study were attitudinal and perceptual, it was necessary to assess the perceptions of the respondents. In addition, not all independent variables were perceptual data, for example data on age, gender and level of education are recorded as objective data. A secondary source (enrollment data) was used to validate this information. In case of discrepancies, data from the secondary source was used for this study. The use of two sources of data might suggest that common method variance is not operating at such a level that invalidates the findings of this study. However, future research could use different sources for measuring financial knowledge and self-efficacy variables.

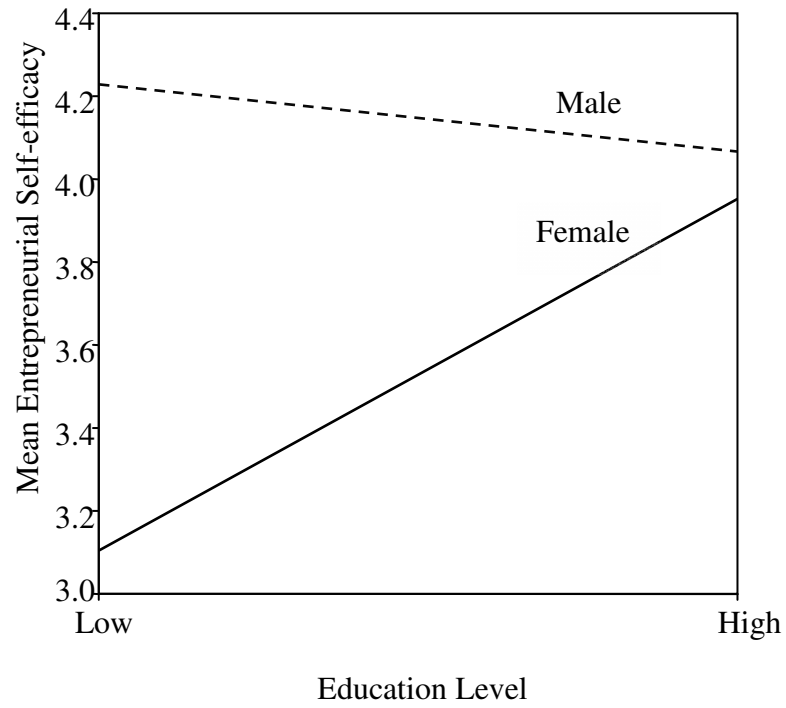
Finally, small sample size is a significant limitation of this study. However, the significant statistical test results indicate a high effect-size and power. Hence the small sample size seems to be adequate for the statistical analyses (Cohen, 1988). Although the findings of this study are generally strong, these findings should not be seen as refuting other explanation of development of entrepreneurial self-efficacy in men and women. The small sample size made the relationship found in this research vulnerable to alternate explanations that might provide a fertile ground for future research.

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FIGURE 1. Education and Entrepreneurial Self-efficacy Relationships for Male and Female



# **CORPORATE VENTURING AND STRATEGIC RENEWAL FROM THE PERSPECTIVE OF PROSPECT THEORY<sup>1</sup>**

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## **ABSTRACT**

This paper explains why strategic renewal and corporate venturing are different and why that difference is theoretically and practically significant. Strategic renewal is seen as a top-down process whereas corporate venturing is seen as a bottom-up process. Consequently, managers who initiate an entrepreneurial initiative are more likely to view its prospects from a reference point of loss avoidance than gain enhancement and therefore should be willing to *accept* more risk than other managers. Entrepreneurs are also more likely to *perceive* lower risk in a given initiative. Behavioral and performance implications for organizations are suggested.

## **INTRODUCTION**

As the two primary components of corporate entrepreneurship, corporate venturing and strategic renewal have received considerable attention in the literature (e.g., Birkinshaw, 1997, 1999; Burgelman, 1983a, 1983b; Covin & Miles, 1999; Zahra, 1993) The distinction between the two concepts can be traced back to Guth and Ginsberg (1990: 5) who refer to corporate venturing as “the birth of new businesses within existing organizations” and strategic renewal as the “transformation of organizations through renewal of the key ideas on which they are built.” Sharma and Chrisman (1999) further clarify these definitions when they suggest that corporate venturing leads to the creation of new businesses within a company and strategic renewal involves the reconfiguration of the strategies and/or structures of existing ones.

Theoretical advances have been made to distinguish forms of corporate entrepreneurship related to strategic renewal (Covin & Miles, 1999) and corporate venturing (Miles & Covin, 2002; Sharma & Chrisman, 1999). However, these advances do not provide a theory to justify the distinction between these two components of corporate entrepreneurship. Others have considered the problem as a matter of focused or dispersed corporate entrepreneurship without explicitly distinguishing efforts at renewal and venturing (Birkinshaw, 1997, 1999). The only empirical study that has directly compared corporate venturing and strategic renewal suggests that “companies in different environments emphasize different corporate entrepreneurship activities, and that these activities are associated differently with indicators of financial performance” (Zahra, 1993: 335). Thus, despite the paucity of studies that compare strategic renewal and corporate venturing, there is some limited evidence that these two forms of corporate entrepreneurship have fundamental differences.

The purpose of this article is to provide a theoretical justification for distinguishing between strategic renewal and autonomous internal corporate venturing (Sharma & Chrisman, 1999). The distinctions are based on the position in the organizational hierarchy of the corporate entrepreneur who conceives and promotes the initiative, and the differences in risk perceptions

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<sup>1</sup> The authors thank Franz Kellermanns for his comments on an earlier draft of this paper.

and reference points between those entrepreneurs and other managers (non-entrepreneurs) who are not involved in the proposal to engage in entrepreneurial behavior but may be asked to fund or implement the initiative. These factors may lead to fundamental differences in the manner in which corporate entrepreneurship initiatives are evaluated and implemented. These differences may also have an influence over the success or failure of these initiatives.

We contribute to the corporate entrepreneurship literature by addressing the issue of why corporate venturing and strategic renewal are different from a theoretical perspective and why these differences matter from a managerial perspective. From these distinctions, we also develop propositions on the organizational behavior that should be observable in strategic renewal and corporate venturing efforts. In the discussion part, we also speculate on some of the performance outcomes to be expected in light of those behaviors. By setting these foundations, we provide a basis for further theoretical and empirical investigation, as well as a framework to help orient managers on how to evaluate and anticipate corporate entrepreneurship initiatives.

To keep the presentation manageable, we shall focus on internal corporate venturing efforts that occurs solely through the autonomous activities of managers and employees at lower levels in an organization. Our focus will also be limited to acts of voluntary strategic renewal. We will not attempt to deal with the risk orientations of managers faced with situations of imminent bankruptcy where all efforts to achieve operational solutions have been exhausted and more severe strategic remedies are the only remaining alternatives (c.f. Hofer, 1980). Finally, we shall concentrate on renewal and venturing efforts initiated by single-business organizations. This will allow us to minimize the levels of organizational hierarchy we need to consider, thereby simplifying our fundamental arguments. However, in our conclusions we will address the implications of our theoretical framework for multi-divisional and multi-national firms so that the reader can better appreciate the dynamics that might occur in these settings.

## **CORPORATE VENTURING AND STRATEGIC RENEWAL**

Because a corporate entrepreneurship initiative starts with an opportunity (or threat) that ends with an organizational commitment to allocate resources (Birkinshaw, 1997), the processes of autonomous internal corporate venturing (hereafter referred to simply as corporate venturing or venturing) and strategic renewal are complex, involving multiple interactions between managers at various organizational levels (e.g. Burgelman, 1983a, 1983b). Although both types of corporate entrepreneurship are viable means to promote, sustain, or develop competitive advantages (Covin & Miles, 1999), venturing and strategic renewal efforts represent dissimilar approaches that require special attention.

Burgelman (1983a) argued that some autonomous strategic activities fall outside the scope of the current concept of strategy. In our terminology, corporate venturing is an autonomous strategic behavior characterized by lower and middle level managers' attempts to search for areas of new business activities and convince top management to support them (Burgelman, 1983b). Corporate venturing is therefore a bottom-up process. It represents an option for growth and diversification that involves risk and uncertainty in pursuit of an unexploited opportunity that alters the corporate strategy of an organization (Block & MacMillan, 1993; Burgelman, 1983a).

In contrast, strategic renewal changes the pattern of an organization's existing resource deployments to avoid or overcome stagnation (Grinyer & McKiernan, 1990) or to manage discontinuous change in the environment (Lant & Mezias, 1990; Meyer, Brooks, & Goes, 1990). Consequently, strategic renewal typically occurs as a response to an internal or external opportunity or threat to an organization that significantly alters the nature of its pre-existing business (Sharma & Chrisman, 1999). Strategic renewal might involve a shift from differentiation to a cost leadership strategy or from narrow to a broad segment scope (Bauerschmidt & Chrisman, 1993). Thus, strategic renewal primarily deals with changes to a company's business strategy within the corporate context. It is a top-down process instigated by top management who select and enact different initiatives to promote changes across the organization.

These basic distinctions identify the location of the entrepreneurs who formulate and promote the different types corporate entrepreneurship initiatives in an organization. Corporate venturing emerges through autonomous processes originating at lower managerial levels. Therefore, the entrepreneurs for a specific corporate venturing initiative are the individuals or teams at lower managerial levels who promote and implement the ventures. In contrast, strategic renewal occurs when top management introduces major changes in the strategy or structure of an existing business to create or sustain competitive advantages (Covin & Miles, 1999). In that case, top managers are the ones who act as the entrepreneurs. However, unlike corporate venturing, strategic renewal initiatives are not implemented by the entrepreneurs themselves but rather by managers and employees at lower levels in an organization who may not have had input into the idea that led to the entrepreneurial effort. In other words, strategic renewal implies an entrepreneurial process that distances the entrepreneurs who originated the effort from the managers who carry it out.

The distinction between the location of the entrepreneur and the roles the entrepreneurs play in the process are important because they help identify the different tensions that occur in corporate venturing versus strategic renewal. In terms of corporate venturing, the promoters may attempt to implement initiatives quickly so top management does not become discouraged and withdraw its support (Burgelman & Sayles, 1986). Unfortunately, such forcing often occurs at the expense of the development of an administrative infrastructure that can cause negative consequences for the venture (Burgelman & Sayles, 1986). By contrast, strategic renewal initiatives may experience organizational resistance if the managers who did not contribute to the original idea, but are responsible for its implementation, do not fully share the vision, commitment, and understanding of the need for the change. Also, the entrepreneurial *orientations* (Covin & Slevin, 1991) of top and lower level managers may vary and this will affect the way they perceive a venturing or renewal initiative. Because of a high entrepreneurial orientation, managers who did not conceive an initiative may still be enthusiastic about the idea but not to the same level as the entrepreneurs from which the idea sprung. Therefore, the entrepreneurial orientations of the managers who did not conceive the initiative will determine the extent to which their perceptions of a particular initiative will diverge from the promoters.

### **The Distinction of Prospects**

In the previous section, we argued that a fundamental difference between corporate venturing and strategic renewal is the location in the organizational hierarchy of the entrepreneur. This

difference leads to a different set of problems and tensions in implementing the two types of initiatives. In this section, we use prospect theory to explain why the difference matters or, in other words, why the different problems in implementing the initiatives occur.

In simple terms, prospect theory proposes that individuals are usually risk averse when faced with a choice of gains and risk seeking when faced with a choice of losses (Kahneman & Tversky, 1979). To avoid confusion, we refer to the former situation as prospects for gain enhancement and to the latter as prospects for loss avoidance. Prospect theory also suggests that individuals will normally evaluate possible outcomes as gains or losses relative to some reference point rather than evaluating them according to the expected values of the alternatives (Tversky & Kahneman, 1992). Empirical work has supported these risk-return relationships (Fiegenbaum & Thomas, 1988). Research has also suggested that prospect theory helps explain why managers escalate commitments on projects with a history of losses; sunk costs cause such decisions to be framed as choices among losses rather than as an assessment of the overall expected values of alternatives (Whyte, 1986). Baron (1998) has been suggested that entrepreneurs may be more susceptible to escalating commitments than non-entrepreneurs.

Managers will base their decisions concerning corporate venturing or strategic renewal according to strategic reference points such as internal capability, external conditions, and time (Fiegenbaum, Hart, & Schendel, 1996). Moreover, reference points such as outcome history and domain familiarity can affect the risk behavior of decision makers (Sitkin & Pablo, 1992). Because individuals do not maintain a comprehensive view of consequences (Whyte, 1986), an initiative can be either perceived from the perspective of gain enhancement or loss avoidance (Tversky & Kahneman, 1992). We argue that the views of the promoters, evaluators, and implementers are likely to diverge in this respect. Thus, strategic renewal and corporate venturing efforts will differ in terms of the reference points in which top management and managers at lower organizational levels evaluate them. Because of divergent reference points, the view of top and lower level managers with regard to the two types of initiatives is also expected to diverge.

Top management will be enticed to engage in strategic renewal when it perceives the failure to pursue the initiative will lead to a certain loss (or a certain loss of an opportunity). Being the creators and promoters of the initiative (i.e., the entrepreneurs), they will tend to be risk seekers who perceive that the organization will lose if the initiative is not implemented. However, top management may perceive the opportunities for corporate venturing brought from lower levels of the organization as a risky chance of gain enhancement relative to the certain gain of the status quo. As a result, top management will tend to be risk averse in their evaluation of corporate venturing efforts. The proposed differences, reflected in the following propositions, are consistent with the arguments of Baron (1998).

*P1. Top management will tend to view strategic renewal from the perspective of loss avoidance and consequently will be risk seeking in their evaluation of such initiatives. This will increase the probability that a given strategic renewal effort will be pursued.*

*P2. Top management will tend to view corporate venturing from the perspective of gain enhancement and consequently will be risk adverse in their evaluation of such initiative. This will reduce the probability that a given corporate venturing opportunity will be pursued.*

The reverse situation regarding risk perceptions obtains from the reference point of the managers and employees at lower organizational levels who are responsible for implementing an initiative. Here, the focus of our attention is exclusively on the managers who are responsible for implementing a plan for strategic renewal or corporate venturing. Similar to the above argument, the corporate entrepreneurs who promote a venturing initiative will perceive a certain loss of opportunity to the organization if the initiative is not implemented. The entrepreneurs will tend to be risk seekers committed to making the initiative work. In contrast, managers at lower organizational levels will be more risk averse toward strategic renewal initiatives induced by top management. Relative to top management, they lack ownership of the idea so they may not see the need for change or may feel threatened by the change. They will compare the risky gain of renewal against the more certain gain of the initiatives that they themselves favor. The commitment to strategic renewal among the managers responsible for implementing the changes when they are not the entrepreneurs is expected to be lower than the entrepreneurs who proposed the effort. Thus:

*P3. Lower level management will view strategic renewal from the perspective of gain enhancement and consequently will be risk adverse in their evaluation of such initiatives. This will decrease the probability that they will be committed to the initiative.*

*P4. Lower level management will view corporate venturing from the perspective of loss avoidance and consequently will be risk seeking in their evaluation of such initiatives. This will increase the probability that they will be committed to the initiative.*

### **Risk Probabilities**

Aside from the differences in reference points of entrepreneurs and non-entrepreneurs, cognitive theory suggests that differences in risk perceptions may lead to divergent assessments of risk probabilities (Kahneman, 1992). Entrepreneurs may be especially susceptible to cognitive biases due to the ambiguity and stress consonant with the decisions to engage in corporate venturing or strategic renewal (Busenitz & Barney, 1997; Simon, Houghton, & Aquino, 1999). Thus, entrepreneurs may perceive a lower probability of failure than non-entrepreneurs. Combined with the opposing reference points and perspectives, the divergence in perceptions is likely to exacerbate the differences in the evaluation of the efficacy of the initiative. Recent research findings support the premise that entrepreneurs perceive business situations more positively than other individuals (Palich & Bagby, 1995). Simon et al.'s (1999) study yielded similar conclusions: entrepreneurs were significantly more likely to succumb to illusions of self-control and belief in the law of small numbers than non-entrepreneurs. They concluded that entrepreneurs appear to be more likely to perceive lower levels of risk in their initiatives. In sum, one would expect that top management would perceive the probability of failure of corporate venturing initiatives to be higher than the entrepreneurs at lower levels in the organization who propose the initiatives. In the case of strategic renewal, top managers, acting as the entrepreneurs, should perceive a lower probability of failure or downside risk than the managers

who will be responsible for implementing such initiative. This leads to the following propositions:

*P5. Top management will perceive lower downside risk in strategic renewal than lower level management. These perceptions of risk probabilities will increase the probability that the initiative will be pursued and decrease the organizational commitment to the initiative.*

*P6. Top management will perceive higher downside risk in corporate venturing than lower level management. These perceptions of risk probabilities will decrease the probability that the initiative will be pursued and increase the organizational commitment to the initiative (should it be pursued).*

## **DISCUSSION AND IMPLICATIONS**

To summarize, we argue that strategic renewal is theoretically distinct from corporate venturing due to the two characteristics of risk assessments that come into play during their formulation, evaluation, and implementation: (1) differences in the reference points of evaluation which determine if the initiative is viewed as a mechanism for gain enhancement or loss avoidance, and consequently whether managers are risk averse or risk seeking; and (2) differences in perceptions of risk probabilities of corporate entrepreneurs and non-entrepreneurs. We have also suggested that these differences can be traced back to the location in the organizational hierarchy of the entrepreneur and the type of strategic change being contemplated. More specifically, we noted that entrepreneurs and non-entrepreneurs might assess entrepreneurial initiatives from different reference points and assign different probabilities to downside risks.

These conclusions lead to implications that are important from a theoretical and practical perspective. First, top managers will possess biases when evaluating the prospects for strategic renewal and corporate venturing. All things being equal, we have suggested that at any given level of risk top management is more likely to engage in strategic renewal and less likely to engage in corporate venturing. This means that many promising ventures proposed by lower and middle level management will not proceed. Furthermore, as specified by Burgelman and Sayles (1986), those that do make it through the corporate evaluation process are likely to be subject to perverse selection pressures that may diminish their ability to provide the returns expected of them in the long term. Thus, it is not surprising that so many corporate ventures fail to meet expectations (Sykes, 1986) and that independent ventures outperform corporate ventures (Weiss, 1981). Second, the bias in evaluation is perhaps more troubling with respect to strategic renewal efforts. Since those responsible for implementing the new strategy and/or structure are likely to possess different reference points and make different assessments of the probabilities of success, their commitments to the initiative is expected to be lower. As we explained, lower commitment might engender resistance, slowing down the process of implementation and further reducing the probabilities of success. That prospect theory and other related risk concepts explain such behavior so well is encouraging. A better understanding of risk and risk perceptions may yield better answers to the problems we have enumerated than have been available heretofore.

As noted above, for the sake of simplicity we limited our discussion to companies following a single-business corporate strategy in a domestic setting. When one considers the situation of a

company that competes in more than one industry with multiple product divisions or even multiple groups, the situation becomes much more complex and much more interesting. The same is true for companies competing internationally using global or multi-domestic structures. In such situations there are multiple reference points and multiple risk probability assessments. One might expect, for instance, that the challenge of strategic renewal in multi-divisional or multi-national corporations would be even greater than in single-business corporations. Divisional managers recognizing the need to engage in renewal efforts would not only need to rally their subordinate managers to the cause but may also need to gain the approval of managers at corporate headquarters, who would be likely to view those efforts from the standpoint of gain enhancement rather than loss avoidance and might also see higher downside risk as well. Although this might put a brake on ill-conceived efforts, it might also stop ones that were more carefully thought out. Likewise, corporate venturing efforts might be rare in companies where their approval is dependent upon the assessments of corporate as well as divisional management. Clearly, there is wide scope for investigating corporate entrepreneurship from a risk orientation, and such investigations may yield many important insights. For example, the potential impediments to corporate entrepreneurship may be especially great in situations where strategic coordination across business units needs to be high, such as when a multi-national firm follows a global strategy. In such cases even corporate managers with strong entrepreneurial orientations may view subsidiary initiatives from a perspective of gain enhancement.

In conclusion, we contribute to the literature by providing a theoretical explanation for how and why corporate venturing and strategic renewal are distinct phenomena. As shown, these distinctions have important managerial implications. We encourage further empirical and theoretical work along the lines taken in this paper.

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## **LINKING ART TO SCIENCE: DIGITAL MEDIA AS A TECHNOLOGY TRANSLATION TOOL**

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### **Abstract**

Technology translation can be achieved through the blending of the sciences and arts in the form of digital imagery. Digital animation and video can be utilized to portray molecular events where the mechanism of action is known but the process occurs at a sub-microscopic level. There needs to be a strong collaboration between scientific advisors and digital artists when creating the animation such that the artistic interpretation of the molecular event conforms to the known and accepted confines of science. The finished animation may be used for information, education or persuasion as entrepreneurial biotechnical companies attempt to find markets, customers and investors interested in their inventions. Educational institutions with programs in the sciences, arts, digital media and medicine need to promote the interaction of students from these disciplines through cross-functional teams and courses. Solutions to problems developed by these teams tend to be broader and more comprehensive than more homogeneous teams.

### **Executive Summary**

Technology is becoming more complex and difficult to understand as new fields or applications of science and medicine are discovered or invented. There is a need to develop new communication forums that simplify the science to a level that can be understood by individuals wanting to use the technology and/or by entities wanting to invest in the newly developing business venture.

Digital imagery can be used as a tool to help facilitate a type of technology translation through the use of digital animation and video. As new discoveries are made in biotechnical, biochemical, medical and bio-analytical fields of science the mechanism of action of the technologies while known is many times at a sub-microscopic level. In order to visualize what is happening at the cellular level, digital media experts in collaboration with scientific advisors create animations demonstrating the mechanism of action through an artistic interpretation of the science that conforms to known and accepted confines of science. These animations can be used as sales tools, educational pieces or used to help persuade equity partners to invest in their newly formed companies. The key to success for these entrepreneurial biotechnology companies is to assist any interested party, regardless of their scientific background, in understanding why the technology being promoted is unique and marketable.

Institutions with programs of study in science, medicine, technology and digital media need to develop coursework or opportunities for interaction between these diverse fields

of study. Our experience has been that diverse cross-functional student teams generate solution sets to problems that are more comprehensive and diverse than teams comprised of members from a more homogeneous background. As the technology revolution continues to evolve the need to explain the technology to non-experts will become critical for the success of newly formed entrepreneurial technology-based companies. The combination of arts and sciences through digital imagery is one technique to help facilitate this technology translation.

### **Introduction**

New technology and scientific breakthroughs, especially those in the medical, pharmaceutical and biotechnology fields, have become so complex that the explanation and comprehension of the technology by scientists in a different field of study is difficult and to a non-scientific individual it can be virtually impossible. As companies commercializing these technologies bring products to market there is an urgent need to find new channels of communication that facilitate the translation of highly technical concepts to the common language of the general population. In many cases the new technologies may be the result of disruptive rather than incremental research and the resulting products may significantly alter an existing market or create an entirely new market that has no competition, recognition or boundaries in place. This paper will discuss the use of digital media as an art form to assist in the technology translation process as products move from prototype to commercial availability and in the relevant pedagogical issues that facilitate the linkage of art and science to a common purpose.

### **Background**

Traditional research protocol for Universities and Federal Research Laboratories have been to conduct basic research that contributes to the underlying scientific understanding but leaves the process of conversion of basic research to commercial products to the private sector. Recently, university and federal research laboratories have seen the limitations of licensing technologies to private industry and are favoring the formation of private corporations from technology developed in their own laboratories by allowing professors/researchers needed release time to commercialize their intellectual property. The emergence of regional technology-based business incubators has generated the necessary infrastructure and cost structure needed for emerging high-technology business ventures from Universities and Federal Laboratories. The location of these technology-based business incubators adjacent to universities and federal laboratories provide a diverse consulting base to address the difficulties encountered in technology transfer from the laboratory bench to the commercial realm. In addition, the existence of these incubators in close proximity to the university provides a self-renewing source of embryonic technology-based businesses for our graduate students to interact with through the course of their study in technology driven entrepreneurial innovation (Clark and Czuchry, 2004).

Through involvement with embryonic technology-based businesses formed through technology transfer from universities and/or federal laboratories we have noted several critical observations. The technical complexity of these businesses is increasing over time and this is especially true in the biotechnology based entrepreneurial firms. In most

cases, the technical focus of the business is narrow in scope and theoretical in nature as the science concept moves from the laboratory to the fledgling business. In addition, the founders of the newly formed corporations, in general, are experts in their respective field of study but have limited to no business experience. Many of these businesses gain initial funding through federal SBIR (Small Business Innovation and Research) grants that foster the further development of the technology to a commercial product.

As the technology moves past the SBIR funding phase and a prototype product is formulated, the founders of the company will require substantial capital for continued development of their product and growth of their corporate entity. Funding sources typically come through commercial channels such as venture capital, small business administration loans, angel investors, initial public offerings and other. We have observed difficulty in communication as cutting-edge scientists attempt to translate “science speak” into a language that can be understood by the financial non-science speaking community. The necessity to communicate the significance of the invention to the financial community and their recognition of potential market significance is becoming more difficult as the complexity of technologies is increasing at an exponential rate. The use of cross-functional student consulting teams has proven invaluable as business, technology and digital media students come together to assist these companies in bringing their product to market through market research, marketing strategy development, advertising forms and forums, competitor analysis and other needed information or assistance. This process of using student teams to assist embryonic technology-based businesses domiciled in regional business incubators has been previously reported (Clark and Czuchry, 2004). One significant learning has been the incorporation of digital visual formats as a tool to assist in the translation of complex technology to potential investors or customers through animation and digital imagery.

### **Digital Media**

Students entering our digital media program envision themselves post-graduation as animators employed in studios in the creation of the next “blockbuster” movie or in creating the next generation of interactive videogames. The reality is that opportunities to work in these premier settings is limited, however there are numerous other outlets for creative capabilities in the design of new and innovative uses for digital technology beyond the scope of entertainment industry. Miller (1999) described an incident where 3D animators were given eight days to create a video animation, to be shown to a group of venture capitalists, describing the mechanism of action of a new matrix metalloprotease (MMP) inhibitor, invented by Agouron Pharmaceuticals, for the treatment of non-small-cell lung cancer. The primary author of this 3D animation, Marie Dauenheimer, was quoted in this article stating “A few years ago, we wouldn’t have had the computer resources or capability to create something of this ilk that quickly. Yet today we were able to design rather elegant animation that showed the drug traveling through the blood stream, into the epithelial layers and eventually stopping the blood supply to the tumor”. In the case of Agouron Pharmaceuticals, the animation was used to describe the molecular process for illustrative purposes, however the use of 3D modeling is becoming more common in designing molecules through structure-based design. This process and was described accurately by Werth (1994) in his description of the process

used by Vertex Pharmaceutical to custom synthesize a molecule that would have the appropriate structure and conformation to combat the AIDS virus.

Other examples of using digital imagery are evident and can be found in the literature illustrating the utility of computer animation for molecular biology educational purposes (Amerongen, 2000, Skweres, 2004) or assisting in the analysis of medical images (Berlage et al., 1966). In reviewing the websites of new biotechnology pharmaceutical companies there is a prevalent use of digital animation to visually describe the proposed mechanism of action of new pharmaceutical entities at the molecular level. This translation of “science-speak” into easily understood visual imagery can be applied to numerous scientific applications and becomes a significant alternative career path for digital media students. The Digital Media Program, however attracts students who view themselves as artists that are experimenting with the new art medium of electrons and many have little to no interest in business and commercial applications of their skill set. We have undertaken education program steps that seek to bridge the arts and sciences by providing students with technical knowledge, an understanding of aesthetics, and practical experience in digital media. With a core emphasis on learning how to develop and express ideas, solve problems and create digital media content, this program leads students through problem, project and process-based learning experiences that teach them how to define, design and develop digital media content, computer graphics and interactive medias. The program endeavors to bring together students, faculty and industry professionals to realize interdisciplinary initiatives that prepare students for the professional challenges of linking the arts to the sciences. These new 21<sup>st</sup> century careers include employment utilizing Web media design, 3D visualization (modeling for data, product, architectural, and other needs), interactive design (for education, entertainment and business applications), communication design, digital video production and special effects and animation. Mark Meadows (2003), author of the text, *Pause and Effect, The Art of Interactive Narrative*, gives an excellent example of the utility of digital animation. He states: “The best learning would occur hands on with the physical subject matter. If you’re studying a rock, the best way to comprehend a rock is to hold it in your hands, look at it, smell it, weigh it – physical interaction. With 3D where you are using 3D, photorealism and motion, we can approach reality far closer than any other media. In this medium, learning is going to be facilitated.” In biotechnology, the process of molecular action although known in many cases, is sub-microscopic and not visible and the use of 3D animation created with scientific direction helps in the understanding of how the body and the molecule interact.

### **The Process**

Our experience of linking digital media and the sciences together is truly in its infancy at our university. Currently students have the opportunity to interact with scientists and create animation that is used to help explain some complex functions in two different manners. For our graduate students, this opportunity is offered in a course entitled “Strategic Experience” which is a culminating experience course for students obtaining a masters degree in business administration, technology and digital media. These students are grouped in consulting teams based on their education, experience and needs and most importantly the consulting teams feature members with diverse educational disciplines.

We have found that by creating cross-functional teams, through bringing many different disciplines together, we create consulting teams that develop solution sets that are broader and more comprehensive than teams with more homogeneous members. We have described the difficulties and positive aspects of managing and directing cross-functional teams in a previous paper (Clark, Johnson and Turner, 2004). When students serve as consultants to emerging businesses at regional technology-based business incubators, they are faced with numerous problems ranging from the need to develop a brand identity, defining their market niche, developing a comprehensive website and communication forum and in finding a way to describe their complex technical process to consumers or individuals that might be interested in investing in their company. In fact, working with these emerging biotechnology companies is a true challenge for our students since many of the companies are dealing with newly emerging or not yet defined market niches.

The second opportunity developed to intentionally link the arts and sciences together is through the Honors Program Thesis Project within the digital media department. In this case a student or teams of students work with a scientific mentor with the end result being an animation of a biochemical, physiological or biomedical process that may be combined with an interactive web or CD interface. In each case, the process for developing the animation is similar (Figure 1). The team meets with the scientist (content advisor) to discuss the technical problem that needs to be described through animation. This part of the process may require multiple meetings until the problem is well defined and there is a significant understanding of the technology and how it works. This is not a simple process since animating events that cannot be seen through a microscope requires some artistic interpretation that must conform to the confines of the known science. In the case of cross-functional teams this process can be accelerated since technology students can assist in the translation of “science speak” to the digital media student team members. Once the problem is defined, the team develops a sketches and a storyboard defining how the animation will be developed and what will be emphasized and highlighted in the completed animation. This part of the process may take several more meetings with the scientific advisor as iterations of the animation process are developed and matched to known or perceived mechanism of action at the cellular level. The prototype animation (timing test) or parts of the animation are developed in animatic format and meetings with the team and scientific advisor are again held to confirm the accuracy and authenticity of the artistic interpretation of the biological event. At this point the final voice-overs are added and the finished 3D models created with color, texture and lighting schemes identified. If there is a strong working relationship between the team members and the scientific advisors and the necessary time has been spent to ensure the scientific accuracy of the animation, the final result is an excellent educational, promotional, information and sales tool for the newly emerging technology. This merging of art and science appears to be an excellent new employment opportunity for digital media students/artists who have successfully learned to interact with the scientific community.

### **Our Experience**

Our experience to date in linking science to the arts has been rewarding and enlightening. The use of digital imagery as a translation tool has allowed our classroom to expand to regional technology-based business incubators, federal laboratories and departments on campus where previously we have not had much interaction, such as the medical school and most recently a newly formed linkage to artists located in our community. Examples of projects completed may provide a basis for understanding the utility of digital imagery in the biotechnology field and the wealth of new educational opportunities it provides.

One embryonic biotechnology company wanted assistance in illustrating how unesterified tocopherols and tocotrienols, when formulated into a hydrolipid cream base, would migrate into the skin layers (epidermis, dermis, subdermis) rather than remaining on the skin surface until the ester bond could be broken (requires the presence of an esterase). The significance of the molecules migrating into the dermis layers is that the tocopherols and tocotrienols act to neutralize free radicals that are formed through exposure to UV radiation, environmental toxins and/or other pollutants. Free radicals can serve as a stimulus for cell mutation and the formation of skin cancers. In this case, a digital cartoon was created showing migration of the molecules and the resulting neutralization of the free radical. It allows the company the opportunity to differentiate its product from others using esterified tocopherols and tocotrienols in their formulation and allows for premium pricing in a commodity driven marketplace.

Our graduate students worked with a new startup bio-analytical company that had developed a new piece of laboratory equipment designed to perform two-dimensional gel electrophoresis of blood proteins based on their hydrophobicity and pH. Although our team never had the opportunity to create the actual digital animation of how the proteins would migrate in this two-dimensional field, they did collaborate with scientists at the company to develop a detailed storyboard of how the final animation would be created to show the proteins movement in the gel. The significance of this technology is that it allows scientist to differentiate proteins from normal and abnormal cells. If protein segments identified from abnormal cells are isolated, the amino acid sequence determined and the conformational structure of the protein identified then companies can work to develop new chemical or biological entities to inactivate the expression of that protein from the cellular DNA. In this case, digital animation will give the company a technology translation that will be understood and appreciated by the investment community helping to move the company to the next level.

A third example was a project entitled: "Visualized Surgical Solutions: Female Incontinence," an interactive walk-through of the surgical procedure for correcting female incontinence. A Professor of Surgery (content provider) and a five-member student team developed an anatomical explanation of the procedure using 3D models of the female pelvis. The project included a series of videos using 3D models to identify the various structural anatomy involved and an interactive, rotatable model of the female pelvis. Also included in the application are a series of video clips of the surgical techniques that could be viewed in pieces, or as a complete video of the entire surgery. This digital imagery used in concert with actual surgical footage provides the physician an excellent platform to describe the process to potential patients. In this case the digital

imagery is used to illustrate a macromolecular process rather than sub-microscopic as discussed in the previous examples.

A fourth example was the subject of a two student's Honors project and was entitled "Visualizing the Human Knee." In this project the students used a combination of digital video in addition to animated 3D models of the bones. What is interesting about this particular case is that by using digital video the students were able to take the video and "clean up" and enhance the images giving the surgery a more aesthetic representation of the actual procedure. Patients considering the surgery can view the operation without having to endure the more graphic scenes typically seen in an operating theatre. In this case the students collaborated with a research physician who was the content and scientific advisor.

Our last example also used a content and scientific advisor from the medical school and was entitled "A 3D Visualization of the Sacroiliac Joint." In this case the animation was used to assist in determining how much room for play there actually is in the sacroiliac joint under in vivo conditions. The student worked with scans of the joint to create a negative image (the inverse of the joint—basically a model of the interior surfaces), to be able to visualize how smooth or rough the surface was, and evaluate the effects of the surface topography on actual motion ability of the joint.

### **Conclusions**

The linkage of arts and sciences generates tremendous benefits where digital imagery can be utilized to facilitate imaging of medical, biotechnical, biochemical and bioanalytical processes. Since many of the processes occur at the sub-microscopic level, the use of digital animation, created under the direction of scientists and maintaining scientific integrity within the known and accepted bounds, provides the opportunity for complex molecular events to be understood by the non-scientific community. This technology translation becomes important for emerging new companies promoting these technologies as they seek customers, markets and the influx of capital to support growth. Institutions with strong science, medical and digital media/imaging departments need to intentionally develop projects and coursework promoting the blending of these diverse technologies through cross-functional teams and classes.

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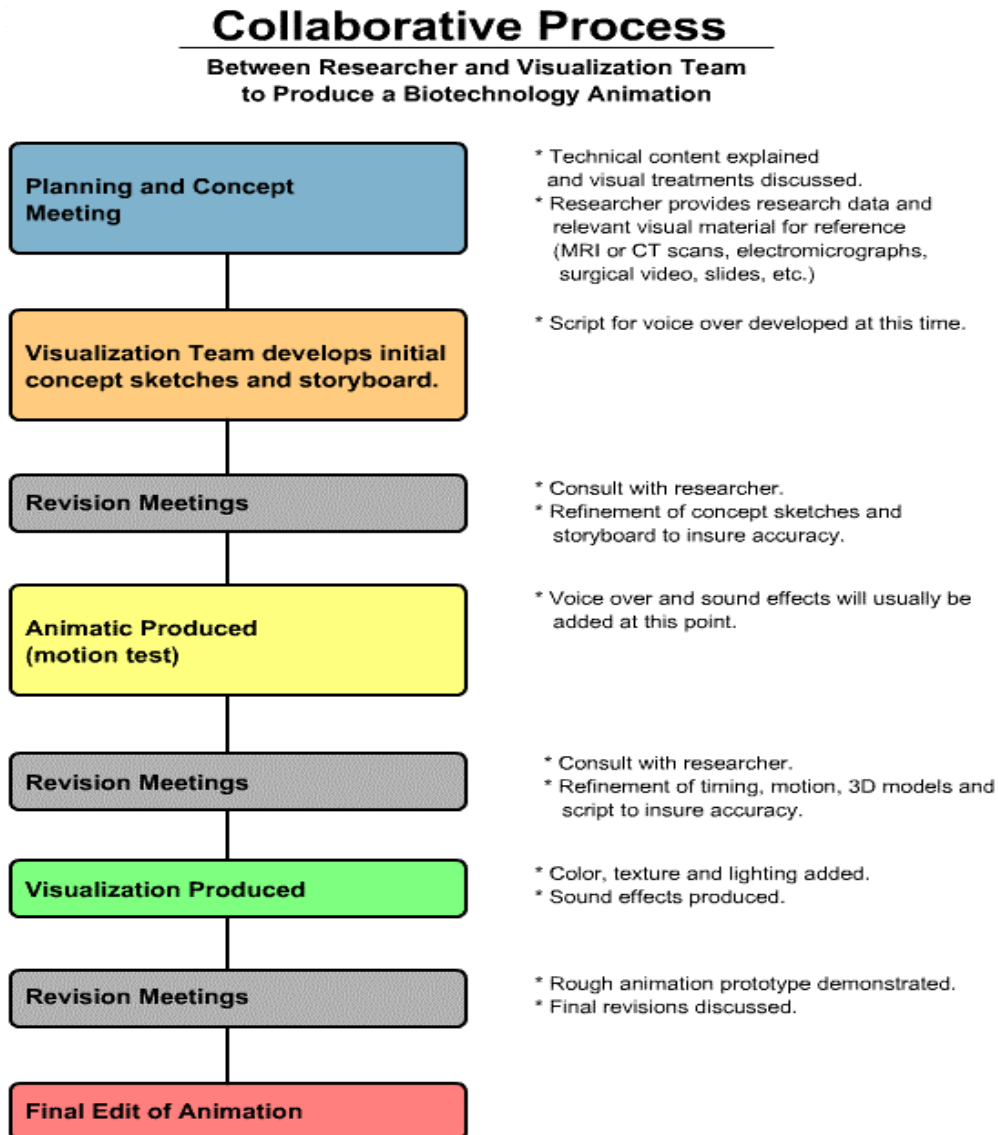
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Figure 1.



# FRANCHISING AS A STATE ECONOMIC DEVELOPMENT TOOL: SOME PRELIMINARY ANALYSIS AND SUGGESTIONS FOR FUTURE RESEARCH

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## ABSTRACT

The purpose of this paper is to explore the potential benefits of using franchising as a state economic development tool. We examined the relationship between concentrations of franchisors and the economic development environment of the state in which the franchise firms were headquartered. Using firms listed in Entrepreneur Magazine's Franchise 500<sup>®</sup>, we identified states with the greatest concentration of ranked firms. To measure the impact on each state's economy, we used a traditional economic development metric, the number of corporate employees. To examine possible factors that might be associated with higher concentrations of franchise headquarters in any given state, we used the Corporation for Enterprise Development (CFED) annual state's economic development Report Card.

As expected, large states such as California, Texas, and Florida were found to be headquarters to a large number of franchisors. The analysis also revealed that several smaller states, such as Minnesota and Ohio had substantially higher numbers of franchisors than states of comparable population. Next, using data from Source Book Publication's Worldfranchising website, we obtained the number of headquarters staff for each firm in the Franchise 500.<sup>®</sup> Analysis revealed that many of the top ranked firms have large headquarters staffs, an indicator of substantial economic impact in the states in which they are located. This study raises questions about whether a state's economic development policy and associated economic incentives may be appropriately targeted to encourage franchise formation and/or growth in order to reap its associated economic benefits. Implications for practitioners and policy makers as well as future research directions are discussed.

## INTRODUCTION

Although entrepreneurs have been studied for their personality (e.g., (Chell, 1984)), their behaviors (e.g., (Gartner, 1988)), and their ability to transform their attributes into business success (e.g., (Shaver, Gartner et al., 1996)), researchers have frequently focused on entrepreneurs because of their economic contributions. Whether viewed as creative destruction ((Schumpeter, 1934)) or entrepreneurial opportunity (von Mises, 1949), economists were among the first to study entrepreneurs primarily because of the value created by their innovations (Stevenson, Roberts et al., 1985). More recently, the study of

entrepreneurship has been expanded in scope to encompass the creation of new business ventures (e.g., (Carter, Gartner et al., 1995)) as well as entrepreneurship within organizations (Jarillo, 1988). This line of research has led to studies of entrepreneurial activities within major corporations (e.g., (Kanter, 1996)) and within hybrid organizations, such as franchise firms (Kaufmann and Dant, 1998). Franchising's economic impact has been a topic of interest to academics, practitioners, and policy makers for many years (e.g., (Bucklin, 1971); (Stanworth and Dandridge, 1993); (Trutko, Trutko et al., 1993)). Viewed from a domestic perspective, franchising is an integral part of the small business and entrepreneurial landscape (Elango and Fried, 1997). Franchising has also had an increasingly visible international presence, especially in developing economies where it has contributed to poverty reduction and wealth creation by stimulating new firm creation and through transfer of expertise through licensing (anonymous, 2004).

Although insightful, studies of franchising's economic impact have primarily centered on the development of franchised outlets. Similar to other large, non-franchised businesses, the headquarters of a franchise is likely to employ a number of professional workers. Additionally, economic benefits from increased travel, conventions, and supply-chain linkages are likely to be realized in regions where a franchise establishes its headquarters. Similar to non-franchised businesses, a franchise is likely to locate in a state where economic development conditions are favorable, such as those areas with a talented labor force, high quality of life, and other factors that support business growth. Despite the number of studies of franchise firms, very little attention has been paid to the economic contributions made by a franchise headquarters on its state and local economy. More specifically, where franchise organizations form and grow remains largely unexplained.

In an effort to address this topic, this paper explores two primary research questions. First, what is the economic impact of a franchise headquarters? Using the number of headquarters employees as a measure, we look at the level of employment of some of North America's top franchise firms. Second, is there a relationship between the headquarters locations of top franchises and those states with favorable economic development conditions? To explore this relationship we analyzed the headquarters locations of Entrepreneur Magazine's Franchise 500<sup>®</sup> firms and the Center for Enterprise Development (CEFD) report card for the states. In this preliminary analysis, we looked at states with the highest and lowest concentrations of franchise headquarters.

## **LITERATURE ON FRANCHISING AND ECONOMIC DEVELOPMENT**

### **Background**

In one of the earlier studies of economic impact, Caves and Murphy revealed that franchise firms were responsible for 38 percent of all retail sales in the United States, and nearly 12 percent of the gross national product (Caves and Murphy, 1976). Although much of the growth in franchising has been through expansion in its traditional industries, such as fast-food, quick printing, and janitorial services (Trutko, Trutko et al., 1993), it is also expanding its impact by penetrating new industries, now accounting for nearly 50 percent of all domestic retail sales, a figure estimated at \$1 trillion (Grunhagen, 2001). A recent study by the

International Franchise Association (IFA) and Pricewaterhouse Coopers claimed that franchising in the U.S. created more than 18 million jobs, and accounts for 9.5 percent of the private sector economic output (anonymous, 2004). Because of its substantial economic impact and far-reaching international expansion, franchising is increasingly considered and important and global phenomenon (Teegen, 2000), and one worthy of study.

### **An International Economic Development Tool**

The ubiquity of franchised outlets is evidenced throughout the world (Swartz, 2001). The United States has been considered as the source of innovation behind many successful international franchise concepts (Fernie and Fernie, 1997). For many U.S. franchisors, international expansion has been growing at a rate that exceeds their domestic growth (Preble and Hoffman, 1995), although not all franchisors choose to expand in this manner (Clarkin, 2002). One measure of the impact of international operations by U.S. franchisors is reflected in the receipt of franchise fees from overseas operations, a figure that exceeded \$569 million in 1999 (Clarkin, 2002). In developed economies, globalization has created opportunities for U.S. franchisors (Shane, 1996), and, albeit to a lesser extent, for European and other international concepts to expand into the U.S. market (Muniz-Martinez, 1998). In developing economies, franchising has been considered a valuable contributor to an emerging small- and medium-sized enterprise sector (Sanghavi, 2001), as well as valuable technology transfer mechanism (Stanworth, Price et al., 2001), helping to build a nation's economic base while offering a tested method of privatization with comparatively low failure rates (Preble and Hoffman, 1995).

### **A Domestic Economic Development Tool**

In similar fashion to the innovators and creators of non-franchised businesses, franchisors have been studied by entrepreneurship researchers. Entrepreneurs are considered to be essential to economic development (Schumpeter, 1934), serving as "protagonist(s) of economic activity" (p. 18) (Stevenson and Jarillo, 1990). According to the U.S. Small Business Administration (SBA), franchised businesses, together with non-franchised small businesses, are considered to be the "building blocks of sustainable economic growth...and they must be the cornerstones of inner city and rural communities" (p.1) (anonymous, 1999). Supporting this effort, the SBA has backed more than 18,600 loans to franchisees totaling more than \$5 billion in the five-year period of 1993 through 1998 (anonymous, 1999).

Bingham and Bowen observed that economic development had become a major priority for state agencies, employing three primary strategies: 1) maintaining existing firms and technologies; 2) recruiting firms from other states, or encouraging opening of branch plants; and 3) creating new industries and enterprises (p. 501) (Bingham and Bowen, 1994). Most economic development initiatives related to franchising have been focused on encouraging the opening of branch outlets by supporting and training prospective franchisees. Franchising has received a great deal of attention among economic development agencies and researchers, in part because of the widespread belief that franchised businesses have overall lower failure rates than non-franchised businesses (e.g., (Barrow, 1989); (Burke, 1996)). Much of this attention, however, has been directed toward the "micro" impact of franchised outlets in rural or urban economic development, both in the U.S. and abroad.

To address gaps in the literature, this study explores the economic impact of franchisors, and potential links between the locations of franchise headquarters and the state's economic development conditions. To accomplish this study, data from three sources were utilized, each of which is described in the following section.

## **DATASET DESCRIPTIONS**

### **Entrepreneur Magazine Franchise 500®**

Data were collected from the January 2004 edition of *Entrepreneur Magazine* for this study. Published annually since 1980, Entrepreneur Magazine's Franchise 500® has been widely used by practitioners and potential franchisees to compare franchise opportunities. In addition to its use by practitioners, Entrepreneur's Franchise 500® dataset has been used, albeit in different capacities, in several academic studies. Authors of previous studies concluded that the Franchise 500® dataset was a reliable source of data for studies of franchising (Lafontaine and Slade, 1996); (Shane and Spell, 1998). Table 1 presents the criteria used by the magazine in its ranking.

[Table 1 about here]

The Franchise 500® ranking is based on pre-determined, weighted criteria, those considered by the magazine to be essential for evaluating and comparing franchises. Although it does not disclose individual weightings assigned to specific criterion, the magazine differentiates between criteria it considers most important and important. The magazine collects data from franchisors through a survey, and requires respondents to submit a UFOC and/or other supporting documentation before inclusion in the ranking.

### **Source Book Publications "Worldfranchising" website**

Source Book Publications provides franchise information through books, databases, consulting, and through a number of websites. Among the books published by Source Book are "Bond's Franchise Guide" and "The International Herald Tribune Franchise Guide." Its websites include [www.worldfranchising.com](http://www.worldfranchising.com), promoted as "the Internet's most comprehensive and up-to-date portal on franchising," and [www.franchisingconsultant.com](http://www.franchisingconsultant.com), a database containing detailed profiles of leading North American franchise consultants and service providers. Source Book's "Worldfranchising" website contains a database of more than 1,100 franchise concepts, with data gathered through a survey of North American franchisors.

### **Corporation for Enterprise Development (CFED)**

For 17 years, the Corporation for Enterprise Development (CFED) has published its "Development Report Card for the States." (available at <http://drc.cfed.org/grades/>) In its report card, states are graded on three composite indices, "Performance," "Business Vitality," and "Development Capacity," each of which is comprised of a series of sub-indexes. The *Performance* index measures how a state's economy is providing opportunities for employment, income, and an improving quality of life. The *Business Vitality* index looks at the degree to which a state's large and small businesses are dynamic and competitive, while *Development Capacity* examines each state's capacity for future development. To calculate

grades for its report cards, CFED collects data on 68 separate measures, and then ranks each state from best to worst on each measure. Overall index scores are calculated by taking the sum of the sub-index scores. Once the scores are compiled, states are rank-ordered, with those that rank from 1-10 given a grade of “A,” those from 11-20 earn “B,” and so on until those states ranked 46-50 receive a grade of “F” in each of the three indexes.

### **Preliminary analysis of states with firms in the Franchise 500®**

Preliminary analysis of the Franchise 500® data was performed using SPSS for Windows V10.5. The frequency of each state was calculated in order to determine which states had the highest and lowest concentration of ranked firms. The District of Columbia and Canada were also assigned unique numbers, making a total of 52 possible headquarters locations.

[INSERT TABLE 2 ABOUT HERE]

As presented in Table 2, the frequency analysis revealed highest concentrations of franchise headquarters among ranked firms in three of the four most populous states: California (33.8 million), Texas (20.8 million), and Florida (15.9 million). Interestingly, the comparatively smaller state of Minnesota (4.9 million) accounted for what appears to be a disproportionate number of franchise headquarters. Conversely, Idaho, Montana, North and South Dakota, and Vermont had only two ranked firms domiciled in their respective states, while Wyoming, West Virginia, and Alabama accounted for only one each.

### **Preliminary analysis of Franchise 500® and headquarters employment**

As presented earlier, one way to measure the economic development impact of a franchise firm is to examine its headquarters employment. Using the top-ranked franchises in the Franchise 500®, this section of the analysis focused on the number of corporate employees in each firm. Source Book Publication’s “Worldfranchising” website was used to determine the size of each firm’s corporate staff.

[INSERT TABLE 3 ABOUT HERE]

Table 3 presents the top-ranked franchises in the Franchise 500®, with the size of their firm’s corporate staff. The table reveals that the top-ranked franchises represent sources of substantial employment, such as 7-Eleven (1,000), Subway (700), and Quizno’s (485). Although Source Book Publication’s survey asked each franchisor to note the size of their corporate staff, they were not required to disclose the location of the employees. In other words, some corporate employees may not be located in the state in which their headquarters exists.

### **Preliminary analysis of headquarters location and the state’s economic development report card**

To explore the relationship between states with higher concentrations of top-ranked franchises and their economic climate, we used each state’s economic development report card, as reported by the CEFD. We assigned a numeric value to the letter grade given in the report card, from an “A” which was assigned a value of “1” to an “F” which was assigned a value of “5” for each of the three indices described earlier in Table 2. In addition to the three indices, a composite was entered, representing the sum of the three. Using this method, states with all “As” would receive a composite score of three, while those receiving all “Fs” on the report card would receive a score of fifteen.

Although a relationship between a state's population and the number of franchise headquarters was evident, it appears that population is not the sole determinant. For example, Minnesota and Alabama have similar populations, 4.9 million and 4.5 million respectively. Despite similar populations, Minnesota serves as the headquarters of 27 of the top-ranked franchises in North America, while Alabama is home to only one of the Franchise 500<sup>®</sup> firms. Georgia (8.2 million), with twice the population of its neighbor South Carolina (4.0 million) has more than six times the number of headquarters among ranked firms.

### **Conclusions and suggestions for further research**

Preliminary analysis using only 2004 data from the Franchise 500<sup>®</sup> indicates that there is value to continuing this line of research. Based on the number of corporate employees found in many franchise headquarters, there can be little doubt that there is economic value associated with employment and associated payrolls. This conclusion does not consider additional indirect benefits that may accrue to these locations through training centers, and their transient economic impacts, such as national meetings and conventions. Also not considered is the flow of franchise or royalty fees to corporate headquarters, the value of creating an innovative and growing organization on the local real estate market and the community at large, and the potential impact on growing a network of local suppliers. These represent potential paths for further research on this topic.

A second potential avenue for research could be more focused on specific economic development conditions, weighing their impact on supporting or constraining franchise formation and development. Issues such as infrastructure, taxes, and employment tax credits have potentially meaningful effects on franchise development. Third, it would appear that franchising could be more than just a tool for expansion of entrepreneurial ventures, but could also be viewed as a state economic development tool, one that may have been overlooked for some time. Properly crafted, economic development incentives and targeted marketing strategies could become powerful and effective tools for developing and recruiting franchise headquarters.

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| Table 1<br>Franchise 500 <sup>®</sup> Ranking Criteria |                                |
|--|--------------------------------|
|  | Criterion                      |
| Most Important   | Franchisor Financial Strength  |
|  | Franchisor Stability           |
|  | Size of System                 |
|  | Growth Rate                    |
| Important  | Number of Years in Business    |
|  | Experience in Franchising      |
|  | Start-up costs                 |
|  | Amount of litigation           |
|  | Percentage of terminations     |
|  | Franchisor financing available |

| Table 2: States with highest and lowest concentration of ranked firms |                  |            |                                   |                      |                  |             |                                   |
|---|------------------|------------|-----------------------------------|----------------------|------------------|-------------|-----------------------------------|
| Highest concentration   |                  |            |                                   | Lowest concentration |                  |             |                                   |
| No. Ranked Firms  | Percent of Total | State      | Population <sup>a</sup> (million) | No. Ranked Firms     | Percent of Total | State       | Population <sup>a</sup> (million) |
| 59  | 11.8             | California | 33.8                              | 2                    | .4               | Vermont     | .61                               |
| 44  | 8.8              | Texas      | 20.8                              | 2                    | .4               | S. Dakota   | .75                               |
| 42  | 8.4              | Florida    | 15.9                              | 2                    | .4               | N. Dakota   | .64                               |
| 27  | 5.4              | Minnesota  | 4.9                               | 2                    | .4               | Montana     | .90                               |
| 27  | 5.4              | Ohio       | 11.3                              | 2                    | .4               | Idaho       | 1.3                               |
|   |                  |            |                                   | 1                    | .2               | Alabama     | 4.5                               |
|   |                  |            |                                   | 1                    | .2               | W. Virginia | 1.8                               |
|   |                  |            |                                   | 1                    | .2               | Wyoming     | .49                               |

<sup>a</sup> U.S. population by state: Population Reference Bureau, available at [http://www.classbrain.com/artstate/publish/article\\_661.shtml](http://www.classbrain.com/artstate/publish/article_661.shtml)

| Table 3: Top-Ranked Firms and Their Headquarters Staff |                |                    |                    |
|--|----------------|--------------------|--------------------|
| Rank   | Name           | Headquarters State | Headquarters Staff |
| 1  | Subway         | Connecticut        | 700                |
| 2  | Curves         | Texas              | 50                 |
| 3  | Quizno's       | Colorado           | 485                |
| 4  | 7-Eleven       | Texas              | 1,000              |
| 5  | Jackson Hewitt | New Jersey         | 235                |

# THE IMPACT OF HUMAN CAPITAL MEASURES ON THE PERFORMANCE OF SMALL, WOMEN-OWNED FIRMS

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## ABSTRACT

A growing number of women are starting and operating small firms. Prior research has often indicated, however, that women-owned businesses tend to under-perform firms owned by men in measures of size, growth, and profitability. This article compares the performance of women- and men-owned small firms in the service and retail industries in an attempt to determine if higher levels of human capital close the supposed performance gap between them. Results reveal that women-owned firms were smaller than men-owned firms, even controlling for industry sector and various measures of human capital. Contrary to prior research, however, women-owned firms were significantly more profitable and exhibited a significantly higher year to year growth rate in sales.

## INTRODUCTION

Small firms are a vital part of the United States economy. The U.S. Small Business Administration defines a small firm as one that has 500 or fewer employees. Using this definition, ninety-nine percent of all firms in the U.S. would be categorized as small businesses. Data compiled by the SBA indicate that there were 22.9 million small firms in this country in 2002 (Small Business by the Numbers, 2003). These firms generated over half of gross domestic product and employed more than half of the work force. In fact, small firms have been responsible for sixty to eighty percent of net new jobs. They are also an important source of innovation in the creation of new products, services, and technologies.

Within the larger category of small businesses, women-owned small businesses are a special sub-set. In spite of their growing numbers, however, women-owned firms continue to lag men-owned firms in a number of performance measures. Typically, women-owned firms are smaller than men-owned firms in terms of assets, revenues, and profits. Overall, women-owned firms tend to be very small and concentrated in highly competitive and less profitable service businesses (Brush, 1992; Chaganti, 1986; Loscocco & Robinson, 1991). These performance discrepancies could be partially due to different lifestyle choices on the part of women small business owners, but they could also be due to differences in the array of skills and experiences that women bring to small business ownership. This research will examine the effect of human capital variables including education and prior business experience on the performance of small women-owned firms to determine if higher levels of human capital are associated with higher levels of firm performance.

## DESCRIPTION OF THE DATA

Data for this study are drawn from the 1998 Survey of Small Business Finances (SSBF) conducted every five years by the Federal Reserve Board. The 1998 Survey is the most recent for which data are publicly available. It includes balance sheet and income statement data on 3,561 U.S. small firms defined as firms having 500 or fewer employees. Survey firms represent a random sample stratified by size, geographic location, gender, and the racial or ethnic identity of the firm owner. Sample weights are provided in order to make it possible to construct population estimates from the sample data. In addition to demographic data, the SSBF provides a wealth of information on the sample firms' use of financial products and services as well as on their use of financial service providers. It is the largest and most comprehensive data set of its type.

## MULTIVARIATE ANALYSIS

In order to explore the relationship between gender, human capital, and various measures of performance, a series of multivariate models were developed. The first of these examined the relationship between various measures of firm size, gender, and independent variables representing various aspects of human capital. The model took the following form:

Model 1:

$$\text{Logsales (or Logassts)} = a + b_1\text{ed2} + b_2\text{ed3} + b_3\text{ed4} + b_4\text{soleprop} + b_5\text{family} + b_6\text{inherit} + b_7\text{ownage} + b_8\text{firmage} + b_9\text{exp} + b_{10}\text{female} + e$$

The dependent variable, Logsales, represents the log of 1998 sales and is a measure of firm size. In a second iteration of the model, the log of total assets (Logassts), also a measure of firm size, was substituted as the dependent variable. The logged form of both variables was used because both values were highly skewed.

Independent variables represent firm or owner characteristics that could be expected to contribute to human capital. The variables Ed2, Ed3, and Ed4 represent various educational levels. Prior research has suggested that more highly educated firm owners tend to operate more successful firms (Kangasharju & Pekkala, 2002; Pena, 2002; Schiller & Crewson, 1997). The lowest educational level, Ed1 (did not graduate from high school), was omitted as the reference variable.

The variable Soleprop identifies firms that are organized as sole proprietorships and thus do not have the benefit of the education or experience that could be provided by partners. The variable Family indicates those firms that are defined by the firm owner as being family-owned, while the variable Inherit indicates those firms that were inherited. The owners of family-owned firms should be able to benefit from the human capital provided by other family members. Similarly, owners who have inherited their firms should benefit not only from the accumulated experience of prior generations but also from the experience of growing up in the business. Ownage and Firmage were included as

independent variables, because one would anticipate that older firm owners would have accumulated a greater amount of life experience, judgment, and maturity, while older firms would have weathered the shocks typically experienced by early stage firms.

The variable Exp indicates the firm owner's number of years of prior business experience. One would anticipate that more experienced owners would be better equipped for firm survival and success. Finally, Female is a dichotomous variable indicating whether or not the firm was owned by a woman.

A considerable amount of prior research has revealed that women-owned firms tend to be more heavily concentrated in the less growth oriented and less profitable sectors of service and retail. Since the intent of this paper is to compare the performance of women-owned firms to comparable men-owned firms, the multivariate analyses are confined to firms in the service and retail sectors. This will eliminate the potentially confounding effect of having a larger number of men-owned firms operating in sectors such as manufacturing and construction which are characterized by larger and more profitable firms. The results of Model 1 are included in Table 1 which reveals that, even controlling for various types of human capital, women-owned firms were still significantly smaller than men-owned firms in terms of total sales and total assets.

A second size model was constructed having total employees (Totemp) as the dependent variable. Since the number of employees is typically a function of firm size, logsales was added to this model as an independent variable. This model had the following form:

Model 2:

$$\text{Totemp} = a + b_1\text{ed2} + b_2\text{ed3} + b_3\text{ed4} + b_4\text{soleprop} + b_5\text{family} + b_6\text{inherit} + b_7\text{ownage} + b_8\text{firmage} + b_9\text{exp} + b_{10}\text{female} + b_{11}\text{logsales} + e$$

In this model, the variable Female was not significant, indicating that when we control for firm size, industry, and measures of human capital, women-owned firms were no smaller than men-owned firms in terms of total employees. This is an important finding, because it suggests that women-owned firms have the same willingness and potential to create jobs as firms owned by men.

A second set of models examined the relationship between various measures of profitability and independent variables representing human capital characteristics. In the first of these, return of sales (ROS) was used as the dependent variable:

Model 3:

$$\text{ROS (or Growth)} = a + b_1\text{ed2} + b_2\text{ed3} + b_3\text{ed4} + b_4\text{soleprop} + b_5\text{family} + b_6\text{inherit} + b_7\text{ownage} + b_8\text{firmage} + b_9\text{exp} + b_{10}\text{female} + b_{11}\text{logsales} + e$$

Return on sales was used as the dependent variable rather than return on assets or return of equity, because prior research has indicated that women-owned firms are smaller in

terms of assets. Thus, their ROA or ROE ratios might be unusually high because of the low denominator. Return of sales, on the other hand, is a measure of operating efficiency. It provides an indication of the firm owner's ability to manage expenses relative to revenues. In this model Tobit analysis was used, because the dependent variable, ROS, was truncated at a lower boundary of zero.

The results of Model 3 (Table 2) reveal that women-owned firms were significantly more profitable than men-owned firms in terms of return on assets. This finding supports prior research which has found that, although women-owned firms are smaller than men-owned firms, they are no less profitable. .

The Tobit model was repeated with a second independent variable representing year to year growth in sales (Growth). The results of this model are also provided in Table 2 which reveals that women-owned firms were significantly more likely to have experienced growth in sales from 1997 to 1998

As a final measure, two additional models were constructed to examine profitability and growth. In this instance, the dependent variable was a dichotomous variable indicating whether or not the firm achieved positive versus zero or negative profits (or growth). The model took the following form.

Model 4:

$$\text{Someprof (or Somegrow)} = a + b_1\text{ed2} + b_2\text{ed3} + b_3\text{ed4} + b_4\text{soleprop} + b_5\text{family} + b_6\text{inherit} + b_7\text{ownage} + b_8\text{firmage} + b_9\text{exp} + b_{10}\text{female} + b_{11}\text{logsales} + e$$

The variable representing gender was not significant indicating that women were no more likely than men to operate firms having positive profits. Women were, however, significantly more likely to operate positive growth firms than men.

## SUMMARY AND CONCLUSIONS

Prior research has been inconclusive regarding the performance of women-owned firms relative to firms owned by men. In general, however, it seems to suggest that women-owned firms are smaller and less growth oriented, though not necessarily less profitable. These results, using data from the 1998 Survey of Small Business Finances, sheds some additional light on those findings. Multivariate analysis reveals that women-owned firms were significantly smaller than men-owned firms in terms of total sales and total assets. Controlling for sales level and industry sector, however, women-owned firms had no fewer employees than men-owned firms suggesting that women-owned firms are just as willing and able to generate jobs as businesses operated by men. Further, these findings reveal that women-owned firms were significantly more profitable than men-owned firms in terms of return on sales. They also demonstrated a significantly higher year to year growth rate in sales. Women-owned firms were no more likely to demonstrate zero or negative profitability than men-owned firms, and they were significantly less likely to demonstrate zero or negative growth. Overall, these results seem to indicate that,

although women-owned firms under-perform men-owned firms in terms of firm size, they do not under-perform in measures of either profitability or growth.

Table 1  
Multivariate Analysis: Measures of Firm Size (Regression Analysis)  
Parameter Estimates

| Variables | Logsales     | Logassts     | Totemp      |
|-----------|--------------|--------------|-------------|
| Intercept | 13.85826**   | 12.13153**   | -75.61242** |
| Ed2       | -0.00564     | 0.46945      | 3.07499     |
| Ed3       | 0.17839      | 0.57058*     | 3.09457     |
| Ed4       | 0.56279*     | 0.92928**    | 7.23753     |
| Soleprop  | -2.07129**   | -1.73072**   | -6.63427**  |
| Family    | -0.54263**   | -0.60414**   | -12.91668** |
| Inherit   | 0.81282**    | 0.77297**    | 11.62575**  |
| Ownage    | -0.03370**   | -0.02645**   | 0.16007     |
| Firmage   | 0.03240**    | 0.02907**    | 0.36310**   |
| Exp       | 0.04151**    | 0.04121**    | 0.00431     |
| Female    | -0.54001**   | -0.54594**   | 2.74327     |
| Logsales  | not included | not included | 7.47572**   |
| R-square  | 0.3196       | 0.3227       | 0.2759      |
| Pr>F      | 0.0001       | 0.0001       | 0.0001      |

\*results significant at the .05 level

\*\*results significant at the .01 level

Table 2  
Multivariate Analysis: Measures of Firm Profitability and Growth (Tobit Analysis)  
Parameter Estimates

| Variables | ROS      | Growth    |
|-----------|----------|-----------|
| Intercept | 0.0898   | -0.2490*  |
| Ed2       | -0.0043  | -0.0114   |
| Ed3       | -0.0123  | 0.0290    |
| Ed4       | -0.0165  | 0.0244    |
| Soleprop  | 0.1763** | 0.0578**  |
| Family    | -0.0044  | 0.0013    |
| Inherit   | 0.0645*  | -0.1238** |
| Ownage    | -0.0010  | -0.0002   |
| Firmage   | 0.0014   | -0.0052** |
| Exp       | 0.0010   | -0.0039** |
| Female    | 0.0330*  | 0.0585**  |
| Logsales  | 0.0056   | 0.0328**  |

\*results significant at the .05 level

\*\*results significant at the .01 level



Table 3  
Multivariate Analysis: Measures of Firm Profitability and Growth  
(Logistic Regression Analysis)  
Parameter Estimates

| Variables | Someprof  | Somegrow  |
|-----------|-----------|-----------|
| Intercept | -3.2837** | -3.1494** |
| Ed2       | 0.5658    | 0.4077    |
| Ed3       | 0.3526    | 0.5162*   |
| Ed4       | 0.2267    | 0.4683    |
| Soleprop  | 1.0077**  | 0.2643**  |
| Family    | -0.0521   | 0.2134    |
| Inherit   | 0.4141    | -0.5372*  |
| Ownage    | -0.0119   | 0.0003    |
| Firmage   | 0.0138    | -0.0072   |
| Exp       | 0.0111    | -0.0134*  |
| Female    | 0.0992    | 0.1968*   |
| Logsales  | 0.3578**  | 0.2615**  |

\*results significant at the .05 level

\*\*results significant at the .01 level

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## **SAGE: AN INTERNATIONAL EDUCATION PROGRAM BASED ON ENTREPRENEURSHIP AND COMMUNITY SERVICE**

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Students for the Advancement of Global Entrepreneurship—SAGE—is a groundbreaking education program that links secondary school student organizations to “consultants/mentors” from local universities and businesses using an interscholastic structure similar to athletic competitions. Its mission: to advance entrepreneurship education and community service-learning across the world, emphasizing ethical business practices, social-responsibility, civic engagement and environmental awareness. SAGE provides a new avenue for teens to become actively involved in creating small businesses and contributing to the community.

During an academic year, a high school SAGE team is challenged to complete real-world projects. Near the end of the year, each team showcases its projects in a competitive “tournament” whose “referees” are local leaders business, civic and education communities. The team that wins its regional or state competition advances to the national competition; the national champion advances to the “SAGE World Cup.” SAGE has been operating as a pilot program for the past two years, and has grown to include approximately 100 high schools—16 high schools in California—and over 80 high schools in 10 other countries. This program is innovative and ambitious, for three reasons. First, SAGE students do not compete for grades; rather, they compete for the same type of recognition that comes with interscholastic sports. Second, SAGE cuts across boundaries between secondary education and higher education; between education and business; and, just as importantly, among countries. One of SAGE’s goals is to give all participants a global perspective along with local insight. Third, SAGE integrates entrepreneurship and community service-learning.

### **INTRODUCTION**

Students for the Advancement of Global Entrepreneurship—SAGE—addresses a global problem: access to educational resources that increase the capacity of young people to become self-reliant and employable in today’s global marketplace. It also addresses additional problems connected to secondary and postsecondary education, including: (1) the need for better collaboration among colleges, K-12, and local businesses to prepare students for life after graduation; (2) resistance to using alternative pedagogies, such as community service-learning (CSL) and problem-based learning (PBL), as a means of reforming curriculum and instruction in settings other than traditional classrooms (e.g., co-curricular student organizations), and (3) the lack of role models and mentors for high school students from nearby universities and businesses.

SAGE's mission is to advance entrepreneurship education and community service-learning across the world, emphasizing ethical business practices, social-responsibility, civic engagement and environmental awareness. This mission is accomplished by linking secondary school student organizations to "consultants/mentors" from local universities and businesses using an interscholastic structure similar to athletic competitions. During an academic year, a high school SAGE team is challenged to complete real-world projects. Near the end of the year, each team showcases its projects in a competitive "tournament" whose "referees" are local leaders recruited from the business, civic and education communities. The team that wins its regional or state competition advances to the national competition; the national champion advances to the "SAGE World Cup."

This paper contributes to the entrepreneurship education literature by describing the SAGE program and offering suggestions as to how this program is related to alternative pedagogies, community development and outreach. The remainder of this paper is organized as follows:

- I. History and background
- II. Description of how SAGE is an innovative learning project grounded in community service-learning (CSL) and problem-based learning (PBL); this description will also include the key features of the program
- III. SAGE's goals and structure
- IV. How SAGE's goals are linked to the new AACSB standards
- V. A description of how SAGE is a unique model for assessing the quality of CSL and PBL projects
- VI. So what?

## **HISTORY AND BACKGROUND**

The SAGE concept was created nine years ago under the name "Cal-High Students in Free Enterprise (SIFE)." A team of students and faculty from California State University, Chico (CSUC), a comprehensive four-year public university in California, started Cal-High SIFE in fall 1995. This program matched college business students with underserved and/or economically disadvantaged high schools. The college students became coaches and mentors in helping high school students develop entrepreneurship projects and hone skills needed to enter the workforce or go on to college.

Two years ago, the program was re-named from Cal-High SIFE to SAGE, for several reasons. First, high school SAGE teams focus on *entrepreneurship* rather than corporate careers as one of their main goals. Instead of merely "teaching others how free markets work in a global economy" and "teaching others how entrepreneurs succeed" (which are the main goals of collegiate SIFE chapters (<http://sife.org>), we wanted students to actually do something entrepreneurial.

Second, we wanted to reflect the *global scope* of the program. In 2003-2004, 16 high schools participated in the California competition, and over 200 high school students came to the CSUC campus at the end of March. This program has been so successful that collegiate teams from China, Kazakhstan, Mexico, Philippines, Poland, Tajikistan, Russia, South Africa and the

Ukraine started similar high school mentoring programs under the guidance and direction of CSUC students and faculty.

A third reason we re-named the project to SAGE was to reflect SAGE's more holistic set of judging criteria that include a component on civic engagement and another on environmental awareness, based on the philosophy of businessman and author Paul Hawken [1993, p. 1]:

*"The ultimate purpose of business is not, or should not be, simply to make money. Nor is it merely a system of making and selling things. The promise of business is to increase the general well-being of humankind through service, a creative invention and ethical philosophy."*

These two judging criteria ensure that SAGE teams include these topics as part of their projects. Exhibit 1 contains the SAGE judging criteria.

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Insert Exhibit 1 about here

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A fourth reason is that the name SAGE more accurately captures our vision and mission. *Sage* is defined in Webster's Dictionary as "wise; proceeding from wisdom; well-judged; grave; serious." This definition, we believe, more appropriately captures our vision of creating better futures through entrepreneurship and community service, with secondary students working collaboratively with older, more experienced consultants from nearby universities and the private sector.

### **SAGE—A COMMUNITY SERVICE-LEARNING (CSL) AND PROBLEM-BASED LEARNING (PBL) PROGRAM**

Experiential education encompasses a wide range of teaching and learning methods which engage the learner actively in whatever is being learned, whether it happens in the classroom, workplace, or community. CSL is one form of experiential learning. CSL is defined as: "A method under which students or participants learn and develop through active participation in thoughtfully organized service that is conducted in and meets the needs of a community, and is coordinated with the community and with an elementary school, secondary school, institution of higher education, or community service program" (National and Community Service Trust Act of 1993). One of the leading campus organizations in this area is the CSUC SIFE team. The mission of collegiate SIFE teams is to make a difference in their communities by learning, practicing, and teaching the principles of free enterprise. While completing community outreach projects, the students develop teamwork, leadership, and communication skills.

One of SAGE's unique features is that university business students are trained to become consultants, mentors and coaches for teams of secondary school students in their region. The university students, who can earn course credit as part of their CSL experience, aid the participating secondary school teacher and his/her SAGE students by helping them identify, deliver and assess outreach activities (readers can find a sample syllabus by going to the following website: <http://www.csuchico.edu/sage>). A pedagogy related to CSL is PBL, defined as

“an instructional method that challenges students to ‘learn to learn,’ working cooperatively in groups to seek solutions to real world problems. These problems are used to engage students' curiosity and to initiate learning the subject matter. PBL prepares students to think critically and analytically, and to find and use appropriate learning resources.” (<http://www.udel.edu/pbl/>). SAGE allows secondary school students to seek solutions to real world problems by working cooperatively on projects that they identify, deliver and assess, with input from their college mentors, their business advisory board (BAB) members and their teacher.

It should be noted that the PBL projects completed by the secondary school students can be integrated into their regular coursework or as a co-curricular activity after school or on weekends, depending on the school's infrastructure.

### **SAGE'S GOALS AND STRUCTURE**

SAGE has three main goals:

- To establish new linkages between secondary schools and universities in North America and abroad, furthering entrepreneurship education and community service for high school educators and their students; the high school students will be assisted by their college consultants.
- To contribute to the learning of business, entrepreneurship, civic engagement and environmental awareness at the secondary school level by creating an infrastructure that relies on CSL and PBL.
- To involve the business community by enlisting business managers, executives and entrepreneurs to participate as guest speakers, consultants and business advisers for SAGE high schools. Further, in the role as SAGE competition judges, they serve as evaluators and graders to determine which educational projects are doing the most to enhance business understanding and economic enterprise.

As for SAGE's structure, a high school teacher organizes a SAGE team at the beginning of an academic year. The adviser also seeks out assistance from a nearby college or university to recruit older mentors/consultants to help the SAGE students. Working with their college mentor, the high school students identify, deliver and assess activities related to entrepreneurship and community service. Near the end of the year, the SAGE teams in the area come together—usually at a university that “hosts” the competition—to showcase their projects in an oral and written presentation to judges. The competitive element incorporated into SAGE is very important. At the SAGE competition each high school is placed into a competitive league, much like athletic competitions.

This structure also allows teams to “benchmark” their best projects against other secondary schools. Unquestionably, one of the strongest motivators for a young person is peer pressure, and the SAGE structure, in a subtle yet powerful manner, has incorporated this motivational technique into a tournament-like setting. Any high school with an active business class is welcome to participate, as are student organizations like Future Business Leaders of America (FBLA), DECA (an association for students and teachers of marketing, management and

entrepreneurship), Junior Achievement, Virtual Enterprise, Future Farmers of America, SkillsUSA or the Technology Student Association (TSA).

Advisors serving on a SAGE high school team's BAB can participate in a second way. These entrepreneurs, business leaders and civic leaders can serve as official SAGE judges at a state, national or global SAGE competition. State and national competitions take place between February and July each year, followed by the "SAGE World Cup" (note: the third annual SAGE World Cup will take place on August 11-14, 2005, in San Francisco. The Second Annual SAGE World Cup took place on May 20-23, 2004 in San Francisco; seven countries participated. Results: Philippines, 1<sup>st</sup> place; Tajikistan, 2<sup>nd</sup> place; China, 3<sup>rd</sup> place; USA and Poland, tie for 4<sup>th</sup> place; South Africa, 6<sup>th</sup> place; Mexico, 7<sup>th</sup> place).

### **SAGE AND AACSB STANDARDS**

On April 25, 2003, the AACSB International (Association to Advance Collegiate Schools of Business) passed its new accreditation procedures and standards for business school accreditation. The AACSB assures quality and promotes excellence and continuous improvement in undergraduate and graduate education for business administration and accounting. The new standards require business colleges wanting accreditation to incorporate a stronger global emphasis into their curriculum. For example:

- "Every graduate should be prepared to pursue a business or management career in a global context. That is, students should be exposed to cultural practices different from their own. The learning experiences should foster sensitivity and flexibility toward cultural differences. For the benefit of all, active support of a number of perspectives is desirable." (AACSB, p. 12)
- "The curriculum management process will result in an undergraduate degree program that includes learning experiences in such general knowledge and skill areas as multicultural and diversity understanding, and such management-specific knowledge and skills areas as domestic and global economic environments of organizations." (AACSB, p. 19)

SAGE addresses these standards by involving university students in a consulting role that includes a global dimension. Exhibit 1 shows the third judging criterion by which high school students are evaluated. This criterion is intentionally broad in scope and vague in specifics. In order to be successful in today's business world, it is important that students interested in pursuing entrepreneurial ventures (or careers in business) be exposed to cultural practices different from their own. Also, it is important that they are aware of key policymaking organizations, such as the NAFTA, ASEAN, IMF, the World Bank, the WTO and the European Union.

It is vital for university students and high school SAGE students to have ample opportunity to learn entrepreneurial skills, while at the same time learning how international trade directly affects many aspects of their lives (e.g., from purchasing decisions to career choices). SAGE builds international linkages between education and business that currently do not exist.

SAGE teams from different states or countries are encouraged to work with each other in determining if there is a potential market for import/export products. Other types of projects might be a study of how free markets work in an economy other than one's own, or an in-depth study of the roles and responsibilities of various policymakers in a global economy. By including a judging criterion with a global dimension, SAGE provides secondary students with an international perspective and, for the most outstanding students, a unique cultural exchange program when they travel to the SAGE World Cup in August each year.

### **SAGE: A UNIQUE ASSESSMENT MODEL**

Another unique feature of SAGE is that accountability is built in as one of the nine judging criteria by which SAGE teams are evaluated. The last criterion reads: "In their projects, how effective were the students in measuring the results of their projects (e.g., pre- and post-test results)?" It is very important that a SAGE team measures the results of its projects. SAGE teams are urged to include an assessment component for each project, and the college mentors make them aware that "what gets measured gets managed." When SAGE teams compete against one another at national and international competitions they have the opportunity to learn how to improve their projects based on judges comments and ratings; they also have the opportunity to see the best projects completed by other teams. This is an example of how the judges' ratings are also used as a formative assessment tool.

Most assessment data currently used to evaluate service-learning projects lie in the area of authentic assessment (Hart, 1994). Examples of SAGE authentic assessment data included the number of organizations in the community who have benefited from SAGE projects. Other data include the annual summary written report and an oral presentation to a critical panel of judges.

Taken together, the SAGE judging criteria provide another form of assessment by offering a feedback mechanism for communicating project outcomes to students and thus represent the equivalent of a syllabus in a course. The judging criteria also help students understand how the judges assess student skills and thus play a role similar to grading policies/exams in a course. Menlo (1993) and Honett and Poulsen (1989) have shown that performance feedback is an effective development tool for students involved in CSL and PBL activities.

As for the university students, they must keep an activity log describing what they did during the semester (the log must show at least 35 hours of service in order to earn one unit of credit). At the end of the semester, the students must also write a reflection essay describe their experience, explain what they learned, offer recommendations to improve the project, and indicate whether or not they plan to continue with the project after the semester is over.

### **HOW TO START A SAGE PROGRAM**

There are three important "legs on the stool" that must exist for SAGE to succeed as a viable program in one's area. First, it is vital that there is a committed, entrepreneurial high school teacher who will serve as a SAGE adviser. Second, one needs a community college or university in the area with business students who have the motivation and incentive to become SAGE



consultants. Third, the community needs to be aware that a SAGE program exists, with business, civic and education leaders willing to participate, both in terms of time and financial support.

1. Entrepreneurial High School Teacher – The typical SAGE adviser is a high school teacher who currently teaches a business class such as “Virtual Enterprise,” is part of a business academy, or is an adviser to a high school business organization like FBLA or DECA (an association for students and teachers of marketing, management and entrepreneurship). In most cases students are already completing entrepreneurship projects or projects related to entrepreneurship, and the teachers are proud of their accomplishments. SAGE provides an additional, public venue for their students to achieve recognition and reward for their accomplishments.

2. Community College/University – Higher education is involved mainly through business departments and colleges, and the dean sees that SAGE has a fit with his/her academic unit. SAGE provides an avenue for entrepreneurship students to obtain hands-on learning; it offers a mechanism by which business departments can offer any business student CSL course credit; and if the campus has a SIFE program SAGE is an outstanding community service project which can help the team excel at the collegiate competitions. Under all three scenarios, SAGE offers the business unit an avenue to gain goodwill from the community at large through positive press and image building. Just like the first leg of the stool, however, for SAGE to take root on a college campus, one needs an entrepreneurial faculty member to champion the cause. This may require release time or overload compensation.

3. Business and Civic Leaders – Community leaders have a vested interest in making sure that today’s youth are educated in entrepreneurship, financial concepts and international trade. SAGE provides a model to help high school students accomplish their dreams through entrepreneurship and community service. Most of these students will enter the work force directly after graduation, go on to college and become a college mentor or start their own business.

Any business or civic leader can participate, once a high school and college in the community has started a SAGE program. Furthermore, any private foundation that supports youth development, service learning, leadership, and innovative K-12 and university partnerships is invited to join our SAGE network. If no SAGE program exists in an area, a business or civic leader can take steps to create one. They can:

1. Urge local high school principals or superintendent to launch a high school SAGE team.
2. Encourage high school teachers who teach economics, social studies, technology, civics, accounting or general business to become a SAGE adviser
3. Arrange for a presentation of the SAGE program to school boards, Rotary Clubs, Chamber of Commerce, etc. (sample templates are available from the author or at the SAGE web site at <http://www.csuchico.edu/sage>).

Once a SAGE program exists, one can:

1. Serve on the BAB of a high school SAGE team.
2. Serve on the BAB of the university working with a local high school SAGE team.
3. Be a guest speaker at periodic meetings.

4. Provide financial support to help fund outstanding projects. This may mean writing a letter of support to the community affairs division or to the non-profit foundation affiliated with your for-profit company.
5. Hire the high school or college students as interns.
6. Volunteer to judge at a High School SAGE Regional Competition.
7. Volunteer to judge at the USA SAGE or World Cup Competitions.

One business leader who supports SAGE is Rieva Lesonsky, Editor-in-Chief, *Entrepreneur* Magazine. She said:

"I want to issue a challenge. If California State University, Chico can create the hugely successful California SAGE program, why can't this happen in Arizona, Texas, Utah, or Nebraska? Why can't there be a nationwide high school SAGE competition? Why can't SAGE be global?"

### **FUTURE PLANS FOR SAGE**

As of October, 2004, CSUC has secured funding to finance the 2004-2005 California SAGE program from the Allstate Foundation, and has also secured funding to expand USA SAGE, thanks to a grant from the Walgreens Foundation (grant proposal copies available upon request). Five states have committed so far: Idaho, Nevada, New York, Pennsylvania and Texas. Moreover, discussions are underway with Colorado, Iowa and Tennessee. Internationally, several more countries are planning to join the SAGE network. We are currently seeking sponsorship for Global SAGE, so that Australia, Chile, Kyrgyzstan and Uzbekistan will be able to join existing SAGE programs. Proposals are currently pending with Ernst & Young, UBS, and the Bank of America Foundation.

### **SO WHAT?**

SAGE enhances international business education programs in 10 countries, and actively engages the business community in activities that promote an understanding of business, entrepreneurship and economics. The activities completed by the institutions of higher education and secondary schools, with input from leaders in the private and public sectors, are contributing not only to a better understanding of entrepreneurship and community service, but also brings the most outstanding teams together to showcase their best projects at the SAGE World Cup. At the World Cup, all participants learn from one another based on the common goals; U.S. participants learn more about the cultural norms, attitudes and entrepreneurship environments in each of the countries in the SAGE network; and just as importantly participants from these countries learn about the entrepreneurship and cultural environments in the U.S.

SAGE can be implemented by universities as a community service-learning program (e.g., integrated into existing coursework, added as a new course, or included as a self-standing, co-curricular program completed by a business student organization). Moreover, secondary schools can implement SAGE using a problem-based learning approach. Toward this end, the projects completed within the SAGE network can be integrated into the curricula of both the secondary schools and higher educational institutions, consistent with the missions, goals and structures in place at each home institution.

## EXHIBIT 1: SAGE JUDGING CRITERIA

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|--|
| <i>In their annual report and verbal presentation, how effective were the students in demonstrating that they:</i>   |
| (1) Completed at least one entrepreneurship project and/or one business-related project (e.g., a “virtual business”)? In completing such project(s), the students show that they have <i>learned</i> about entrepreneurship and business, and have been able to <i>apply</i> their knowledge and skills to plan and implement their project(s).  |
| (2) Completed at least one community outreach project(s)? In completing such project(s), the students have shown that they understand the importance of social responsibility, and the ethic of “giving back.” An example would be a significant teaching project, whereby students have taught financial management skills to others, such as younger students or senior citizens (e.g., budgeting, time value of money, accounting, saving and investing)? |
| (3) Included at least one type of “global” component in their activities during the year (e.g., did students work with students or businesses from another country to import/export products; did they study how free markets work in an economy other than their own; did they study who are the key policymakers in a global economy?).  |
| (4) Understand the importance of civic engagement in a democratic society, and that each citizen can exercise their freedom by registering to vote and participating in public elections?  |
| (5) Understand the importance of being responsible stewards of the environment in a free market economy?   |
| <i>In their projects, how effective were the students in:</i>  |
| (6) Utilizing at least one or two college “consultants/mentors” from a nearby college or university to help them identify, deliver, assess and present their projects?   |
| (7) Utilizing a Business Advisory Board (each team should have at least three active BAB members, at least two of whom come from the private sector)?  |
| (8) Utilizing mass media (e.g., newspapers, TV, radio, billboards, and newsletters)? Attach newspaper articles to the annual report.   |
| (9) Measuring the results of their projects (e.g., pre- and post-test results; financial statements)?  |

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# Response to Michael Porter: An Alternative Model for Supporting Inner City Firms

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## Abstract

Small businesses are an essential part of the United State economy. According to the U.S. Small Business Administration, small firms employ 53 percent of the workforce and contribute 47 percent of sales. They are responsible for 51 percent of gross domestic product and account for the vast majority of net new jobs (The Facts About Small Business, 1999). Small firms are also a major source of innovation, producing twice as many new product and service innovations as larger firms.

Firms owned by minority business owners represent a special subset of small firms that are growing even more rapidly than small firms in general. The number of black-owned

firms increased by 26 percent from 1992 to 1997 to a total of 823,499 firms. This compares to a 4 percent growth rate for non-minority owned firms for the same timeframe. Simultaneously, revenues for black-owned firms increased by 120 percent to a total of \$71 billion (Minorities in Business, 2001). The numbers for Hispanic-owned firms are equally impressive. In 1997, Hispanic-owned firms totaled 1.4 million firms representing an increase of 80 percent from 1992. During that same timeframe revenues more than doubled to a level of \$184 billion.

Minority-owned firms are worthy of study in and of themselves for several important reasons. First, firm ownership provides a path to economic empowerment for entrepreneurs and their families. Prior research indicates that, on average, the level of household wealth for black and Hispanic families falls well below of that of white families (Badu et al., 1999; Blau & Graham, 1990; Smith, 1995). Simultaneously, however, research reveals that individuals who own their own firms have higher household income and wealth than the population in general (Haynes, 2001). Thus, owning and operating a successful small business can be a strategy for minority families to achieve the “American Dream”.

Second, a vibrant small business sector is key to the economic revitalization of many inner city communities. Since minority families tend to represent a higher percentage of the inner city population, it is important to have a range of flourishing small businesses to serve their needs as well as those of the larger community. In his article entitled “The Competitive Advantage of the Inner City”, Michael Porter (1995) presents a convincing

case for the economic role played by urban small businesses. Although Porter argues for a relatively free market approach to the development of urban small businesses, others contend that this will not happen without government intervention and additional sources of support (Dymski, 1996; Rogers et al., 2001). This article will describe one such program conducted by the University of Hartford, the Upper Albany Program, which combines resources from both the public and private sector to support small and emerging businesses in one of Hartford's neighborhoods.

The University of Hartford, in partnership with the Upper Albany Main Street Program, launched a few years ago (and currently manages) a successful community-based service learning initiative centered on creating relationships and building the capability of our culturally diverse area entrepreneurs. By empowering the community and by focusing on developing self sufficiency and skill advancement, the area is showing signs of economic growth. This article describes how a private university with a public mission can champion and follow-through on a plan to revitalize and support a commercial district leading to clear and measurable outcomes.

This articles highlights that minority-owned businesses have enjoyed a significantly higher growth rate over the past few years compared to their counterparts; it emphasizes that entrepreneurship can be an alternative to unemployment or underemployment in culturally diverse neighborhood historically plagued with crime and unemployment; it shows that minority-owned businesses are uniquely knowledgeable in identifying and providing products and services to the rapidly growing minority segment of the economy;

it shows how a community based program can be the vehicle for economic development and be at the center of urban intern cities growth; and lastly, this article highlights that little is know about what drives the success of minority-owned businesses.

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# **SELF-ASSESSED LEADERSHIP TRAITS OF FRANCHISEES VS. MANAGERS: IS THERE HOPE?**

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## **ABSTRACT**

Organizational leadership traits, hope level, organizational commitment, and service quality perceptions of franchised managers and franchisees are differentiated in the current study in order to add to the current understanding of the role of franchising in entrepreneurship and to help franchise systems improve efficiency. For scholars, the dynamic relationship between entrepreneurship, franchisees, and management is an important and developing triangle in the organizational behavior literature which merits further investigation. For practitioners, the role of leadership styles in franchising and entrepreneurship presents a valuable recruiting imperative. The current research proposes a study for better understanding of the variations between these roles in organizations.

## **INTRODUCTION**

Franchising has been one of the fastest growing methods of doing business in the U.S. and abroad for the last half century. It is a less expensive, less risky form of doing business than developing a start up company (Taylor, 2000). Because of the dominance of this form of doing business, the exploration of franchisees' perceptions as well as the perceptions of the managers that work with them is needed to investigate the differences between franchising and other types of entrepreneurship, but also in order to increase the effectiveness of franchised organizations.

## **BACKGROUND LITERATURE**

### *Entrepreneurship Theory and the Resource-Based View of the Firm*

There is extensive literature on the role of entrepreneurship in economic development. The work of Schumpeter (1934) is a key building block in the argument that new firms are essential to a revitalized economic order. In this view, entrepreneurs destroy the existing economic order by introducing new products and services, by creating new forms of organization, or by exploiting new raw materials. Opportunity recognition and subsequent action are essential to entrepreneurship. The importance of acquiring resources for new venture formation and growth



is a long-standing theme in the entrepreneurship literature (Gartner, 1985; Covin & Slevin, 1991; Stevenson & Gumpert, 1985; Timmons, 2004). Alvarez and Busenitz (2001) have linked entrepreneurship theory and the Resource-Based View (RBV) of the firm by identifying resources as the central focus of the two theoretical models. In entrepreneurship, opportunities are recognized because individuals have heterogeneous views of resources while RBV views heterogeneous resources across firms as the basis for sustainable competitive advantage.

Resource-Based View theory addresses one of the central issues in management - the identification of the factors that make firms different and are responsible for above average performance (Rumelt, Schendel, & Teece, 1994). In this perspective, resources of the firm, both tangible and intangible, and their combinations are employed by managers to provide competitive advantage (Amit & Schoemaker, 1993; Barney, 1986; Conner, 1991; Penrose, 1959; Prahalad & Hamel, 1990; Wernerfelt, 1984). The sustainability of the competitive advantage of resources, capabilities and core competencies depends on factors such as the rate of environmental change, degree of imitation and the availability of substitutes (Hitt, Ireland, & Hoskisson, 1999). The challenge for managers is how to develop and use resources under conditions of uncertainty, complexity and intra-organizational conflicts (Amit & Schoemaker, 1993).

The acquisition of financial resources and human resources in the form of a management team are cited as particularly important (Timmons, 2004). The RBV of the firm has more typically dealt with the deployment of resources in established firms. Recent research provides an expanded definition of human resources (capital) and social capital that take into account the personal characteristics and connections of the entrepreneur (Brush & Greene, 1996). This work can provide a link between the RBV and the extensive research on the individual entrepreneur (Shaver & Scott, 1991). Some of the personal characteristics that have received attention in the literature include need for achievement (McClelland, 1961), locus of control (Rotter, 1966), propensity for risk (Slevin & Covin, 1992), and vision (Falbe & Larwood, 1995).

The resource based view of the firm provides an explanation for the functioning of the franchisor-franchisee relationship. The franchisor obtains capital, managerial expertise and knowledge of local markets from the franchisee. In turn, the franchisee depends on the franchisor for a business system including strategies and tactics, policies and procedures, operating experience, technology, advertising, and a valuable brand name. Each contributes a bundle of complementary resources which provide the firm a competitive advantage. However, an important difference is that franchisees are not managers in their business, rather they are the owners and as such franchisees, for the most part, tend to put much more into the effort of running their business, yet this RBV of the firm could be extended to the relationship between the franchisee who brings resources and managers who deploy those resources.

#### *Franchising as a Form of Entrepreneurship*

The franchisor, or founder of the unique business format system, fits clearly into the definitions of entrepreneurship found in the literature as reviewed by Low and MacMillan (1988), such as carrying out new combinations (Schumpeter, 1934); driven by the perception of opportunity (Stevenson, Roberts, & Grousbeck, 1989); and the creation of new ventures (Gartner, 1985). Franchising encompasses entrepreneurial characteristics such as the introduction of new products

and services, innovative marketing, openness to change, outrunning the competition and fast growth (Aldrich & Auster, 1986; Gartner, 1985).

While franchisees differ from the traditional entrepreneurs in that they are buying a license from an organization that has a market tested concept and a structured set of operating procedures, usually decreasing their risk substantially relative to a traditional start up business, they are still business owners, which classify them as a particular type of entrepreneur. Entrepreneurship entails: innovativeness, risk taking, and proactiveness (Burgelman, 1983; Morrison, 2000). Despite the control of the franchisor, a franchisee still must commit to a certain amount of risk taking and proactiveness in the running their business successfully.

### *Current Research*

Young, McIntyre, and Green (2000) conducted a content analysis of the first thirteen volumes of the International Society of Franchising (ISOF) Proceedings (1986, 1988-1999). Twelve major topics of research were identified. Entrepreneurship and franchising encompassed twelve papers out of 285 papers and ranked eighth in frequency. No papers on leadership per se were presented; however, six papers on power and influence were presented. Overall, ISOF members' research interests primarily reflect the results provided by Elango and Fried's (1997) review of franchising research published in journals. They identified an absence of research involving training, control systems, cooperative advertising, and communication. Leadership was not mentioned.

The managers and franchisees of a business must work together in a system that maximizes the performance of the business. The franchised organization, the franchisee, the managers and the hourly employees makes up a diverse set of interactions when operating a business. As such, this study will hone in on the relationship between self-assessed leadership traits (organizational leadership traits, hope level, organizational commitment, and service quality perceptions) of franchisees and the managers in the organizations, which seem to be missing from the franchising literature.

### *Organizational Leadership Traits*

In a pilot research study done by Welsh et al (2001), it was determined that the perceptions of the vision, leadership, and operations of franchise systems were different depending on whether you were a franchisee or a franchisor in the system. Franchisors viewed themselves as much more likely to recognize rapid change in the industry and company, focus more on research and development, and be more innovative than the perspective of the franchisee regarding the same franchisor. Franchisors also viewed themselves as more long-term and strategic than the franchisees in the system. By using the same organizational leadership traits analyzed in that initial pilot study, the current study intends to analyze the similarity and differences between the perspectives of franchisees and managers in franchise systems, rather than the differences between franchisees and franchisors.

### *Proposition 1*

The leadership style of franchisees will differ from the leadership styles of manager

### *Hope in Franchisees and Managers*

A theory measuring hope and the usefulness of hope was developed by Snyder et al (1991). Snyder determined that hope, beyond wishful thinking, is represented by a person's ability to use their willpower or desire (agency) to get something (goal) accomplished, and their ability to create various paths to get the goal accomplished (pathways). These two components (agency and pathways) help determine how successful someone will be at achieving their goals. Hope has been a construct that has been researched in academics, athletics, and physical and mental health areas and has been positively correlated to positive performance outcomes, but has lacked empirical research in business settings to date beyond Peterson and Luthans' (2003) exploratory study using "state" hope with managers in a single fast food restaurant chain, and Adams, et al. (2002) who examined some emerging concepts of hope in the workplace. The concept of hope has not been fully explored relative to business leadership and performance.

In current management and business literature, the trend has been to start looking at the positive traits that people have and not as much at the negative traits that have been prevalent in the literature regarding work performance. Luthans (2001, 2002) introduced the term positive organizational behavior (POB) and positive approach to leadership (PAL) (Luthans, et al., 2002) to describe the construct of trying to encourage managers and leaders to support people in developing their strengths instead of reprimanding and criticizing people for their weaknesses. The traditional positive organizational behavior constructs most related to hope are: self-efficacy and optimism.

Self-efficacy (confidence) theory is similar to hope theory (Bandura, 1977). The theories are related in that agency or willpower is similar to efficacy expectancies and pathways or waypower is similar to outcome expectancies. The concept of hope is different in that Snyder (2002) has determined that agency and pathways are equally important to goal accomplishment and operate in a combined, iterative manner, while Bandura (1977) posits that efficacy expectancies are the most critical component of self-efficacy.

Hope is different from optimism because hope is initiated and determined through oneself rather than by external forces. Optimism theory tends to make external attributions for negative outcomes, rather than making internal attributions (Seligman, 1998). Optimism uses the agency component of having drive or motivation to get goals accomplished, but not necessarily the ability to find various pathways to get goals accomplished. In measuring hope, the pathways and agency are both equally important (Snyder, 2002). In the literature on franchising, the personality of individuals that chose to go into franchising is more "adventuresome, risk taking and aggressive" than those not in a franchisee position.

#### Proposition 2

Franchisees will have higher levels of hope than managers.

#### *Organizational Commitment*

Organizational commitment has been defined as the magnitude of an employee's relationship with a company. Many times, it is related to various factors such as the employee's belief in the organization's goals and values, the employee's attitude in giving effort for the company and the desire to remain with the company (Mowday, Steers, and Porter, 1981). Hunt, Chonko, and

Wood (1985) viewed organizational commitment as having the strong need to stay with the company when given opportunities to leave.

Empirical work regarding organizational commitment exists within the business and hospitality research that underscores the importance of this concept to franchised organizations. Many earlier studies linked the organizational commitment variable with its relationship to role ambiguity, role conflict, work-family conflict, job satisfaction and intentions to stay (Good, Sisler, and Gentry, 1988; Johnston et al, 1990; Michaels et al, 1988). Recently, a study of organizational commitment in hotel managers supported past literature claiming that work overload, conflict and job ambiguity can all reduce organizational commitment and that a feeling of importance, expectations of pay, social involvements and organizational dependence lead to increased levels of commitment (Maxwell & Steele, 2003). Understanding the differences between managers and owners of franchised businesses and being realistic about their various levels of commitment can aid franchise organizations in setting policies and procedures which are realistic, fair and improve upon the performance of the organization.

#### Proposition 3

Franchisees will have more organizational commitment than managers.

#### *Service Quality*

Service quality as defined by Zeithaml, Parasuraman, and Berry (1991) is made up of five attributes. These attributes include tangibles, reliability, empathy, assurance, and responsiveness. Tangibles refer to the physical appearance of the actual organization. Reliability is the ability to do for the guest what the business said they were going to do. Empathy refers to the ability of the staff to put themselves in the shoes of the customer. Assurance refers to the delivery of the service while making the customer feel like you are trustworthy. Responsiveness refers to the speed of the delivery and the speed at which the business responds to customer needs. These five attributes represent a good assessment of the service quality expected by the consumer.

From the inside of a franchised business, understanding the perceptions and the differences in perceptions of service quality between the managers and the franchisees is critical in order to better employ service training systems that are realistic and effective. The current survey instrument was created in order to determine the perception of franchisees and managers regarding the service provided by the organizations to the customer. In aligning company policies, it is important that both franchisees and managers understand the service they are delivering to the guest. Further we may surmise that hopeful individuals will have a higher perception of the service being delivered and that more committed individuals will perceive higher levels of service delivered and finally this may vary by leadership trait.

#### Proposition 4

Franchisees will have a higher perception of service quality than managers.

### **OBJECTIVES OF STUDY**

Since both franchisees and the managers in the franchised organizations play a key role in the success of the business, it is important to understand the inter-relationships and perceptions of

these inter-relationships between franchisees and managers. Specifically, the variables investigated in this study include perceived organizational leadership traits, hope levels, organizational commitment and service quality perceptions of the individuals.

### **SURVEY ITEMS**

*Organizational Leadership-* The first hypothesis was tested by the use of the Organizational Leadership/Entrepreneurship items on the survey. These 15 items were taken from a pilot survey distributed to a random sample of members of the British Franchise Association and the International Franchise Association developed by Welsh et al (2001). Through this pilot study, it was determined that franchisors and franchisees did not view the vision, leadership, and operations of the franchise system the same.

*Hope-* The dispositional hope items were developed and validated by Snyder, et al. (1991). The 12 items consist of four items measuring agency, four measuring pathways, and four distracter items. The instrument demonstrates both internal reliability (alphas ranging from .74-.88 for the overall scale, and alphas of .70-.84 for the agency and .63-.86 for the pathways subscales) and temporal reliability (test-retests range from .85 for three weeks to .82 for 10 weeks). The agency and pathways subscales were related, but not identical (Snyder, 2002; Babyak, Snyder, & Yoshinobu, 1993). The hope scale has also received extensive concurrent and discriminant validation support, as well as experimental manipulation-based convergent validation (Snyder et al., 1991).

*Organizational Commitment-* Items used to measure organizational commitment were adapted from Mowday, Steers and Porter (1981). For a review of the use of this scale, see Zajac and Mathieu (1990). Reliability estimates for Michaels et al (1988) reported an alpha of .90 for the items, while Good et al (1988) sampled 595 department stores and arrived at an alpha of .91, thus all studies proving consistent in reliability estimates.

*Service Quality-* Using a modified version of SERVQUAL (Parasuraman et al, 1986), the managers' and franchisees' perceptions of quality delivered to guests were evaluated. The perceptions tell us what the manager feels the company is delivering at the current moment on all of the attributes of the service quality instrument. The SERVQUAL questionnaire has been used extensively with all validities and reliabilities confirmed across and within service industries. There are five items measuring reliability, with four items measuring empathy, assurance, responsiveness, and tangibles. Most past studies have reported reliability alpha estimates of .87 and .90 across the multiple dimensions of tangibles, reliability, empathy, assurance, and responsiveness, again, acceptable in terms of reliability (Parasuraman et al., 1986).

### **IMPLICATIONS FOR PRACTICE**

Franchising is an essential method of doing business in the U.S. and globally. Increasing the understanding of the leadership styles of franchisees and the managers working for them will help to discern the effectiveness of these various leadership styles with the positions held in the organizations. The current study will determine if there is a difference between the franchisees of today and their managers. The current study will help to fill a void in the entrepreneurship and franchising literature regarding self-assessed leadership traits and the hope that could lead to improved performance and success in franchised systems.

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# **ENTREPRENEURSHIP: A DIVERSE CONCEPT IN A DIVERSE WORLD**

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## **Abstract**

*Entrepreneurship is an ancient concept that is both simple and complex at the same time. Conceptualizations, definitions, understandings of the phenomenon, have eluded scholars and practitioners for a very long time. While we struggle to try and capture it, as we seem to get closer to a satisfactory resolution, we find that the concept continues to evolve. This paper presents a historical summary and synthesis of entrepreneurship and (re)raises some significant issues that are unresolved.*

## **THE HISTORY ENTREPRENEURSHIP**

The concept of entrepreneurship has been around as long as man has existed. Its serious study and documentation, however, has been around only a couple hundred years, and the field of entrepreneurship studies has only been seriously coalescing over the last fifty. A handful of academic programs focused on entrepreneurship by the mid 1970's but has grown to universal acceptance in curriculum, research and practice

Let's go back in time to chronologically reference some of the more important writings on entrepreneurship. Throughout this journey, recognize the many nuances of the definition, causation and person/environment controversies that contribute to the fuzziness of the concept known as entrepreneurship and analyze our conclusion that the field has arrived at an era demanding better entrepreneurship, an entrepreneurship that is more visionary, disciplined and sensitive to the openness of modern systems. We lead you in the application of open systems theory (some other similar theories that we discuss that are closely aligned to open system thinking are complex adaptive theory, systems theory, emergent theory and learning organization theory). We conclude by illustrating how open systems theory has emerged as a point of light from this mass of literature; and how the future study and practice of entrepreneurship might proceed along the systems vein based on some logical assumptions arising from systems theory that helps synthesize a definition that is more operational, capturing behaviors that constitute entrepreneurial events and subsystems epitomized by the American socio-economic system.

## **Diversity of Literature**

The history of entrepreneurship study is multi-disciplinary, multi-national and rather

lengthy and abstruse. The scope of the literature, the number of authors and the multi-disciplinary nature of entrepreneurship complicate any comprehensive literature review. Yet, we'll try to keep it manageable.

The literature on entrepreneurship since Cantillon, 1437 doesn't exactly clean up conceptual, definitional and theoretical matters; in fact, in many ways theoretical progress has left us more puzzled on many issues. For good reason, Wilken (1979) used the search for the Heffalump as a metaphor to describe the search for a definition of entrepreneurship. The mystical Heffalump search is particularly poignant because the Heffalump is a leviathan beast of "Winnie the Pooh" fame, which is a large and intimidating entity that exists in an unknown kingdom that is mysterious and abstract. In our opinion, the connotation of the word entrepreneurship, itself, is leviathan, having many roots, a large trunk and many extremities -- indicative of quite a long and diverse past that has roots in several languages and a variety of nations, eras, cultures and other tributaries, which contributes to its subjective and diverse connotation and annotation. Table I identifies and categorizes entrepreneurial theorists through history.

All the timelines for entrepreneurship in Exhibit I start roughly in the 18<sup>th</sup> century, because the 18<sup>th</sup> century was when entrepreneurship began to be studied and written about in earnest. Cantillon's reference to entrepreneurship is often cited as one of the first, so that's where the literature really begins to take form.

Many of the timelines presented in Exhibit I are traditional views spun a little differently. However, some of the timelines represent non-traditional interpretations of historical phases, stages or transitions in entrepreneurship study and knowledge. All are worth noting. The timelines are amalgams from the historical and current literature.

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Table I about here

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Exhibit I about here

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## **DEFINITIONS OF ENTREPRENEURSHIP**

Many writers have also tried to provide a specific definition for entrepreneurship, identifying what they believe makes entrepreneurship distinct from other forms of economic and management thought and behavior. Table II provides a sampling of definitions covering a variety of perspectives across various eras, with an emphasis on recent developments. These definitions incorporate a wide expanse of skills, thought processes, intentions and actual behaviors. The diversity in the emerging definitions seems to only foil attempts at establishing some universal definition. The diversity and complexity seems to be expanding not contracting, making any condensation into a single summary definition dubious.

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Table II about here

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## SUMMARY

Entrepreneurship is an intriguing and important topic, and has been throughout history. Entrepreneurship is distinguished by a unique managerial style and the interrelationships and outcomes it produces in our organized socio-economic existence. The history of the study of entrepreneurship has considerable literature, which emphasizes the importance and uniqueness of the entrepreneurial style. The entrepreneurial style is compelled to constantly rethink our wisdom about how organizational life works; and the style is always lurking to be creative, innovative and change things. This purest and most powerful form of management strives to advance our potential for organizational excellence to new levels of capability, as it intentionally endeavors to learn more about reality and influence our future more effectively. It's going to take forever to genuinely discover how extremely complex and dynamic concepts like entrepreneurship fit into man's perfect future and how entrepreneurial management can be used to give us ultimate progress. We better get started!!

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**Table I: A Chronological History of Entrepreneurial Theorists**

| <b>CLASSICAL (to about 1850)</b>  |
|---|
| <b>Richard Cantillon (Irish)</b> - (Herbert & Link, 1982, p. 21)            |
| <b>Francois Quesnay (French)</b> - (Herbert & Link, 1982, p. 25)            |
| <b>Anne-Robert, Jacques Turgot (French)</b> - (Herbert & Link, 1982, p. 29) |
| <b>Nicolas Baudeau (French)</b> - (Herbert & Link, 1982, p. 27)             |
| <b>Jeremy Bentham (English)</b> - (Herbert & Link, 1982p. 43)               |
| <b>J. B. Say (French)</b> - (Herbert & Link, 1982, p. 32)                   |
| <b>David Ricardo (English)</b> - (Herbert & Link, 1982, p. 40)              |
| <b>Adam Smith (English)</b> - (Herbert & Link, 1982, p. 38)                 |
| <b>J.H. von Thünen (German)</b> - (Herbert & Link, 1982, p. 45)             |
| <b>John Stuart Mill (English)</b> - (Herbert & Link, 1982, p. 44)           |
| <b>Bruno Hilderbrand (German)</b> - (Herbert & Link, 1982, p. 74)           |
| <b>Gustav (Hans) Schmöller (German)</b> - (Herbert & Link, 1982, p. 75)     |
| <b>H.K. Von Mangoldt (German)</b> - (Herbert & Link, 1982, p. 48)           |
| <b>NEOCLASSICAL (to about 1950)</b>   |
| <b>Karl Marx (German)</b>   |
| <b>Alfred Marshall (English)</b> - (Herbert & Link, 1982, p. 53)            |
| <b>Leon Walras (French)</b> - (Walker, p. 1)                                |
| <b>Carl Menger (Austrian)</b>   |
| <b>Francis Walker (American)</b>  |

|   |
|---|
| <b>Friedrich Von Wieser (Austrian)</b> - (Herbert & Link, 1982, p. 51)  |
| <b>Eugen Von Böhm-Bawerk (Austrian)</b>   |
| <b>Francis Y Edgeworth (1926, English)</b> (Herbert & Link, 1982, p. 51)  |
| <b>F.W. Taussig (American)</b> - (Herbert & Link, 1982, p. 68)  |
| <b>Warner Sombart (German)</b> - (Herbert & Link, 1982, p. 75)  |
| <b>Max Weber (German)</b>   |
| <b>Israel Mayer Kirzner (Austrian)</b> - (Herbert & Link, 1982, pp. 95-96)  |
| <b>John Bates Clark (American)</b>  |
| <b>Harvey Leibenstein (Austrian)</b> - (Herbert & Link, 1982, p. 100)   |
| <b>Edwin F. Gay (American)</b>  |
| <b>A.C. Pigou (English)</b> - (Herbert & Link, 1982, p. 56)   |
| <b>Ludwig von Mises (Austrian)</b>  |
| <b>Schumpeter (German)</b> - (Herbert & Link, 1982, p. 73, p. 75)   |
| <b>John Keynes (English)</b> - (Herbert & Link, 1982, p. 68)  |
| <b>MODERN (to about 1980)</b>   |
| <b>Frank H. Knight (American)</b> - (Herbert & Link, 1982, p. 69)   |
| <b>Arthur Cole (American)</b> - (Herbert & Link, 1982, p. 7)  |
| <b>Arthur Koestler (English)</b> - (Herbert & Link, 1982, p. 3)   |
| <b>Bert Hoselitz (American)</b>   |
| <b>Jacob Bronowski (English)</b> - (Herbert & Link, 1982, p. 2)   |
| <b>G.L.S. Shackle (English)</b> - (Herbert & Link, 1982, p. 3-4)  |
| <b>S. M. Kanbur (American)</b> - (Herbert & Link, 1982, p. 83)  |
| <b>F. B. Hawley (American)</b> - (Herbert & Link, 1982, p. 65)  |
| <b>T. W. Schultz (American)</b> - (Herbert & Link, 1982, p. 104)  |
| <b>David McClelland (American)</b>  |
| <b>MODERN SITUATIONALISTS</b>   |
| <b>Jeffrey A. Timmons, Leonard Smollen and Alexander Dingee</b> – ( <i>New Venture Creation: Entrepreneurship in the 1990s</i> , Homewood, IL: Irwin, 1990)               |
| <b>Robert C. Ronstadt</b> – ( <i>Entrepreneurship</i> , Dover, MA: Lord Publishing, 1984)   |
| <b>Lanny Herron and Harry Sapienza</b> – <i>Entrepreneurship Theory and Practice</i> , 49-55, 1992)   |
| <b>Gifford Pinchot</b> – ( <i>Intrapreneuring: Why You Don't Have to Leave the Corporation to Become an Entrepreneur</i> , 1985)  |
| <b>Hans Schollhammer</b> – ( <i>The Encyclopedia of Entrepreneurship</i> , Prentice Hall: Englewood Cliffs, NJ, 1982)   |
| <b>Karl Vesper</b>  |
| <b>William D. Guth and Ari Ginsberg</b> (Corporate Entrepreneurship, <i>Strategic Management Journal</i> , 11 (1990), 5-15.)  |
| <b>Jeffrey G. Covin and Dennis P. Slevin</b> – <i>Entrepreneurship Theory and Practice</i> , Fall 1991 Vol. 16, No.1 pp. 7-26)  |
| <b>Deborah V. Brazeal</b> – <i>Journal of Business Venturing</i> , 8: 75-100, 1993)   |
| <b>L. Hrebiniak</b> – <i>Administrative Science Quarterly</i> , Vol. 30, pp.: 336-349, 1985)  |
| <b>OPEN SYSTEM THEORISTS</b>  |
| <b>H. Stevenson, H. Irving Grousbeck, M. J. Roberts and A. Bhidé</b> – ( <i>New Business Ventures and the Entrepreneur</i> . 5 <sup>th</sup> ed., Richard D. Irwin, 1999) |
| <b>J.S. Hornsby, D.W. Naffziger, D.F. Kuratko and R.V. Montagno</b> – (An Interactive   |

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|---|
| Model of Corporate Entrepreneurship Process. <i>Entrepreneurship Theory and Practice</i> , 17(2), 29-37,1993)   |
| <b>M. B. Low and I. C. MacMillan</b> - (Entrepreneurship: Past Research and Future challenges. <i>Journal of Management</i> , 14, 1988, 339-369)  |
| <b>H. E. Aldrich and M. A. Martinez</b> - (Many Are Called, but Few Are Chosen: An Evolutionary Perspective for the Study of Entrepreneurship. <i>Entrepreneurship Theory and Practice</i> , Summer 2001, 41- 56) |
| <b>B. Bird and M. Jelinek</b> - (The Operation of Entrepreneurial Intentions. <i>Entrepreneurship Theory and Practice</i> , 13 (2): 21- 29,1988)  |
| <b>Chester Barnard</b> - (For instance see, S. Robbins and M. Coulter, <i>Management</i> , Prentice Hall, 2002, p.19)   |
| <b>Peter F. Drucker</b> - (For instance see, <i>Innovation and Entrepreneurship</i> , Harper Business, 1993)  |
| <b>Peter Senge</b> - ( <i>The Fifth Discipline</i> , Doubleday, 1990)   |
| <b>Russell Ackoff</b> - (For instance, see Ackoff Center Weblog)  |
| <b>Daniel Katz and Robert Kahn</b> - ( <i>The Social Psychology of Organizations</i> , Wiley, 1996, p.17)   |
| <b>Tom Peters and Robert Waterman</b> - ( <i>In search of Excellence</i> , Warner Books, 1988)  |
| <b>Joseph Vogel</b> - (Entrepreneurship, Evolution, and the Entropy Law, <i>Journal of Behavioral Economics</i> , Vol 18, #3, p.186)  |
| <b>Mike Moms, Pam Lewis and Don Sexton</b> - (Re-conceptualizing a Entrepreneurship: An Input-Output Perspective, <i>SAM Advanced Management Journal</i> , Winter 1994, V59, #1, p.219)                           |
| <b>Amir Bhidé</b> - ( <i>The Origin and Evolution of New Business</i> , Oxford, 2000, P.xiii)   |
| <b>Melissa A. Shilling</b> - (Toward A General Modular Systems Theory and Its Application to Interfirm Product Modularity, <i>AMR</i> , 2002, v27, #4, 553-74)  |
| <b>Deniz Ucbasaran, Paul Westhead and Mike Wright</b> - (The Focus of Entrepreneurship Research: Context and Process Issues. <i>Entrepreneurship Theory and Practice</i> , Summer 2001                            |
| <b>Hans Landström</b> - (The Roots of Entrepreneurship Research. <i>New England Journal of Entrepreneurship</i> , 1999, p.10 - 20)  |
| <b>Per Davidson and Johan Wiklund</b> -. (Levels of Analysis in Entrepreneurship Research: Current Research Practice and Suggestions for the Future, presented at annual SBIDA Conference, 2002, San Diego)       |
| <b>Claudia Bird Schoonhoven and Elaine Romanelli</b> - (The Entrepreneurial Dynamic: Origins of Entrepreneurship and the Evolution of Industries, Stanford, CA: Stanford University Press, 2001)                  |

## Exhibit I: Time Line of Entrepreneurial Thought

| Time                                  | ... 1750                   | 1800                               | 1850                     | 1900                  | 1950                      | 2000                                   |
|---------------------------------------|----------------------------|------------------------------------|--------------------------|-----------------------|---------------------------|--|
| 1. <b>FALCONE/OSBORNE FRAMEWORK</b>   | ... Classical →            |                                    | Neo Classical →          |                       | Modern →                  | Modern Situationists<br>Open systems → |
| 2. <b>TERMS &amp; CONCEPTS</b>        | Risk, Profit<br>Innovation | Freedom Behavior<br>Administration | Thinking<br>Competency   | Change<br>Equilibrium | Regulation<br>Personality | Organic<br>Development                 |
| 3. <b>DEFINITIONS</b>                 | Nominal                    |                                    |                          | Reliable              |                           | Operational                            |
| 4. <b>ORGANIZATION</b>                | Agrarian                   | Mechanistic                        | Scientific               | Humanistic            | Responsible               | Learning Organization                  |
| 5. <b>TYPES OF THEORISTS</b>          | Novices                    | Economic                           | Behavioral               | Scientists            | Organization Theorists    | E-Specialists                          |
| 6. <b>HEBERT AND LINK THEORETICAL</b> | Early                      | Meandering/Classical               | Neo Classical            |                       |                           | Extended Theory                        |
| 7. <b>POLITICAL MARKETS</b>           | Random                     | Legislated                         | Bureaucratic/            | Democratic            | Representative            | Adaptive                               |
| 8. <b>KOTLER'S MARKETS</b>            | Production                 |                                    | Product                  | Sales                 | Marketing concept         | Societal-marketing concept             |
| 9. <b>BEHAVIOR</b>                    | Elitist Freeist            | Physiocrat/Descriptionist          |                          | Structralist          | Keynesian                 | Traitist Leader Situational Proactive  |
| 10. <b>THEORY</b>                     | Describers                 | Prescribers                        |                          | Theorists             |                           | Interveners                            |
| 11. <b>IMPERIALISTS</b>               | Early(English, French)     |                                    | Middle(American, German) |                       | Late(Japanese)            | Globalists/Americans                   |

**Table II: Compilation of Entrepreneurship Definitions**

1. Entrepreneur is a maker of history, but his guide in making it is his judgment of possibilities and not a calculation of certainties (Shackle, in Herbert and Link (Herbert & Link, 1982), p. viii).
  2. Many people set themselves up ... as merchants or entrepreneurs ... They pay a certain price for a product depending on when they purchase it, to resell wholesale or retail at a certain price (Cantillon, in Herbert & Link, 1982, p. 15).
  3. ... must possess art of superintendence and administrator (Say, in Herbert & Link, 1982, p. 32).
  4. Central figure in productive system is the entrepreneur. (He) buy(s) the factors of production, the use of the land, labor, machinery and work(s) them up into half-manufactured or finished products, where he sells to other entrepreneurs or consumers, at a price covering his expenses and remunerating his working and waiting (Edgeworth, in Herbert & Link, 1982, p. 55).
  5. Entrepreneur is legal owner of an enterprise (F. Von Wieser, in Herbert & Link, 1982, p. 51).
  6. Carrying out of new combinations of firm organization -- new products, new services, new sources of raw material, new methods of production, new markets, and new forms of organizations (Schumpeter, 1934, op. cit.).
  7. Uncertainty bearing...coordination of productive resources...introduction of innovations and the provision of capital (Hoselitz, 1952, op. cit.).
  8. Purposeful activity to initiate and develop a profit-oriented business (Cole, 1959, op. cit.).
  9. Creation of new organizations (Gartner, 1985, op cit.).
  10. Entrepreneurship, in reality is an approach to general management that begins with the opportunity recognition and culminates with the exploitation of opportunity (D. L. Sexton & N. B. Bowman - Upton, *Entrepreneurship: Creativity and Growth*, MacMillan, 1991, p. 12).
  11. Entrepreneurship refers to activities involved in creating new resource combinations that did not previously exist (R. A. Burgelman, M. A., Mardique, and S. C. Wheelman, *Strategic Management of Technology and Innovation*, Irwin, 1988, p. 32).
  12. Entrepreneur is one who perceives opportunity and creates organization to pursue it (Bygrane, Ed., *The Portable MBA in Entrepreneurship*, 2nd Edition, John Wiley & Sons, Inc, 1997).
  13. Entrepreneurship is a process by which people pursue opportunities, fulfilling needs and wants through innovation, without regard to the resources they currently control (Stephen Robbins & Mary Coulter, *Management*, 6th Edition, Prentice Hall, Upper Saddle River, NJ, 1999, p. 26).
  14. Entrepreneurship is the pursuit of opportunity beyond the resources available today (Howard Stevenson, USASBE/SBIDA Conference, San Antonio, Plenary Speech, 2/17/00).
  15. Emergent, chaotic, and unpredictable character...termed "newstream activities" (R. M. Kanter and L. Richardson, Engines of Progress: Designing and Running Entrepreneurial Vehicles in Established Organizations: The Enter-Prize Program at Ohio Bell, 1983-1989, *Journal of Business Venturing*, 6 (January 1991): 63-82).
  16. Fundamentally, entrepreneurship is a human creative act. It involves finding personal energy by initiating and building an enterprise or organization, rather than by just watching, analyzing, or describing one. (J. A. Timmons, *New Venture Creation: Entrepreneurship in the 1990's*, 3rd ed., Irwin, Homewood Ill, 1990, p. 5).
  17. Entrepreneurship is the launch and/or growth of ventures through the use of innovative risk-assuming management. (F. L. Fry, *Entrepreneurship: A Planning Approach*, West Publishing, St Paul, Minn., 1993, p.27).
- An integrated concept that permeates an individual's business in an innovative manner (D. F. Karatko and R. M. Hoggets, *Entrepreneurship: A Contemporary Approach*, 4<sup>th</sup> ed., The Dryfus Press, 1998, p.6).



## **“HANDS ACROSS THE PARKING LOT” – LEARNING FROM DOING**

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### **ABSTRACT**

This paper describes the process that evolved from cooperative efforts between faculty in the College of Engineering and in the School of Management at the Florida Institute of Technology. From this experience the authors describe the model for linking Capstone Engineering Senior Design Projects in the College of Engineering to Market Research Projects in the School of Management.

### **INTRODUCTION**

Florida Tech's intensive undergraduate engineering programs (in Electrical and Computer Engineering, Computer Science, Mechanical Engineering, Civil Engineering, Chemical Engineering, Aerospace Engineering, and Ocean Engineering) have resulted in a number of outstanding Senior Design Projects. Examples include STEMSCOPE (a compact scanning tunneling microscope), Marvin (an autonomous robot with GPS navigation and proximity sensors) and Europa (a flying submarine).

During the past two years, the Florida Tech Senior Design programs have become highly coordinated across Engineering Departments and structured for improved effectiveness. To facilitate increased, sustainable product realization success, the senior design experience for computer engineers, electrical engineers, aerospace engineers and mechanical engineers now begins in the spring semester of the junior year.

Within the College of Engineering there exists a Senior Design Commercialization and Entrepreneurship Program (Ports et al 2003) for advanced undergraduate students. Entrepreneurial undergraduates with a GPA of at least 2.75 may be approved to also take the graduate level courses in the program.

During Spring semester 2002, the School of Management at Florida Tech became aware that the College of Engineering was integrating facets of Engineering Senior Design across the

Engineering curriculum. The School of Management was interested in encouraging and supporting the efforts of COE as well as providing management students experience in working with engineering students. The School of Management desired that their graduates have skills in working with engineers and have an understanding and grasp of issues faced in managing in science and technology based companies.

The focus of this paper is on Engineering Design Market Research Projects. These are collaborative projects by Marketing students in the School of Management for senior design engineering teams in the College of Engineering. The projects simulate the realities of defining products for market in an industrial context. In some cases, for entrepreneurial senior design teams intending to start a business around their senior design project, the projects can add considerable value to the evolving business case for the enterprise. The paper describes the goals of the projects, the evolution of a process for completion of the projects, and areas of focus for continual improvement in the undertaking.

## **OVERVIEW OF FLORIDA INSTITUTE OF TECHNOLOGY**

Florida Tech celebrates its 46<sup>th</sup> anniversary this year (2004). The university was founded in 1958, initially to provide convenient, part time, continuing education opportunities to the scientists, engineers and technicians who were working at what is now the Kennedy Space Station. Today the university is an accredited, coeducational, independently controlled and supported university. Over 2,500 students attend full-time at the Melbourne, Florida campus. These students are enrolled in more than 130 degree programs in science and engineering, aviation, management, humanities, psychology and communication. Master's degrees are offered in more than 60 disciplines and Doctoral degrees are offered in 22 disciplines. The 130 acre Florida Tech campus, located in Melbourne, Florida, includes a picturesque botanical garden, is 5 minutes from the Indian River, 10 minutes from the Atlantic Ocean and 50 minutes from Kennedy Space Center.

Because Brevard County is home to Kennedy Space Station and a number of defense and space related companies, the population includes many scientists, researchers and technological employees. Many of our youth are more scientifically aware than populations resident in other locales. In fact, the county has more winners in high school science fairs than any other county in Florida. However, the emphasis on space science and government contracting embedded in the local culture results in little or no training available to youth, researchers, and employees in the multiple steps and decisions that are needed to bring technology products to market. The pervasiveness of the space program in the economic development of the county and the culture of its inhabitants can be seen in many cultural, business, and demographic facets. Twenty percent of the eighty schools in the county carry a name related to the space program. Fourteen of the largest thirty employers are primarily in the space or defense industries. Only 6% of the employees from the top thirty employers do not work in space/defense, government, education, or health industries.

In June 1997, the university received a \$50 million grant from the F. W. Olin Foundation. As a result of this grant, two major facilities were completed in the fall of 1999 – an Engineering Complex and a Life Sciences Building. Construction of the new Charles and Ruth Clemente

Center for Sports and Recreation was made possible by a generous gift from a Florida Tech trustee and his wife, and the F. W. Olin Foundation. Additional new construction includes new student housing and the \$14 million F. W. Olin Physical Sciences Building.

In Spring 2002, two full-time faculty members, one from the College of Engineering and another from the School of Management discovered that each was working to bring more entrepreneurship offerings to their respective environments. One of the programs this collaboration spawned is the **Engineering** Design Market Research Projects discussed in this paper.

### **The Undergraduate Senior Design Sequence in the College of Engineering**

Across the U.S., about 65,000 engineering students work on a development project as the capstone experience of their undergraduate engineering degree each year. At Florida Tech a capstone experience is part of the degrees in electrical, computer, aerospace, mechanical, ocean, civil, and chemical engineering and in computer science. The instructors from the College of Engineering Departments meet regularly to synchronize their courses to advantage.

As an example, consider the electrical and computer engineering department series of three senior design capstone core courses. Beginning with Junior Design in the spring of the Junior year, typically multidisciplinary teams of undergraduates self-form, and spend the next three semesters focused on conceiving, defining, designing, validating and demonstrating innovative new product ideas. System Design I and System Design II are taken in the Fall and Spring terms of the senior year. The students work on cross-functional teams and learn by participating in and delivering results for business planning, new product development, project management, project execution and closure, a little marketing, and the definition and production of launch collateral materials such as articles, patent disclosures and application notes. Each team conceives a new product idea, then defines it, determines its value proposition, designs it, verifies the design, develops and builds it, validates it and prepares for a “whole product” market introduction. The culmination of the course sequence is the Student Design Showcase. The Showcase, spanning all departments in the College of Engineering, is set up in the gymnasium in a “trade show” environment, and is open to all faculty and students, the public, local companies, schools, team sponsors and the press. Each team has its own booth, and demonstrates their project results. Junior design teams also have booths, as do project sponsors, the School of Management, Florida Tech’s business accelerator (Florida TechStart) and an array of invited guests.

The business plans and feasibility studies included in the sequence are abbreviated and intended to introduce engineering students to business considerations beyond technical feasibility. For their feasibility studies, the teams analyze the technical, schedule, marketing and engineering NRE (non-recurring expense) financial feasibility for several potential projects or variations on a basic project, and use this information to help finalize their project choice. The business plans require the teams to outline their projects (a “product” description and early estimates of timelines and bills of materials for construction) and to develop a defensible value proposition for their product (a short statement which explains why anyone would a) buy this product and b) buy it from us). Following this, the business plan contains a risk analysis (technical, schedule, financial and marketing), a competitive analysis, team capability analysis, and initial definitions

of “out-of-bounds” conditions which may arise during the project and require “managerial” (professorial) intervention.

The business plan elements generated by College of Engineering students correspond to the elements of a real business plan that engineers on the product definition team might be expected to provide. Other elements, such as TAM/SAM/SOM (Total Available Market / Served Available Market / Share of Market) analyses, financial analyses (forward costing and pricing models, new product revenue projections, etc), operations planning and the business perspective on market environment and trends, are not done, as these would be done by the finance and business areas of a company.

During the fall semester in 2003, the School of Management collaborator approached the School of Management marketing professor about including engineering senior design projects as market study projects in Marketing classes. The marketing professor agreed to participate and was given the name of the College of Engineering contact. The results of this informal first effort were disappointing. Establishing contact and timeframes was extremely frustrating for the SOM marketing professor. By the end of the semester nine projects were completed. The SOM collaborator in discussions with the SOM marketing professor and the COE senior design coordinator learned the results of the studies did not reach the Engineering students on a consistent basis, the relevance of the content of the studies to the projects was not clear, and there was no mechanism for feedback between management and engineering student groups.

In early January 2004, the School of Management collaborator invited both the COE contact and the SOM marketing professor to discuss the project from each of their perspectives. COE was pleased with the project. The SOM collaborator was under the impression that COE was not viewing the project as beneficial to them but was participating because they were “doing what the SOM wanted us to do.” The COE believed the project was for the benefit of SOM students rather than directed toward benefiting their own students.

After listening to discussion of the project and where the timing difficulties were on “each side of the parking lot” the SOM collaborator suggested she draft a “strawman procedure” and circulate it for comments to both the SOM marketing professor and the COE coordinator of senior design. This draft was exchanged at least twice between the representatives from both schools and the process described in Appendix A of this paper will be tested during the fall semester of 2004. By the time of the conference in which this paper will be presented, we will have an addendum for our Fall 2004 experience.

### **So What?**

All parties to this undertaking believe they needed to have a “learning experience” before they were able to identify a process they believe will work. The nature of the technology based opportunities seeking marketing studies is quite different from the kinds of projects marketing students usually identify and select. The markets for the technology projects challenges the expertise of both students and the marketing professor. Bringing about cultural and capability changes requires all parties to be willing to learn from experience. Students learn that their professors are also learning as they go. All these are situations the students may face in company settings.

## **CONCLUSION**

Our experience has demonstrated that resources other than financial support are required to achieve “Entrepreneurship Across the Curriculum.” Interested and committed faculty cooperating between schools is key. Enabling interested faculty to discover one another is a challenge. Harmonizing class activities between cooperating courses needs early attention. Students need formal mechanisms to initiate discussion and cooperation to jump start the process. Finally, enthusiastic support of pilot projects by the Dean’s of the respective colleges encourages faculty to “make it happen.”

## **APPENDIX A**

### **Draft Procedure**

#### **Market Research for Engineering Design Projects**

### **Background**

The College of Engineering consists of the following engineering programs:

- Chemical Engineering
- Electrical Engineering
- Computer Engineering
- Computer Sciences
- Environmental Science and Environmental Resource Management
- Civil Engineering
- Meteorology
- Ocean Engineering
- Oceanography and Coastal Zone Management
- Mechanical Engineering
- Aerospace Engineering
- Engineering Systems

Undergraduate engineering students are required to complete a design project as part of their curriculum.

In several programs, Junior level students form teams and identify and select their projects in a 1 credit course during the second semester of their junior year.

Senior level students design and build the project selected in the junior year. Occasionally there is a junior level project abandoned or a new senior level project defined. However, this is the exception.

Some of the engineering programs (for instance, Civil Engineering) have no junior level course, doing the entire project during the senior year. In one case, Ocean Engineering, the projects are designed and built during the spring of the junior year, and implemented at sea during the following summer, before the beginning of the senior year.

Sometimes the engineering projects are believed to have commercial potential. Three scenarios are possible:

- 1) Teams working on the design project want to commercialize.

- 2) Engineering faculty believe the product has potential but students are only interested in completing the requirements for their degree and have no continuing interest in the product or technology.
- 3) The product idea was presented to the university by an outside person or firm and that person or firm desires to commercialize the product.

If work done by the Engineering Design students is believed to have commercial value, it can be desirable to have marketing classes prepare a marketing study for the product idea.

The School of Management offers Marketing classes as part of its curriculum.

Three areas needing policy and procedures are identified.

1. How are intellectual property issues handled?
2. How are Engineering Projects nominated for consideration as projects by the marketing students?
3. How do Marketing students select the projects to be completed?

#### **I. INTELLECTUAL PROPERTY OWNERSHIP**

At this time, Florida Tech has no written policy for student IP. Any student who develops intellectual property, even on university property with university tools in a university lab or facility, has full rights to it. There is a policy for professorial IP, however: the university owns the patent and shares any and all IP revenue evenly between the university, the inventor's college or school, and the inventor. IP developed on contract from an external funding source is typically addressed in the terms of the contract. The authors are encouraging the university to develop a written policy regarding student inventors, as more and more senior design projects are entrepreneurial in nature and the university policy, or lack thereof, can be expected to be tested soon.

#### **II. NOMINATING ENGINEERING DESIGN PROJECTS FOR MARKETING STUDIES**

Screening of projects at the senior level for commercial potential will be done in the College of Engineering by the second week of the fall and spring semesters. Short summaries (typically drawn from project team documents) for projects with commercial potential will be compiled by the home department instructor for each senior design course and forwarded to a designated professor in the Florida Tech School of Management for review.

#### **III. SELECTING ENGINEERING DESIGN PROJECTS FOR MARKETING STUDIES**

1. The School of Management professor or designate will review the nominated design projects and select those appropriate for further consideration.
2. The marketing classes will set aside a class period for "pitches" of projects.

3. The marketing professor will coordinate this date with the appropriate engineering professor(s) and will provide an e-mail with dates of times of “pitching” opportunities.
4. Teams desiring to give a “pitch” will “register” with the marketing professor giving a brief description of their project, the name of the person who will make the pitch, and contact information for that person.
5. On the agreed date, one or more members from engineering design team desiring a market study will visit the marketing class and give a 3 minute pitch on their project. Marketing students will have 3 minutes for questions. Not every project pitched will be selected for a market study. The pitches may need to be made in multiple courses or course sections.
6. Marketing students will select projects and the teams requesting projects and their senior design course instructor will be notified by email if they were accepted or not. It is possible for the same project to receive offers for more than 1 marketing study.
7. Marketing students will work with and interact with the engineering students while completing the market study.
8. At the conclusion of the study there will be four copies prepared to be distributed as follows:
  - a. Copy for grading
  - b. Copy to engineering team member
  - c. Copy to the senior design course instructor
  - d. Copy to School of Management Collaborator

Marketing students will make oral presentations to their client – The Engineering Design Team. Presentation time will be coordinated by the Engineering Design Coordinator.

### **REFERENCE**

Ports, Ken, Carmo D’Cruz, Muzaffar Shaikh, and Carolyn Fausnaugh. (2004)/ Taking Senior Design Course Projects to Market. Proceedings of the 2004 American Society for Engineering Education Annual Conference and Exposition. Salt Palace Convention Center. Salt Lake City, Utah. June 20-23, 2004

Teaching non-business majors

RUNNING HEAD: Teaching non-business majors

**The role of entrepreneurship research is to discover and create new knowledge that**

**supports entrepreneurship education and research**

**75% of new business startups are service/retail**

Teaching entrepreneurship to non-business majors: A constructivist learning approach

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Teaching Entrepreneurship To Non-Business Majors: A Constructivist Learning  
Approach

ABSTRACT

This paper describes the Authentic Case Study (ACS) project, which is a comprehensive project that has been successfully used to teach non-business students about entrepreneurship. The project was developed from a constructivist learning perspective, where learning activities are connected to the state of the learner. The project uses self-directed and small group learning activities to teach students basic concepts in entrepreneurship. The primary learning activity is a business plan project which uses an authentic, local setting and draws upon business owners and other individuals embedded in the setting to contribute to student learning.

Teaching Entrepreneurship To Non-Business Majors: A Constructivist Learning  
Approach

EXECUTIVE SUMMARY

This paper describes the Authentic Case Study (ACS) project, which is a comprehensive and collaborative semester-long project that has been successfully used to teach non-business students about entrepreneurship. The project has been used in an undergraduate program where students programs have limited formal business training. The project was developed from a constructivist learning perspective, where activities are connected to the state of the learner. The project uses self-directed and small group learning activities to teach students basic concepts in entrepreneurship. The primary learning activity is a business plan project which uses an authentic, local setting and draws upon business owners and other individuals embedded in the setting to contribute to student learning.

In the ACS project, student teams develop a business plan for a new venture that could be viable in the central business district located in the university community. The Authentic Case Study resembles a traditional case study in that data is presented about a realistic business scenario. In the ACS, students work with 'live' data relating to the central business district to research their target market, assess market conditions, analyze competition and select a location. Entrepreneurs and other business people act as primary

## Teaching non-business majors

resources for students as they develop business plans. Community business people also provide authentic assessment of student projects.

Entrepreneurship education continues to broaden its scope to include more nontraditional audiences. In addition to college campuses, entrepreneurship training is being offered to a wide variety of audiences including youth, economically disadvantaged, and older adults (Consortium for Entrepreneurship Education). Educators must consider diverse learning approaches to meet students' needs. Constructivist approaches such as the one outlined in this paper may be useful for educators whose entrepreneurship students have limited business backgrounds.

## Teaching Entrepreneurship to Non-Business Majors: A Constructivist Learning Approach

Entrepreneurship curricula have been standard in business colleges for decades. More recently, in response to a recognition that entrepreneurial activity and interest does not occur exclusively among business majors, universities have begun to offer courses and minors in entrepreneurship to non-business majors. Research has found most entrepreneurs do not graduate with business degrees (Kauffman Foundation). Teaching principles of entrepreneurship and venture creation to individuals who do not have a strong business background requires a different approach than one might use in a business school setting. This paper describes an authentic case study approach to teaching an introductory entrepreneurship course in a non-business curriculum to students with limited business knowledge.

The Authentic Case Study (ACS) project is a comprehensive and collaborative semester-long project which has been successfully used to introduce non-business students to entrepreneurship concepts. The premise that underlies this project is that presenting entrepreneurship knowledge and content using traditional methods does not adequately address non business students' lack of prior business knowledge. The project has been used in an undergraduate program in Family and Consumer Sciences, where students major in dietetics, family studies, food service administration, interior design, and apparel merchandising and design. The entrepreneurship course was developed as a response to the aforementioned broad interest in the topic, as well as advice from alumni and advisory board members. Students in these programs have limited formal business

## Teaching non-business majors

training, yet their career interests are in areas where the majority of entrepreneurial start-up activities are likely to occur.

The project was developed from a constructivist learning perspective, where learning activities are connected to the state of the learner. In the constructivist framework, learning activities provide a path into the subject for the learner based on the learner's previous knowledge. The project uses self-directed and small group learning activities to teach students basic concepts in entrepreneurship. The primary learning activity is a business plan project which uses an authentic, local setting and draws upon business owners and other individuals embedded in the setting to contribute to student learning.

Case studies are often used as teaching tools in entrepreneurship courses. The "case method" involves the reading and discussion of a descriptive document about a business or business scenario called a "case." The case presents data that can be used to offer students an opportunity to apply existing knowledge, and to research, analyze and solve a realistic business problem (Mauffette--Leenders, Erskine, & Leenders, 1997). Business cases usually require that students have a certain level of business knowledge on which they can base their discussion. Most students in the family & consumer sciences programs have not taken courses in finance, accounting, marketing or management, which presents a challenge in understanding the details of a case. Therefore, the ACS project was developed to introduce students in the course to the basics of venture creation and small business management. The project is based in an

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interactive and realistic setting, allowing students to more easily assess problems and search for solutions.

In the ACS project, student teams develop a business plan for a new venture that could be viable in the central business district located in the university community. The Authentic Case Study resembles a traditional case study in that data is presented about a realistic business scenario. In the ACS, students work with ‘live’ data relating to the central business district to research their target market, assess market conditions, analyze competition and select a location. Entrepreneurs and other business people involved in the business district act as primary resources for students as they develop business plans. Secondary data on market size, economic conditions, competition, space availability and occupancy costs are provided by the downtown business association and local government sources. Community business people also provide authentic assessment of student projects at the end of the semester.

The project employs active learning strategies in student teams to achieve course objectives. The course objectives are to increase students’ knowledge of entrepreneurship and understanding factors involved in startup of a small enterprise. The course is also designed to develop students’ verbal and written communication and critical thinking skills. In addition, students are presented with opportunities to assess personal fitness for an entrepreneurial career in the course.

## PEDAGOGICAL FOUNDATIONS

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### Constructivist approach

The teaching approach used in this course was based on constructivist learning principles. Constructivist learning is predicated on the idea that individuals create their own new understandings on the basis of an interaction between what they already know and believe and ideas and knowledge with which they come into contact (Resnick, 1989). Constructivist principles view learning as a social activity where learning is enhanced by connections with other human beings. Active learning strategies that include interactions with other learners are an essential part of effective constructivist teaching (Richardson, 2003). The consequences of this approach mean that the teacher must focus more on the learner in planning learning activities, and less on the content area. Learners should have opportunities to revisit ideas, and ponder and revise them in order for significant learning to take place. Motivation is essential for learning in the constructivist paradigm. A key element in motivating learners is to help them understand ways in which knowledge can be used.

In a constructivist learning environment, learning takes place in relationship to whatever prior knowledge the learner has. Bloom (1956) suggests that knowledge and comprehension are essential for applying, analyzing and evaluation information about a topic. Prior knowledge includes the factual and practical knowledge that a person possesses in a given domain, and numerous studies on learning have shown that domain-specific prior knowledge facilitates learning (Muller-Kalthoff & Moller, 2003).

Therefore, teaching strategies in entrepreneurship courses for non-business majors need

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to take students' limited prior business knowledge into account when designing learning activities.

The development of constructivist learning environments favors activities that are designed through embedded learning in an authentic environment where the focus is on realistic approaches to solving real-world problems. Discovery methods encourage experiential learning, which involves learning by doing. In this environment, the instructor acts as a coach and analyzer of the strategies used to solve these problems, rather than the source of knowledge. Learning activities stress conceptual interrelatedness, and provide multiple representations or perspectives on the content. Evaluation serves as a self-analysis tool, therefore the instructor must provide tools and environments that help learners interpret the multiple perspectives of the world. The result makes learning internally controlled and mediated by the learner (Jonassen (1991; Wilson & Cole, 1991).

## Active Learning and Small groups.

A constructivist approach uses learning experiences that are active, where a learner can reflect on and evaluate learning experiences, and build on them to construct new knowledge and meanings (Yager, 1991). Active learning strategies, which place students in the center of the learning process, are increasingly being used to enhance student learning in the college classroom (Warren, 1997). Whereas traditional methods of teaching take the view that information is 'owned' by the instructor, active learning methods engage students in the learning through critical problem solving and active application of information. Traditional teaching philosophies place most of the



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responsibility on the teacher, with students perceived as passive receptacles of knowledge. Conversely, active learning methods require students to prepare for learning outside of the classroom, participate in classroom discussion, listen to other class members' ideas, and accept a level of ambiguity (Warren, 1997). Benefits of active learning include better content and critical thinking abilities, improved time management, interpersonal and communication skills, and higher levels of student motivation (Boulmetis, 2000; Salemi, 2002).

The constructivist paradigm stresses the importance of human interactions in the learning process. When peers work together there is a great deal of modeling, cognitive disequilibrium, feedback, and perspective-taking that emerge as students explain and receive explanations from their colleagues. Small groups are effective because they increase student-to-student interaction, shift the responsibility of learning from the instructor to the student, and stress problem-solving skills that enhance student cognition. The positive outcomes of collaborative learning include positive interdependence, individual accountability, interpersonal and communication skills (Johnson, Johnson & Smith 1998). Small-group learning allows students to relate course material into their existing knowledge base, thus producing a deeper, contextualized level of understanding of content (Kurfiss, 1988). Student-centered learning environments can result in richer, deeper, more comprehensive and more complex thinking (Cuseo, 2002).

## THE AUTHENTIC CASE STUDY PROJECT

The ACS project is a teaching tool that was used in an entrepreneurship course in the Department of Family & Consumer sciences at a Midwestern university. Students in

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the course are family and consumer science majors, and have had few if any business courses as part of their programs. The ACS uses a live, concurrent, interactive environment in which course concepts can be applied to the writing of a proposal for a new business. Prior to the start of the semester, the instructor identifies a specific environment in which student teams will create the business plan. The central business district (CBD) in the city where the university is located has been used for this project because it is accessible to students, there is an ample supply of entrepreneurs and other business people willing to act as information resources and informal consultants, and the situational factors fit likely interests of students. The CBD in this community maintains a website rich with data needed for market research. Economic data needed for opportunity assessment is also readily available from county and state government websites. The project is introduced in the first class session, and becomes the focus of learning activities for the entire course. Course activities focus on assessing prior student knowledge, and building a knowledge base via textbook and other readings. Guest speakers and active research provide additional information for students as they create a business plan. Following is an overview of course activities.

*Assessing prior knowledge.* Students are assigned a writing exercise in the first week of class to assess their understanding of entrepreneurship and small business management. The assignment requires them to read several articles on entrepreneurs and entrepreneurship. Students then write a brief essay describing their understanding of what skills and abilities are required to be a successful entrepreneur, as well as a personal assessment of their suitability as an entrepreneur. This exercise provides the instructor

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with a benchmark for evaluating students' level of general knowledge about entrepreneurship, and also serves as an awareness-building exercise for students.

Students are also given a not-for-credit quiz to assess their prior knowledge about the CBD. The quiz follows an assignment to visit the CBD to gather information about the area's features and business activities. These exercises ensure that students have a rudimentary understanding of the environment in which their business plan will be developed. The director of the downtown business association is then invited to class to speak about the history, current state and future plans for the CBD.

*Idea generation.* Creativity and idea generation is a key element of entrepreneurial activity, and the course activity that students seem to enjoy the most. Following exploration of the case study environment, student teams are formed. Teams brainstorm ideas for a business that could be viable in the CBD. From brainstorming sessions, teams create a preliminary description of their business idea, including a brief description of the business, its intended target market and products/services offered. The proposals are then evaluated by other student teams on compelling need, uniqueness, evidence of demand, and potential for competitive advantage. These exercises allow students to both give and receive constructive criticism, and to deliberate on and revise their ideas based on peer reactions. This exercise addresses the social component of constructivist learning, which uses individual contributions and group discussion to construct new meaning.

*Business plan development.* Student teams complete the business plan in three segments. The requirements for each segment are introduced along with appropriate chapters of the text and readings. The first section includes a description of the business

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concept and mission statement. The second section includes a description of the target market and competitive analysis. The third section includes marketing, operational and financial plans. Drafts of each section are reviewed by peers and the instructor before proceeding to the next section, and teams are expected to incorporate suggestions into the final plan. This step is an important learning activity not only for receiving feedback, but for giving it. Students have commented that the activity of giving feedback has led to insights into improving their own projects.

Constructivist learning places emphasis on student input in developing learning outcomes. To create the outline and evaluation criteria for the business plan project, students are first presented with an instructor-generated outline and criteria, which are based on information supplied by the textbook used in the course<sup>1</sup>, and a website sponsored by the Small Business Administration<sup>2</sup>. Students review textbook and Small Business Administration, as well as several completed business plans (both good and bad examples. An entrepreneur and a small business loan officer from an area financial institution are then invited to the class to speak about the process of developing a business plan. The entrepreneur's presentation focuses on the process she followed in developing a business plan, as well as reflections on lessons learned from the process. The loan officer presents the business plan process from the point of view of the lender. After the speaker visits, instructor-guided class discussions are used to modify the original business plan outline and evaluation criteria, and to distribute the 200 evaluation points to each section according to student evaluation of textbook and website materials and speaker input. This process usually results in modification of point distribution

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<sup>1</sup> Zimmerer & Scarborough (2002). *Essentials of Entrepreneurship and Small Business Management*. Prentice Hall.

<sup>2</sup> [http://sba.gov/starting\\_business/planning/writingplan.html](http://sba.gov/starting_business/planning/writingplan.html)

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among business plan sections, but leaves the original parts of the business plan outline intact.

One of the biggest challenges arising from a limited business background for students in this course is developing financial plans. Because it is not reasonable to expect that students with limited background in accounting and finance will become proficient in financial forecasting as a result of this course, a financial profile calculator from a small business website<sup>3</sup> is used to develop a pro forma income statement for the business. The calculator creates a typical income statement for small businesses in a wide range of business sectors by inputting a sales estimate. After a lecture focused on basic elements of financial planning and an in-class activity to develop annual sales estimates for each of the first three years of the business, student teams use the financial profile calculator to develop pro forma income statements for the proposed business. Student teams then confer with local business experts (a small business owner, an accountant and the instructor) during a class session to modify the results of the financial calculator results to fit the students' business concept and local factors. Advisors work with student teams to suggest changes in cost of goods sold and/or expense projections based on the specific characteristics of business concepts.

The 'finished product' required for the project is a professionally presented written proposal, and a poster presentation of the highlights of the plan. Students are also required to develop an 'elevator speech' explaining their business idea. The speech is a 30 second personal introduction and explanation of the business concept.

*Outcome assessment.* There are multiple methods for assessing cognitive and affective achievement of learning objectives in this course. Knowledge, comprehension

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<sup>3</sup> the financial profile calculator is available at <http://www.bizstats.com>

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and application of factual material from the text are assessed through online quizzes and through accurate application of course concepts to the business proposal. Critical analysis and synthesis skills are assessed through a series of writing assignments. These assignments include self-reflection writing assignments, synthesis of speaker presentations, and reactions to various reading assignments..

Affective outcomes include personal awareness (assessed in writing exercises), participation in class activities (measured through attendance and contribution to class discussions), and teamwork (assessed via team evaluations of each member).

The ACS project is the primary tool for assessing students' comprehension of course material, as well as their ability to use course concepts in a meaningful manner. Analysis and synthesis skills are demonstrated through students' ability to gather market research and use it to develop the business plan. The instructor provides assessment on the technical aspects of the plan (completeness, professional presentation, appropriate application of course concepts), which, along with quizzes, in class participation activities and writing assignments, comprise the student's final course grade.

The final exam in the course consists of a 'new venture fair' where student teams present their business plans in a poster session format to local business people. Four or five individuals who have participated in the course as speakers or consultants act as 'judges' of the business plans. Students present their ideas to the judges during a two hour poster session. After discussing student plans with each team, judges award a 'most creative', 'best presentation' and 'most feasible' award. Students know in advance that their grade for the final exam is based on instructor assessment of their performance and are not determined by the awards, although there has been a positive correlation between

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points awarded by the instructor and awards conferred by the judges. This ‘authentic’ assessment is designed to give students the opportunity to demonstrate their learning in a realistic environment. Authentic assessment is a form of assessment in which students perform real-world tasks that demonstrate meaningful application of essential knowledge and skills. The natural competition that arises out of the award system appears to be a highly motivating factor in generating professional-level business plans.

## Project successes and limitations

The methods used in this course have received positive evaluations from students. Student rating of their understanding of factual material in the course was high (3.65 on a 4.0 scale). Guest speakers are often mentioned as highlights of the course. Student comments indicated that they enjoyed the creativity involved in completing the project.

Because the ACS relies on using a real environment, information required to complete the project may be imperfect and incomplete. This can be frustrating to students; however, the instructor regularly reminds students that this is what the real world is like, and the value of getting a realistic experience.

Constructivist learning approaches have been criticized in some circles because students’ learning is considered to be subjective rather than objective. Some scholars believe that constructivist approaches may not be the best way for students to learn basic skills and knowledge. Further, teaching in a constructivist environment requires that the instructor have a depth of understanding of the subject matter in order to guide students in interpreting material (Richardson, 2003). However, considering the experiential focus

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on entrepreneurship education, the constructivist view seems to be an appropriate method of learning about entrepreneurship, especially in this population.

A single entrepreneurship course in a student's undergraduate education is probably not sufficient to create a successful entrepreneur. This course focuses on what entrepreneurs do, and does not address the theories that underlie entrepreneurial behavior. The goal of this course for family and consumer sciences students is to increase their understanding of entrepreneurship, to consider entrepreneurship as a career possibility, and to instill entrepreneurial attitudes that can be used in a variety of life's endeavors.

Entrepreneurship education continues to broaden its scope to include more nontraditional audiences. In addition to college campuses, entrepreneurship training is being offered to a wide variety of audiences including youth, economically disadvantaged, and older adults (Consortium for Entrepreneurship Education). Educators must consider diverse learning approaches to meet students' needs. Constructivist approaches such as the one outlined in this paper may be useful for educators whose entrepreneurship students have limited business backgrounds.



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# **BUSINESS PLAN OR BUSINESS SIMULATION FOR ENTREPRENEURSHIP EDUCATION?**

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## **ABSTRACT**

This paper explores the effectiveness of the business simulation across three entrepreneurship classes at the University of Illinois at Chicago. Its findings are tentative because no other study has reported the efficacy of a business simulation for teaching entrepreneurship. The use of this experiential learning method in entrepreneurship education is important, because entrepreneurship educators prefer experiential learning for their students and recognize the relative shortcomings of a lecture-based entrepreneurship class. The results indicate that a business simulation is a positive learning experience for students.

## **INTRODUCTION**

A business plan writing exercise is a common teaching method for an entrepreneurship course. In a class size of twenty or less, a business plan writing exercise can be an effective pedagogical exercise. However, the value of the exercise diminishes as the enrollment increases. Fewer students are able to pursue their own venture idea, and there is less time to critique a student's individual business plan. Due to these shortcomings, a business simulation was chosen as the term project under the assumption that the simulation will provide students enrolled in larger classes a more effective term project than the business plan writing exercise. The business simulation used for this study is *Threshold Competitor* by Anderson, Beveridge, Scott, and Hofmeister (2003).

### **The Business Plan**

The U.S. Small Business Administration provides the generally accepted rationale for entrepreneurs to write a business plan:

“A business plan precisely defines your business, identifies your goals, and serves as your firm's resume. The basic components include a current and pro forma balance sheet, an income statement, and a cash flow analysis. It helps you allocate resources properly, handle unforeseen complications, and make good business decisions. Because it provides specific and organized information about your company and how you will repay borrowed money, a good business plan is a

crucial part of any loan application. Additionally, it informs sales personnel, suppliers, and others about your operations and goals.” (www.sba.gov)

In spite of these benefits, the business plan exercise has several shortcomings:

- (1) Students never experience the market’s reaction to their decisions.
- (2) The business plan is essentially a static document providing no real insights beyond an understanding of start-up issues and costs within a competitive environment.
- (3) Very little emphasis is placed on the intuitive aspects of opportunity recognition.

David Gumpert in his book, ***Burn Your Business Plan!***, presents a more succinct explanation of the shortcoming of a business plan: “In our society, we love “magic” solutions to our problems ... business plans have become a seemingly magical solution for entrepreneurs trying to figure out an easy way to obtain money from investors – you write a plan, show it to investors, and they write you a check.” (Gumpert, 2002, p29.)

### **Why Leave The Business Plan Behind?**

Originally, the business plan writing exercise worked well because students could select their own venture idea and the class size was small enough to allow sufficient class and instructor time to critically examine each business plan. During these critiques, the student’s vision, market insights, and personal goals can be discussed. Students could work alone or in self-selected teams based on their interest in the venture idea. The result was five to ten business plans per class that is a manageable number of plans to evaluate.

Without a doubt, entrepreneurship has arrived and average class size has significantly increased. The larger classes placed a real burden on the learning experience from the business plan writing exercise. There is not sufficient class time or instructor time to allow 50 or more students to write their own business plan. Teams of four or more became necessary but caused a decrease in the student’s personal interest in the idea. As average class size grew to over 50 students, students could no longer select their partners based on their shared vision of the venture opportunity, and disinterested students approached it with little enthusiasm losing the original purpose of the business plan writing exercise.

The challenge is to find a class exercise that would get more students more engaged in exploring issues they will need to resolve during start-up decisions under considerable uncertainty and to meet the challenges of managing an early start-up business in an emerging industry. The answer was to re-structure the course by eliminating the business plan writing exercise and replacing it with two projects: Opportunity analysis worksheets to allow each student to explore their individual venture ideas and a business simulation.

### **What is wrong with the business plan?**

- (1) In his book, ***Burn Your Business Plan***, David Gumpert presents compelling argument: “. . . why the conventional written business plan has become incompatible with important trends in the business and economic environment.” (Gumpert, 2002, p9). In order to support his argument, Gumpert quotes venture capitalist: “I don’t read business plans . . .

I look at the entrepreneur.” (Gumpert, 2002, p12) and professional investors calling business plans the equivalent of “intellectual push-ups. Nice exercise, but not necessarily relevant to anything in the real world.” (Gumpert, 2002, p14) In addition to investors, three professors studying the value of business plans concluded: “There was no strong relationship between performance and the use of a formal business plan” (Gumpert, 2002, p42). Gumpert believes that “The business plan as it is conceived and used by many entrepreneurs is passé. It has been corrupted to the point that it is over-emphasized by entrepreneurs, and under-utilized by investors (Gumpert, 2002, p13).

### **Business Simulation: *Threshold Competitor***

“Kolb defines learning as the process whereby knowledge is created by the transformation of experience. Business simulations are one form of experiential learning, which often is a very effective way of learning... People learn from their experience.” (Haapasalo and Hyvonen, 2001)

***Threshold Competitor*** provides experiential learning by requiring teams to select a strategy, implement the strategy, experience the results of their decisions, and compete directly with the companies established and run by their classmates. The simulation begins as an early start-up manufacturing firm in an emerging market. After the initial investment, the students must organize a management team to takeover the firm and make thirty decisions each quarter including pricing, marketing, marketing research, production, inventory, employment, employee training, and financial decisions. In addition to these decisions, the simulation has eight management dilemmas to challenge the team. The advantages of the simulation include the following:

- (1) All decisions are interrelated as decisions are in a real business.
- (2) The students experience the growth and maturity of an industry.
- (3) The students learn the value of market research.
- (4) The students are emotionally engaged from the start of the simulation and become more passionate about their firm during the semester.

The value of simulations as a learning method is strongly supported by others. Johne (2003) believes that the simulation’s strongest selling point is its ability to have students learn through experience. To support his point, Johne states: “Studies have shown that people who train on a simulation program retain about 75% of the material. In comparison, lectures yield a retention rate of only about 5%, audio-visual Presentations 20% and discussion groups 50%.”

### **Measuring the Effectiveness of Simulations**

If simulations should be an integral pedagogy in entrepreneurship courses, then the question remains of how the students’ learning experience can be demonstrated. Any attempt to answer this question is filled with challenges, because it is difficult to quantify the learning benefits of a business simulation. Henderson and Lawton (2002, p108) identified two key questions: “Two key questions surrounding the use of simulations have troubled users since the very earliest days of gaming are: (1) What do participants learn from engaging in a simulation experience? (2) Is a simulation better than alternative pedagogies for accomplishing certain learning objectives?”

How can the benefits of the simulation be demonstrated in light of the two problems was also noted by Schumann, Anderson, Scott and Lawton (2001): (1) “There is a void in the literature that reports the effect of simulation exercises on results either from the student’s or from the employer’s perspectives.” (p219) and (2) “The principal obstacle to assessing these higher levels of learning is the lack of suitable assessment instruments.” (p217) After noting these two problems, Schumann (et al) present the following recommendation: “Since business simulations are designed to be a more realistic environment in which to learn, one might therefore hypothesize that the use of simulations will result in improved behaviors.” (p218)

Sauaia and Aidar (1998) struggled with similar problems but they relied on Roger (1972) to help them understand the full meaning of experiential learning. Roger offered the following explanation of experiential learning:

- a) Involves the whole person both affectively and cognitively;
- b) Comes from within the learner. Even when the first stimulus comes from outside, the sense of discovery, achievement and understanding come from within;
- c) Penetrates the learner and bring about changes in his personality;
- d) Can be evaluated by the learner, who will know whether it is meeting his needs and clearing up his doubts;
- e) Is meaningful and is part of the development of the whole of the learner.

Two models have been suggested for use in measuring the efficacy of simulations. Both models will be used to interpret the survey results. The first model is Kirkpatrick’s Framework and the second is a cognitive and affective learning criteria.

Kirkpatrick’s Framework Schumann, et al (2001), recommended Kirkpatrick’s Framework (1998) as a guide for assessing the efficacy of simulations in a college setting. The framework identifies four levels of learning:

Level 1 – Reaction is how the participants in the learning experience feel about the experience. . . . In the context of evaluating a business simulation, reaction measures the simulation participants’ satisfaction with the simulation experience. Level 2 – Learning is the degree to which participants in the course’s change attitudes, improve knowledge, or increase skill as a result of the simulation. Learning can be said to have taken place when attitudes change, knowledge is increased, or skill is improved as a result of the experience (Kirkpatrick, 1998). Assessing learning involves measuring changes – a change in attitudes, or an increase in knowledge, or an increase in skills. Level 3 – Behavior is the degree to which learners have changed their behavior outside of the learning environment because of their participation in the learning activities. (Kirkpatrick, 1998). “. . . behavior refers to whether the learners are actually using what they learned. . . .” (Schumann, et al, 2001) When evaluating business simulations, behavior could be defined as the degree to which learners are exhibiting the attitudes, knowledge, and skills taught in one class to subsequent classes and non-academic settings. (Schumann, et al, 2001). Level 4 - Results refer to the degree to which the output of the participant’s workgroup or organization has improved because of learning simulation. (Schumann, et al, 2001)

Cognitive and Affective Learning is proposed by Sauaia and Aidar, (1998). They used cognitive and affective learning as a basis for evaluating the value of simulations used in Brazil and believed that the student or professional preparing to become a manager is subject to two kinds of demand:

- a) To acquire knowledge pertaining to the science of administration and to continually widen his knowledge base: cognitive learning;
- b) To develop technical and behavioral skills in the application of knowledge, to practice the art of administration, to affectively and emotionally interact with people at work and share a satisfying atmosphere: affective learning.

They concluded that, traditional education, based on accumulating memorized information regarding the management science is no longer suitable. Academic institutions may fail unless they concentrate on the cognitive and affective development of the student; the two areas proposed by Rogers (1972). Sauaia and Aidar went on to identify the central problems of evaluating simulations in Brazil:

1. What are the main variables to be found in business games?
2. What are the critical dimensions summarized by the variables studied?
3. What is the relative importance given by the participants to the elements of satisfaction and learning in business games?

## **DATA COLLECTION**

A questionnaire was developed in order to fill the void in literature. The students' experiential learning experience was examined with two different instruments: (1) a questionnaire that directly asked them to evaluate their learning experience with the simulation. Twenty-three questions were asked using a five-point Likert scale and six questions were asked regarding the student's individual performance as well as the performance of their team, and (2) a peer evaluation that asked them to rate their team members performance in relation to eleven different team activities of which the simulation work represented four of the eleven team activities. In this way we can examine the student's self-reported learning experience and determine the value of the simulation within the context of all the other required team assignments.

### **Analysis - Kirkpatrick's Framework**

Tables<sup>1</sup> 1, 2, 3 and 5 show the questions that were used to measure each level of learning in the Kirkpatrick Framework. A five-point Likert scale was used to measure the students' opinion with the following values: 1=strongly agree, 2= somewhat agree, 3= neither agree or disagree, 4=disagree and 5=strongly disagree.

Overall, the students "somewhat agreed" with all questions regarding the first three levels of learning with an average score of 2.60 (Table 1), 2.60 (Table 2), and 2.71 (Table 3) for levels 1, 2, and 3 respectively. A higher average is certainly desirable. However, these averages are very good when two other measures are considered: (1) only 40.2% of the students agreed that they mastered the simulation by the end of the semester (Table 3) and (2) only 47.6% of the students reported that all team members shared the simulation work equally (Table 5). Consequently, an

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<sup>1</sup> Due to space limitations, tables are not included. Please contact the author for a copy of the tables.

above average rating is good when mastery and participation is below average at best and implies that less skilled and less active students still did learn some skills.

A review of the averages for the first three levels identify the top reasons to explain the efficacy of the simulation. For the reaction level, the students felt that the simulation was a good experience (59.8%), very challenging (61.7%) and that the dilemmas were both interesting (58.1%) as well as challenging (54.2%). On the learning level, students believed the simulation helped them become more proficient at inventory management (67.9%) and managing the price/quality value relationship (66.7%). At the behavior level, the students found that the dilemmas caused their team members to discuss the issues (57.9%) and using the solo version help the student (58.9%).

In order to explore the data further, the percent agreeing and disagreeing with each statement is compared and reported in Table 4. By examining overall percentages, we find half the class agreed that they learned at all levels. Table 4 compares the three levels and shows that Level 2 has the highest ratio of agree to disagree with a ratio of 3.9:1

Kirkpatrick's fourth level of learning, the degree to which the students worked together as a team, is measured by asking about their level of participation. Table 5 reports these results and shows the relatively modest level of participation, 47.6%, as noted above. Interpretation of this data is limited because this is a cross-sectional survey. However, a few additional insights about this learning level can be gained from the data reported in Table 5:

- (1) Students gave a C+ grade for their team's ability to work together.
- (2) One or two students really worked on the simulation for a third of the teams.
- (3) Over 10% of the students reported that they did less than their fair share of work on the simulation.

Overall, this measure of learning clearly shows that all students were not actively engaged in the learning experience of the simulation, but it also shows that a significant percent of the students were fully engaged in the learning experience of the simulation and in some cases over two-thirds of the students reported learning while team participation was below average.

### **Analysis - Cognitive and Affective Learning**

In the spirit of exploratory studies and considering the limitations of the data set, two levels of analyses are performed. First, a correlation analysis is performed to determine the variables that are highly correlated with each of the variables selected to measure each type of learning. Second, regression analysis is performed to determine the ability of the highest correlated variables to explain the change in those variables selected to measure each type of learning. Tables 6 through 9 report the correlations and Table 10 reports the results of the regression analysis.

Interestingly, the top same ten variables that correlate with each of the four measures are the same but in different order. The regression analysis suggests other factors that may contribute to the students' learning experience than is found using Kirkpatrick's Framework. Overall, each



regression explained a considerable amount of variation in the students' learning experience ranging from 33.9% to 63.9%. Four variables are significant in explaining at least one of the dependent measures. Using the Cognitive and Affective Model, students learned the impact of the venture team on the performance of their firm; helped them become more proficient at managing cost of goods sold; exposed them to real-life business decision-making situation; and helped them become more proficient at financial management. The first two variables explained both cognitive and affective learning while the last two explained only affective learning

### **Analysis - Peer Evaluation**

What is the simulation's relative importance to the team's overall performance? This question can be partially answered by the students' peer evaluation. At the end of every class, each student is required to rate the performance of each team members on eleven different team activities using a ten-point scale. Four of the ten criteria describe work on the simulation while six criteria relation to other team projects and work. Ten represents that the student took a lead role in the particular activity while 1 indicated that the student did not contribute to the particular team activity. On average, students' participation rating ranged from a low of 79.3% to a high of 85.9% (Table 11). Overall, this finding indicates that all teams performed at an above average level and reflects the previously reported rating using the Kirkpatrick Framework findings.

Of the eleven questions, a key question is whether a student would like to work with the same student again. This is a litmus test of a student's performance. The regression analysis (Table 12) explains 67.6% of the variance and shows that three variables explain the variance in a student's preference to work with the student again. The top two reasons are expected: The student's ability to facilitate an excellent working relationship among team members, and the student's regular attendance at meeting. Both factors are fundamental to any group work. However, the third and only other variable that explained a student's desire to work with the student again, at the 95% confidence level, is the student's contribution to the simulation's quarterly decisions. This finding provides indicates the value of the simulation to create a group work ethic.

### **Conclusion**

Entrepreneurship education is finally arriving as a recognized academic discipline, and successful entrepreneurs are recognized as the "hero's" of economic growth. However, the question remains: How do we educate entrepreneurs? We know experience is the greatest teacher for entrepreneurs even though expensive and failure can be devastating for the entrepreneur and his or her family. During the early 80s, entrepreneurship classes were small and educators could effectively use a business plan writing exercise to engage the student into critically examining their venture idea. As enrollment grew significantly during the 90s, the exercise lost its effectiveness to help students evaluate their individual venture idea. Today's challenge is to educate entrepreneurs within the environment of large classes, and this study analyzes the ability of a business simulation to teach students about entrepreneurship through experiential learning.

The value of the business plan writing exercise in teaching entrepreneurship is being challenged by the increasing class size. This paper considered a business simulation as an alternate team project for teaching students entrepreneurial skills. Overall this study suggests that the simulation did teach several essential financial and marketing skills as well as the impact of good team performance.

In addition, this study confirms a common challenge in most classes that require team or group projects: obtaining active participation by all team members. It is not known whether the team participation found in this study is normal, above normal, or below normal. Further studies are certainly needed to assess the level of team participation as well as compare the learning experience of students doing a business plan writing exercise versus a business simulation. In either case, the simulation is worthy of further study and consideration in the teaching of entrepreneurship.

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# **Toward a Framework of Financial Planning in New Venture Creation**

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## **Abstract**

Empirical studies across different industrial countries have shown a positive correlation between planning intensity and the success of a business venture. Nevertheless, financial planning is typically regarded as a major obstacle in the process of new venture creation. Analytical techniques for large-scale and international enterprises are not fully appropriate for dealing with start-up planning. However, the existing literature which focuses on business ventures lacks a clear theoretical approach.

In this article, we develop a coherent comprehensive framework that draws out interdependencies among the financial planning components, elements, and individual items. We also determine a starting point of the planning process, show the linkage to other functional areas of business planning, and emphasize the structure, interdependence, and adjustment of elements within an iterative planning process. This provides the firm founder with a fundamental decision-making instrument, which supports the evaluation and exploitation of entrepreneurial opportunities, as well as the formulation and implementation of the corporate strategy.

The framework comprises five financial planning elements concerning sales, related expenses, investments, capital requirements, and financing, which results in three components: planning of income statement, balance sheet, and cash flow statement. We demonstrate how the robustness of the financial plan can be tested by employing sensitivity analysis, scenario analysis, and simulation. The quantitative result of this process is a consistent financial plan. The components of our approach are fully consistent with generally accepted accounting principles (IAS and U.S. GAAP).

## **1. Introduction**

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 (Gumpert & Stancill, 1986; Hayen, 1982; Hergert, 1987; McGrath & MacMillan, 1995; Pettit & Singer, 1985; Wilkinson, 1987). Yet, there exists no generally accepted guideline for aligning financial planning with the creation process of a start-up. A coherent comprehensive framework which draws out interdependencies among the planning components, elements, and items is still lacking. The importance of planning in new venture creation is supported by recent research which has detected a positive correlation between planning intensity and the success of new

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\* I would like to thank Matthias Raith for critical comments.

ventures (Stewart, Watson, Carland, & Carland, 1999). Delmar and Shane (2003) argue that planning is a significant precursor to action in start-ups. There also exists a significant positive relationship between formal planning by small firms and financial performance (see, for example Bracker & Pearson, 1986; Schwenk & Shrader, 1993).

Our starting point is the framework suggested by Shane and Venkataraman (Shane & Venkataraman, 2000; Venkataraman, 1997). They view entrepreneurship as a nexus of enterprising individuals and valuable opportunities which constitute the process of existence, discovery, and exploitation of entrepreneurial opportunities. Once the opportunity is discovered, its exploitation requires the investment of limited resources. The expected value is determined by four groups of factors: the characteristics of the opportunity itself, psychological factors (such as motivation, core self-evaluation, cognitive properties, risk taking, extraversion), non-psychological factors (as for instance education, career experience, age, social position, opportunity cost) (Shane, 2003; Shane & Venkataraman, 2000), and the entrepreneur's personal characteristics. Together, this leads to significant deviations in the estimation of the expected value of an opportunity and the resulting financial planning process.

As this perspective reveals, the profitable exploitation of opportunities is related to the task of systematic planning and the calculation of costs and revenues. We define *financial planning* as the process of systematic and quantitative forecasting of all cash in and outflows relevant for the exploitation of entrepreneurial opportunities, in order to support financial decisions within the future planning period. The essence is based on the notional anticipation of future outcomes and the application of an appropriate decision making mechanism. Financial planning, viewed in this light, serves as a mechanism for dealing with uncertainties. Distinct from the definition of financial planning, the pro forma *financial plan*, composed of income statement, balance sheet, and cash flow statement, is the numerical result of the financial planning process.

## **2. Conceptual Framework of Financial Planning for Decision Making in New Venture Creation**

The financial planning process, regarded as a set of decision making instruments, includes three core components:

- (i) planning of the income statement,
- (ii) planning of the balance sheet,
- (iii) planning of the cash flow statement,

By definition, the numerical results of the financial planning process are three appropriate pro forma statements. The triad suggested here relies on the internationally accepted accounting principles. If the venture is financed with venture capital or considerable changes in equity are expected, a fourth component, viz. the "statement of stockholders' equity", would provide a better understanding of the equity events and transactions (refer to SFAC 5, IAS 1). A key supplementary instrument, the "footnotes", contains information on principles, assumptions, details, connections, schedules, and methods used to produce the components, elements, and items of the statements. This provides the groundwork for the planning process. The core components require the (monthly or periodically) planning of five elements, defined as financial planning elements:

- (i) planning of revenues;

- (ii) planning of related expenses;
- (iii) planning of investments (all nonrecurring investments);
- (iv) planning of capital requirements (both all nonrecurring investments and recurring expenses);
- (v) planning of financing.

Figure 1 serves as a comprehensive overview for the following discussion. Although the components of balance sheet and income statement planning are simplifications, they are for the present purpose.

### **3. Planning of Financial Elements**

A crucial issue arising with any conceptual framework is the determination of the starting point. This is of particular importance for our purposes, because of the connections between the elements. The planning of sales is a recommended starting point due to existence of interdependencies with other functional areas. An estimate of the sales volume and price can be extracted from the preceding market analysis and estimated market needs, as well as from a written justification of sales forecasting. In contrast to Gumpert and Stancill (1986), we suggest here that the estimation of sales should be divided into two parts: price and volume. Both are based on several factors, e.g. target market, market boundaries, forecasted development of the target market, customer pattern and taste, competitors, marketing mix. The relationship between these two variables characterizes market demand. How many products and services are customers willing to purchase at different price levels? How does this relationship change over time? Subsequently, the entrepreneur is able to calculate the most likely revenues from the expected sales volume and the target price, which provide the input data for further technical methods. Again, both sales volume and target price have to be supplemented with supporting information and detailed explanations in the footnotes, since this provides the basis for further planning elements and should, therefore, be reviewed continuously.

After assessing the planning revenues, the level of sales volume determines two planning elements. Related expenses starting with the cost of goods sold (labor, material, overhead, etc.; except depreciation) can be calculated. Furthermore, a derived production plan specifies the required level of capacity of production and service which ascertains the needs of nonrecurring investments. In order to obtain a clear picture separate schedules for the production plans are recommended. Based on the production level, the entrepreneur calculates the remaining expenses – general and administrative, selling, research and development, and other expenses – to complete the element “planning of expenses”. It is inappropriate to classify these items as percentages of sales. Instead, each item requires a detailed schedule (Gumpert & Stancill, 1986). This is particularly necessary for other expenses that should not be treated as a “pool for residual items”. After finishing the investment plan, the entrepreneur prepares a depreciation plan to include depreciation in cost of goods sold. Once more, all items should be supplemented with detailed information in the footnotes. At this point, however, we cannot yet specify the amount of interest and tax expenses of the income statement.

All cash outflows identified up to this point are aggregated in order to calculate the capital requirements which include nonrecurring investments and recurring expenses. Up to this point,

the revenues and expenses are accounted for in the income statement. Sales and expenses do not always result in cash flows, e.g. invoices are paid and payments are received from customers at a later point in time. Thus, the firm founder has to estimate the percentage of revenues and expenses that are collected this month, the next, and in later months. From this computation, accounts receivable and payable are extracted. For this, a separate schedule is appropriate. The next step is to plan financing. The objective of an optimal capital structure is to minimize the weighted average costs of capital. Based on the financing plan, interest expenses are given. This poses a challenge to the entrepreneur since the whole project depends significantly on the available funds. After finishing the financing and restatement of all other elements, the entrepreneur calculates interest expenses and includes this item in the income statement in order to determine taxes.

#### **4. Planning of the Income Statement**

Overall, the income statement planning is based on the following financial planning elements: planning of revenues, planning of related expenses, a depreciation plan extracted from the planning of investments, and interest payments calculated from the planning of financing. Depending on the opportunity, the simplified income statement of figure 1 can be exhibited in a more detailed plan. Deducting the cost of goods sold from sales results in gross margin. Subtracting further the operating expenses yields operating income. Operating expenses may be broken down into general and administrative expenses, selling expenses, research and development, as well as other expenses. In subsequent steps, the entrepreneur deducts interest and tax expenses. In addition, there are four different methods to account for revenues: completed contract, percentage-of-completion, installment, and cost recovery method. Revenues are included in both the income statement (revenues) and the balance sheet (account receivables), depending on the credit policy. This is important for the estimation of cash flows, because high credit sales, all else being equal, lead to later cash inflows and, thus, to greater capital requirements. When calculating expenses, fixed costs should be separated from variable costs. Consequently, a (cash flow) breakeven analysis can be conducted to find the point where revenues are high enough to cover cash outflows and maintain the level of operations.

#### **5. Planning of the Balance Sheet**

As in the income statement, items in the balance sheet depend on the nature of the entrepreneurial opportunity and should be consistent with accounting standards. Given the planning of investments, capital requirements, and financing, the entrepreneur generates the information necessary for the preparation of the projected balance sheet. Starting with the investment plan, the entrepreneur determines the amount of fixed assets (property, plant, and equipment) required for the production of the desired level of output. This represents the nonrecurring investments. In case the contractor of the PP&E offers financing, this would be recognized in the financing plan. Sources of financing which are particularly interesting for new ventures, due to limited funds, are leases or so called off-balance-sheet financing

As already discussed in section 3, the entrepreneur calculates a separate schedule of what percentage of sales is collected in each month. Accounts receivable and payable are stated in the balance sheet. It is often the case that new companies will not receive credit in order to purchase

raw material, which ultimately requires more committed funds. A more sophisticated task is determining inventories before they are recognized as cost of goods sold. For example, the inventory of a manufacturing company consists of raw material, work-in-process, and finished-goods, whereas a retailer or wholesaler shows unsold goods as merchandise inventory in the balance sheet. They are calculated separately in accordance with the production schedule. In addition, three alternative accounting methods are applicable for inventory and cost of goods sold: last-in, first-out; first-in, first-out; and average cost. For simplification, the average cost method is recommended. Moreover, a fast growing venture must consider a higher requirement of working capital, which will probably not be able to finance all of the growth from internal funds. The planning and management of account receivables, payables, and inventory is a critical task for start-ups. After determining the capital requirements, the most crucial element is the planning of financing which specifies the source of funds available to the enterprise. Typically, the start-up faces considerable difficulties in acquiring funds. As a result, the obtained capital actually narrows not only the other planning elements but also the entire corporate strategy.

## **6. Planning of the Cash Flow Statement**

As figure 1 illustrates, cash flow planning is derived from all other planning components and elements. It strives to identify the optimal amount of cash flows. Most important is maintaining liquidity, since unprofitable firms with positive cash flows may still operate, but profitable ventures with a lack of cash will become insolvent. In addition, a surplus of liquidity is undesirable because this would counteract profitability. International accounting standards provide a structural classification of cash flows in terms of operating, investing, and financing activities. This separation is recommended for business ventures as well, because the amount of cash flows contains little information by itself, whereas the categorization is informative and consistent with generally accepted accounting principles (for an opposing view, see Gumpert & Stancill, 1986; Hayen, 1982). After planning cash flows from operating activities (CFO), available cash flows for investment (CFI) and financing (CFF) are determined. For strict accounting purposes, SFAS 95 and IAS 7 govern the preparation of cash flow statements and permit both the direct and indirect method. However, the Financial Accounting Standards Board and the International Accounting Standards Board encourage use of the direct method (SFAS 95.27, IAS 7.19). Nevertheless, the most widely-used is the indirect method.

## **7. Applied Technical Methods**

Since financial planning is future oriented, all future cash flows have to be estimated in advance: a process that can be accomplished by a variety of forecasting methods. The data reliability heavily depends on the accuracy of the forecasting process. Methods generally fall into three major groups:

- (i) Judgmental methods are non-quantitative, based on individual experience and intuition. Forecasted values are ascertained by individual and group decision making processes.
- (ii) In contrast, extrapolation or series methods are quantitative in nature and typically based on observations made in the past in order to forecast future values. Thus, by investigating past data, we search for underlying patterns and relationships in order to extrapolate historical patterns into future forecasts.
- (iii) Causal methods are based on logical cause and effect relationships by means of linear and non-linear regressions.

Judgmental methods are generally applicable to new venture creation but their judgmental diversity results in a lack of accuracy and is subject to biases, e.g. optimism and overconfidence (Kahneman, Tversky, & Slovic, 1982). However, judgmental methods can be improved considerably by integrating expert opinions using methods for forecasting from “intentions data” (MacGregor, 2001; Morwitz, 2001; Rowe & Wright, 2001). The second approach is inappropriate in the context of startup financing since historical values are unavailable. Furthermore, causal methods can only be employed when the logical cause and effect relationships are not based on past data. In case the null hypothesis of the cause and effect relationship can be approved, the forecasted value will occur at a specific confidence level. In general, there is a significant difference between existing firms and new ventures: in the latter case, input data from past events are not available for the planning process, and there is no controlling system to rely on. Supplemental comments on assumed forecasting relationships are especially imperative for causal methods.

## **8. Decision Making**

The issue that needs to be addressed is which approach should guide the entrepreneur in her future 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 forecasting the timing of cash flows, the firm founder anticipates bottlenecks and financial slacks which enhance the allocation of scarce resources. A decision made today creates a set of subsequent decisions and alternatives tomorrow (Hammond, Keeney, & Raiffa, 2002). The framework supports the firm founder 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). Planning also reduces uncertainties in the process of decision making. Castrogiovanni (1996) defines this as a direct learning benefit by means of “proactive learning” which is generally incorporated in the planning process. The firm founder attempts to identify potential scenarios and causal relationships. Thus, uncertainty may stimulate planning and planning results in “proactive learning” (Castrogiovanni, 1996). Consequently, nascent entrepreneurs should conduct their own planning process to accomplish the most learning benefits (Castrogiovanni, 1996).

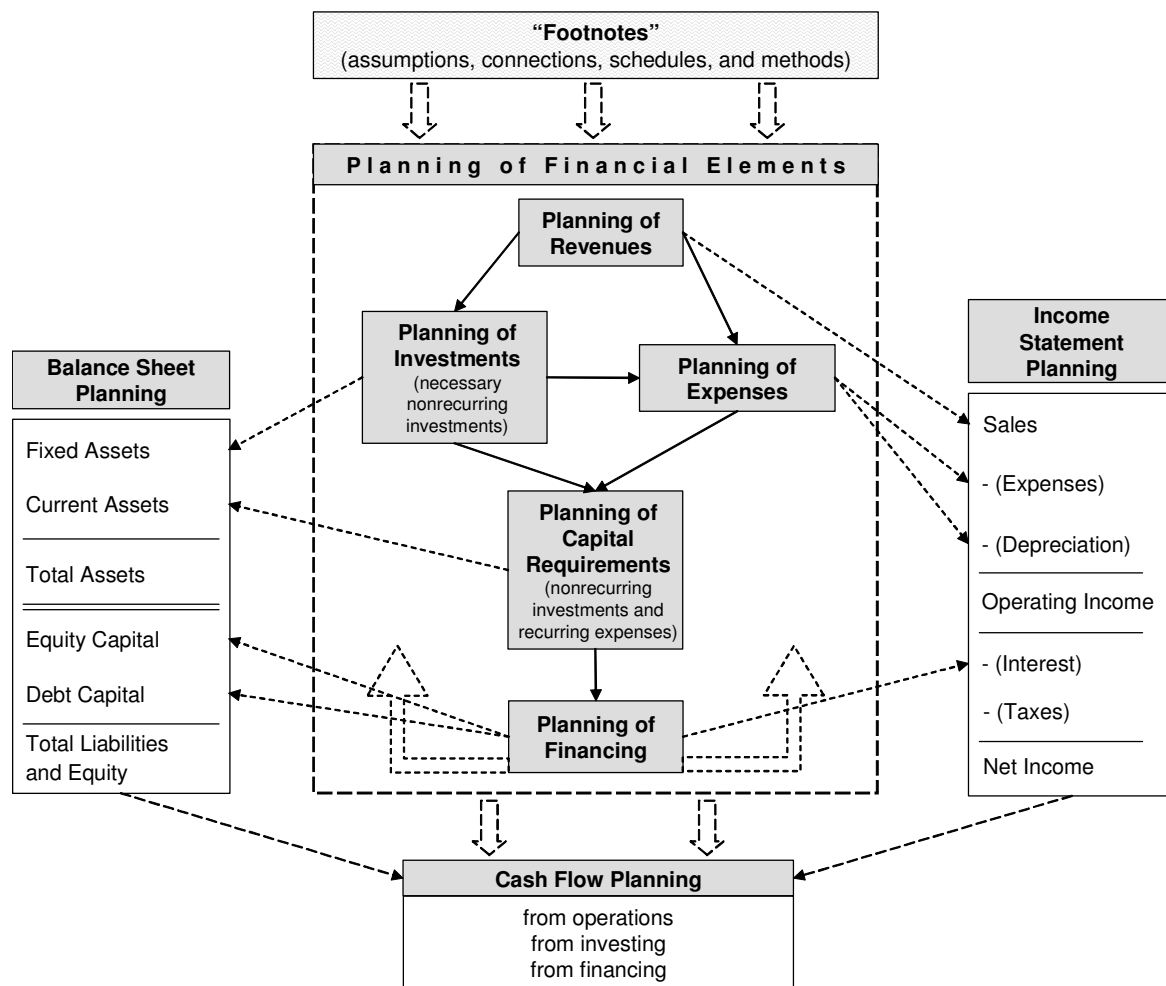
## **9. Conclusion**

In this article, we develop a coherent, theoretically grounded comprehensive framework for financial planning in new venture creation. Before starting with any quantitative projection, the entrepreneur gathers and analyses information concerning the new venture, conducts a thorough market analysis to specify market needs, evaluate relevant external threats and opportunities, as well as internal strength and weaknesses. This leads to assumptions and connections which build up the foundation of the whole financial planning process. Thus, the sales volume and price can be extracted from the preceding analyses and written justification. The revenues determines related expenses and a derived production plan specifies the needs of capital investments. By



aggregation, the entrepreneur calculates capital requirements. The next step is the planning of financing which initiates an adjustment mechanism due to financial “bottlenecks” that leads to an iterative planning process. The described process defines the five financial planning elements: planning of revenues, planning of related expenses, planning of investments, planning of capital requirements (all nonrecurring investments and recurring expenses), and planning of financing. Finally, the robustness of the financial plan can be tested by employing sensitivity analysis, scenario analysis, and simulation. These methods are applied to financial planning elements and components. Because all cash flows have to be estimated in advance, appropriate forecasting methods must be employed.

**Figure 1: Conceptual framework of financial planning in new venture creation**



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CAN MUSIC EDUCATION ENCOURAGE ENTREPRENEURIAL THINKING?  
AN ALTERNATIVE APPROACH TO GENERAL MUSIC EDUCATION  
CURRICULUM DEVELOPMENT

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Abstract

*This paper opens a discussion of an alternative approach to music education, one that strives to encourage the growth of entrepreneurial thinking through the use of curriculum integration, problem-based learning and project-based learning in a general music curriculum. The case is made that creative thinking is the nexus between the two seemingly disparate subject areas of music and entrepreneurship, and that music can contribute significantly to the development of the kind of thinking needed by future entrepreneurs. A general music curriculum framework is under development and will be made available upon request.*

## **INTRODUCTION**

Entrepreneurship education is an exciting and emerging field of study in K-12 education. Although still in its infancy (Watson, 2001), this field of study is generating many initiatives that offer opportunities to revitalize classrooms and curricula in a time when teachers are faced with the daunting task of “leaving no child behind.” This paper discusses the traditional and contemporary ideologies of entrepreneurship education, the desired student outcomes that come from using entrepreneurial thinking, the components that are needed to accomplish the inclusion of entrepreneurship initiatives in a K-12 setting and finally the research-based support for using an approach that encourages entrepreneurial thinking through a general music education curriculum that includes creativity-, problem- and project-based learning.

## **TRADITIONAL AND CONTEMPORARY IDEOLOGIES**

Because entrepreneurship education was born in the business schools it is not surprising that early coursework and curricular models reflected a focus on business. Core areas of entrepreneurship were identified, including: 1) identification of an idea or opportunity that was marketable as a service or product, 2) acquiring or getting commitment for funds, in spite of risks, to pursue market potentials, and 3) creation of a business or organization to implement the opportunity in reality (Kourilsky & Carlson, 1997). Curricular models reflecting this focus at the university level have gradually been passed down to secondary and even elementary schools. In the K-12 setting, the standard elements that are considered vital by most traditional entrepreneurship educators are:

- The curriculum must be about entrepreneurship
- The curriculum should be experience-based or experiential
- The curriculum should be based on learning theory principles
- The curriculum should grow slowly, beginning with a pilot stage, then an enhancement stage, evolve through a custom transfer stage and end with a mass transfer stage of development
- The final stage should be taught by certified instructors and should offer certification courses
- The curriculum should fit the target group and environmental constructs
- The curriculum should regularly undergo evaluation and enhancement (Kourilsky & Carlson, 1997).

Some are beginning to shift the focus from business only. One indication of this comes from Calvin A. Kent, whose following remarks seem to support a broader definition of the field.

Entrepreneurship should be defined, in the broadest possible context, as a process of creative change. It may result in the formation of a new business, but then again it may not. The purpose of entrepreneurship education should be to foster creative activity and independent action wherever it is needed. What is traditionally viewed as entrepreneurial activity (starting a business) should not be the only goal or outcome of an entrepreneurship education program. There are tremendous benefits to be gained from entrepreneurship education in addition to that of spawning the next generation of business initiators. A population that is more creative, innovative, risk-taking, and acclimated to change is a population that is more likely to be successful in all its endeavors. Narrowing the limits of an entrepreneurship education program to just a single goal of producing more new business start-ups would be folly (Kent, 1990, p. 6).

There is growing interest in understanding how to encourage entrepreneurial thinking. One Vanderbilt University project, entitled *Entrepreneurs In Action!*, was designed so that new ideas about the entrepreneurial nature of teaching and learning could be employed. The project combined entrepreneurship education fundamentals with new constructs of learning theory to foster independent thinking, creativity and problem solving skills in the belief that such skills are a necessary part of “entrepreneurial thinking” (Goodin, 2003). *Entrepreneurs in Action!* was intended to build on the successes of such programs as *The Jasper Project*, developed by the Cognition and Technology Group of Vanderbilt University (CTGV). *Jasper* is a series of videodisc-based adventures using problem-solving, social interaction, and integration of subject areas to help improve mathematical cognition in 5<sup>th</sup> grade children and up. Both projects reveal that creativity-, problem-, and project-based approaches that are founded in real life stories bring significant meaning to learning (CTGV, 1997). Four pedagogical components consistently emerge: 1) strategies that foster creative thinking, 2) problem-based instruction, 3) project-based instruction, and 4) strategies that lead to experiential or experience-based knowledge from cross-disciplines (Kent, 1990). The contemporary approach is different than the traditional approach, in which students start with an introduction to new facts or principles and are taught to access this new information by the use of applications problems. In this case knowledge may become inert, not active (CTGV, 1997). Contemporary approaches use real-life scenarios that are problem-, or project-based so that the learning of new concepts and principles is active and dynamic. The scope is holistic, cross-disciplinary and relevant to the local community.

### **DESIRED STUDENT OUTCOMES FROM ENTREPRENEURIAL THINKING**

Knowing how entrepreneurs think and how they process information and learn is vital in developing curricula for K-12 students (Young, 1997). Practicing entrepreneurs acquire knowledge for completely different reasons than students. This is because they are faced with truly novel problems or, at least, problems that they have not faced before. Novelty comes from changing goals or from new ideas or ways of looking at or doing some task. They must learn how to draw from their experiences and they need to be less subject-centered in their application of knowledge and more focused on how knowledge can be applied in a problem-centered situation (Kourilsky, 1990). These are the characteristics that must be developed in a student to make an entrepreneurship education program effective (Kent, 1990). Two curricular approaches have been used to advance these desired student outcomes. The first, a composite model, provides instruction to a student from a traditional academic department, usually a “business track.” The second is an integrated model. Specialists from the community and university, who have a vested interest in entrepreneurial processes, have direct involvement in this type of program (Clouse & Goodin, 2001-2002).

### **COMPONENTS TO INCLUDE IN K-12 SETTINGS**

Researchers and educators agree on the importance of strategies that foster creative thinking, problem-based instruction, project-based instruction and cross-discipline strategies that lead to experiential or experience-based knowledge. Current research informs us regarding the nature of

creativity and the ways that creative thought processes are enhanced through problem-based learning and project-based learning as part of a curriculum.

### **Creativity and the Development of Creative Thought Processes**

As one entrepreneurship educator said, “Not all creative people are entrepreneurs nor are all entrepreneurs creative.” Still, the key to great entrepreneurial success lies in the ability to innovate (Kao, 1990). What is creativity and how can curricula help develop creativity? One definition is as follows:

A product or response will be judged as creative to the extent that (a) it is both a novel and an appropriate, useful, correct, or valuable response to the task at hand, and (b) the task is open-ended with more than one way of doing it (Hennessey & Amiable, 1987).

Scientist Antonio Zuchichi (1996) stressed that creativity requires memory and imagination. If we accept that the background elements of creativity include memory and imagination, it is easy to assume that there is a relationship between creativity and intelligence. However, brain research has shown that while low intelligence yields low creativity, higher intelligence yields both lower and higher levels of creativity. Social psychologists suggest that creativity arises from three components: 1) domain-relevant skills, including factual knowledge, sets of cognitive pathways, technical skills and special talents, 2) creativity-relevant skills, which are defined by personality dispositions that are given to risk-taking, deep concentration and the ability to readily take on problems and imagine new ways to solve them, and 3) intrinsic task motivation, meaning the variables of motivation a person has with a particular problem or task. This component, according to some, is the most neglected in the classroom (Hennessey & Amiable, 1987).

Prior to the lesson/activity these strategies will foster classroom creativity: 1) confront a new, ambiguous uncertainty by building anticipation and expectation, 2) make the familiar strange (or the strange familiar) by analogies, 3) look at something from every point of view as is reasonably possible, 4) ask for predictions, 5) ask questions that make students look at knowledge or experiences in a new way, and 6) structure tasks just enough to give direction or clues and encourage risk-taking or going beyond what is known. Remember that creative learning develops best when methods are varied and informal. During the lesson/activity the following should be used: 1) keep anticipation as the motivation for learning, 2) do not limit possibilities but encourage constructive, creative responses, 3) make the exploration of missing pieces and possibilities systematic and deliberate, 4) use open-ended strategies, 5) use surprises deliberately, 6) juxtapose seemingly unrelated ideas, 7) allow time to think, experiment and test ideas, and 8) encourage visualizations. Following the lesson/activity, teachers should: 1) revise predictions, 2) reorganize and review the knowledge gained from the experiences, and 3) encourage digging deeper beyond the obvious solutions (Torrance & Myers, 1970).

Teachers sometimes do not fully understand what type of creativity they are trying to develop in students. Anna Craft (2000) calls the creativity of all people “little ‘c’ creativity,” noting the fact that all children possess some amounts of this type. She asserts that the vast majority of children need opportunities to use this type of creativity often, and that teachers must choose pedagogical approaches that invite it. She proposes that teachers misunderstand what creativity is and mistakenly strive to develop “high ‘c’ creativity.” This type of creativity is like that of historical

figures that society deems as geniuses or as profound (Craft, 2000). Strategies that support little 'c' development includes those that incorporate the use of multiple intelligences in the classroom, call for both convergent and divergent thought processes and promote imagination, play, and invite questions and "possibility thinking" (Craft, 2000). For learning activities to foster creativity in students they must be allowed to become solvers of real problems, not just absorbers of knowledge. Teachers must become problem setters, problem seekers, coaches, listeners, promoters and creative thinkers, not just knowledge givers (Starko, 2001).

Entrepreneurship educators value creativity, as is shown by the following 12 strategies, grounded in creativity research, that will develop creative initiative in students:

1. Serve as a role model of creativity
2. Encourage the questioning of assumptions
3. Allow for mistakes
4. Encourage sensible risk-taking
5. Design creative assignments and assessments
6. Let the students define the problems for themselves
7. Value creative ideas and products
8. Allow time to think creatively
9. Tolerate and encourage toleration of ambiguity
10. Prepare students to face obstacles
11. Be willing to grow and adapt
12. Have a nurturing environment (Sternberg, 1996).

One way to learn how to develop an environment conducive to creative thought is to know what will not work. Researchers have identified 5 teaching "don'ts" that can kill creativity:

1. Having children do work for an expected award – Evidence shows that this undermines internal motivation and creativity of performance.
2. Using a lot of surveillance – Evidence shows that all children were less motivated to solve problems or play. Older students responded as though they were being evaluated.
3. Restricting choices of how to do an activity – Evidence shows that constraints of any type lower interest in creative activity.
4. Set up of competitive situations – Evidence shows that competition between peers for recognition or reward is undermining to the intrinsic motivation needed for creativity.
5. Have children focus on expected evaluation – Research shows that evaluations increase extrinsic motivation, not intrinsic motivation, which is not conducive to creative thought processes (Hennessey & Amiable, 1987).

### **Problem- and Project-Based Learning Using Cross-Disciplinary, Experiential Knowledge**

All of the previously listed strategies for fostering creativity contain one common feature– the requirement of a problem. The underpinnings for project-based and problem-based learning (PBL) were originally conceived in the work of philosophers like Bruner, Gagne and Dewey (Barrows, 2000). These philosophers promoted strategies of self-directed learning that fostered the flexible transfer of knowledge. Students solving real problems gain experience that is connected to knowledge in a deeper way and develop a flexible and creative cognitive style (Evenson & Hmelo, 2000).

Problem- and project-based learning methods are holistic, experiential and in harmony with Gardner's multiple intelligences research (Fogarty, 1997). They match the curricular reform movement in schools today (Lambros, 2002). Teachers must embed national standards in the objectives of each problem in such a way that students accomplish the objectives even if they find multiple solutions for the problem (Bridges & Hallinger, 1995). Teachers may combine these models or develop them separately. They may use this approach in one classroom or across the entire school curriculum.

To implement a problem- and project-based curriculum the following steps should be included: 1) use faculty and community experts as consultants in designing the overall problem or for project development, 2) use faculty and community experts as consultants for student learning and as panelists for the students' projects, 3) let events and local issues open opportunities for discussions of problems and projects with students and faculty, and 4) share student products and solutions with faculty and community experts. Teachers must verify the relevance of the problem, understand its context and develop assessment tools that match. They should allow for time constraints, resources, preparation of the environment, assignment of teams or groups and guidelines for the role of the primary leader in a project (Bridges & Hallinger, 1995).

As stated earlier, entrepreneurship education includes these pedagogic elements in both traditional and contemporary approaches. However, present approaches to entrepreneurship education and to entrepreneurial learning are possibly becoming two sub-related fields within entrepreneurship. Fresh approaches are currently trending toward the encouragement of entrepreneurial thinking, rather than simply the creation of new business ventures (Clouse & Goodin, 2001; Young, 1997).

## **ENTREPRENEURIAL THINKING IN THE GENERAL MUSIC CURRICULUM**

The discussion thus far has laid the groundwork for a problem-based approach to entrepreneurship education, but has not yet addressed the role of a K-12 general music education program in the encouragement of entrepreneurial thinking. Our research reveals that this is a relatively unexplored area but that there are some important areas of commonality.

Many methodologies are available to music educators who are designing a general music education curriculum (Atterbury, 1992). In contrast to the contemporary models of entrepreneurship education, the general model for teaching music is based on the conservatory teacher, where learning occurs through imitation of the master teacher; it is "teacher centered." While this may work for musically motivated students (high "c"), it results in many students dropping out of music because the experiences they have had are not relevant, internalized or personalized. Tait (1992) states that "society is going to need many more creative people in the next decade, and knowledge of the creative process is going to help fulfill that need."

Creativity and problem solving go hand in hand with song writing and improvisation; the main difference is the timeframe it takes to create or get feedback (Bean, 2000; Csikszentmihalyi & Rich, 1997). Research shows that writing music contributes to aesthetic works, increases higher order thinking and flexible problem solving, builds a tolerance for ambiguity between content



and concept, builds a community feeling, gives students a sense of ownership and offers another integrative tool in content area learning (Bean, 2000).

The Music Educators National Conference (1999) conveyed twelve imperatives in what was called the *Housewright Declaration: Vision 20/20*. This project was designed to indicate, for music educators, the possible future direction that music education was taking and made suggestions on how to best meet the future demands that could be placed on music educators. Several of the open-ended imperatives given could allow for the inclusion of entrepreneurship education and entrepreneurial learning in a general music program, as follows:

- Number one – participation and experience (which gives rise to experience-based knowledge and active learning)
- Number six – involvement of professional community (opens the doors to those who can help conduct problem- and project-based learning methods)
- Number seven – formal and informal curricular integration (which supports the cross-disciplinary requirement needed to include entrepreneurial ways of thinking)
- Number twelve – identify barriers (which means music educators must be able to recognize a problem and then be innovative problem solvers)

Bennett Reimer (1999) points out that music yields products and is a process. Entrepreneurship education directly relates to processes that bring products into being and offers new ways to look at the products or processes that are constructed (Kent, 1990). In another section of the *Vision 2020* document, Carlesta Elliot Spearman, a professor of music at Keene State College, NH, states that the 21<sup>st</sup> Century will bring “innovations and creative adaptation of teaching methodologies and materials in music education” (Spearman, 1999).

## **CONCLUSIONS AND RECOMMENDATIONS**

There are many examples of areas where convergence between a music education curriculum and entrepreneurial thinking could occur. The National Advisory Committee on Creative and Cultural Education stressed the “nurturing of individual expression, often through self-directed learning and creative activity” (Adams, 2001). The committee goes on to say that academic skills are still highly valued by employers, but words like flexibility, adaptability, social skills, communication skills, cultural awareness, and creative thinking are part of the vocabulary of governments and employers today. Research validates that when learning experiences are based on inquiry students become self-directed problem seekers and solvers through creativity, innovation and critical thinking skills (McLaughlin, 2000). These are the same basic components that research has prescribed for entrepreneurship education.

If, as we propose in this paper, all children have a certain degree of creativity (small “c”), then the following beliefs naturally follow: 1) creative education can foster creative thinking and problem-solving, 2) the effective combination of creative thinking and problem-solving will bring about what we term “entrepreneurial thinking,” and 3) entrepreneurial thinking is a prerequisite to entrepreneurship. Our recommendations for blending the two fields are built on these beliefs, and are structured around three main points: 1) infusing music education throughout the K-12 experience while 2) seeking deep curricular connections with specific

entrepreneurship education goals, and 3) following up with specific entrepreneurial ventures as culminating educational experiences.

Much work remains to be done in the development of a curriculum that effectively combines music with entrepreneurship. The temptation is to simply provide students with the opportunity to start a music publishing business, or to create a performance group, or to connect them with the Songwriter's Guild. Such approaches, in our view, shortchange the very real possibility that a fusion of arts and entrepreneurship offers. The field of curriculum development is crying out for the kind of fresh approach that brings relevance to learning. When our students grasp the deeper similarities that exist between creative fields like music and the entrepreneurial thinking so necessary to business venture development, when they see that creativity is required in both venues, then perhaps they will be less likely to "turn off" the entrepreneurial spirit that is a part of their very makeup.

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**COMMON PROBLEMS OF RURAL SMALL BUSINESSES:  
A COMPARISON OF AFRICAN AMERICAN- AND WHITE-OWNED FORMATION AND  
EARLY GROWTH FIRMS**

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**ABSTRACT**

This study investigated the types of problems encountered by rural businesses that used Small Business Centers for counseling. The sample included 250 retail and service firms and their problems were stratified according to Chrisman and Leslie's (1989) integrative problem classification system. Analyses were conducted to determine the most common types of problems encountered by these businesses and the relationship between the types of problems reported and the owner's race and firm's developmental stage. Strategic problems (55.6%) were the most commonly encountered problems by business owners in the sample, regardless of race or developmental stage. The second most common type of problems was administrative (33.6%), while the least common type of problems was in the area of operations (10.8%). Although no significance was found between the type of problems and the owner's race, a significant relationship was found between problem type and the firm's developmental stage such that businesses in the formation stage are more likely to encounter strategic problems and early growth firms more often experience administrative problems.

**INTRODUCTION**

According to the Small Business Administration (SBA), approximately 66% of small businesses survive their first two years of existence. The survival rate drops to only 39.5% after six years of operation (SBA Office of Advocacy, May 2002). These statistics serve only to confirm that starting and maintaining a successful small business is difficult at best. However, within the classification of small businesses, there is a subset of small businesses that has an even greater failure rate. According to the SBA, of the African American businesses with employees and positive payrolls that started in 1992, only 34.7% survived after four years of operation (SBA Office of Advocacy, November 2001). In addition, for the time period 1992 to 1997, all minority classifications except African American-owned businesses surpassed the gross receipts growth rate of all U.S. small businesses (Minority Business Development Agency, July 2001). Two contributing factors that generally lead to higher failure rates for African American-owned small businesses are less access to capital and a need for better management and technical training (Thompson, 1991).

Research points out that small businesses are more likely to be located in rural areas with less access to resources (Headd, 2000). A weak infrastructure often makes it difficult for business owners to take full advantage of economic opportunities. As indicated in a 2003 report from the Kellogg Foundation, entitled *Mapping Rural Entrepreneurship*, some of the obstacles in rural regions include limited networks, financial constraints, low demand levels, unskilled labor, and cultural barriers. As outlined in the report, the keys to improving entrepreneurial activity in rural communities is to promote entrepreneurship education, provide greater access to capital, and offer high-quality business assistance. Entrepreneurship can become a substantial component of rural economic development if the business climate is improved in these areas. Eastern North Carolina relies heavily on small businesses to provide jobs and economic growth. However, like many other rural areas, this region is faced with a high business failure rate and a low business startup rate (NC Department of Commerce, March 10, 2004).

### **PURPOSE OF STUDY**

The purpose of this study was to determine the types of problems encountered by rural businesses that use Small Business Centers for counseling and the relationship between these problems and the owner's race and the firm's developmental stage. This study focused specifically on businesses in the formation and early growth stages of development. According to Dodge and Robbins (1992), business owners in the formation stage develop a business plan and attract financial support to allow their ideas to become a reality. The early growth stage, while still presenting a high level of uncertainty, is often characterized by steadily increasing sales as business owners become keenly aware of customer demands.

In order to be effective, small business assistance programs must develop a proper match between the needs of their clients and their program offerings (Nahavandi & Chesteen, 1988; Chrisman, 1999). As pointed out by Chrisman and Leslie (1989), a better understanding of the problems faced by small business owners leads to more effective outside assistance that can have a direct impact on the management practices of these firms. Rice and Matthews (1995) noted that business counselors must understand the developmental stage of their clients in order to effectively identify and serve their most critical needs. Prior research by Olson (1987), Kuratko and Hodgetts (1989), and Dodge and Robbins (1992) examined the types of problems most prevalent in the different developmental stages of a small business. Olson (1987) proposed that a start-up business is more apt to encounter problems related to product creation and development. Kuratko and Hodgetts (1989) and Dodge and Robbins (1992) found that problems in the areas of marketing, finance, and capital acquisition are the most prevalent in the startup phase of a small business.

Later, as a business enters its growth and maturity stages, Olson (1987) and Kuratko and Hodgetts (1989) found that administrative and managerial problems are more prevalent. Dodge and Robbins (1992) suggest that external problems become less important and internal problems increase as a small business moves through its developmental cycle. However, Dodge and Robbins warned that problems may carry over from stage to stage if they are not properly resolved. A more thorough understanding of the types of problems encountered by African American-owned business, and in which stage they are encountered, may help increase their ability to develop and position their firms for long-term success.

The welfare and success of minority-owned small businesses is very important, especially in rural areas such as eastern North Carolina. Interestingly, based on our random sample, a surprisingly high percentage (45.2%) of the business owners that sought assistance were African American. The health and growth of African American-owned small businesses often serves as a strong barometer for the overall progress made by minorities in the U.S. (Feldman, Koberg & Dean, 1991; Thompson, 1991). Acs, Tarpley, and Phillips (1998) suggest that one of the main contributions small businesses make is to allow millions of people, especially minorities groups, to enter the economical and social mainstream of American society. Because the success of minority-owned small businesses is so important to the economy and because these businesses report such different growth and success rates (SBA Office of Advocacy, November 2001), additional research is needed to help understand any differences between the types of assistance needed based on the owners' race and the firm's developmental stage.

### **CLASSIFICATION OF PROBLEMS**

Chrisman and Leslie's (1989) integrative system was designed to classify the types of decisions needed to start and maintain a successful business and to help analyze the common problems faced by small business owners. Small business problems are classified into administrative, operating, or strategic categories. Administrative problems center on the organizational structure of a business and its ability to acquire and develop resources (Chrisman & Leslie, p. 42). These problems generally include accounting, finance, personnel, and general management issues. Operating problems are more common in the functional areas of a business, including issues in the areas of marketing, production, operations, and inventory control (Chrisman & Leslie, p. 42). Strategic problems involve the ability of small business owners to match their product or service offering with the demands of the external environment. This requires the business owners to understand the focus of their business and the needs of their target market. Business owners with strategic problems often need assistance with a feasibility study, business plan, pro-forma financial analysis, or market research (Chrisman & Leslie, p. 42).

### **SMALL BUSINESS CENTERS (SBCS)**

For a variety of reasons, entrepreneurs often turn to community colleges for assistance before making a commitment to start a new business venture (Warford & Flynn, 2000). North Carolina, in particular, has used its community college system as a strong economic development tool (Dougherty & Bakia, 1999). The primary community college program in North Carolina aimed specifically at serving the needs of small business owners is the Small Business Center. Each of North Carolina's 58 community college campuses houses its own SBC. North Carolina's network of SBCs is one of the largest state sponsored small business assistance systems of its type in country. The primary goal of these centers is to increase the success rate and the number of viable small businesses by providing personalized assistance to prospective and existing small business owners (North Carolina Community College System, March 10, 2004). Given the striking differences in minority representation, success rates and income, the following research questions have been derived to increase our understanding of any differences in problems experienced by business owners receiving assistance from SBCs as a result of race and organizational development.

## **RESEARCH QUESTIONS**

Research Question 1: What types of problems are encountered by rural small businesses that use SBCs for counseling based on the owners' race (African American or White) and the firm's developmental stage (formation or early growth)?

Research Question 2: Is there a relationship between the types of problems encountered by rural small businesses that use SBCs for counseling and the owners' race (African American or White) and the firm's developmental stage (formation and early growth)?

## **METHODOLOGY**

A random sample of 250 small businesses from the retail and service sectors was taken from clients that received confidential counseling from SBCs in eastern North Carolina between 2001 and 2003. A detailed breakdown of the sample is shown in Table 1. The data was collected during the spring of 2004. Each client that receives counseling from a SBC must complete a "Request for Counseling" form. These forms are used to record a client's problem(s) and to note the type of counseling provided at the SBC. Administrative records can offer a large amount of rich data in a variety of areas, such as client characteristics, services provided, and services needed (Rothman & Gant, 1987). Chrisman and Leslie (1989) recommend the use of clients' files as an importance source of information for studying small business assistance programs.

## **RESULTS**

Frequency crosstabulation counts were used to answer the first question. These counts indicated the types of problems encountered by the 250 small businesses in the sample based on the owner's race and the firm's developmental stage. Strategic problems (55.6%) were the most commonly encountered type of problems by small business owners in the sample, regardless of race or developmental stage. The second most common type of problems was administrative (33.6%), while the least common type of problems was in the area of operations (10.8%).

As seen in Table 2, the distribution of problems encountered by African American-owned and White-owned firms was very consistent. Of the 113 businesses that were African American-owned, 64 (56.6%) firms experienced strategic problems, 39 (34.5%) firms experienced administrative problems, and 10 (8.9%) firms experienced operating problems. The problems encountered by the 137 White-owned firms included 75 (54.7%) firms with strategic problems, 45 (32.9%) firms with administrative problems, and 17 (12.4%) firms with operating problems.

The distribution of problems encountered by formation and early growth businesses varied according to their developmental stage (see Table 3). Whereas the most common problems encountered by businesses in the formation stage (71.8%) were strategic, early growth businesses (48.5%) more often faced administrative problems. Also of importance was that 19.8% of early growth businesses experienced operating problems, while only 4.7% of businesses in the formation stage experienced these types of problems. Overall, the distribution of problems for

early growth businesses was much more evenly distributed than with businesses in the formation stage, which overwhelmingly faced problems that were strategic in nature.

A crosstabulation between type of problems and the owner's race and firm's developmental stage was also calculated to uncover any patterns when the variables were examined in conjunction with each other (see Table 4). The most common type of problem facing African American-owned firms in the formation stage was strategic (69.3%), while the African American-owned early growth firms most often encountered administrative problems (50%). Similarly, strategic problems (74.3%) were the most common for White-owned businesses in the formation stage and administrative problems (47.6%) were more common for White-owned business in the early growth stage. Regardless of race, the most common type of problem encountered by firms in the formation stage was strategic (71.8%) and the most common type of problem facing early growth firms was administrative (48.5%). The least common type of problems for firms, regardless of race or developmental stage, was operating problems. Early growth firms, however, experienced the greatest number of operating problems. Approximately 20% of the White-owned early growth businesses and 18.4% of the African American-owned early growth firms encountered operating problems.

The second research question examined the possible existence, and strength, of relationships between the type of problems encountered by rural small businesses and the owner's race and the firm's developmental stage. Pearson's chi-square was used to determine whether or not a relationship existed between these variables. If a significant relationship was found, lambda was used to determine the strength of the relationship.

Based on the results of the Pearson's chi-square test (see Table 5), no significant relationship existed between the types of problems encountered by rural small businesses that use SBCs for counseling and the owners' race. However, the developmental stage of the business was found to have a significant relationship ( $p < .001$ ) with the type of problems encountered by firms in the sample. In addition, significance ( $p < .001$ ) was found when developmental stage was examined in conjunction with race.

Because significance was discovered between the type of problems and the firm's developmental stage, and between development stage and race when examined together, lambda was calculated to determine the strength of these association. The results indicated that a moderate association existed between the types of problems encountered by small businesses and their developmental stage such that businesses in the formation stage are more likely to need assistance with strategic problems, whereas early growth firms are more likely to need administrative assistance. In addition, a moderate relationship continued to exist between the type of problems encountered by small businesses and the firm's developmental stage when the owner's race was held constant. Regardless of race, businesses in the formation stage are more likely to need assistance with strategic problems and early growth firms are more likely to need administrative assistance.

## **CONCLUSIONS**

The findings of this study indicated that the majority of small business owners with firms in the formation stage rely on counseling to help them resolve strategic issues that are core to the



development of a successful enterprise. Conversely, owners of businesses in the early growth stage were more apt to seek counseling for administrative problems. Whereas both African American and White owners of early growth businesses are searching for ways to improve administrative tasks and reduce expenses, most owners of businesses in the formation stage, regardless of race, need help establishing a solid foundation for their business. Although this does not help explain the lagging performance of African American-owned small businesses, it does help us better understand the needs of small business owners. A better understanding of the types of problems prevalent in the various developmental stages allows business counselors to offer more effective assistance that can have a direct impact on the success of their clients (Rice & Matthews, 1995). Strategic assistance at the onset of an entrepreneurial venture is paramount.

As indicated in *Mapping Rural Entrepreneurship*, many states do not focus on the needs of business owners during the startup stage of business development. SBCs can serve as the one of the primary vehicles in rural North Carolina for helping emerging business owners develop a strong foundation for their enterprises, thereby improving their chances for long-term survival. Past research has shown that entrepreneurs often turn to community colleges for assistance before making a commitment to start a new business venture (Warford & Flynn, 2000).

Interestingly, in a prior study on business counseling, Chrisman and Leslie (1989) suggest that clients should rely primarily on small business assistance programs for help with administrative and operating problems. They concluded that these programs are better able to provide assistance that allows businesses owners reduce their costs, rather than help with strategic issues such as business planning or market analysis. The insights gained from the current study can be used by small business assistance programs to create better counseling services aimed at meeting the strategic needs of business owners. Specifically, SBCs should consider concentrating on counseling owners of newly formed businesses, allowing other programs, such as Small Business Development Centers, to focus on serving the needs of firms in the growth stages of development.

## **FUTURE RESEARCH**

There are four main limitations we believe future research should address. First, the present study was unable to compare the problems encountered by businesses from other minority classifications and business development stages. No other minority class or developmental stage was sufficiently represented in our sample data. Future research should include other minority classifications and business development stages when available. Next, our sample was limited to retail and service organizations because of a lack of representation from other business sectors. Involving different business classifications can only add to our understanding of the types of problems encountered by rural small business owners. Third, because the data was archival and did not include information about the availability of startup capital, we were unable to investigate how capital may have affected the different subgroups. Minorities often have more difficulty acquiring startup capital but we were unable to investigate if there were actual differences in startup capital between subgroups and how that may have affected the different ventures. Finally, we were unable to investigate the economy's impact on the various ventures. Although the economy may play a role in the types of problems experienced by the different ventures, because the data was collected from businesses operating during the same period of

time in eastern North Carolina it is presumed that the ventures were subjected to similar economic forces. Future research may investigate the impact of the economy on the problems encountered by small businesses with longitudinal studies.

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Table 1. Race and Developmental Stage Breakdown

|                  | Devel Stage | Percent | Devel Stage  | Percent | Totals |
|------------------|-------------|---------|--------------|---------|--------|
| Race             | Formation   |         | Early Growth |         |        |
| African American | 75          | 30.0%   | 38           | 15.2%   | 113    |
| White            | 74          | 29.6%   | 63           | 25.2%   | 137    |
| Totals           | 149         |         | 101          |         | 250    |

Table 2. Problems and Race Crosstabulation

|                | Race             | Percent | Race  | Percent | Totals |
|----------------|------------------|---------|-------|---------|--------|
| Problems       | African American |         | White |         |        |
| Administrative | 39               | 34.5%   | 45    | 32.9%   | 84     |
| Operating      | 10               | 8.9%    | 17    | 12.4%   | 27     |
| Strategic      | 64               | 56.6%   | 75    | 54.7%   | 139    |
| Totals         | 113              |         | 137   |         | 250    |

Table 3. Problems and Developmental Stage Crosstabulation

|                | Devel Stage | Percent | Devel Stage  | Percent | Totals |
|----------------|-------------|---------|--------------|---------|--------|
| Problems       | Formation   |         | Early Growth |         |        |
| Administrative | 35          | 23.5%   | 49           | 48.5%   | 84     |
| Operating      | 7           | 4.7%    | 20           | 19.8%   | 27     |
| Strategic      | 107         | 71.8%   | 32           | 31.7%   | 139    |
| Totals         | 149         |         | 101          |         | 250    |

Table 4. Problems and Race & Developmental Stage Crosstabulation

|                  |                | Devel Stage | Percent | Devel Stage | Percent | Totals |
|------------------|----------------|-------------|---------|-------------|---------|--------|
| Race             | Problems       | Formation   |         | E. Growth   |         |        |
| African American | Administrative | 20          | 26.7%   | 19          | 50.0%   | 39     |
|                  | Operating      | 3           | 4.0%    | 7           | 18.4%   | 10     |
|                  | Strategic      | 52          | 69.3%   | 12          | 31.6%   | 64     |
|                  | Totals         | 75          |         | 38          |         | 113    |
| White            | Administrative | 15          | 20.3%   | 30          | 47.6%   | 45     |
|                  | Operating      | 4           | 5.4%    | 13          | 20.6%   | 17     |
|                  | Strategic      | 55          | 74.3%   | 20          | 31.8%   | 75     |
|                  | Totals         | 74          |         | 63          |         | 137    |

Table 5. Pearson's Chi-square and Lambda Results

| Independent Variable                       | Dependent Variable | p-value | df | Lambda |
|--|--------------------|---------|----|--------|
| Race                                       | Problems           | .665    | 2  | na     |
| Developmental Stage                        | Problems           | .0001   | 2  | .153   |
| Race-African American Developmental Status | Problems           | .0001   | 2  | .143   |
| Race-White Developmental Status            | Problems           | .0001   | 2  | .161   |

# **DIVERSITY IN SMALL AND LARGE WORK ENVIRONMENTS: WHY THE SEMANTIC AMBIGUITY?**

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## **ABSTRACT**

Diversity is not a term or concept that is easily understood by employers, whether small or large. This paper provides a number of definitions of diversity including dictionary, ascribed status traits, achievement status traits, resource-based view, evolutionary, and political ideology definitions. There is also discussion on how and what an organization of any size may do to deal with diversity in the workplace and possibly leverage it to create a competitive advantage. Ultimately, the discussion focuses on the problems and consequences of not having a consensus on the meaning of diversity.

## **INTRODUCTION**

Ask 10 people to define the term diversity, and you will more than likely get 10 different responses. This is hardly surprising but perhaps one of the most challenging issues in today's diverse business environment. By and large, everyone, both small and large employers and those in between, "values diversity," but as will soon be revealed, the "diversity" they are valuing may vary greatly from person to person and organization to organization.

Though many academicians, consultants, and politicians have attempted to define this ambiguous term, general consensus has yet to materialize, and may never emerge. Diversity has already achieved the status of being one of those concepts that is, by its very nature, a paradox. Diversity is simple, yet complicated. It has, over time, taken on a life of its own with different connotations for different constituencies. In fact, diversity's evolving symbolic meanings "serve as a simple verbal code for the complex problem from which it originated, but no one is really sure any longer what it actually means" (Thomas, 1996, p. 6). Given the lack of consensus in the ever-growing body of diversity literature, it seems that the term itself may be in danger of being relegated to the role of just another "buzzword." Yet, this "buzzword" has now been adopted as justification for preferential college admissions (*Grutter v. Bollinger*, 2003) and may soon become a justification for public sector hiring decisions as well.

There is no one unifying definition of diversity from which the fields of management study or practice may receive direction. Still, if a single, unifying definition of "diversity" could be adopted, a more focused analysis on the diversity of intellectual business knowledge might occur.

This paper presents a wide range of definitions of diversity. Based on each definition, there is some discussion on how and what an organization, whether small or large, may do to handle diversity and possibly use diversity to create a competitive advantage. In the end, the focus turns

to the problems and consequences of not having a consensus on “diversity,” but unfortunately, offers no unifying definition of the term.

## **DEFINITIONS OF DIVERSITY**

Diversity, as a term, is not a recent addition to the English language. Linguistically, “diversity” first appeared in the 12<sup>th</sup> century as a word implying “difference, oddness, wickedness, perversity” (Digh, 1998, p. 117). While most of those meanings have disappeared over time, one of them, “difference,” has persevered to become closely intertwined with today’s meaning of diversity in the workplace.

### **Dictionary Definition**

Though it may appear trite, one of the first sources typically consulted when attempting to discover the meaning of a word is a dictionary. *The Merriam-Webster Collegiate Dictionary* (1997) defines diversity as “the condition of being diverse” (p. 244) where diverse is defined as “composed of distinct or unlike elements or qualities” (p. 244). This definition provides a valuable reference point from which other definitions of diversity may follow. Under this definition, diversity focuses on unlikeness or differences as the core element of the definition. As will be seen, this term rapidly expanded in a number of directions to reflect similar meanings in some instances and much different meanings in others.

The federal government has shown interest in the term, particularly during the previous two decades. United States equal employment opportunity (EEO) laws, the common sources from which the subject of diversity usually confronts the business environment, define “diversity” in terms of race, gender, ethnicity, age, national origin, religion, and disability (Wheeler, 1994). Once again, when examining the criteria that compose diversity, the Equal Employment Opportunity Commission (EEOC), the regulatory agency for most EEO laws, focuses on unlikeness or difference between individuals in terms of physical characteristics (with the exception of religion). As an example, if diversity was being examined from the perspective of gender, an organization may observe that its workforce is composed of substantially more men than women. Thus, in order to make the workforce more “diverse,” an effort will be made to employ more women. Similarly, if diversity was being sought from the perspective of race, an employer may find that there are substantially more non-Hispanic whites in the workforce than individuals from other racial backgrounds. As a result, a diversifying approach may be to increase the effort to recruit individuals from racial backgrounds other than non-Hispanic whites.

### **Ascribed Status Traits Definition**

This particular federal government frame of reference, attaining diversity based on race, gender, ethnicity, age, national origin, religion, or disability, views diversity from the perspective of an individual’s ascribed status traits. Ascribed status traits are traits assigned to an individual without reference to innate differences or abilities of the individual (Linton, 1936; Foladare, 1969). In other words, individuals cannot control these status traits (e.g., an individual cannot control his or her age or gender). This federal government frame of reference seems to parallel *The Merriam-Webster Collegiate Dictionary* definition of diversity, since both focus on unlikeness and difference. Eligibility for government contracts, grants, and aid money is

predicated on organizations achieving certain levels of this form of “diversity” in their workforces (41 U.S.C. Part 60).

From a business perspective, diversity promulgated on the basis of race, gender, ethnicity, age, national origin, religion, or disability may have the tendency to push organizations to “hire by the numbers” (e.g., a certain percentage of the workforce must be women, Hispanics, African Americans, etc.), an action that may actually violate Title VII’s prohibition on employment decisions that consider race, etc. (Robinson, Franklin, and Wayland, 2002). This situation may contribute to why both small and large businesses have such difficulty with diversity as defined by the federal government. Additionally, it may also contribute to an employer’s reluctance to accept a different and broader definition of diversity. Such a perspective presents no obstacle to measuring diversity. Ascribed status traits are readily observable and permit easy recording and reporting to federal agencies. Because of its ease of measurement and the tangible consequences associated with achieving or progressing toward it, this concept of diversity enjoys wide currency in business organizations.

### **Achievement Status Traits Definition**

A more broad definition of diversity would include the elements previously mentioned associated with the federal government definition of diversity (i.e., race, color, religion, sex, national origin, age, and disability), along with, but not limited to, elements such as sexual orientation, value systems, personality characteristics, education, language, physical appearance, dress, marital status, lifestyle, beliefs, tenure with an organization, and economic status (Carr, 1993; Thomas, 1992). There is a distinct change in definition that occurs with the inclusion of these new elements into the diversity definition. No longer is diversity confined to the boundaries associated with ascribed status traits but it further encompasses personal decisions. Now the concept and definition have been expanded. Achieved status traits are open to individual achievement, thus requiring special qualities or skills (Linton, 1936; Foladare, 1969). Examples of achieved status traits are the education level and language proficiency of an individual, because these elements are based on the individual’s ability to apply his or her cognitive abilities toward a certain area of study or expertise.

To the list of achieved status traits, personal decisions may be added. Elements associated with personal decisions become a facet of this definition of diversity because diversity no longer has to be viewed solely from a numbers perspective (e.g., the percentage of women in the organization’s workforce, etc.). These are characteristics unique to individuals that are less readily observable, and therefore, more difficult to measure. For example, an individual that has strong environmental beliefs, or a male that wears his hair in a pony tail, can be thought of as a new dimension of diversity. Diversity is defined along any number of dimensions including tolerating, valuing, celebrating, managing, harnessing, or leveraging diversity (Digh, 1998).

### **Resource-Based View Definition**

The resource-based definition of diversity has led to new interpretations that diverge from the achieved status definition. One of the most recognizable definitions that fit this new interpretation comes from Roosevelt Thomas. Thomas (1992; 1996) defines diversity as a comprehensive managerial process for developing an environment that works for all employees. He further, paradoxically, explains diversity as all the ways in which people are different and

similar. This new word, “similar,” was a dramatic change in the definition of diversity. No longer was diversity being promoted under the auspices of difference; it was now being promoted with the seemingly semantically, contradictory term of “similar.” This raises the question, given the definition of diversity having been traditionally based on the core issues of difference, how can there be a new definition based on difference and similarity, if these two terms, difference and similar, are antonyms? Thomas (1996) attempts to explain this apparent paradox through an analogy of jelly beans:

. . . visualize a jar of red jelly beans; now imagine adding some green and purple jelly beans. Many would believe that the green and purple jelly beans represent diversity. I suggest that the diversity instead is represented by the resultant mixture of red, green and purple jelly beans. It is easy to see these jelly beans as a metaphor for employees . . . It could also easily represent the mixture of product lines, functions, marketing strategies, or operating philosophies (p. 6).

This change in definitions has prompted an entirely new school of thought around diversity that appears to be related to the resource-based view of the firm. In short, the resource-based view of the firm suggests that a business may be able to create competitive advantages from resources that are internal to the organization (e.g., employees, human resource functions, etc.) instead of relying on competitive advantages that are external to the firm (e.g., natural resources used for products, political/tax climate of a country, etc.). These internal resources become the new energy resources of the company with the distinguishing feature that they must be created, not bought (Zou and Cavusgil, 1995). For example, if a small business operates in an industry that is plagued by high employee turnover (e.g., the health care industry which has a chronic shortage of registered nurses), a potential competitive advantage exists for a small health care facility that is able to substantially decrease and maintain low turnover rates over its competitors. The ability to decrease and maintain the desired turnover rate may need to incorporate some changes in organizational structure and in the organization’s human resource policies and procedures to avoid simple duplication of this effort by competitors. In other words, the ability to achieve and maintain a low turnover rate must be systematic, yet complex, so as to preclude competitors from duplicating the small organization’s efforts (Porter, 1987).

Diversity fits well with the model of the resource-based view of the firm. This “fit,” of sorts, is perhaps why the definition of diversity has taken on a meaning characterized by differences and similarities. To illustrate this “fit,” consider the following basic tenets of the resource-based view of the firm which are then compared and interrelated to diversity.

The first tenet of the resource-based view of the firm is that it suggests that organizations are packages of tangible and intangible resources. Thus, it can be assumed that intangible resources, like employees and the reputations of organizations, are becoming equally as important as the fixed assets that businesses actually own. This is particularly true of smaller organizations. Second, the resource-based view of the firm suggests that managerial and organizational culture affect those aforementioned intangible resources. Based on this, it seems logical to conclude that organizational culture can affect new ways of approaching a challenge which can then create new ways of thinking and a new knowledge base. Third, especially in an increasingly global marketplace, the resource-based view of the firm implies that demand and supply forces drive resource management. Given this situation, an organization that understands these forces and is

best able to determine what is needed, where it is needed, and for what length of time, while doing it at relatively lower cost, may be able to create a competitive advantage. Finally, the resource-based view of the firm suggests that resource management is no longer about controlling products or services, but also about controlling functions and processes. Thus, technical competence may only be one component of what a successful employee will need to possess to be successful in an organization (Zou and Cavusgil, 1995). Interestingly, Williams' and O'Reilly's (1998) 40-year review of diversity research suggests that diversity can produce negative or positive consequences for organizations depending upon how researchers operationally defined diversity and the organizational constraints under which work groups operated.

How does diversity relate to these tenets of the resource-based view of the firm? Every single one of these tenets revolved around the issue of people and their skills/contributions to the organization. As an example, the ability to create an intangible resource based on employees may be achieved by employing individuals who are diverse (different and similar) from the perspective of the ascribed and achieved status traits and elements of personal characteristics. These diverse individuals have a variety of different life experiences, cultural backgrounds, and varying skill sets and thus can provide new approaches to challenges, new experiences, and new thoughts toward these challenges. The goal, from the organization's perspective, may not necessarily be simply finding a way to solve the challenges. Even more, the goal is to create intellectual knowledge and capital within the organization that can be applied, not just toward solving the challenge, but more importantly, toward creating a competitive advantage that cannot be easily duplicated. No doubt, there are significant implications for small firms.

The previous description of how diversity interrelates with the resource-based view of the firm is important because it provides one explanation of why the definition of diversity has taken on so many different meanings. In an ever-increasing hypercompetitive marketplace where it is becoming increasingly difficult to differentiate and squeeze further efficiency out of products/services, external resources, value-chain activities, and so forth, organizational leaders and academicians have set out to change the mindset of competition by focusing on issues such as diversity from which to create competitive advantages. A new definition of diversity, which is inevitably followed by a new strategy from which to capture its synergies, is an opportunity to discover and develop a new competitive advantage from which to make an organization more successful. Furthermore, diversity no longer has the negative connotation of "hiring by the numbers." Instead, diversity is viewed as an organizational asset that is sought after because of the possible competitive advantage that may result.

### **An Evolutionary Definition**

Diversity can also be defined outside the realms of the resource-based view of the firm. Levine (1991) has tracked the definition of diversity for more than 40 years, and he classifies these definitions into four categories. The first category, born of the 1960s era, is labeled as "representation," and its focus revolved around bringing more underrepresented identifiable groups of individuals into an organization. The second category is termed as "support." This definition of diversity, a product of the 1970s, was focused on retaining underrepresented groups of individuals who had joined the organization. "Integration" is the third category by which diversity was defined. This effort, a development of the 1980s, attempted to make underrepresented individuals an integral part of the organization. Finally, the 1990s coined the



category “multiculturalism.” The emphasis surrounding diversity during this timeframe was on creating a shared community that simultaneously maintains the distinctiveness of the groups of which it is composed.

Looking back over time, it becomes apparent that the ever mutating definition of diversity, no doubt, adds to the confusion over what is exactly meant by “diversity.” It may be argued that 10-year time periods are a substantial amount of time from which to achieve diversity within an organization, but when considering the change in attitudes toward diversity that has taken place, the struggles of how to change employee mindsets on the subject, the complexities associated with measuring diversity, and most importantly, the difficulty in simply defining the term, 10-year time periods appear very short. In fact, the definition of diversity oftentimes changed before organizations could complete any of the goals associated with these aforementioned categories of diversity (e.g., representation, support, integration, and multiculturalism) (Levine, 1991). Given this situation, Levine (1991, p. 5) argues that today’s definition of diversity is nothing more than “a jumble of definitions and an assortment of incomplete agendas--a prescription for turmoil.” In such an environment, attempting to achieve diversity is aiming at a moving target.

### **A Political Ideology Definition**

As might be expected, there are still other ways to view diversity. For example, one can define “diversity” through politically conservative and liberal lenses. Lynch (1997) presents the “conservative view” of diversity as “civil rights moralism” and the “liberal view” as “business-demography pragmatism.” Perhaps by viewing diversity from these two extremes, an organization may be able to frame its definition of diversity.

Civil rights moralism was founded on three premises: proportional representation, cultural relativism, and identity politics (Lynch, 1997). Proportional representation grew from the core ideas of the civil rights movement and affirmative action. It suggested that these mechanisms were necessary to eradicate the deeply held racial and sexual biases in the United States, and thus, the only way to measure progress was through ethnic and gender proportionalism in an organization’s workforce. In this regard, we have returned to ascribed traits view.

Cultural relativism held that universalistic standards (e.g., test scores, grades, etc.) were biased toward white males, and therefore placed other groups at a disadvantage. As a consequence, such standard had the effect, in practice, of making workplaces less diverse.

Identity politics presumed that only members of a given group that fully understood its culture could communicate effectively to that group. For example, only an African American manager will represent the interests and feelings of other African American managers and customers. Civil rights moralism primarily focused its efforts on organizational change (e.g., CEO change agents, sensitivity training, etc.). Over time, this school of thought has undergone considerable change similar to the change that has affected affirmative action. This change can be best characterized as a shift from “equality of opportunity for individuals” to “proportional representation for women and minorities” (Lynch, 1997, pp. 26-27).

Business-demography pragmatism was developed in an effort to distance diversity from the generally negative attitudes associated with affirmative action (Lynch, 1997). Roosevelt Thomas has been one of the leaders associated with this school of thought. He suggests that diversity is a business necessity that avoids the divisiveness that can occur when considering diversity strictly on the basis of race and gender (Thomas, 1996; Lynch, 1997). Diversity is a “living concept” that will take the shape of the influences affecting that organization. This broad definition, which is ethical in nature, may seem to dilute the diversity issue. However, Thomas (1996) argues that it forces manager to understand diversity, causing them to consider whether action should be taken. The challenge is in understanding what diversity is, beyond the rhetoric and slogans. The business-demography pragmatism view of diversity pushes all organizations, small and large, to focus their diversity efforts on understanding how other groups may view and react to organizational policies and practices. At this time, the employee is able to view situations from a different vantage point whereby he or she does not accept only dichotomous actions or thinking patterns, but instead becomes open to new ways to approach and address situations involving diversity (Gentile, 1996). This “living concept” of diversity is more concerned with questions that are subsumed with diversity. For example, answering the question, “how and why we, as individuals, perceive, feel about, and behave toward groups to which we do not belong?” (Gentile, 1996, p. 12) may uncover issues about human potential and need for learning and growth. Depending on the answer to a question such as this, one’s strengths and weaknesses may be discovered which may then be operationalized into strategies and outcomes that benefit the organization.

Clearly, these two approaches, civil rights moralism and business-demography pragmatism, are at opposite ends of the spectrum when considering the definition of diversity. Diversity does not, unfortunately, get much clearer when defining it as it applies to the federal government, resource-based view of the firm, or through evolution (i.e., representation, support, integration, and multiculturalism). There are many other ways from which to approach the definition of diversity, but it is debatable over whether any conclusive definition could be reached. There is, however, one common theme that ripples throughout the diversity literature. This theme suggests that regardless of the definition of diversity an organization may adopt, how and what the organization does to handle diversity is what is important.

## **SO WHAT?**

Diversity is not an easy concept to understand. This may come from attempting to cover too many concepts under a single word. Initially, this paper outlined and discussed various definitions of diversity. The conclusion drawn from this review is that the definition of diversity varies greatly from organization to organization, regardless of size, and no single definition is likely to gain universal acceptance. As a consequence, the ability of organizations to deal with diversity in their workplaces will continue to spark much debate. Yet, without a common definition, the debate is likely to go no where. No meaningful research on the topic can be attempted so long as there is no general consensus as to what “diversity” really is. Nor can there be any real guidance offered to small or large organizations to change their structures, policies, and procedures in order to handle diversity and reap the benefits resulting from diversity. If we do not really know what diversity is, we can hardly know when we benefit from it. In such an instance, the ability to fall back on the core values of the organization will be the foundation by which to create consensus and decide on whether to act on diversity-related issues.

## CONCLUDING REMARKS

It is likely that for the majority of organizations diversity will continue to be a trait ascribed concept (race, color, religion, sex, etc.). Why? This definition of “diversity” can be readily observed and measured. Also, though the benefits of a diverse workforce may not be easily discerned, the costs for not diversifying are very real and will continue to focus more on legal consequences (litigation, fines, court costs, loss of contracts, etc.) related to proportional representation. Still, in today’s global environment, it is to the advantage of all organizations, particularly small ones, to seek competitive advantages. Under the resource-based view, diversity may be used to create such a competitive advantage, and at the same time, such focus should overcome the obstacles of not diversifying.

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**HAVE FINANCE COMPANIES GAINED SHARES IN THE SMALL BUSINESS  
LOAN MARKET DURING THE 1990S: EVIDENCE FROM THE 1993 AND 1998  
SURVEYS OF SMALL BUSINESS FINANCES**

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**ABSTRACT**

This study utilizes the National Surveys of Small Business Finances in 1993 and 1998 to examine changes in the use of finance companies by small business borrowers. In the 1990s finance company receivables increased by over 7 percent annually. Did small businesses benefit from this increased lending activity? This analysis of 1998 and 1993 Surveys of Small Business Finances confirmed the importance of finance companies as the second most important institutional suppliers of credit to small business borrowers--they remained as important providers of credit in vehicle loans, equipment loans, and lease financing. While on surface, small business borrowers were more likely to utilize finance company for traditional loans in 1998 than 1993, this result held only for capital leases and mortgage loans which were not major sources of financing to small firms--less than three percent of small business borrowers hold a lease or mortgage loan from a finance company in 1998. This research suggests that the share of total debt held by finance companies has remained remarkable stable since 1993. In addition, this study suggests that the relationship between small businesses and finance companies has remained virtually unchanged from 1993 through 1998-- Finance companies continued to attract low credit risk clients, similar to commercial banks. These findings are important to practitioners and small business owners as they explore financing options for specific types of loans.

## **INTRODUCTION**

Finance companies play an important role in providing short- and intermediate-term financial capital to small business borrowers. Finance companies had roughly \$1 trillion in financial assets in 2000, which positioned them between commercial banks and credit unions (Dynan, Johnson and Slowinski, 2002). About 1,000 companies make up the finance company sector, which is about twice as large as the credit union sector, but only about 20 percent of the size of the commercial banking sector (Dynan et al, 2002). Finance companies realized a substantial growth in their owned and securitized receivables over the 1990s, however it appears that finance company involvement with the small business customers has remained relatively static. The purpose of this study is to use the most recent high quality data on small business finances to evaluate the importance of finance companies and other lenders and assesses changes in borrowing behavior of small business owners.

## **LITERATURE REVIEW AND PUBLIC POLICY RELEVANCE**

Finance companies are a major supplier of financial capital to businesses with over \$500 billion of business receivables outstanding in 2000 (Dynan et al, 2002). Finance companies are an important source of capital (primarily for vehicle loans, capital leases and other asset backed credit) for small business borrowers. Earlier research suggests that finance companies are not the "pawn shops" of the small business lending market (Haynes, 1995). However, more recent research suggests that financial companies are especially important to riskier borrowers, especially highly leveraged borrowers (Carey, et al, 1998). While finance company receivables grew at an annual rate of just over 7 percent in the mid-1990s, finance company receivables to small businesses appear to have been very stable (to slightly declining) over this period of time. Even though a higher percentage of small businesses were using finance companies in 1998 than in 1993 (Bitler, Robb and Wolken, 2001), the share of total small business debt held by finance companies appears to have declined.

Are finance companies becoming less interested in providing financial capital to small business borrowers? The robust economy of the mid-1990s created substantial wealth in the U.S. economy, however the growth in aggregate wealth was higher among households without any business ownership than among households owning one or more businesses (Haynes and Ou, 2002b). Recent evidence reported by Carey, et al (1998) suggests that finance companies are important to riskier borrowers. Finance companies have been important lending organizations for small businesses because they have been more likely to assist riskier borrowers in preparing their loan package and monitoring their loan. If finance companies are less likely to supply financial capital to small business (and especially to riskier small businesses) then these businesses must search for other lenders. These riskier borrowers will likely find other lenders in this competitive market, however these lenders may be more likely to charge higher prices and be less likely to engage in business planning and monitoring efforts that decrease the default rate

of these riskier businesses. If these riskier borrowers are more likely to fail, then the taxpayer cost of subsidizing SBA loan guarantees and other loans increases.

## EMPIRICAL CONSIDERATIONS

### Data

This study utilizes the 1993 and 1998 Surveys of Small Business Finances (SSBF). The SSBF is the national survey conducted by the Federal Reserve's Board of Governors for information on small businesses on their uses of different financing sources. The 1993 survey has 4,638 observations representing nearly 5 million small businesses while the 1998 survey has 3,561 observations representing 5.2 million small businesses. All analyses in this study utilize the population weights provided in the data set. All loan amounts were adjusted for inflation from 1992 to 1998 using the Producer Price Index as reported by the U.S. Department of Labor (Bureau of Labor Statistics, 2004).

### Models

This study will utilize descriptive statistics and other linear and non-linear statistics to test the hypotheses proposed by this study. The objective of this study is to determine if finance companies are more significant sources of financial capital in 1998 than in 1993. Over the period of time from 1987 to 1998, commercial banks and thrifts have realized a less stringent regulatory environment and unprecedented merger and acquisition activity. This environment should allow commercial banks and thrifts to be more competitive and enable them to capture a higher percentage of the financial capital market. Therefore, one would expect finance companies to serve a smaller percentage of all firms and supply a smaller percentage of the total financial capital borrowed by small businesses in 1998 than in 1993.

This segment of the study will be analyzed by comparing descriptive statistics on the percentage of firms using finance companies for at least one loan or lease and the market share held by finance companies and other lenders for 1993 and 1998. The variable of interest in this model is the data collection year. If finance companies are expected to reach a smaller percentage of firms in 1998 than 1993, then the sign on the dummy variable for year (1993) would be positive. These analyses employ two regression models and the concatenated data from the 1993 and 1998 Surveys of Small Business Finances. The first model utilizes a logistic regression algorithm to assess whether small businesses are more likely to hold a finance company loan or lease in 1998 than 1993 and is specified as follows:

$$FINC_i = f(\text{year}; \text{risk}, \text{relation}, \text{age}, \text{size}, \text{legal}, \text{industry}, \text{urban}, \text{woman}, \text{minority})$$

where  $FINC_i$  is a dummy variable for owners holding a loan or lease from a finance company; *year* is dummy variable for 1993 SSBF data; *risk* is a continuous variable measuring the firm quality or credit risk of the business using the Altman Z statistic; *relation* is a dummy variable indicating a lending

relationship with a commercial bank; *age* is a continuous variable indicating the age of the firm; *size* is a continuous variable of the number of employees in the firm; *legal* is a series of dummy variables indicating the legal organization of the firm (sole proprietorship, partnership, subchapter s corporation and regular corporation); *industry* is a series of dummy variables indicating the standard industrial classification of the firm (mining/construction, manufacturing, transportation, wholesale, retail, FIRE and services); *urban* is a dummy variable indicating urban location; *woman* is a dummy variable indicating that a majority of the business is woman-owned; and *minority* is a dummy variable indicating that a majority of the business is minority-owned.

The second model utilizes a Tobit regression algorithm to assess whether small businesses held a larger share of outstanding debt in finance company loans or leases in 1998 than 1993. About one-third of the sample holds no loans or leases, therefore loan shares are clustered around zero. A Tobit analysis addresses the problem of ordinary least squares estimates that are inconsistent (biased toward zero). The second set of models is very similar to the first set, except for the dependent variable being the share of outstanding debt held by finance companies for each type of loan or lease.

## RESULTS

This study utilizes the Surveys of Small Business Finances (SSBF) for two years, 1993 and 1998 to examine who uses finance companies. This section compares the samples in 1993 and 1998; and examines the probability of holding a finance company loan in 1993 and 1998 and the share of aggregate value of finance company loans in 1993 and 1998.

The two installments of the SSBF utilized similar sampling frames, but the characteristics of the small businesses differed substantially. Utilizing the population weights, the 1998 SSBF small businesses surveyed were somewhat younger (14.3 years old in 1993 versus 13.3 years old in 1998); more likely to be sole proprietors or subchapter s corporations and less likely to be regular corporations; more likely to be engaged in the transportation or services industries; less likely to be engaged in mining/construction, wholesale or retail trade; and more likely to be owned by a woman or minority.

This study examines whether finance companies are more significant sources of financial capital in 1998 than in 1993. This examination of the significance of finance companies assesses the probability that a small business borrower would utilize a finance company for any loan or lease and assesses the share of total finance capital borrowed from a finance company. A higher percentage of all small businesses indicated that they had utilized a finance company in 1998 than in 1993 (12.4 percent in 1993 versus 13.3 percent in 1998). The likelihood of holding any particular type of loan was remarkably constant over the two years, where these small businesses were most likely to hold vehicle or equipment loans or leases from a finance company. The regression analysis provides evidence of minor changes in the use of finance companies from 1993 to 1998. Small business borrowers are somewhat more likely to hold a finance company loan in

1998 than 1993 with the most significant positive changes occurring in mortgage loans and leases (Table 1).

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Table 1 about here

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Finance companies held over 12 percent of the value of all loans held by small business borrowers in 1993 and 1998. They appeared to lose market share in line of credit and vehicle loans and increase market share in equipment loans.

A Tobit regression analysis was employed to examine the share of total debt held by finance companies in 1993 and 1998 (Table 2). This analysis supports the previous logistic regression analysis by suggesting that small business borrowers held a larger share of total debt with finance companies in 1998 than 1993. The increases in the share of total debt occurred only in leases and mortgage loans held by finance companies.

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Table 2 about here

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## CONCLUSIONS

A previous study of finance companies in 1995 suggested that finance companies were not the "pawn shops" of the financial capital business, attracting high risk borrowers and charging high prices; but, lenders attracting borrowers with similar risk profiles to commercial banks and charging them competitive prices for their loans (Haynes, 1995e). This current study suggests that small businesses relationships with finance companies have remained virtually unchanged from 1993 through 1998.

The univariate analysis suggests that small businesses are somewhat more likely to utilize a finance company in 1998 than 1993 (12.4 percent in 1993 versus 13.3 percent in 1998), however the share of aggregate loans actually declined slightly from nearly 13 percent in 1993 to 12.3 percent in 1998. The multivariate regression analyses suggest that small business borrowers were more likely to utilize a finance company in 1998, but only for leases and mortgage loans. Small business use of the major products marketed by finance companies, vehicle and equipment loans, remained unchanged.

The less stringent regulatory environment faced by finance companies would suggest that finance companies would have the opportunity to encroach on the market share of commercial banks. However, it was the commercial banks gaining market share from 1993 to 1998 in all categories of loans, except leases. While finance companies appear to have gained some market share for equipment loans, there appears to be no evidence of finance company encroachment on the market share held by commercial banks. The



most substantial negative changes in market share were realized by leasing companies and other businesses loaning money to small businesses.

Commercial banks are providing larger amounts of money to about the same percentage of all small businesses in 1998 as they did in 1993. In contrast, finance companies appear to be providing about the same amount of money to about the same percentage of all small businesses. While the total business debt held by finance companies has increased substantially during this time (Dynan et al, 2002), it appears that this increase in business debt held by finance companies is for large businesses (assuming that the number of small businesses has remained relatively constant, around 5 million small businesses). Other sectors, especially real estate, seem to have captured the attention of finance companies.

Finance companies clearly are important to small business borrowers, but finance companies appear to be satisfied with the status quo (attracting about 12 to 14 percent of small businesses and providing about 12 to 13 percent of their financial capital). While this analysis has proceeded under the assumption that commercial banks and finance companies are essentially competing with substitute products, the complementary relationships between commercial banks and finance companies may be more important. Further research is needed to explore this critically important relationship between the number one and two lenders of financial capital to small business borrowers.

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Table 1 Logistic Regression Summary

| Dependent Variable                    | Any Finance |         | Line of Credit |         | Lease    |         | Mortgage |         | Vehicle  |         | Equipment |         | Other    |         |
|---------------------------------------|-------------|---------|----------------|---------|----------|---------|----------|---------|----------|---------|-----------|---------|----------|---------|
| Variable <sup>1</sup>                 | Estimate    | p-value | Estimate       | p-value | Estimate | p-value | Estimate | p-value | Estimate | p-value | Estimate  | p-value | Estimate | p-value |
| Intercept                             | -0.8716     | 0.0001  | -3.7832        | 0.0001  | -3.6424  | 0.0001  | -3.1521  | 0.0002  | -1.4492  | 0.0001  | -2.3810   | 0.0001  | -8.5841  | 0.0148  |
| Year dummy (1993)                     | -0.1886     | 0.0063  | 0.0472         | 0.8208  | -0.3146  | 0.0308  | -0.8467  | 0.0104  | -0.1295  | 0.1220  | -0.1319   | 0.3984  | -0.5769  | 0.1151  |
| Firm quality (Altman Z)               | -0.1420     | 0.0001  | -0.1786        | 0.0001  | -0.1464  | 0.0001  | -0.3061  | 0.0001  | -0.1080  | 0.0001  | -0.1511   | 0.0001  | -0.2503  | 0.0028  |
| Commercial bank relationship          | 0.2290      | 0.0013  | 0.0543         | 0.7966  | 0.3817   | 0.0119  | -0.0664  | 0.8463  | 0.1473   | 0.0889  | 0.4289    | 0.0084  | 0.3635   | 0.3368  |
| Age of the firm                       | -0.0126     | 0.0002  | -0.0275        | 0.0167  | -0.0102  | 0.1453  | -0.0323  | 0.1123  | -0.0078  | 0.0490  | -0.0188   | 0.0196  | -0.0035  | 0.8421  |
| Number of employee                    | 0.0045      | 0.0001  | 0.0069         | 0.0008  | 0.0049   | 0.0030  | 0.0088   | 0.0138  | 0.0030   | 0.0269  | 0.0040    | 0.0338  | 0.0042   | 0.2972  |
| Legal organization: partnership       | -0.1277     | 0.4013  | 0.6213         | 0.0776  | -0.0760  | 0.8400  | -0.9270  | 0.2184  | -0.2294  | 0.2376  | 0.3109    | 0.3292  | -2.8647  | 0.2797  |
| Legal organization: sub s corporation | 0.3394      | 0.0002  | 0.1886         | 0.4906  | 0.6995   | 0.0006  | -0.2925  | 0.4562  | 0.3411   | 0.0018  | 0.3314    | 0.1289  | -0.0073  | 0.9871  |
| Legal organization: corporation       | 0.4196      | 0.0001  | 0.0961         | 0.7294  | 0.8981   | 0.0001  | -1.0376  | 0.0422  | 0.3719   | 0.0006  | 0.6114    | 0.0031  | -0.5012  | 0.3196  |
| Manufacturing                         | -0.3406     | 0.0146  | 0.2444         | 0.6343  | 0.4718   | 0.1405  | -1.5570  | 0.1819  | -0.5441  | 0.0009  | 0.0517    | 0.8457  | 4.5706   | 0.1837  |
| Transportation                        | 0.1172      | 0.5034  | 1.2297         | 0.0164  | 0.9556   | 0.0084  | -0.3126  | 0.7457  | -0.2071  | 0.3246  | 0.9160    | 0.0011  | 5.0020   | 0.1473  |
| Wholesale trade                       | -0.3246     | 0.0213  | 0.5324         | 0.2802  | 0.4782   | 0.1418  | -2.1875  | 0.2245  | -0.4343  | 0.0072  | -0.5076   | 0.1106  | 4.0309   | 0.2444  |
| Retail trade                          | -0.4034     | 0.0004  | 1.2688         | 0.0011  | 0.1070   | 0.7201  | -0.2437  | 0.6788  | -0.6316  | 0.0001  | -0.8066   | 0.0026  | 4.2906   | 0.2107  |
| Finance, insurance & real estate      | -0.8892     | 0.0001  | -0.7909        | 0.3164  | 0.2001   | 0.5989  | 0.8975   | 0.1410  | -1.3506  | 0.0001  | -0.8379   | 0.0332  | -10.8408 | 0.9920  |
| Services                              | -0.4278     | 0.0001  | 0.1870         | 0.6462  | 0.5445   | 0.0386  | -0.0123  | 0.9811  | -0.6992  | 0.0001  | -0.7009   | 0.0024  | 3.4558   | 0.3138  |
| Urban                                 | 0.2484      | 0.0059  | 0.2736         | 0.3033  | 0.1790   | 0.3606  | 0.6561   | 0.1814  | 0.2680   | 0.0157  | -0.2405   | 0.1896  | 1.0858   | 0.0821  |
| Woman-owned business                  | -0.2450     | 0.0056  | -0.8749        | 0.0057  | -0.2490  | 0.1952  | 0.8476   | 0.0100  | -0.1847  | 0.0852  | -0.6638   | 0.0055  | 0.3559   | 0.3698  |
| Minority-owned business               | 0.0370      | 0.7660  | -0.3472        | 0.4127  | -0.1387  | 0.6317  | 0.3909   | 0.4011  | 0.0266   | 0.8609  | -0.2940   | 0.3880  | 0.3262   | 0.5668  |
| -2 log likelihood                     | 5,947       |         | 1,011          |         | 1,777    |         | 456      |         | 4,432    |         | 1,583     |         | 367      |         |
| Number of Observations                | 8,198       |         |                |         |          |         |          |         |          |         |           |         |          |         |

<sup>1</sup> The left out categories are sole proprietorship in the legal organization classification and mining/construction in the industrial classification.

Table 2 Tobit Regression Summary, All Owners

| Dependent Variable                    | Any Finance<br>Company Loans |         | Line of Credit |         | Lease    |         | Mortgage |         | Vehicle  |         | Equipment |         | Other    |         |
|---------------------------------------|------------------------------|---------|----------------|---------|----------|---------|----------|---------|----------|---------|-----------|---------|----------|---------|
| Variables <sup>1</sup>                | Estimate                     | p-value | Estimate       | p-value | Estimate | p-value | Estimate | p-value | Estimate | p-value | Estimate  | p-value | Estimate | p-value |
| Intercept                             | -0.5464                      | 0.0001  | -4.1449        | 0.0001  | -3.7401  | 0.0001  | -3.8512  | 0.0001  | -1.4959  | 0.0001  | -2.9008   | 0.0001  | -8.3063  | 0.0012  |
| Year dummy (1993)                     | -0.0911                      | 0.0132  | 0.0314         | 0.8629  | -0.2993  | 0.0165  | -0.8238  | 0.0071  | -0.0985  | 0.1551  | -0.1113   | 0.3977  | -0.4948  | 0.1238  |
| Firm quality (Altman Z)               | -0.0719                      | 0.0001  | -0.1636        | 0.0001  | -0.1217  | 0.0001  | -0.2719  | 0.0001  | -0.0924  | 0.0001  | -0.1252   | 0.0001  | -0.2056  | 0.0088  |
| Commercial bank relationship          | -0.0069                      | 0.8570  | 0.0252         | 0.8913  | 0.2716   | 0.0344  | -0.2412  | 0.4104  | 0.0887   | 0.2183  | 0.3286    | 0.0164  | 0.3392   | 0.2982  |
| Age of the firm                       | -0.0064                      | 0.0003  | -0.0270        | 0.0073  | -0.0087  | 0.1367  | -0.0169  | 0.2800  | -0.0063  | 0.0515  | -0.0150   | 0.0198  | 0.0006   | 0.9659  |
| Number of employee                    | 0.0022                       | 0.0010  | 0.0071         | 0.0032  | 0.0051   | 0.0039  | 0.0084   | 0.0227  | 0.0026   | 0.0449  | 0.0039    | 0.0457  | 0.0037   | 0.3869  |
| Legal organization: partnership       | -0.0774                      | 0.3171  | 0.4639         | 0.1426  | -0.1240  | 0.6738  | -0.5789  | 0.3369  | -0.1814  | 0.2299  | 0.2856    | 0.2695  | -11.6812 | 0.9997  |
| Legal organization: sub s corporation | 0.1443                       | 0.0027  | 0.0901         | 0.7030  | 0.5470   | 0.0012  | -0.2997  | 0.3814  | 0.2722   | 0.0026  | 0.2704    | 0.1308  | -0.0063  | 0.9868  |
| Legal organization: corporation       | 0.1917                       | 0.0001  | 0.0068         | 0.9773  | 0.7051   | 0.0001  | -0.7449  | 0.0754  | 0.2955   | 0.0009  | 0.5121    | 0.0031  | -0.4292  | 0.3106  |
| Manufacturing                         | -0.2176                      | 0.0041  | 0.1404         | 0.7415  | 0.3739   | 0.1642  | -1.1472  | 0.1818  | -0.4458  | 0.0014  | 0.1020    | 0.6639  | 3.2754   | 0.1239  |
| Transportation                        | 0.0825                       | 0.3978  | 1.0241         | 0.0261  | 0.8665   | 0.0067  | -0.2095  | 0.7893  | -0.2037  | 0.2719  | 0.9226    | 0.0007  | 3.8090   | 0.0796  |
| Wholesale trade                       | -0.1940                      | 0.0113  | 0.4227         | 0.3025  | 0.3703   | 0.1760  | -1.4503  | 0.2125  | -0.3548  | 0.0104  | -0.3874   | 0.1506  | 2.9010   | 0.1746  |
| Retail trade                          | -0.2301                      | 0.0002  | 1.0374         | 0.0018  | 0.1055   | 0.6593  | -0.2913  | 0.5538  | -0.5285  | 0.0001  | -0.6443   | 0.0046  | 3.0041   | 0.1539  |
| Finance, insurance & real estate      | -0.5285                      | 0.0001  | -0.4763        | 0.4046  | 0.2013   | 0.5105  | 0.4623   | 0.4037  | -1.0989  | 0.0001  | -0.6064   | 0.0541  | -8.6365  | 0.9998  |
| Services                              | -0.2537                      | 0.0001  | 0.1207         | 0.7124  | 0.4298   | 0.0451  | 0.0076   | 0.9857  | -0.5937  | 0.0001  | -0.5058   | 0.0099  | 2.3565   | 0.2584  |
| Urban                                 | 0.1545                       | 0.0011  | 0.2066         | 0.3679  | 0.1201   | 0.4519  | 0.4557   | 0.2420  | 0.2431   | 0.0072  | -0.1466   | 0.3539  | 0.8592   | 0.0892  |
| Woman-owned business                  | -0.1326                      | 0.0039  | -0.8420        | 0.0026  | -0.2295  | 0.1488  | 0.8046   | 0.0079  | -0.1593  | 0.0667  | -0.5267   | 0.0058  | 0.3270   | 0.3442  |
| Minority-owned business               | 0.0003                       | 0.9964  | -0.2894        | 0.4193  | -0.1393  | 0.5590  | 0.3910   | 0.3316  | 0.0340   | 0.7842  | -0.2141   | 0.4260  | 0.3421   | 0.4837  |
| -log likelihood                       |                              | 3,365   |                | 562     |          | 1,046   |          | 246     |          | 2,756   |           | 934     |          | 207     |
| Number of Observations                |                              | 8,198   |                |         |          |         |          |         |          |         |           |         |          |         |

<sup>1</sup> The left out categories are sole proprietorship in the legal organization classification and mining/construction in the industrial classification.

# **A NEW APPROACH TO RURAL ENTREPRENEURSHIP: A CASE STUDY OF TWO RURAL ELECTRIC COOPERATIVES**

Kirk C. Heriot, Western Kentucky University, and Noel D. Campbell, North Georgia College & State University

## **ABSTRACT**

This paper develops a model for rural entrepreneurship as a means for developing new businesses. The purpose of the paper is to propose an approach to economic development that is well suited to rural locations. In the first section, we describe the current literature. In the next section, we describe the rural electric cooperative. In the third section, we build on work Wortman (1990) and Lyons (2002) to propose a new approach to economic development that is built around a cooperative model using rural electric cooperatives as the lead institution for stimulating entrepreneurship in rural communities. We believe this model provides the basis for future development of entrepreneurship in rural areas throughout the United States. In the following section, we demonstrate the efficacy of this model through a case study of two electric cooperatives that have engaged in economic development. The paper concludes by discussing how the electric cooperative incubator model is well suited to stimulating entrepreneurship in rural areas.

## **INTRODUCTION**

Entrepreneurship and the role of small businesses in economic development in the U.S. has been widely established (Sherman and Cappell, 1998). The United States Small Business Administration (SBA) maintains descriptive statistics emphasizing the enormous contributions that small firms have had on the American economy, such as 53.7% of all employment in the U.S. and 55% of all innovations. Yet this good news is tempered by statistics indicating failure rates over 50% for firms during their first four years of operation among small firms (SBA, 2003; SBA, 2002). Although small-firm growth accounts for a significant share of net new employment in this country, failure rates of small firms are particularly high in rural areas, where jobs are needed most.

Because of the importance of small firms and their high failure rates, government initiatives at the federal, state, local levels-as well as private intervention programs-have been created to assist in the creation and growth of small start-up businesses in rural areas. The best known programs include Small Business Development Centers (SBDC), Small Business Institute (SBI), Service Corp of Retired Executives (SCORE), and small business incubators (See Wortman, 1990a for a detailed list of other types of policies and programs).

The Small Business Administration (SBA) provides assistance to rural small businesses through their Small Business Development Center (SBDC) programs, and each SBDC is tasked with assisting rural small businesses. Yet Van Horn and Harvey point out that despite the efforts of the SBA and other organizations, "entrepreneurial firms ... in rural areas, face a host of difficulties related to their external and internal environment. They are small and isolated. The people and information base to provide expert support for critical decisions and functions do not exist internally or externally in the rural location" (Van Horn and Harvey, pg. 157-158,1998).

The problems facing small firms in rural areas are compounded by a combination of logistics and reduced federal funding. The SBA has suffered cutbacks in many programs, such as the

elimination of the Small Business Institute program. This predicament means the rural small business must choose to seek assistance from a SBDC that may be geographically distant, unaffordable due to travel time and distance, or simply unavailable. This leaves the rural small firms in these remote areas with few options for assistance.

Despite our knowledge regarding business assistance programs in the United States, stimulating business growth in rural areas continues to be a challenge. In particular, we seem to lack a consistent model or framework for economic development in rural areas. The purpose of this research is to recommend a framework for economic development that is well-suited to a rural environment and builds upon our understanding of business assistance. Our emphasis is to propose a specific model of business assistance for rural areas that can easily be duplicated in a variety of rural settings. Other researchers have proposed general models of assistance programs for rural areas that are so general that they may prove difficult to duplicate across the diversity of rural settings that exist in the U.S.

We highlight the problems traditionally facing these would-be entrepreneurs. Then, building on the work of Wortman (1990) and Lyons (2002), we then propose a systemic approach where rural entrepreneurship is developed around a network supported by a rural electric cooperative that receives support from other committed institutions. The use of a variety of supporting institutions ensures that value is added at every stage of the process. The paper concludes by discussing how this model is well suited for creating incubators or other support programs in rural America. The implications for policy makers, economic development leaders, and academicians are discussed.

## **LITERATURE REVIEW**

### **Entrepreneurship in Rural America**

Rasmussen (1985) points out that, as of 1985, the federal government had analyzed rural development for over 90 years. Many of the economic problems facing rural America are driven by demographic changes such as depopulation and an aging populace. Rural development as defined by Sauer (1986) includes issues such as encouragement of farm-related enterprises, technical and management assistance for rural entrepreneurs, analysis of federal farm policies, technical assistance to local governments located in rural areas, rural transportation, rural telephone service and information systems, natural resource management, rural financial history, rural families, and family management in rural areas.

Wortman (1990) points out that rural development has been equated with rural industrialization, community economic development, community development, and cultural assessment of rural resources. Thus, rural economic development is merely a point along a continuum ranging from economic well-being to overall well-being (Sears, Reid, Rowley, and Yetley (1989, referred to by Wortman, 1990)).

Wortman argues, "Economic development and entrepreneurship are clearly related. Year in, year out, the Annual Report of the Small Business Administration has reported that more than two-thirds of all new jobs that are created in the U.S. are developed through the entrepreneurial spirit involved in small businesses. Therefore, rural economic development and rural entrepreneurship are also clearly related" (Wortman, 1990, p. 222). He defines the term rural entrepreneurship as "the creation of a new organization that introduces a new product, serves or creates a new market, or utilizes a new technology in a rural environment" (Wortman, 1990a, p. 222).

## **Economic Assistance in Rural America**

Rural Americans have limited access to economic assistance from the federal government. The page restrictions of the proceedings limit our ability to describe the programs that are prevalent in rural areas, except to list them: 1) The SBA has limited funds and tends to emphasize assistance in densely populated areas; 2) The Small Business Institute (SBI) was once an SBA program, but is now administered by a non-profit organization. It was once located in over 500 universities and colleges throughout the U.S. It has fewer than 150 locations today. Incubators are another means of economic assistance in rural areas. Incubators nurture young firms, helping them to survive and grow during the start-up period when they are most vulnerable. Incubators provide hands-on management assistance, access to financing and orchestrated exposure to critical business or technical support services. Research on incubators has emerged as one of the most topical debates in business schools, among business leaders, and by those formulating public policy over the past quarter century (Brandt, 1991; Sherman and Cappell, 1998; Bearse, 1998). Interestingly, however, very few studies have evaluated *rural* incubators. Nonetheless, incubators show some promise as a means of economic development in rural areas as the NBIA reports over thirty percent of all incubators in the U.S. are located in rural areas, although many of them tend to be adjacent to urban areas. The remaining problem is determining who will be the catalyst to initiate the process required to create an incubator. Culp (1990) and Sherman (1999), and the NBIA (NBIA Website) point out that it takes a considerable amount of time to create an incubator.

## **A Systemic Approach**

Wortman argues “there is no single approach for the support of rural entrepreneurship” (Wortman, 1990, p. 229). Traditional attempts to stimulate economic growth by luring big businesses to rural communities have largely failed. Other programs aimed at creating local small businesses have similarly failed. Wortman contends that their collective failures may lie in the lack of interrelationships between the many types of programs. Each of the many programs and policies he describes operate independently. Programs, policies, agencies, banks, and other institutions are stretched too thinly to serve the needs of far flung enterprises in rural areas. Thus, he calls for a unified public-private approach whereby governmental agencies and private organizations work together to stimulate entrepreneurship in rural regions. Wortman (1990) describes in detail what he calls Rural Economic Development Zones (REDZs) that would span as many as four county governments. He goes into great detail to describe how to locate these REDZs in the most efficient manner and even explains how they might overcome political and institutional problems.

Twelve years after Wortman’s discussion of how to develop rural entrepreneurship, Lyons (2002) points out that none of the many economic development strategies has been very successful in turning U.S. rural economies around (Lyons, 2002). He points out, “Rural poverty for the past few decades has been, and continues to be, a nagging problem in the U.S.” (Lyons, 2002, p. 194).

Lyons (2002) and Wortman (1990a) argue that the most current response to these challenges in rural America are the development of strategies for encouraging “home grown” (Lyons, 2002, p. 194) businesses. The basic idea is that these “new ventures will provide jobs or at least self-employment; will remain in the areas where they were spawned as they grow; and will export their goods and services outside the community, attracting much-needed income” (Lyons, 2002, p. 195).

However, considerable debate exists as to how to best accomplish this daunting task. Lyons points out that the many initiatives employed in the U.S. are done so in isolation. While there are examples of attempts to coordinate entrepreneurial development on regional scales, Reynolds and White (1997) point out that most efforts to stimulate entrepreneurship in rural areas are highly fragmented. Lichtenstein and Lyons (1996) argue that in order to be successful in developing entrepreneurship, rural areas must overcome the barriers to successful entrepreneurship, specifically fragmented internal linkages (among community members) and external linkages (with other communities). Thus, the solution to the problem of rural economic development is the creation of linkages among regional entities that combine their resources to support entrepreneurship.

Unfortunately, the frameworks provided by Wortman (1990) and Lyons (2002) are so broadly described they beg the question exactly how might a rural community actually implement their ideas? Lyons (2002) argues that his recommendation for networks that build on social capital can be highly tailored to the situation. He specifically avoids providing solutions that he labels “cookie cutter” or “one size fits all” (Lyons, 2002, p. 198). We concur that both he and Wortman have separately captured the essence of a successful answer to the problems facing rural communities. While they use different terminology and approach the problems from different perspectives, they are essentially advocating a cooperative approach to rural economic development that attempts to stimulate the creation and sustainability of entrepreneurial firms. We believe this approach represents a good starting point, but believe that rural areas require something more concrete in order to actually apply what Lyons and Wortman recommend.

### **Rural Electric Cooperatives**

Most Americans take for granted the electricity, telephones, water and waste disposal services available to them. Yet, this was not the case as recently as 60 years ago. In 1932, only 10 percent of the nation’s farms had electricity compared to 70 percent of urban dwellers (USDA Website, 2004). It is highly likely that one went without these necessities of modern life and the standard of living they make possible. In 1936, modern utilities came to rural America through the creation of the Rural Electrical Administration. Within the federal legislation, Title V, Sections 501 and 502 address economic development; Section 501 of Title V authorizes the US Department of Agriculture to provide technical advice and assistance to borrowers utilizing the authority under section 312 to engage in rural economic development activity. Section 502 of Title V established a Rural Business Incubator fund, its uses, eligibility, and funding. To implement its goals the administration made long-term, self-liquidating loans to state and local governments, to farmers' cooperatives, and to nonprofit organizations; no loans were made directly to consumers. In 1949 the Rural Electric Administration (REA) was authorized to make loans for telephone improvements; in 1988, REA was permitted to give interest-free loans for job creation and rural electric systems. By the early 1970s about 98% of all farms in the United States had electric service, a demonstration of REA's success. Since 1994, the REA has been called the now called the Rural Utilities Service.

[Figure 1 about here]

Today, 1,000 rural electric cooperatives serve 30 million Americans in 48 states — 10 percent of the U.S. population.<sup>1</sup> Figure 1 below shows the extent of rural electric cooperatives in the U.S. Electric cooperatives own and maintain nearly half of all distribution lines in the

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<sup>1</sup> According to Mr. Blaine Stockton of the USDA Public Utilities Service.

country, which cover three-fourths of the nation's land area. Rural electric cooperatives average 5.8 consumers and generate about \$7,000 per mile of line. In contrast, investor-owned utilities, or public utility districts, average 35 consumers and collect \$59,000 per mile of line.

## **THE RURAL ENTREPRENEURSHIP MODEL**

The constraints that arise when trying to develop entrepreneurship in a rural location have been described in detail. These regions of the country often lack the coordinated public-private arrangements needed to fulfill the incubation and assessment processes and lack the cross-institutional coordination to successfully encourage entrepreneurship (Lyons, 2002).

Thus, we propose the model shown in Figure 2 as a framework for developing entrepreneurship in rural communities. Lyons (1999) argues that successful economic interventions take place only in win-win scenarios characterized by a collective economic strategy; a situation is highlighted by a number of elements: a sense of community and networking, dynamic sponsorship based upon competitive pressures (the sponsoring agencies stand to gain when entrepreneurs are successfully fostered), knowledge and technology transfer, leveraging entrepreneurs' capabilities and skills (through expert training and mentoring), and facilitating access to capital (through a mix of public-private mechanisms) (Lyons, 1999).

[Figure 2 about here]

Our proposed model emphasizes the electric cooperative as the catalyst for change. The National Rural Electric Cooperative Association (NRECA) points out that rural electric cooperatives have been involved with economic development for over 60 years. They have been involved with economic development even when there was not a formal process as they "brought new business, new services, and new facilities to rural America.... But community and economic development today requires new funding, new partners, and new strategies (NRECA, 2003, p. 3).

Rural electric cooperatives are an unusual business organization because they belong to their members. They share a responsibility to their members to preserve and promote what is in the best interest for their community. Thus, they have a unique self-interest in the economic well-being of the communities they serve. "Commitment to community and economic development is a necessity in order for a rural electric cooperative to survive" (NRECA, 2003, p. 5).

From a theoretical perspective, the model of rural entrepreneurship that we propose can be extended to many rural communities because of the commonality that exists among the central figure in our model, the rural electric cooperative. Building a model around rural electric cooperatives takes advantage of the predisposition of rural electric cooperatives to engage in economic development (NRECA Website, 2004). As Figure 1 demonstrated, rural electric cooperatives are located throughout most of the continental U.S. Thus, the proposed model can be implemented in a variety of locations, with only minor modifications to the overall structure based upon the potential partners available to the individual electric cooperative.

## **RESEARCH DESIGN**



We propose to extend Lyons (2002) and Wortman's (1990) perspectives on rural economic development by evaluating a similar, but somewhat different approach to economic development based upon case studies of two rural electric cooperatives. Previous research has emphasized the value of the case-study method as a qualitative research strategy (St. John and Heriot, 1991; Audet and d'Amoise, 1998). In particular, Yin (1994) and Earnstadt (1989) have explained the value of the case method. The choice of a case study method is theoretically driven. Case research has high exploratory power and allows dynamic, decision-making processes to be more deeply investigated (Audet and d'Amoise, 1998).

The selection of the two locations was not random. It was purposeful as is appropriate in a case study where the researcher seeks a deeper, richer understanding of a process or phenomena (Yin, 1994). Each of these electric cooperatives is highlighted in material developed by the National Rural Electric Cooperative Association that was made available to the researchers. Additionally, the researchers were able to speak with the general managers of each of the electric cooperatives in order to gain a deeper insight into their situation.

## **The Case Study**

### Whiteville, North Carolina

The Brunswick Electric Membership Cooperative (BEMC) service area is in southeastern North Carolina, a region that has suffered economically in recent years due to shutdowns in local manufacturing and declining farm incomes. The co-op has responded to the situation in a number of ways, including providing facilities to encourage the development of small businesses.

BEMC supports three business development centers through its Rural Consumer Services Corporation (RCSC) located in Winnabow, Whiteville, and Tabor City, NC. We focus on the Whiteville location. The Whiteville location provides affordable, commercial space for new and expanding businesses. This location is a mixed-use incubator that supports professional, service, manufacturing or light assembly businesses. The facility also provides a supportive environment for entrepreneurs that includes business counseling, access to high speed internet, light office equipment, secretarial support, general interior and exterior maintenance, and a shared conference room and training facility.

In 1989 BEMC worked to develop partnerships and build a nonprofit business incubator facility in southeastern North Carolina. This was one of the first applications approved under a new program funded by (then) Rural Electrification Administration (REA) to stimulate economic development in rural areas in the U.S. BEMC tackled the project by setting up a spin-off corporation, the Rural Consumer Services Corporation (RCSC), in 1989. The co-op financed RCSC through partnerships with a number of local and national entities, including the Rural Electrification Administration (now USDA Rural Development's Rural Utilities Service), the Farmers Home Administration (whose business, community and housing programs are now part of Rural Development), and the North Carolina Technological Development Authority. Further funding and other support came from local community colleges, local development organizations and local businesses and individuals. The first funds were used as seed money to open a Business Development Center in Whiteville, N.C., in 1991.

Two more centers were later opened using additional funding in nearby Winnebow and Tabor City. According to Chip Leavitt, CEO and General Manager of BEMC, the co-op minimized

expenditures of members' funds. "The basic approach was for BEMC to serve as a catalyst for the project," he says. "Our investment was not in membership dollars, but primarily in staff and management resources to develop partnerships, pursue other financing sources and garner community support for the project" (NRECA, 2003, p. 29). BEMC provided a loan of \$128,000 to help finance the building in Winnabow.

RCSC is now self-supporting from rental income. Annual expenditures for the business centers total \$160,000, including management and technical support, maintenance, utilities, etc. Since the first center opened in 1991, the overall program has housed 32 businesses and helped create almost 800 new jobs.

Table 1 summarizes the financial resources necessary to make the Whiteville Business Development Center a reality. RCSC has not accomplished everything on its own. As researchers suggest (see, e.g., Lyons, 2002), they have partnered their efforts with public and private organizations to help create opportunities for small start-up businesses. The ongoing management of RCSC Business Development Centers is made possible by the continuing partnership between BEMC, RCSC and the Small Business Development Center. Southeastern Community College provides on-site management for the Whiteville facility. The community college also provides business counseling services and entrepreneurial training programs (USDA Website, 2004).

[Table 1 about here]

#### Black River Falls, Wisconsin

Much like the facility in Whiteville, NC, the facility in Black River Falls, Wisconsin is the result of the efforts of the Jackson Electric Co-op. Since the 1970s Jackson Electric Co-op (JEC) in Black River Falls has been the moving force in the development of an industrial park, a business incubator and a satellite of the Western Wisconsin Technical College in its service area. The co-op receives 50 percent of its commercial and industrial KWh sales from the 76-acre industrial park, in which all sites are sold. The business incubator graduated eight small businesses totaling 100-plus employees. Major employers are: Leeson Electric Motor Company (250 employees) and Nelson Industries (100 employees). Recently, Jackson Electric Co-op competed with 40 other communities to win the site for a Land O' Lakes animal milk replacement plant, employing 45 people at a total cost of \$15 million. Since the original park sites are filled, a new adjoining park is under development. Adjacent to the park is a medium security prison (350 employees) and the Ho-Chunk Tribal Corporate Headquarters (350 employees).

From 1970 to 1978, JEC manager Mike Anderson, then manager of Customer Services, served as mayor of the City of Black River Falls. He was able to obtain 90 grants from the US. Economic Development Administration and the Upper Great Lakes Regional Planning Commission to develop the 76-acre industrial park. He also created a \$500,000 city of Black River Falls revolving loan fund, to be used to assist in the financing for business and industries that were locating in the park.

The Jackson Economic Development Corporation (JEDC), established by Jackson Electric Co-op, has a \$480,000 revolving loan fund. JEDC has a \$4 million portfolio, the result of funding from the Cooperative Finance Corporation (CFC), the RUS, Dairyland Power Cooperative (G&T), the state of Wisconsin and the use of the revolving loan fund.

This \$4 million has generated an additional \$35 million of investments in the industrial park and other area businesses. Private and public sector funders provide \$1.5 million in loans at low interest rates. Public sector funds are provided through the US Department of Agriculture's Rural Business Services program (formerly the Rural Utilities Service).

[Insert Table 2 about here]

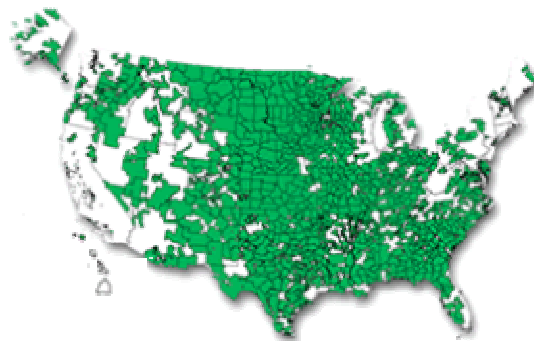
Black River Falls project has not accomplished everything on its own. As researchers suggest (See, e.g., Lyons, 2002), they have partnered their efforts with public and private organizations to help create opportunities for small start-up businesses. The ongoing management of the facility is provided by Marilyn Vasquez. The original industrial park, business incubator, and the satellite campus of a nearby technical college are the result of partnerships between JEC and several organizations, both public and private. Western Wisconsin Technical College offers special courses for small businesses. Enrollment in this satellite campus of the technical college has grown to over 1,400 students in a county with only 18,000 citizens. JEC created the Jackson Economic Development Corporation to manage the overall project.

## CONCLUSION

The two case studies in this paper demonstrate the potential for developing entrepreneurship in rural areas of America by building a network of economic support with a rural electric cooperative as the "hub". The research model proposed in this study emphasizes the electric cooperative as the catalyst for developing rural entrepreneurship. However, a perusal of the model shows that partnerships are critical to its overall success. The proposed model is good business for electric cooperatives and the regions they serve. The U.S. government regularly publishes statistics that demonstrate the strong impact that small new business ventures have on our nation's vitality (SBA, 2002). By trying to develop new businesses and new jobs, rural electric cooperatives are able to ensure that people will continue to want to live and work in their region.

**References** Available Upon Request.

Figure 1. Location of America's Cooperative Electric Utilities



Source: National Rural Electric Cooperative Association Website  
([http://www.nreca.org/nreca/About\\_Us/Our\\_Members/Our\\_Members](http://www.nreca.org/nreca/About_Us/Our_Members/Our_Members))

Figure 2. A Model for Building and Sustaining Rural Entrepreneurship

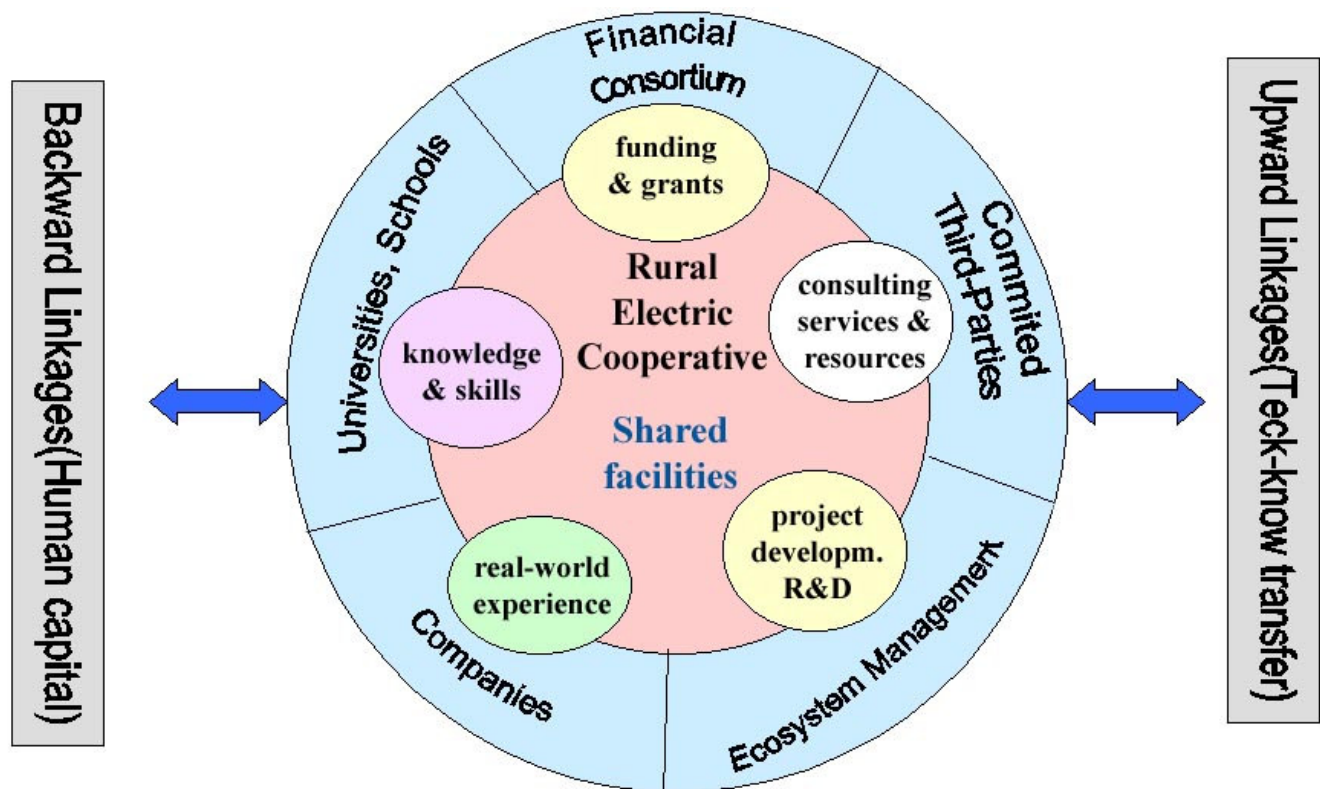


Table 1. Funding of the Whiteville, NC Rural Electric Co-op's Facility. <sup>2</sup>

| <i>Source of Funds</i>  | <i>Amount of Funds</i> |
|---|------------------------|
| USDA Rural Economic Development Loan (repaid)                 | \$100,000              |
| North Carolina Technological Development Authority            | \$100,000              |
| <i>North Carolina Rural Economic Development Center, Inc.</i> | \$30,000               |
| <i>USDA Industrial Development Center</i>                     | \$32,000               |
| <b>Columbus County, NC</b>                                    | \$32,000               |
| <b>Total</b>  | <b>\$379,000</b>       |

<sup>2</sup> The road and building are owned by BEMC and leased to RCSC.

Table 2. Funding of the Black River Falls, WI Rural Electric Co-op's Facility.

| <i><b>Source of Funds</b></i>                | <i><b>Amount of Funds</b></i> |
|--|-------------------------------|
| <i><b>City of Black River Falls</b></i>      | \$80,000                      |
| <i><b>Dairyland Power Cooperative</b></i>    | \$100,00                      |
| <i><b>State of Wisconsin</b></i>             | \$100,000                     |
| <i><b>Rural Utilities Service (USDA)</b></i> | \$100,000                     |
| <b>Total Loans</b>                           | \$380,000                     |

## **BUSINESS OPPORTUNITIES FOR INTERNATIONAL ENTREPRENEURSHIP**

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## **ABSTRACT**

The last decade of the 20<sup>th</sup> century has shown that modern changes can occur in a short period of time in our modern economic history. If we take a look in our rear view mirror, we will notice our bridges for travel no longer constrain us to a limited portion of a specific state, county or governing country. The roadmap has been extended beyond borders, which has changed the scope of our national and global marketplace. Many people have cruised the globalization steering wheel down the information superhighway. Many organizations have sped this journey up through the development and changes of corporate compatibility. Some people have placed their vehicle on cruise control making sure to stay on the path that leads through each valley, canyon, and causeway.

What is their purpose? Who will be the one behind the wheel establishing the new face of international expansion? The spirit of International Entrepreneurship is a major contributing factor that has affected the way people expands their horizons. No longer does one feel that their road to Entrepreneurism stops within the borders of their own country. The key elements of entrepreneurial drive and the economical, political, technological and social changes that have occurred over the last decade have dramatically created business opportunities for global business.

International Entrepreneurship has led pioneers and others down the paths of entrepreneurship freedom stopping at every nook, corner, and valley to find out the opportunities that will unfold in today's emerging international markets.

## **INTRODUCTION**

### **ENTREPRENEURIAL COMPATIBILITY**

Entrepreneurial Drive is a society that is unlike other organizations existence in today's global economies of scale. The Entrepreneur's passion is to conquer and seize opportunities that most individuals would not tackle and do not have the emotions to stomach. Their motivation is one of pro-activeness in their initiatives to be a steward for change through innovative products or services. They have a creative mind that can think independently about ideas of success and failure. Most Entrepreneurs are known for their hard work and their dedication to their respective businesses. Entrepreneurs have established themselves as taking risk and leaders of optimism. These unique men and women make up a strong percentage of today's innovator's to be the leaders of global expansion in the 21<sup>st</sup> century.

### **Keys of Entrepreneurial Drive**

Entrepreneurs have a unique form of identity from their inception as being leaders in our business forefront. These keen attributes lead highly talented individuals to be less resistant to change and provides them with a burning desire of resiliency to succeed. The entrepreneurial drive sets the table for everyone to have the business savvy or opportunity to succeed.

The Key Ingredients to Entrepreneurial Drive:

- ❖ *Seizes opportunities* for personal and professional benefit
- ❖ The *creative* Ability to develop business opportunities
- ❖ Entrepreneurs are *Independent thinkers*
- ❖ *Hard worker* and so is their environment
- ❖ *Optimistic*-Uncertainty does not bother these types of individuals.
- ❖ *Innovator*- The strongest quality of an Entrepreneur
- ❖ The ability to be a *Risk taker*
- ❖ The ability of an entrepreneur linked to their leadership as a *Visionary*
- ❖ An Entrepreneur is a *Leader*

The Entrepreneurial drive *seizes opportunities* that will benefit them both personally and professionally. Entrepreneurs have a tendency to be a *hard worker* and they carry these same expectations into their environment. *Optimism* drives their spirit and the *uncertainty* does not bother these type of individuals. The entrepreneurial spirit establishes ones ability to be a *risk taker* and have a *vision* for the success of their idea. They have to be *innovators* to the products and services they sell and a leader that reflects the environment of their strategic vision.

### **Multi National Corporations and Global Markets**

From the late 1940's through the late 1960's, multinational corporations (MNCs) from the United States had little competition in global markets.<sup>i</sup> In fact, Multinational corporations were the only forms of organizations allowed to eat in the lion's den of China for several years. Today, smaller firms have the *created ability to develop business opportunities* through smaller companies who take less resources and operational cost to secure an opportunity in the global marketplace.

More and more American entrepreneurs are embarking on the road to China and many have found their fortunes. Over the past two decades, as China has liberalized its economy, several large companies have prospered by moving manufacturing into China or more rarely, by producing goods for the Chinese Market.<sup>ii</sup> Investments by major organizations like GM, Volkswagen and other major automobile manufactures are drastically expanding their operations in China. The behemoths have faced several roads that are hard to overcome because of their intensive size and labor costs. The corporate streamline of a major multinational organization only absorbs the ideas of a loose idea thinker.

### **Global Opportunities for Small Businesses**

Yet more than often not, major multi nationals have found making money in China considerably harder than expected.<sup>iii</sup> With intensive operational cost, small entrepreneurs and businesses have been able to seize the opportunity in the international markets of China.

Many corporations have faced the difficulties of working with Multi national corporations and the powers of strategic alliances in the China markets. Small businesses like Robert Kushner's Pacific China Industries Ltd. have been able to open the gates of China and have been well received in the Chinese market. One contributing factor to their success as a small business entrepreneur is the research and study time placed in the international markets with a smaller



team focus and a smaller scales strategy that has captured the short-term audience of the Chinese market.<sup>iv</sup> Robert's personal savvy led him to China. His professional drive helped him to understand the cultural differences that would lead to the expansion of his company's products and services.

### **The Entrepreneurial Test**

Entrepreneurial compadibility is influenced by people who think *independently*. The people who are "outside the box" and have difficulty conforming to structure remove themselves from the foundation of a corporation. Some major corporations embrace this spirit and formulate the ideas to be incorporated with their strategic plans and vision. If they are unsuccessful in their environment, the entrepreneurial tendency is to take the optimistic approach and leave the corporate structure and develop a flat structure with the correct environment for business.

## **ECONOMICAL CHALLENGES OF INTERNATIONAL ENTREPRENEURSHIP**

The economic compatibility that will lead the wave of International expansion through hearts of compassion and new ventured entrepreneurs will have to *adapt* and *change* to the constant economic filters of geographic economics. The issues of *foreign trade* have conducted barriers for entry for all opportunists who would like to expand their business into global markets.

The United States has seen a rise in debt over the past few years. From mid-2000, the U.S. and *global economy* has weakened significantly following one of the largest stock market declines in the postwar period, the terrorist attacks of September 11, 2001, major internal combustion in major corporations leading to corporate failure, and the wars in Iraq.<sup>v</sup>

These economic events have played a significant impact on the judgment for idealist to produce opportunities in the national and global markets. The economic picture in the United States has played a major role in the impact on the emerging markets in Eastern Europe, Asia and Latin America. The United States budget deficit, *global interest rates*, and *the U.S. dollar* have been exposed by the debt linked to the United State government and policy.<sup>vi</sup> It has developed adverse effects on short and long-term interest rates. The traditional distribution structures in Japan, Europe and other countries have seen rapid changes to entry barriers into key markets for small business that offer products and services.

### **Global Market Integration**

The economic picture today is one of several bundled hot buttons. Each geographical region of the world now has been integrated to the advancement in technology and services. This threshold has developed several key communication channels that have broken down the environment of semantics and sparked the interest for organizations to consider global integration.

Though many U.S. consumers associate *globalization* with leading multinationals like Coca-Cola or GE that have huge operations in many countries, small businesses have actually been one of the main drivers of global integration. According to the U.S. Department of Commerce, between

1987 and 1999, the number of small and mid-sized U.S. exporters more than tripled, to 224,000.<sup>vii</sup> By 1999, 97 percent of American exporters were small businesses, though smaller exporters still only accounted for one-third of total U.S. export sales.<sup>viii</sup>

## **Global Inflation**

According to *Grolier's On-line Encyclopedia*, *Inflation* is a process in which the average level of prices increases at a substantial rate over a considerable period of time. In short, more money is required to buy a given amount of goods and services. An understanding of *global inflation* is key to build opportunities in international entrepreneurship simply because it is a foothold to your revenue streamline in your international venture(s) of business. For the first time in the history of the world, inflation is a universal phenomenon with all currencies tied together. Global inflation outlines the environment for which you formulate certain strategies as they affect different segments of the global market space.

## **THE INTERNATIONAL ENTREPRENEUR POLITICAL PERSPECTIVE**

The emerging global economy brings together unity and global nations, which provides outlets of competition. Worldwide competition gives an opportunity for entrepreneurs as well as the buying consumer population. The roadways that open also creates a market capitalization which endorses free enterprise in new markets and small markets that are considered large enough to become viable opportunities.

The main concern of the 21<sup>st</sup> century will be the geopolitical forces that monitor and issue policy for the exchange of goods and services in the global markets. As competition develops in certain markets the contingency for *protectionism* will become the hot button in most respective markets. The passions for trade will grow and has already established this trend in the last decade of the 20<sup>th</sup> century. The economies of industrialized world have entered their mature state of the product life cycle and will be more than modest over the next twenty years.

The Organization for Economic Cooperation and Development estimates that the economies of the OECD member countries will expand about 3 percent annually for the next 25 years, the same rate as the past 25 years.<sup>ix</sup> Organizations like the World Trade Organization (WTO) was formed to help the social, political, and economic changes that will lead the global economy to the future victories in the International Trade and Policy.

When an entrepreneur is formulating a strategic decision to enter a global market you should keep in mind the different geopolitical challenges. You should know your state of controllable and uncontrollable initiatives when entering a market. With the continued strengthening for opportunities in international entrepreneurship one must focus on the continued strengthening and creation of regional market groups:

European Union (EU)

ASEAN Free Trade Area (AFTA)

Southern Cone Free Trade Area (Mercosur)

North American Free Trade Agreement (NAFTA)

Free Trade Area of America (FTAA)

Asia-Pacific Economic Cooperation (APEC)

The market groups have enabled entrepreneurs into emerging markets and help to protect policy and practices of business worldwide. Entrepreneurs will constantly have to examine the way they conduct business and remain flexible enough to react to the rapidly changing global trends to be competitive.

When an entrepreneur seizes an opportunity in global markets there are several factors he or she should consider to entering an emerging market for global business:

Key Areas for an entrepreneur to understand when researching opportunities in global markets:

1. Understanding the balance of trade relationship between merchandise imports and exports in prospective target markets.
2. Extensive research on the political forces of the global environment to have alternatives outlines for strategy and implementation for barriers to enter market(s).
3. Understand the development of domestic industry and how countries will protect existing industry by establishing tariffs, quotas, boycotts, monetary barriers, non-tariff barrier, and market barriers.<sup>x</sup>

The market groups and research techniques will be explored in later chapters of experimental exercises and the areas of study chapters of this book. The Political and Legal issues for an entrepreneur will be a challenging process for one to win in their quest for International emergence for global markets.

## **SOCIAL AND CULTURAL DIFFERENCES IN INTERNATIONAL MARKETS**

### **Corporate Culture and Entrepreneurship**

Since the 1990's, the need to pursue corporate entrepreneurship has arisen from a variety of pressing problems including: technological changes, innovations, and improvements in the marketplace.<sup>xi</sup>

The Corporate Culture has also formed a relative deprivation towards many entrepreneurial spirits that exist in this organizational culture. The spirit of the entrepreneur has perceived weakness in the traditional methods of corporate management.<sup>xii</sup> Most of this is caused by power and influence from top-level management and corporate streamlining. The chain of command takes control and the end result is the loss of entrepreneurial-minded employees who are disenchanted with bureaucratic organizations.<sup>xiii</sup>

The bureaucracy enables other organizations to find opportunities and opens the door for organizations that possess a flatter structure. The word globalization has helped link doors that used to be closed. New technologies and the pursuit for core competencies has led to growing levels of international competition

The pursuit of corporate entrepreneurship as a strategy to counter these problems, however, creates a newer and potentially more complex set of challenges on both a practical and a

theoretical level. On a practical level, organizations need guidelines to direct or redirect resources towards establishing effective entrepreneurial strategies. On a theoretical level, researchers need to continually reassess the components or dimensions that explain and shape the environment in which corporate entrepreneurship flourishes.

### **Workforce Diversity and Globalization**

Organizations understand that they are no longer constrained to their natural national borders. A British firm owns Burger King, and McDonald's sells burgers in many different eastern countries. American companies receive almost 75 percent of their revenues from sales outside the United States.<sup>xiv</sup> These examples illustrate that the world has become a global outlet and community. In return, entrepreneurs have become capable of working with people from different cultures. *Globalization* has led many organizations to *adapt* to working with people of different ethnic decent and understanding the opportunities to work with managers in different markets representing different cultures. To work effectively in different cultures, entrepreneurs must understand the significance of the cultures they wish to build relationship and customer rapport as well as adapt their management style to their differences.

### **THE TECHNOLOGICAL EFFECT ON INTERNATIONAL ENTREPRENEURSHIP**

Technology has been a key to help moving products from manufacturer to end-user, providing local inventory, technical product support, sales and service. Technology moves at a record pace and sometimes when obtained is already obsolete. In today's world technology is a challenging and ever evolving field. New computer technologies, increased competition and continued growth in global markets make today's opportunities to entrepreneurship remarkably different from what it was only a few years ago.

### **WHAT CAN BE LEARNED**

#### **Successful Business Opportunities in International Entrepreneurship**

Most people understand the challenges they face when they opt to go into business for themselves. Everyone knows the road of having success in the corporate environment of small, medium and large corporations. *Free Enterprise* has been an incredible advantage to Americans in our national democracy. The freedom of private business to organize and operate for profit in a competitive system without interference by government beyond regulation necessary to protect public interest and keep the national economy in balance only exists in democratic forms similar to the United States.<sup>xv</sup> So how does that affect pursuing opportunities in our global society? Our assumption must take us back to the most important questions that anyone pursuing or seeking a business opportunity must face. Do you know if you are entrepreneurial compatible?

#### **Entrepreneurial Savvy**

The professional benefit of being successful with an International business opportunity will depend on one's self as well as enabling others to act and share in the creative of the organization's mission. The *entrepreneurial drive* must lead others to understand their

importance of ownership and empowerment in the organization. They must ask as stewards who understand the organizational culture and environment. The organization as a whole must be optimistic and look for the opportunity to produce results. The entrepreneurial leader must model the way for the organizational community to understand their vision and purpose. Allot of soul searching will transpire for the entrepreneurial drive to catch on as a fever that is burning hot through their entire organizational community. Encouraging others and building an organizational environment that shares the optimistic uncertainty with a vision end mind will lead to a successful organization in today and tomorrow's global society.

### **Alternative Approaches of International Entrepreneurship**

The International Entrepreneur must know that he will place allot of emphasis on work ethic Through the power of a vision or growth image even if it is only an illusion. In perhaps the most crucial strategy that must be set in motion early for a business opportunity to be successful from it's embryonic beginnings.

The opportunities for business opportunities in the international market place for an entrepreneur are not as challenging as they were just one decade ago. There are several alternative approaches that can be utilized as a competitive advantage for the emergence into global markets.

- ⇒ The Internet and its expanding role in International markets
- ⇒ The Political and Social Integration of big emerging Markets (Asia, Eastern Europe, Japan, and China).
- ⇒ The economic spurt evolving in global middle-income households.
- ⇒ The collaborative qualitative and quantitative research conducted by organizations through strategic alliances, corporate and functional development in major corporation and small business.
- ⇒ Trends in channel structures in Europe, Japan, and developing structures
- ⇒ Ethics and Social Responsibility in today's global environment.<sup>1</sup>

An entrepreneur must understand all of the facts and assumptions to entering his idea into the global market space. Once this steward has assessed their organizational core competencies, they must evaluate the alternative approaches to make a successful launch into the 21<sup>st</sup> century with their newfound business product or services. These strategies will be discussed in later chapters of this book. The Macroenviroments, Economical, Political, Social, and Market driven/technology demands need to be examined as possible causal factors in the success or failure of international entrepreneurship. The right drive, the right passion and the right strategic window will lead unique men and women to be the revolutionary business leaders of global expansion in the 21<sup>st</sup> century.

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## **CHARITIES & ENTREPRENEURSHIP: WHAT TO DO WHEN THE MONEY RUNS OUT**

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## **CHARITIES & ENTREPRENEURSHIP: WHAT TO DO WHEN THE MONEY RUNS OUT**

### **Abstract**

The role of the social entrepreneur, the challenges he/she faces when working with the changing environment of charities, and the steps that have been successfully taken by some charitable organizations to secure funding are detailed. A framework to guide charities seeking funding in the world of for-profit companies is proposed. Steps include (1) fill an existing need in the marketplace, (2) build on existing human resources, (3) teach business skills as you bring in money, (4) provide employment opportunity as you develop funding, (5) take advantage of special governmental opportunities, and (6) build on successes to become serial entrepreneurs.

### **Introduction**

The current environment for charities is undergoing radical change. Gift giving by individuals has been decreasing because of poor general economic conditions and people are becoming more skeptical about the way their donations have been used by charities. Federal and state funding is drying up as government agencies wrestle with decreased tax revenues, increased demand for services, changing priorities, and other budget drains. As jobs have continued to move abroad and the demand for unskilled workers has decreased, more people are looking for charitable institutions to help in times of crisis. These increased needs are stretching meager resources to the breaking point. Compounding these problems is the lack of coordination and communication among charities which results in fragmented services. Finally, many charities are now being asked to match a percentage of funding received from governmental agencies before the award is made. Charitable organizations are breaking new ground and pioneering new approaches for generating funding on their own so that they can fulfill their missions. Social entrepreneurs are building new models for the charitable organizations of the future.

What lessons can we learn from the pioneers already innovating in the marketplace? For practitioners, researchers and the groups and individuals trying to guide the development of these organizations, those are the questions that must be answered for success in the future.

Steps that have been successfully taken by some charitable organizations to secure funding are detailed. A framework to guide charities seeking funding in the world of for-profit companies is proposed. Steps include (1) fill an existing need in the marketplace, (2) build on existing human resources, (3) teach business skills as

you bring in money, (4) provide employment opportunity as you develop funding, (5) take advantage of special governmental opportunities, and (6) build on successes to become serial entrepreneurs.

## **WHAT TO DO WHEN THE MONEY RUNS OUT**

People are becoming more skeptical about the way their donations have been used by charities. News reports and other research have shown that a much larger percentage of each dollar donated has been going to administration rather than to provide the charitable assistance that individuals thought they were supporting. At the same time, federal and state funding is drying up as government agencies wrestle with decreased tax revenues, increased demand for services, changing priorities, and other budget drains. As jobs have continued to move abroad and the demand for unskilled workers has decreased, more people are looking for charitable institutions to step in and help in times of crisis. These increased needs are stretching meager resources to the breaking point.

Compounding these problems is the lack of coordination and communication among charities which results in fragmented services. The needy are the losers when they cannot discover where to go and who to see for help. Finally, many charities are now being asked to match a percentage of funding received from governmental agencies before the award is made. This means that organizations must be proactive in generating additional funds. Into this environment, we are now seeing that social entrepreneurship is on the rise. Organizations are breaking new ground and pioneering new approaches for generating funding on their own so that they can fulfill their missions. Many are just beginning to identify and pursue opportunities to become more self-sufficient. As they move into new areas, they must innovate, adapt and learn from their successes and failures. It is a brave new world for charities and the people they must serve. Social entrepreneurs are building new models for the charitable organizations of the future. The purpose of this research was (1) to survey current efforts by non-profit charitable institutions for innovative new ways to solve some of the funding problems they now face and (2) to develop a framework that other organizations may use in making their own decisions for action in this area.

What avenues to self-sustaining funding will be open to charitable organizations in the near future? What lessons can we learn from the pioneers already innovating in the marketplace? Are some strategies more successful than others? For practitioners, researchers and the groups and individuals trying to guide the development of these organizations, those are the questions that must be answered for success in the future.

## **Forces Creating the Need for Diversified Funding**

Recent history shows the current economic climate coupled with federal and state funding trends leave many non-profits with flat or reduced budgets. Either of these elements could drastically affect the delivery of social services. Combined they are often fatal to charities in a number of ways.

The effect of poor economic conditions on non-profits is multi-faceted. A lagging economy influences both small and large-scale charitable donations. As businesses down-size, corporate giving decreases substantially. A December, 2002, *Newsweek* article that reports corporate philanthropic donations shows that they declined by 14.5 percent the previous year. (1) This figure takes into account the sizeable donations given after the September 11<sup>th</sup> terrorists attacks. More recent studies show this trend has continued. In a new survey, the *Chronicle of Philanthropy* reports the country's largest corporations cut their charitable donations in 2002 and 2003. (2) These corporate cut backs also affected individuals and charities on a more personal level.

As companies tighten their belts in reaction to hard economic times, so do those who are caught in the corporate crunch. For typical middle class families struggling to provide for themselves, donating to charities they strongly believe in is simply out of reach. As a result, gift giving is left in the hands of a small number of



philanthropists who typically support a single cause. Additionally a weak economy generates a surge in individuals and families seeking assistance. As these individuals join the ranks of others already in need of services, many non-profits are scrambling to acquire additional dollars - putting them in direct competition with each other. Unfortunately as these agencies seek much needed funding, trends in government spending are going in the opposite direction.

Federal and state funding has decreased substantially over the last several years. In addition to slashing budgets of government run programs, charities that typically rely on federal and state dollars have also taken a beating. Fewer dollars are being allocated for social services while the need for these services continues to increase. As operation costs continue to climb and the number of those needing assistance sky rockets, many agencies struggle to stay afloat. For example, many HUD funded programs are now being required to provide a twenty five percent match as part of their grant requirements. These new stipulations place an additional burden on the already strained budgets of a number of charities. As operational costs continue to climb, the financial responsibilities of charities grow, and the number of those in need escalates, agencies are increasingly seeking private donations to expand their revenue. Like state and federal funding, charitable donations are declining. In addition to the current economy, gift giving has also been affected by recent negative media coverage of a few major non-profits, including the United Way and American Red Cross. As reported by *USA Today*, charities raised more than \$2 billion related to the events of 9/11. (3) As the media began to report discrepancies in the amount of donations received compared to the amount going directly to victims of terrorism, many donors began to question exactly how their donations were being spent. Because individuals are more inclined to give when they know their money is going directly to those in need, many became disillusioned to find out not all donations made to charities, the Red Cross in particular, were going specifically to the victims of terrorism. Even though the Liberty Fund was later established to earmark donation for victims, the public's perception had already been changed by the previous reports. This uneasiness has led many to think twice before giving to charities in the future.

Like the Red Cross, the United Way has seen a drop in overall donations as their use of funds and accounting practices were questioned in a scandal involving a past CEO of the agency. Publicity surrounding United Way of the National Capital Area's former CEO, Oral Suer admitted theft of over \$500,000 evoked suspicion in the agency's overall monitoring of funds. According to the *Washington Post*, the National Capital Area saw a decline in donations from \$90 million in 2001 to \$19 million in 2002. (4) As a result of the scandal, United Way chapters across the nation have been hit hard by a decrease in support and social service agencies are feeling the brunt of it. As a number of programs rely on agencies like the United Way for a large portion of their funding, many are left seeking new alternatives to supplement their flat or decreased sources of revenue. The question is: how do they continue to provide services to the growing number of those in need and at the same time make up for the decline in donations to support these services? In the sections that follow, we survey current research on these topics and present examples of some innovative ideas agencies have come up with to answer this question.

## **Research on charities and entrepreneurship**

The search for prior academic research on charities and entrepreneurship was difficult. Little has been written specifically about this particular area. Therefore, the search was broadened to include the larger domain of social entrepreneurship. Social entrepreneurship is not a new phenomenon. It has been around for a very long time. However, it has been difficult to establish conceptual boundaries for the term because of the many different approaches and perspectives used when discussing it. Current usage of the term includes two different approaches: the leader and the organization. The problem comes in trying to separate the leader from the venture. Just as with mainstream entrepreneurs, it is difficult to divide the two. (5) Researchers are only now

beginning to converge on some of the conceptual aspects of this phenomenon. Some researchers have tried to conceptualize social entrepreneurship as it pertains to leadership of public organizations (6) or development of public policy. (7) Others have defined social entrepreneurs by their missions which differ from those of business entrepreneurs. Dees (8) states that for social entrepreneurs, the social mission is explicit and central, a fact that affects how social entrepreneurs perceive and assess opportunities. The primary mission of the social enterprise is to create superior social value for its clients. In order to do this, social entrepreneurs must find innovative ways to ensure that their ventures will have access to resources as long as they are creating social value. Dees goes on to state that “Any definition of social entrepreneurship should reflect the need for a substitute for the market discipline that works for business entrepreneurs. We cannot assume that market discipline will automatically weed out social ventures that are not effectively and efficiently utilizing resources. The following definition combines an emphasis on discipline and accountability with the notions of value creation taken from Say, innovation and change agents from Schumpeter, pursuit of opportunity from Drucker, and resourcefulness from Stevenson. In brief, this definition can be stated as follows: Social entrepreneurs play the role of change agents in the social sector, by: Adopting a mission to create and sustain social value (not just private value); recognizing and relentlessly pursuing new opportunities to serve that mission; engaging in a process of continuous innovation, adaptation, and learning; acting boldly without being limited by resources currently in hand, and exhibiting a heightened sense of accountability to the constituencies served and for the outcomes created.”

The authors have used this definition of social entrepreneurs to guide this study. What follows is identification of ventures created by social entrepreneurs as they pursued opportunities to serve their various missions.

### **Searching for solutions in a changing environment**

So far, we have discussed who the social entrepreneur (actor) is and what challenges he/she may face when working with the changing environment of charities (context). Our next step is to identify the steps (actions) some organizations have taken to secure funding for their organizations in this changing world. What have some charities and not-for-profits done to compensate for the decrease in funding and gift-giving from the general public? In doing our research, we have come across numerous examples of how charities and not-for-profits (NFPs) have augmented their budgets and cash inflow.

**Benhaven**, a New Haven, Conn. charity, operates a school for autistic children (9). For numerous years, Benhaven received many inquiries from local school districts on how best to educate autistic students. While Benhaven provided answers to these requests, responding took staff members away from programs at Benhaven. The officials at Benhaven decided to start a consulting business (Benhaven's Learning Network) to provide the needed assistance to the local community. The consulting firm expects to break-even this year and to add additional consultants as it continues to expand.

**The Boys and Girls Clubs (BGC) of Western Pennsylvania** (10) which is classified as a 501(C)3 organization opened the Outlet Connection a number of years ago to provide additional funds to the parent organization BGC. The Outlet Connection teaches at-risk youth entrepreneurial skills that they might not get elsewhere, such as interacting with customers, ordering and displaying merchandise, taking inventory, and even policing for shoplifters. Everyone that works at the Outlet Connection takes pride in the store and no task is too menial for anyone, that even includes unloading trucks and making sure the bathrooms are kept clean. The kids from the BGC even go on buying trips with the store manager, because she believes that the kids have a better notion of what customers want.

**The Tomorrow Project** started in 1994 as the San Diego Women's Bean Project, which has its roots in the Catholic Charities Department of Homeless Women's Services in San Diego, California. It is sponsored by Rachel's Women Center and Catholic Charities of San Diego. (11) The mission of The Tomorrow Project is to

provide very low-income women the opportunity to change their lives in three specific areas: lack of viable skills, poor self-image, and alienation from mainstream USA. The Tomorrow Project provides training and workshops where the women can learn new skills and social and job skills. The Tomorrow Project manufactured and sold 2,500 soups in 1994, with sales increasing every year. In 2003, the project produced and sold 12,500 soup products. The homeless shelter benefits monetarily through the sale of soups manufactured by the women.

In 2002, **The Northwest Center**, a local charity in Seattle, Washington, generated \$22 million in revenue from its 10 commercial businesses(12). Charities throughout the US and abroad have been facing falling donations and contributions and, unlike many other charities, The Center engages in minimal fundraising. Approximately a third of its income comes from federal contracts: The Center has contracts to clean all of the buildings in downtown Seattle that are federally owned. The Wagner-O'Day Act of 1938, mandated employment opportunities for individuals with disabilities; these mandates were strengthened by the Javits-Wagner-O'Day Act of 1971, which sets aside some federal jobs for disabled workers. "The Wagner-O'Day Act mandated that the federal government purchase brooms, mops and other suitable commodities furnished by community programs employing people who are blind." (13) "The expanded (1971) Javits-Wagner-O'Day (JWOD) Act (41 U.S.C. 46-48c) permitted nonprofit agencies serving people with other severe disabilities to participate in the program and authorized nonprofit agencies to provide not only supplies, but also services to the federal government." (13)

**St. Vincent dePaul Rehabilitation Services (SVdP)**, now know as St. Vincent DePaul Enterprises, started in Portland, Oregon, in 1972 as a sheltered workshop with only five disabled clients.(14) Over the years, SVdP has started and operated numerous for-profit endeavors, such as temporary staffing services, production of outdoor furniture, bus shelter cleaning and security services, and electronic document conversion service. In 1996, SVdP had an operating budget of \$15 million and over 800 employees and was recognized as one the fastest growing organizations in the Portland area.(14) The organization has not only developed its own sources of funding, it has also built organizations that can offer employment to its disabled clients.

**Pioneer Human Services** organized as a non-profit, provides employment, training, and rehabilitation for socially handicapped individuals (ex-cons, parolees, recovering alcoholics and substance abusers) in Seattle. (15) Pioneer has an annual operating budget of \$30 million which comes from its 10 businesses, including a wholesale food business, a corporate cafeteria for Starbucks Coffee, a daily institutional food business, a hotel in downtown Seattle, and a property management company.

**The Pittsburgh Center for Creative Play (TPCCP)** (16) is a charity that teaches children with different skill levels to play. The organization used both grants and loans to purchase a building which it partially occupies, and rents out approximately 12,000 feet to four other entities that bring in \$70,000 in rent a year. In November, 2001, the Center released a CD of children's songs slowed down so that kids with disabilities could sign along. The Center currently is about 50% self-sufficient, but hopes to increase that percentage to 80% by 2007. The down side to this growth is that the Center probably needs to restructure because the business end has become so profitable. Originally, TPCCP believed that sales would total approximately 2,500 copies, but, the Center ended up selling 25,000 copies of the CD. The Center had a "hit" on its hands, and is branching out into holiday music that will be promoted by a national advertising campaign and TV commercials, with hopes of netting \$116,000 from sales.

**Life's Work of Western Pennsylvania** (16) is a charity that helps people with disabilities and employment barriers. The organization was founded in 1927 to assist immigrants who needed vocational help finding jobs. Bob Mather, Life's Work director, got a personal insight into handling disabilities after a head-on car accident that left him in a wheelchair. While recuperating, he developed an initiative to help transform the agency into a more competitive business venture which Mather calls a "mission-based social enterprise." Life's Work has a partnership with an entity that created Jurassic Dog Products. The partnership shares the same facility which

allows Life's Work clients to package and label the products. Life's Work has started 3 for-profit businesses and is in the process of opening a Ben & Jerry's partner shop. "Ben & Jerry's PartnerShop Program is a form of social enterprise, a growing movement in which nonprofit organization leverage the power of business for community benefit." (17)

**The Delancey Street Foundation** in San Francisco was founded in 1971 by an ex-addict/convict with money borrowed from a loan shark. (15) Delancey Street is a multi-million dollar rehab program for addicts, prostitutes and ex-cons. The foundation, which has expanded into five other locations throughout the U.S. (Brewster, NY; Greensboro, NC; San Juan Pueblo, NM; and Los Angeles, CA), has multiple for-profit businesses that it operates, although not all locations have all businesses.

**Rubicon Programs** (15), located in San Francisco, is a non-profit supported by social purpose enterprises that produce approximately \$3 million yearly. Rubicon has several for-profit businesses that include Rubicon Bakery, Rubicon Buildings and Grounds, and Rubicon Employment Services. "The employment services business provides a variety of job training, employment, housing, and mental health services for the disabled, homeless, and ex-welfare recipients." (15)

### **A framework for action**

So what can we learn from the experiences of these diverse organizations? While each entity has a unique story to tell, there are some actions that have application for a wide array of charitable organizations. Development of for-profit enterprises to provide funding for parent charitable organizations seems to be a wave of the future. The organizations in our study were tenacious in their endeavors. They assessed the market to identify any niches that they might fill. When doing so, they kept in mind that their missions were social in nature and took advantage of any opportunities to combine their social mission with their for-profit activities. In some cases, they were able to build ventures for training their clients. In other cases, the new for-profit ventures actually were sources of permanent employment for their clients. These organizations took advantage of all opportunities they could find, especially the existing governmental opportunities available to them. Finally, in several cases, the organizations learned from their early successes and failures and went back into the marketplace to build a series of new ventures. These specific actions could be integrated into many charitable organizations as they search for stability and constant sources of at least a portion of their funding. The foundations for building new ventures are well known. However, their application to charitable organizations is a new. We can see from this research that a number of charitable institutions have been successful in creating innovative businesses to aid them in fulfilling their social missions.

### **A Framework to Guide Charities Seeking Funding in the World of For-Profit Companies**

- \*Fill an existing need in the marketplace* (Benhaven, Pittsburgh Center for Creative Play)
- \*Build on existing human resources* (BGC of America, Pioneer Human Resources)
- \*Teach business skills as you bring in money to support charitable activities* (Tomorrow Project)
- \*Provide employment opportunity as you develop funding streams* (Rubicon Programs)
- \*Take advantage of special governmental opportunities* (The Northwest Center, SVdP Enterprises)
- \*Build on successes in the market to become serial entrepreneurs* (Life's Work of Western PA, Delancey Street Foundation)

## **CONCLUSION AND IMPLICATIONS**

The research presented here has illuminated the various ways that not-for-profits and, more particularly, charitable organizations have developed to generate reliable streams of funding so that they can fulfill their social missions. Results show that these pioneering entrepreneurial efforts have allowed the organizations to

become self-sustaining in some instances and certainly less dependent upon contributions in others. Many of these efforts have created new jobs and opportunities for the individuals that the organizations were originally created to serve. While there is no "one-size-fits-all" solution to the differing needs of so many charitable institutions, different approaches have proved successful for different situations and groups. This study has presented a framework which can be used as a guide for charities seeking funding in the world of for-profit companies.

The results of this research are important in a number of areas. As teachers lead individuals into the field of entrepreneurship, they now have yet another path to show to potential entrepreneurs. Many students do want to contribute to society and are looking for ways to do just that. They will be able to identify ways to combine their entrepreneurial talents with a genuine desire to serve as they see the successes enjoyed by these organizations.

This research has just touched the surface of one area of social entrepreneurship. Much more needs to be done in understanding the specific problems and issues that charitable organizations face today. In addition to identifying various paths to self-sufficiency for these organizations, researchers need to learn which path is most likely to result in success for which type of organization. There is a need for models to help understand this phenomenon. This is an area that will provide opportunity for research for many years to come.

Finally, providing this information to would-be social entrepreneurs is a first step. The information currently available is very general in nature. Social entrepreneurs need specificity and models for success that they can emulate as they move into uncharted waters. However, this early effort at building awareness and knowledge in the area is welcome and should be followed by much more.

The authors feel this area of social entrepreneurship is one that is vital to the social fabric of our communities. There is a need for both practitioners and academics to come together to help to build knowledge and understanding for those social institutions that act as a safety net for the less-advantaged of the world.

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# **LEARNING FROM FAILURE: HARD LESSONS ON LAUNCHING NEW TECHNOLOGIES FOR OLD MARKETS.**

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## **ABSTRACT**

The case study tracks the trials and tribulations of a new venture launched to provide leading edge, vertical market software in an established industry. The experiences of the protagonists in the case validate long held theories, concepts and models that inform the study of entrepreneurship, most important of which is the need to research and assess the environment (both macro and micro) before launching a new venture.

The learning from the case of Entrada Technologies provides a compelling example of the need for entrepreneurs to clearly understand the environment into which they are planning to launch any new venture, particularly one targeted at an industry dominated by complex information technology supply chain. This start up software company learns some very hard lessons when the owners assume that they can be successful with a product that provides elaborate functionality to a market that demands the basics. Technical integration with disparate, customized backend systems, reliance on hardware that changes faster than Moore's Law estimates, and a supply chain with little tolerance for low margins are just some of the barriers exacerbating this new venture's problems.

## **Background**

Entrada Technologies began operations with the launch of an order management software application for vertical markets, which was designed to run on mobile computing hardware known as "pen tablets." With the pen tablet hardware, a field sales rep could navigate the computer screen using a stylus rather than a mouse, and use advanced software applications to enter data while in retail outlets. At the time of the company's launch, the pen tablet hardware was the first generation of devices that enabled field sales reps to enjoy full screen Windows functionality while away from their desktop PC back at the office. Mobile access to Windows' advanced feature set through the pen tablet hardware represented a significant productivity improvement opportunity for organizations that relied on a mobile sales force to create orders and manage their product inventories in retail outlets.

Entrada's initial software offering that ran on the pen tablet hardware was trademarked the Virtual Cooler, because it enabled sales reps in the beer industry to view a graphic representation of their products, in addition to a standard text view. With the Virtual Cooler software, beer industry sales reps simply used the stylus for their pen tablet hardware to "tap" the graphic image of their products on the hardware screen, and then enter their order quantities. The Virtual

Cooler application also allowed sales reps to collect other information while visiting retail customers, such as product inventories and competitive pricing data.

## **The Launch**

The Virtual Cooler was originally created by a programmer named Larry Brown, who had developed the software for internal use within the beer distributorship that he had inherited from his father. The programmer's concept of using the graphic images of a product to build orders and collect data was innovative enough for Mr. Brown to apply for a patent on the process. After months of revisions and resubmissions, Mr. Brown was awarded the patent, which ultimately led to his decision to "go to market" with his invention.

From the outset, Mr. Brown recognized that his expertise was primarily technical. In an effort to ramp up his new venture quickly, he decided to sign an exclusive software distribution contract with Intermec, a leading mobile computing hardware company. Under the contract, Intermec was given the exclusive right to market and sell the Virtual Cooler software either directly to potential end users, or through their nationwide network of hardware/software resellers known in the industry as Independent Software Vendors (ISV's). In exchange for the exclusive distribution rights, Intermec paid Entrada \$500 per licensed user of the Virtual Cooler software, and agreed to provide all necessary technical support and end user/ISV training.

After establishing the Intermec distribution arrangement, Mr. Brown was challenged with the laborious task of insuring technical integration between his Virtual Cooler software and the various enterprise systems used by the distributors within the beer industry. The accuracy of the data transmitted by the field sales reps, as well as the timeliness of those transmissions was critical to the efficient operations of Entrada's potential customers. When the substantial challenges associated with securing seamless technical integration began to require more and more of Mr. Brown's time, he realized he needed someone to focus on increasing the company's sales and managing Entrada's internal operations. To attack those issues, Mr. Brown recruited a long time friend from the beer industry, Tim Kane, to fill the role of President for the new company. Mr. Kane's short-term focus was to assist Intermec in the marketing and sales of the Virtual Cooler software. Part of Mr. Kane's compensation package included a share of ownership in the company.

Mr. Brown employed a third individual from his beer distribution business, Tom Hugle, to manage the product quality and provide technical support to Intermec. Mr. Hugle had contributed some of the programming code to the Virtual Cooler, so he was the logical choice to fill the role of product support. Mr. Hugle was also given a share of ownership in the company. The three partners agreed that Mr. Brown would be responsible for providing financial support during Entrada's start up phase. The actual funding came from Mr. Brown's beer distributorship. The required monthly cash infusions were transferred from a beer company expense account into Entrada's general ledger as part of a "monthly technical support contract." It was understood that Entrada would provide technical development and support for the beer company in return for funds to cover Entrada's monthly expenses until they reached profitability.



## **The Virtual Cooler Product Strategy**

Mr. Brown's original strategy was to use the resources of his strategic partner Intermec to market the Virtual Cooler software. His belief was that by partnering with a leader in mobile computing hardware to vertical markets, Entrada would reap the benefits of an established supply chain through Intermec's extensive Independent Software Vendor network. In addition, Mr. Brown saw potential operating efficiencies for Entrada by relying on Intermec's vast training and support resources to deploy the Virtual Cooler software to potential end users in the beer industry. Mr. Brown assumed that the advanced functionality of the Virtual Cooler software would create an immediate surge in demand for the product once they had completed the technical integration with the Intermec pen tablet hardware and the disparate enterprise systems used by the various beer distributors across the country.

Intermec's product strategy for the Virtual Cooler software was to market it as a "bundled" solution to their resellers and end users. The approach allowed Intermec to sell an integrated mobile computing solution that included Entrada's Virtual Cooler software, Intermec's pen tablet hardware, and all the peripherals needed to take orders and collect data from retail outlets. Intermec priced the Virtual Cooler bundle as a high-end niche product for sales reps that needed to do more than simply take an order. The entire bundle would cost the end user \$5,000 per route. Intermec established the Virtual Cooler bundle margin for their Independent Software Vendors at around 20%. The margin was significantly less than the ISV's made selling Intermec's primary mobile computing order management system, which was a keypad type hardware device that ran a DOS based application. The average selling price for the keypad bundle was around \$4,500 per route. Intermec's ISV's typically made a 40% margin on the keypad bundle.

## **Trouble in Product Paradise**

Technical integration with the existing information supply chain in the beer industry was proving to be a bigger challenge than originally anticipated by Mr. Brown and his limited support staff. As the Entrada technical staff was just beginning to understand the issues associated with transmitting data from the Virtual Cooler user in the field to the various enterprise systems used by their initial customers, they were also experiencing problems running the Virtual Cooler software on Intermec's pen tablet hardware. In early installations, sales reps were experiencing "lock-ups" where the software would stop working in the field, forcing the sales reps to restart their units while in their retail accounts. The technical issues usually resulted in orders and data being lost, which required the sales reps to rebuild their orders and re-transmit the data a second time while in the field.

The ongoing technical integration issues meant that Intermec and Entrada had to spend an inordinate amount of time trying to enable the initial users of the Virtual Cooler bundle to execute their basic order taking processes without failure. As a result, Intermec was not able to focus any resources on training their internal technical support staff on the Virtual Cooler software. Since Intermec's own technical staff never received training, there was no one

available to train their network of ISV's. Most of the onus for resolving the technical issues and getting the ISV's trained then fell back on Entrada's limited resources.

Within six months, Intermec's ISV network had concluded that the Virtual Cooler software bundle was not providing their customers with enough value to warrant its premium pricing. The ISV's were not willing to spend extra time and money to "test" the Virtual Cooler bundle, so they began replacing any Virtual Cooler bundles that they had sold to that point with the less functional, but highly reliable, keypad solution. The fact that the keypad bundle also provided the ISV's with higher profit margins than the Virtual Cooler bundle only expedited their decision to stop selling the Virtual Cooler bundle.

With their staff working long hours on resolving the technical issues, and support from their supply chain waning, Entrada was facing the prospect of going out of business practically before they had even begun. In the face of disaster, the partners regrouped to discuss their options. Mr. Kane took the lead in outlining an alternative business model for the company that required several critical changes to the original approach designed by Mr. Brown.

### **The New Business Model**

The first major change Mr. Kane suggested was a redesigned product strategy to allow Entrada to enter potential markets beyond the beer industry. The company would need to develop a full line of software products designed to meet the needs of any consumer packaged good company, from the basic end user to the most advanced. Critical to the new product strategy would be the development of a low cost, Pocket PC based order management software, designed to replace the less functional, but very expensive keypad hardware running the DOS based application. The goal was to use the Pocket PC product to build their customer base, then trade those customers up to Entrada's more functional, and more profitable, products as the customers' needs evolved. The positioning of the company's product portfolio was key, both from a functionality and a pricing perspective.

The next change Mr. Kane proposed was to eliminate the exclusive software distribution contract with Intermec, and become hardware resellers for all the major manufacturers of mobile computing hardware in the vertical market space. The goal was to focus potential customers on the range of functionality available across Entrada's software product portfolio, then present hardware options that allowed end users to choose whatever hardware they wanted.

Part of the elimination of their Intermec contract required Entrada to establish a direct relationship with a network of ISV's, many of which were existing resellers for most of the major hardware manufacturers anyway. Entrada would attempt to sign reseller contracts with the largest ISV's in the nation primarily through offering higher margins for selling the company's software. The goal was to provide an incentive to the ISV's with a 40% margin, thus enabling the ISV's to make the type of margins they had come to expect when reselling other mobile computing solutions. The final piece of the revised business model Mr. Kane developed was to raise the awareness and credibility of the company and its products through aggressive target marketing and high profile strategic alliances.

The other partners agreed to Mr. Kane's plan for the redesigned business model. The responsibility for executing the plan was Mr. Kane's, who was given the title of Chief Executive Officer to go along with his additional responsibilities. Mr. Hogle would oversee the new product development and support, which would be the critical foundation for the successful implementation of the new business model. Mr. Hogle and his development staff estimated that the new products would take approximately six months to complete. Mr. Brown agreed to continue providing the funding for the company through the existing arrangement with his beer distributorship for the new product development period.

Over the ensuing six months the company made tremendous strides toward creating a high demand for the soon to be released products. The company's targeted print campaign was raising awareness and demand in the beverage industry. Anticipation of the company's new products also provided Entrada with credibility when negotiating reseller contracts with the various Independent Software Vendors across the country. The company had even connected with software giant Microsoft, who had been looking for any vertical market opportunities to seed their rewritten Pocket PC operating system. Since Entrada's forthcoming Pocket Routebook was being designed to run on the Pocket PC platform, Microsoft signed Entrada to a Joint Developer contract to help them to expedite the development of the new software. Entrada reaped numerous benefits from the new partnership, including a case study on Microsoft's website and opportunities to present their new product suite to major consumer packaged goods companies like PepsiCo.

## **Paradise Lost**

The new business model appeared to be working with all aspects of the plan successfully implemented ahead of schedule, except for the completion of the new products. The company added six new employees to focus on expediting the development of the new software. While the additional employees relieved some of the burden on the existing development staff, the company was still having trouble meeting product delivery timelines. In spite of those issues, Entrada was able to maintain the perception in the marketplace that they were still a leading supplier of mobile computing software, primarily due to the strong relationships the company had built with their strategic partners like Microsoft.

Early test releases of the Entrada's new products proved unsuccessful in spite of the development staff working overtime for weeks on end. It was clear to Mr. Brown and Mr. Kane that the company needed additional resources and competencies to complete and deploy the new products. Mr. Brown was reluctant to continue providing funding through his beer distributorships, as he felt the additional resources would create too large of a financial drain on his personal assets. Mr. Kane and Mr. Brown agreed that the only solution was to seek outside funding for the company. Mr. Brown did agree to fund Entrada's monthly expenses out of his own personal accounts until outside investors were found.

Mr. Kane spent the next few weeks writing the business plan to present to investors. In the development of the business plan, the question of how to represent Mr. Brown's ongoing financial support to potential investors became an issue. Mr. Brown wanted to continue accounting for the cash infusions to the company as income to Entrada in return for their ongoing

technical support of his beer distributorships. Mr. Brown believed that showing his financial support as long-term debt in the financials of the business plan would make Entrada look less inviting to outside investors. However, Mr. Brown made it clear that he did want to be compensated by any outside investors for the money he had put into the company up until that point. Mr. Kane disagreed with Mr. Brown's approach because he believed it would be a confusing story to try and explain to potential investors. A compromise was reached, and it was agreed that the details of Mr. Brown's investment would be provided to each potential investor when their respective due diligence process began.

Within three months, Mr. Kane had engaged several serious investors for potential funding. The effort was timely, as Mr. Brown had grown increasingly frustrated by the financial commitment required to cover Entrada's overhead during the protracted product development cycle. However, when negotiations with the potential investors reached the point of discussing ownership shares in exchange for investment dollars, Mr. Brown felt very strongly that he should not have to give up more than 10 – 15% of the company. Unfortunately, most investors that were interested in Entrada were asking for a minimum of 25% of the company for the amount of dollars required to reach profitability. When Mr. Brown refused to compromise on the question of ownership, the search for outside investors stalled. Mr. Brown continued to cover the significant monthly expenses for the company in the hope that the new products would soon be completed and begin to provide increased revenue.

### **A Light at the End of the Tunnel**

Just when it appeared there were no further options, Entrada was invited to participate in a trade show at the national convention of the brewer for which Mr. Kane had worked for twenty years. Only five other software companies were invited to participate in the trade show. During the opening meetings of the convention, all of the brewer's seven hundred beer distributors from across the nation were assembled to hear presentations from key management. During the speeches on the first morning of the convention, the Vice President of Sales made a surprise announcement that all distributors would be required to move to "a common mobile computing software and hardware platform for all their sales reps within two years." The audience of beer distributors was surprised to see Entrada's software as the visual on the forty-foot screen behind the VP of Sales.

After the speech, the beer distributors descended upon Entrada's booth at the trade show to discuss purchasing the company's software. While Entrada was not necessarily the only software option distributors would have for their sales reps, the fact that it was shown on the screen during the speech created a huge impression on the audience. Mr. Brown seized the opportunity and began soliciting some of the other software vendors at the trade show to buy Entrada.

Within two weeks of the trade show, Mr. Brown had secured a preliminary purchase offer from a competitive software company located in Canada. The Canadian company was pursuing a "roll up" strategy in the marketplace through attempting to purchase its competitors for shares of stock in their company. Their stated goal was to acquire a large customer base from competitors, then

execute an initial public offering. Their original offer made to Mr. Brown for Entrada and all its assets was 1,000,000 shares of stock that the privately held company valued at \$2.50 per share.

Mr. Brown offered a portion of the shares of stock from the Canadian company to the other partners. Mr. Hugel went along with the sale, however, Mr. Kane had several concerns about the details of the sale. First, he had evidence that the Canadian company had engaged in questionable business practices in the past with regard to the treatment of their customers. Second, the deal did not include any assurances of future employment to Entrada's twenty employees. Finally, since the Canadian company was privately held, Mr. Kane asked to see a detailed shareholder's agreement that defined the valuation formula for their stock, the restrictions on the future sale of the stock, and other related information. No documentation was ever provided.

As a limited partner, Mr. Kane refused to agree to the sale of the company. The Canadian company's offer did include a time limit, so Mr. Brown ultimately agreed to buy Mr. Kane's share of Entrada so he could dispose of the company with no potential legal barriers.

## **EPILOGUE**

The Canadian company began their due diligence process on Entrada shortly after Mr. Brown had secured all ownership shares of Entrada. Once the process was complete, the Canadian company reduced the amount of their initial offer significantly. Mr. Brown still agreed to sell Entrada in spite of the lower offer. By June of 2004, the Canadian company had reduced the Entrada staff to three individuals and closed the company's offices in West Palm Beach. All Entrada customers were forced to sign revised annual maintenance contracts that included increased fees for customer support. In a stunning announcement, the beer company that had implied its endorsement of the Entrada software a year earlier informed all its distributors that they were going to be forced to purchase a customized mobile computing software application that the brewer itself had developed internally.

## **“SO WHAT?”**

This case study provides several practical lessons, particularly for entrepreneurs attempting to launch technology-based ventures in vertical markets. Each lesson is a validation of past learning in the field of entrepreneurial studies.

**Lesson 1:** Engaging in effective environmental assessment prior to launching a new venture is essential (Wheelen and Hunger, 2004). Conducting research and analysis of the industry in which the new enterprise will compete can clarify the competitive environment and help the entrepreneur understand the potential barriers to entry (Porter, 1985). In the case study, the protagonist, Mr. Brown had the means and opportunity to understand the potential supply chain barriers to successful launch of his software product. Instead, in an effort to move quickly, he signed an exclusive distribution contract with Intermec, the leading provider of the keypad hardware, to take his product to market.

**Lesson 2:** An objective reflection of the internal strengths and weaknesses in terms of structure, resources, culture, competencies and responsibilities will illuminate “gaps” when attempting to conduct effective scenario planning (Day and Shoemaker 2000). While the initial software product developed for internal use in Mr. Brown’s beer operation had promise, the skills required to accomplish complex data integration with disparate enterprise architectures were low. Additionally, Mr. Brown could have better understood his financial risk through effectively building scenarios that accounted for the competency gaps.

**Lesson 3:** Defining and evaluating dependencies that create uncertainty when attempting to take an idea from research and development to market is a critical planning objective for technology entrepreneurship. Selecting the optimal alliances that provide access to contingent technology and mitigate potential technology barriers can improve the chances for success (Balakrishnan and Wernerfelt, 1986). In the case study, partnering with Intermec was one alternative that proved ineffective. The redesigned business model required multiple strategic alliances in an attempt to reduce dependencies on one hardware partner and one reseller network. However, the timing was poor since the window of opportunity for funding was closing faster than the new products could be developed.

**Lesson 4:** Prior to seeking outside funding, develop realistic expectations based on objective assessment of an organization’s relative position in the market. Additionally, insure complete “transparency” when presenting the venture to potential investors (DeCeglelie, 2000). Entrada’s partners had not agreed on the specifics of an acceptable deal with potential investors, nor had they been completely honest about the financials. The end result was that Mr. Brown did not get his initial investment back, and he ended selling the entire enterprise just to get out of the business.

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## **SMALL BUSINESS DEVELOPMENT IN POLAND: A REMEDY FOR HIGH UNEMPLOYMENT**

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### **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 paper discusses small business development in Poland, one of the Central and Eastern European Countries transforming from a command economy into a market-oriented economy. The paper is primarily concerned with the key components of transition: restructuring of the ownership, changing the character of firms into private enterprises and creating a complex labor market. The paper gives an overview of how small business development generates employment in the economy and shows one of the critical problems in the transition, high unemployment rate. The study shows that small business development plays a very important role in the process of transition from command to market oriented economy in Poland. Expansion of free enterprise in Poland constitutes an important factor in economic development, stimulating output, creating employment and lowering the high level of unemployed in the Polish economy ([www.parp.gov.pl/publikacja17.php](http://www.parp.gov.pl/publikacja17.php)).

### **INTRODUCTION**

Development of the private business sector in Poland constitutes an important component of economic development and is an essential factor in decreasing the level of unemployed 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, 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.

The first section of the paper deals with the transformation from a centrally planned economy to market oriented economy and examines macroeconomic indicators with the focus on high unemployment rate. The second section compares the dynamic growth of GDP with the growing number of firms in the private sector, particularly small and medium size firms. It also shows the increasing share of the private sector in GDP. The third section examines the role of the private sector, particularly small and medium firms, in generating employment in the Polish economy. Since the private sector now constitutes the base of employment in Poland, this section examines how development of small and medium business firms can hamper the growth of unemployment in Polish economy. The final section shows the result of the globalization process and the strong involvement of small and medium firms in foreign trade.

## **TRANSFORMATION FROM A COMMAND INTO A MARKET-ORIENTED ECONOMY**

### **Assessing Transition**

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 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 to Poland's economy began in 1980 with the Solidarity movement, followed by martial law in 1981. 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. Privatization took place, as state owned firms were converted to private ownership. 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)).

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).

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 gross domestic product (GDP), unemployment, and inflation.

### **GDP per Capita and Economic Growth**

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 1) 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%.

x-----

Figure 1 about here

x-----

## Unemployment Rate

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 2). 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 2 about here

x-----

## Inflation

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*. 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 3 about here

x-----

## **Globalization of the Polish Economy; The European Union**

The centrally planned economies were isolated from the global markets and world competitive forces. Sudden transition in 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. 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. The top priorities in Polish economy are the competitiveness of exports, the problem of unemployment and budget deficits, and the development of financial markets.

## **SMALL BUSINESS DEVELOPMENT AND EMPLOYMENT CREATION**

### **Number and Size of the Small Business Firms in Poland**

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. 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 1).

x-----  
Table 1 about here  
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. 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 2 about here  
x-----

## The Share of Private Sector in Gross Domestic Product

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 3). 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 share 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 3 about here

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).

x-----

Figure 4 about here

x-----

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 nr 4). 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.

## Share of Private Sector in Employment

**Dynamic development of the private sector in the Polish economy constitutes the most important factor generating employment in the economy and the key factor decreasing the number of unemployed. 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 labor units in 2001 was as follows: micro firms employed 14.72%, small firms 20.85% and medium firms 26.58% of the national employment.**

x-----

Table 4 about here

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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*, 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 ([www.parp.gov.pl](http://www.parp.gov.pl)).

## SUMMARY

This paper has found that private business enterprise development plays an important role in the acceleration of economic growth and constitutes a crucial factor in building labor markets, creating employment, and lowering the number of unemployed in Polish economy. 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. 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.

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## FIGURES AND TABLES

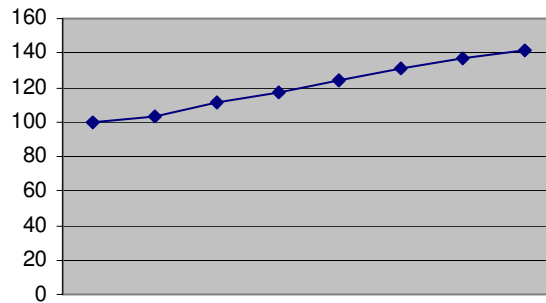


Figure 1. Gross Domestic Product per capita (1990 - 2000)

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)

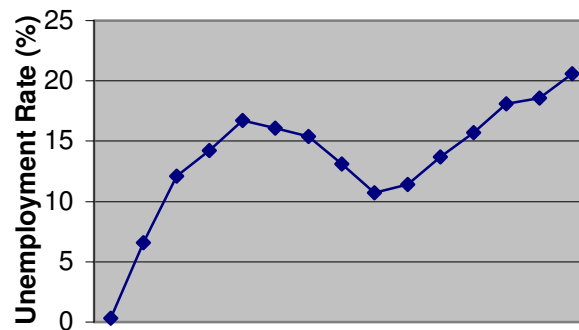


Figure 2: Unemployment Rate in Poland 1990 – 2004

Source: Polish Official Statistics [www.stat.gov.pl](http://www.stat.gov.pl)

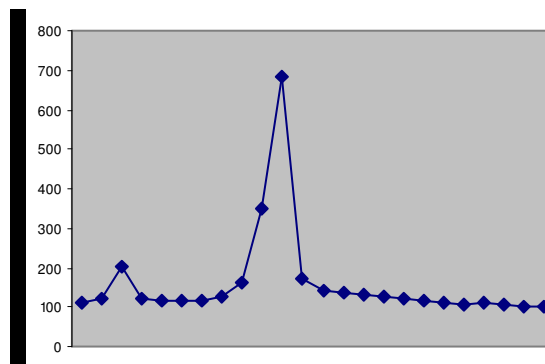


Figure 3: Consumer Price Index 1980 – 2003 (previous year = 100)

Source: Polish Official Statistics [www.stat.gov.pl](http://www.stat.gov.pl)

Table 1: 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 2. Number and Size of Firms in Private Sector in Poland in % (1999-2002)

| Private Sector |           | Firms            | Micro | small | medium |              |
|----------------|-----------|------------------|-------|-------|--------|--------------|
| year           | All firms | 1 - 249 employee | 1-9   | 10-49 | 50-249 | large (250+) |
| 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 3. Share of Private Sector in GDP in Poland (%): 1999-2002

| Private sector |           | Firms            | micro | small | medium |              |
|----------------|-----------|------------------|-------|-------|--------|--------------|
| year           | All firms | 1 – 249 employee | 1-9   | 10-49 | 50-249 | large (250+) |
| 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)

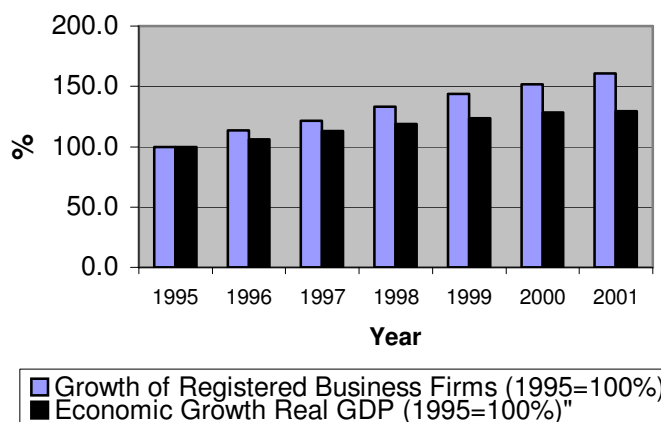


Figure 4. Economic Growth vs. Growth of Registered Business Firms

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 4. Employment in Private Sector in Poland (%)

|      | Private Sector | Firms            | micro | small | medium |              |
|------|----------------|------------------|-------|-------|--------|--------------|
| year | All firms      | 1 – 249 employee | 1-9   | 10-49 | 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)

**Sustainable Entrepreneurship:  
Broadening the Definition of ‘Opportunity’**

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**Notes:** This version draws heavily on past work by the author. Also, the author wishes to thank many who have selflessly offered advice and support, especially John Baden and Dean Shepherd for their keen insights and tireless efforts.



# **Sustainable Entrepreneurship: Broadening the Definition of ‘Opportunity’**

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## **Abstract**

The ‘New Economy’ and its offspring, the ‘New Competitive Landscape’, are oft-characterized as producing ‘new forms’ and ‘new functions’, often from ‘new voices’. This paper discusses one set of under-appreciated ‘new voices’ producing ‘new winners’ that are arising from proactively seeking opportunities that are sustainable not just on the economic dimension but also on social and environmental dimensions. Over the last several years, a working group of scholars and practitioners has focused on a broader definition of ‘opportunity’, broadening the construct of ‘opportunity’ to include social and environmental dimensions. It is a most opportune time to recognize that, for entrepreneurial managers, ‘opportunity’ is much more than economic.

## **Introduction**

Opportunity-seeking is essential for organizations to survive in the new competitive landscape. One aspect of increased competitive pressure arises from an expanded set of pressures which push the organization to ‘add value’ to their environments, especially social and environmental. However, we also observe that individuals and organizations are increasingly focused on the ‘pull’ of environmental and social opportunities (e.g., Hawken 1993; Porter & van der Linde, 1995). That is, there exist significant perceived opportunities that are both economically sustainable and environmentally beneficial.

An important question is “Why do strategic decision makers of some firms fail to see what appears objectively to be a lucrative new opportunity (from the environmental perspective of stakeholders)?” In short, how do we encourage the identification of viable, environmental opportunities? We must recognize that opportunity is in the eye of the beholder. That is, we construct or enact opportunities; we do not ‘find’ them.

Well-developed theory and robust empirical evidence demonstrates how perceptions of organization members, channeled through intentions, can inhibit - or enhance - the pursuit of new opportunities. This analysis proposes an intentions-based model of how environmental opportunities emerge and offers suggestions how to develop a cognitive infrastructure that is opportunity-friendly. *How then do we develop such ventures? Do they really exist? If so, how can we sustain the sustainability?*

## **The Nature of ‘Sustainable’ Opportunity: Theory and Evidence**

First, we must consider the nature of entrepreneurship itself. If voluntary forces such as markets are to benefit the environment or other social issues, some person must identify an opportunity sufficiently enticing to motivate action. That’s what entrepreneurs do; they are alert to opportunities, motivated to act on them, and able to mobilize resources to pursue them.

Acting on an opportunity requires that someone first see that opportunity. However, seeing opportunities can be more difficult than it seems. Entrepreneurial thinking requires a cognitive focus on seeking opportunities, while bureaucratic thinking emphasizes avoiding threats.

Fortunately, we already know the critical antecedents of entrepreneurial thinking: A potential opportunity must be perceived as both desirable and feasible. This is just as true for environmentally-friendly opportunities.

### **A COGNITION-BASED MODEL OF ENVIRONMENTAL OPPORTUNITIES**

The centrality of perceptions in opportunity identification argues for taking a cognitive approach for insights into the nature of innovative activity and how to nurture it. In particular, social psychology offers the construct of intentions as a consistently useful device to integrate past findings from a theory-driven, empirically robust vantage (Ajzen, 1987; Tubbs & Ekeberg, 1991). Intentions models prove consistently robust both in explanatory power and predictive validity. This conceptual framework thus offers a parsimonious mechanism for diagnosing barriers to the pursuit of environmental opportunities.

#### **How Are Environment-Based Opportunities Perceived?**

**First**, organizations do not see opportunities, individuals do. In Krueger and Brazeal's words, entrepreneurial potential requires potential entrepreneurs (1994). An organization with a strong orientation toward seeing opportunities must support individual organization members who have that orientation toward opportunities. **Second**, we have a natural tendency to simplify the world by categorizing situations. Here, we tend to categorize environmental issues (from a strategic perspective) into opportunities and threats in an ongoing, continuous process. We also know that perceptions of opportunity depend closely on perceptions that a situation is positive and that it is controllable (Dutton, 1993). **Third**, opportunity perceptions reflect an intentional process. In short, intentions are driven by perceptions of feasibility (e.g., controllability) and by perceptions of desirability (e.g., positiveness). Fishbein and Ajzen have developed a theoretically sound, empirically robust framework for understanding intentions that appears applicable to most planned behaviors, specific or general, proximal or distal. **Fourth**, we have some understanding of the mental models that entrepreneurs (innovators) share, the scripts and schema that differentiate entrepreneurs from non-entrepreneurs (Bird, 1988; Mitchell & Chesteen, 1996). It seems probable that we have cognitive access to both an opportunity schema and a threat schema. Which schema is activated first (or activated more strongly) depends on critical cues from the environment. **Fifth**, a review of the literatures on entrepreneurship and innovation finds strong arguments for intentionality (Bird, 1988; Katz & Gartner, 1988), existing applications of intentions models and the impact of self-efficacy (Krueger & Brazeal, 1994).

#### **Increasing An Organization's Potential for Seeking Environmental Opportunities**

What influences an organization's readiness for the change required to pursue new opportunities? What is necessary for an organization to learn how to identify new opportunities? Senge (1992) focuses on what he labels simply "mental models": Managers' and employees' internalized cognitive schemata that guide much of their daily activity. We all need multiple schemata to adapt to a changing world. In turn, this requires that we learn multiple mental models and that we learn how to learn new schemata.

Intentions are at the heart of all this. Intentionality is deeply ingrained in how we process information into action. Any planned behavior is intentional by definition, thus strategic behaviors are inherently intentional. As such, it becomes useful to understand that intentions depend on a handful of critical antecedents. Personal and situational influences affect intent only

by affecting these critical antecedents. The latest version of the intentions framework, Ajzen's 'theory of planned behavior' posits that intentions toward a given target behavior depend on certain fundamental underlying attitudes. These specific attitudes reflect decision makers' attributions about a potential course of action. Decision makers should perceive the course of action as **(a)** within their competence and control (thus feasible), as **(b)** personally desirable and **(c)** consonant with social norms. Barriers to any of the critical antecedents will represent a substantive inhibition to an organization's intent to seek and act on opportunities. If we inhibit the intent, we inhibit the action.

### **Insert Figure 1 about here**

**Critical Attitudes:** Ajzen's theory of planned behavior argues that perceptions of desirability and feasibility explain (and predict) intentions significantly. Intentions are driven by perceptions that outcomes from the behavior are personally desirable and that they are socially desirable. Figure 1 shows that intentions toward adopting an environmental opportunity are best predicted by three critical perceptions: **(a)** that the innovative activity is **(a)** perceived as personally desirable, **(b)** perceived as supported by social norms, and **(c)** perceived as feasible.

**Exogenous Factors:** How do intentions models handle other variables, those that are exogenous to the attitude-intention-behavior process? Exogenous factors such as individual differences and purely situational influences operate indirectly on intentions (and thus behavior) by changing these antecedents, not by directly affecting intentions.

**Precipitating Factors:** Research also suggests that certain exogenous variables can serve to facilitate or 'precipitate' the realization of intentions into behavior (Shapero, 1982; Krueger & Brazeal, 1994; Stopford & Baden-Fuller, 1994).

### **Demonstrated Antecedents of Intentions**

Perceived Desirability - Personal Attitude: In the Ajzen-Fishbein framework, personal attitude depends on perceptions of the consequences of outcomes from performing the target behavior: their likelihood as well as magnitude, negative consequences as well as positive, and especially intrinsic rewards as well as extrinsic (in short, an expectancy framework). However, the model also argues that these perceptions are learned.

Perceived Desirability - Social Norms: Social norms represent perhaps the most interesting component of the Ajzen-Fishbein framework. This measure is a function of perceived normative beliefs of significant others (e.g., family, friends, co-workers, etc.) weighted by the individual's motive to comply with each normative belief. Social norms often reflect the influence of organizational (or community) culture. That is, the impact of climate and culture on intent operates by its impact on perceptions of desirability (and perhaps feasibility as well). For example, work group relationships do influence individual innovation (Scott & Bruce, 1994).

Perceptions of Feasibility - Self-Efficacy: Albert Bandura and his associates have developed and elaborated a social-cognitive model of human agency (e.g., Bandura, 1986, 1995). This model argues that taking action requires consideration of not just outcome expectancies (i.e., desirability) but also perceived self-efficacy (i.e., feasibility). This becomes particularly critical with significant strategic change (e.g., a new venture into a range of environmentally friendly products). Bandura defines self-efficacy as an individual's perceived ability to execute some

target behavior. Thus, it reflects the perception of a personal capability to do a particular job or set of tasks. Measuring perceived efficacy is relatively straightforward; one can use simple self-report measures (Bandura, 1986; Eden, 1992).

Perceptions of Feasibility - Collective Efficacy: However, perceptions of personal competence need not translate into perceptions of organizational competence. If fellow organization members are needed to support an intention, perceptions of collective efficacy are likely to be important (Bandura 1986, 1995). This point is crucial: Organization members may be perfectly capable of finding and promoting new opportunities and their self-efficacy beliefs may be high. Yet, perceptions that collective efficacy is low can inhibit opportunity seeking.

Exogenous Factors: Research often examines variables other than attitudes and intentions, but intentions models posit that these exogenous variables operate indirectly on intentions (and thus behavior). As the model suggests, most exogenous factors influence intentions (and behavior) through influencing one or more critical attitudes.

Precipitating Factors: As Figure 1 suggests, exogenous factors may also influence the intention-behavior relationship by precipitating, or facilitating the realization of intentions (Shapero, 1982; Ajzen, 1987; Stopford-Fuller & Baden, 1994). One such factor may be perceptions of resource availability (Triandis, 1967) or a personal propensity to act on environmental opportunities (Shapero, 1982).

### **Building a Supportive Cognitive Infrastructure**

Shapero (1982, 1985) argues that for an organization to maintain a reasonable supply of opportunity-seeking individuals requires that organizations provide a congenial environment - from the perspective of the prospective opportunity-seekers. Opportunity-seekers may enact an organizational environment that is personally favorable, but doing so requires a learning-supportive cognitive infrastructure. How do we help organization members perceive more environmental opportunities as desirable and feasible?

Shapero proposed that communities and organizations seeking to innovate should provide what he called a 'nutrient-rich' environment for potential entrepreneurs. This 'seedbed' would provide intangible 'nutrients' such as credible information, credible role models, visible social norms, and emotional/psychological support as well as more tangible resources. McGrath (1995) points out that organizations need to support its members in learning from adversity. Organizations should provide opportunities to attempt innovative strategies at relatively low risk (i.e., trying and failing is not career-threatening).

Consider the useful metaphor of the antenna. We are much more likely to notice (and take seriously) signals from directions we are already looking. Intentions contribute to how an organization's antennae are 'tuned.' We are less likely to notice opportunities from directions that do not appear desirable and feasible. Increasing the perceived desirability and feasibility of environmental opportunities should 'tune' the antenna in that direction. As such, organization members are obviously more likely to respond to highly credible cues. Increasing the credibility of cues that encourage the pursuit of environmental opportunities may require the perception of signals from more credible sources such as top management, a visible champion, or a trusted

mentor. The cognitive infrastructure should enhance perceptions in organization members that an environmental opportunity is personally and socially desirable and that members are personally and collectively competent to pursue environmental opportunities. Such a cognitive infrastructure would provide the empowerment needed to promote more proactive seeking of environmental opportunities.

**(a) Increasing Feasibility Perceptions:** To promote feasibility perceptions about environmental opportunities, we need to increase perceptions of personal ("I can do this") and collective ("We can do this") efficacy. Perceived feasibility entails perceptions that resources are available and obstacles are surmountable (including the obstacle of having tried and failed). Fortunately, promoting perceived efficacy is relatively straightforward and reasonably well understood; we already know how to do this (Eden, 1992). Organizations and communities need to be vigilant in providing the necessary explicit cues and explicit support. As already noted, providing hands-on (and generalizable) mastery experiences that increase perceptions of personal (and collective) efficacy are invaluable.

**(b) Increasing Desirability Perceptions:** However, desirability perceptions may require more complicated interventions. Increasing perceived desirability requires that individuals perceive mostly positive outcomes for their innovative activity, including intrinsic rewards such as a supportive culture. Again, objectively supportive reward systems need not be perceived as such by the person rewarded. Supportive formal rewards can be trumped by informal punishments (Brazeal & Weaver, 1990).

## CONCLUSIONS

Understanding what inhibits entrepreneurial activity in an organization activity requires understanding how we construct intentions toward a prospective course of action. Mental models of what we intend reflect why we intend an action. Intentions-based models capture how individuals really formulate mental models. Perceptions of desirability (personal and social) and perceptions of feasibility (personal and organizational) are critical to the construction of intentions toward important behaviors. An organization's cognitive infrastructure should enhance, not impede, these critical perceptions.

The pursuit of entrepreneurial opportunities appears quite amenable to the use of such models in teaching and practice as well as research. We look forward to further testing the model.

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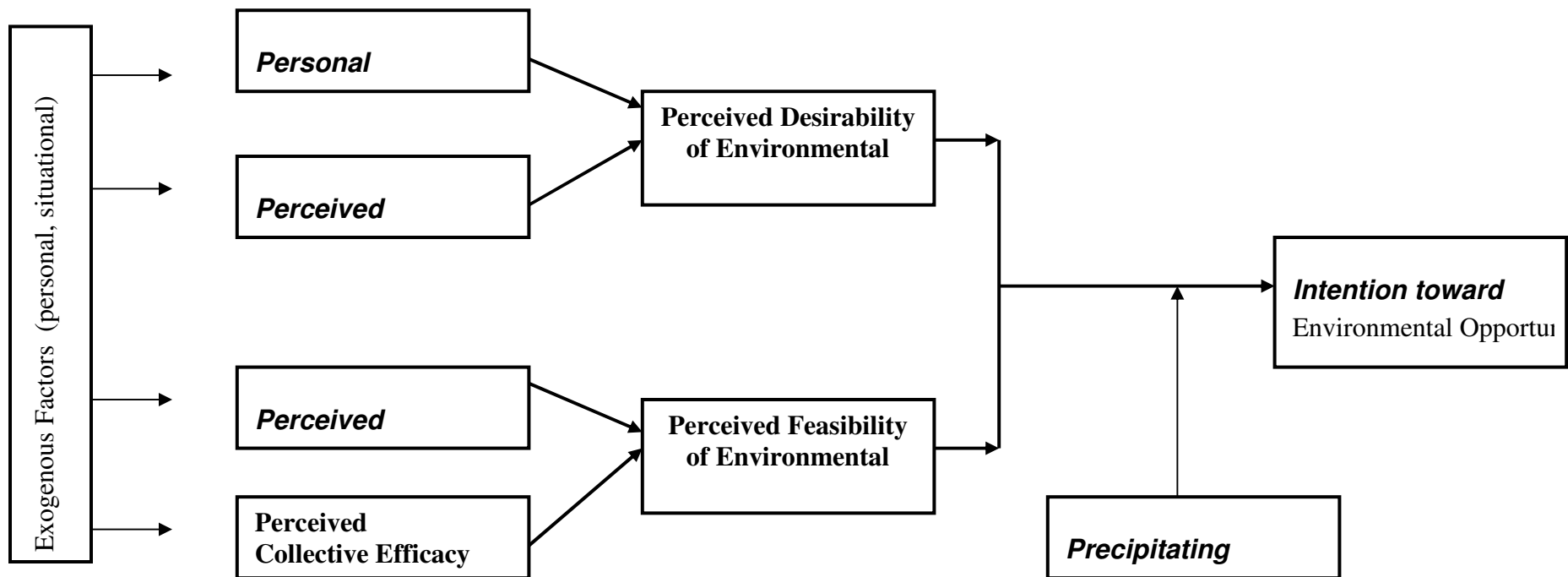
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**Figure 1. Intentions Model (Shapero, 1982; Krueger, 1993)**

**IDENTIFYING GROWTH OPPORTUNITIES:  
TESTING A PERSONAL 'ENTREPRENEURIAL ORIENTATION'**

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# **IDENTIFYING GROWTH OPPORTUNITIES: TESTING A PERSONAL 'ENTREPRENEURIAL ORIENTATION'**

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## **Abstract**

Does there exist a personal (individual-level) 'entrepreneurial orientation' analogous to Covin and Slevin's (organization-level) entrepreneurial orientation? If the entrepreneurial organization tends to reflect strong organizational biases toward being innovative, independent/autonomous, proactive, risk-accepting, and aggressively competitive, it would make sense that its managers (and perhaps employees) would share these biases. However, these biases are attitudinal and thus malleable. If we can identify components of a personal entrepreneurial orientation we should be able to influence those in desirable directions through education, training and organizational (or community) interventions. Results suggest that we can identify valid (and malleable) components of a personal entrepreneurial orientation (e.g., associated with significant opportunity-seeking behavior)

## **INTRODUCTION**

Hamel and Prahalad (1989, 1994) argue persuasively that the attitudes and actions of senior managers are absolutely vital to a firm developing and maintaining a 'strategic intent'. Managers must devote considerable attention toward continuously seeking out new opportunities, often outside the firm and usually beyond present conditions. They argue that for an organization to have a strong strategic intent, its managers must also have their own strategic intent.

Can we identify measures that capture a personal analog to each EO dimension? Using the dimensions proposed by Covin and Slevin (1991) and extended by Lumpkin and Dess (1996), we will identify appropriate measures as described below. Following past researchers, Covin and Slevin (1991) map out three dimensions: Innovativeness, Proactiveness, and Risk-Taking. Lumpkin and Dess (1996) suggest the inclusion of Competitiveness and Autonomy. Hamel's and Prahalad's 1994 arguments also suggest that an organization's strategic intent should include a strong future orientation, an equally strong orientation toward boundary-spanning with external environments, and a significant resilience to setbacks in the opportunity search process, thus we include these three dimensions as well. Finally, if we seek to identify a healthy entrepreneurial orientation, we must also look for the "dark side" (to use Kets de Vries's felicitous phrase). Is the growth entrepreneur seeking the opportunity to grow a firm or grow his reputation? However, there is a more dangerous barrier to strategic thinking: the relative absence of critical thinking. If we are at all concerned about successful (or healthy) strategic thinking, then we need to consider the "dark side" carefully.

## **STRATEGIC THINKING; ENTREPRENEURIAL THINKING**

If there is one thing that strategy scholars, consultants, entrepreneurs, and managers agree on -- it is the need for more strategic thinking. Thinking strategically appears to overlap considerably

with the notion of thinking entrepreneurially. That is, both entail a strong, committed orientation toward seeking opportunities. Thinking strategically (i.e., entrepreneurially) seems absolutely central for organizations (and individuals) whether for survival or growth in these times of rapid and accelerating change. Most of us certainly need to enhance our abilities to identify opportunities that we can act upon. While this growing focus on strategic thinking seems most timely and needed, we still need to understand this concept both in terms of more intellectual rigor and in terms of practical utility.

### **What Is 'Strategic Vision' Anyway?**

'Strategic Vision' reflects the result of strategic thinking processes. Thus, let us consider strategic thinking. A review of both practitioner and scholarly publications finds that 'strategic thinking' as a term is growing rapidly in prominence. However, it is striking that there is little or no consensus on a definition, beyond the ability and willingness to identify new opportunities (often opportunities for growth). As such, it has much in common with Hamel and Prahalad's notion of 'strategic intent' (1989). If this isn't to be just the "Buzzphrase of the Day", we need a more rigorous look, especially about how to define it and how to nurture it! The practitioner and scholarly literatures do seem to converge on four key things.

First and most important, like strategic thinking, strategic vision is an outcome. It does not exist in a vacuum; it is an emergent phenomenon. However, there is a growing consensus of what strategic vision "looks like" - or should (e.g., Baum, 1995). The 'heart' of strategic thinking ultimately remains: The ability and willingness to identify, analyze, and pursue new opportunities; the 'heart' of strategic vision emerges from the opportunities identified.

Still, the crucial question remains: How does strategic vision emerge?

Second, this outcome is multi-faceted. That is, there are multiple dimensions that drive the emergence of strategic thinking and thus strategic vision. The practitioner and scholarly literatures offer three useful dimensions, each of which can be measured rigorously and each of which can be used readily by managers and consultants. These include:

*Entrepreneurial orientation:* This orientation toward opportunities obviously suggests parallels with entrepreneurship research on how organizations seek opportunities, especially the notion of a firm's "entrepreneurial orientation" toward identifying opportunities for growth. EO was first suggested by Covin and Slevin (1991) and extended by Lumpkin and Dess (1994) and has been empirically validated at the firm-level. The dimensions of EO include: Innovativeness, Competitiveness, Risk-Accepting, Autonomy, and Proactiveness. We will propose below how this framework can be readily adapted to individuals.

*Future orientation:* Hamel and Prahalad (1994) more recently show the power of simply asking managers how much time they spend looking at future possibilities. Moreover, the needed ability for managers to think more than one move ahead

*External orientation:* Similarly, Hamel and Prahalad ask how much time is spent looking outside the organization, as does Peter Drucker (e.g., 1985).

*The 'Dark Side'*: Kets de Vries (1989) points out that entrepreneurs who seek opportunity can easily cross the line into a more dysfunctional opportunism. In fact, many business leaders' opportunity-seeking reflects certain pathologies (e.g., narcissism). Similarly, Winslow and Solomon (1989) note that many entrepreneurs might be easily classified as "mildly sociopathic." In short, opportunity-seeking can be for the wrong reasons. As such, it might make sense to explore narcissism and other characteristics.

Third, it is not just a trait or set of traits. Nor is it just a skill or set of skills. It does reflect certain trait-level phenomena (such as a tolerance for uncertainty) and certain necessary skills (such as critical thinking). However, situational phenomena are vital too: The organizational context should actively support strategic thinking (e.g., Senge, 1992). Strategic thinking is unlikely to surface in organizations where it is unrewarded.

However, the cognitive processes of senior management has long been seen as a significant influence on strategy in general and on identifying opportunities in specific. While personality and demographic data – even attitude data – have rarely predicted entrepreneurial behavior, such data can predict what types of opportunity are perceived.

In particular, Sexton and Upton (e.g., 1991) have shown that growth-oriented entrepreneurs do share certain characteristics. Covin and Slevin (1991), followed by Lumpkin and Dess (1996), show that growth-seeking firms also share certain characteristics.

Thus, to nurture strategic thinking requires consideration of both personal and situational factors:

- \* Some set of individual attitudes toward thinking strategically (relatively stable, yet malleable, person-based measures)
- \* Some set of learnable attitudes (e.g., critical thinking and creativity)
- \* A supportive cognitive infrastructure: An organizational context that rewards strategic thinking and supports the acquisition of requisite skills and attitudes (Krueger, 1999). McCall (1992) argues for providing specific developmental experiences that provide specific 'lessons' for strategic managers. Why not 'lessons' re strategic thinking?

In this research we examine the first component. If we select appropriately, we should be able to identify attitude-type measures that predict opportunity-seeking. Having done that, we can then use that knowledge to help nurture those attitudes. To do this requires selection based on both sound theory and sound psychometric properties.

## RESEARCH QUESTIONS

- (1) Can we identify measures analogous to EO at the individual level of analysis?
- (2) Are such measures associated with opportunity-seeking?
- (3) Can these findings be translated into a valid, reliable instrument?

## RESEARCH DESIGN

*Design:* We collected data on opportunity-seeking from multiple sources, then analyzed each proposed measure separately and collectively with respect to the PEO measures. We tested subjects by comparing subject scores on PEO measures to their scores on opportunity identification. A pilot study and univariate analysis suggested that correlation analysis was appropriate and adequate. Note that we collected multiple measures for each construct.

*Dispositional Measures:* The measures we propose for such a study need to be relatively proven. That is, they have already demonstrated exceptional validity, stability, and reliability in samples of managers and entrepreneurs and in other achievement-related circumstances. However, additional pretesting on a comparable sample is desirable. Measures should also be plausibly analogous to the EO and related dimensions noted above. In particular, each scale has seen prior usage in entrepreneurial or managerial settings. Table 1 offers an overview of the measures employed. The author re-validated each scale employed on a separate sample, finding excellent stability and reliability for each.

*Dependent Measures:* Global opportunity perceptions (3) distinct measures, collected separately.

Level of Opportunity: Ss were given multiple scenarios and asked to rate the level of opportunity in terms of the perceived probability that a “good” (significant and personally-viable) opportunity exists. This offers a measure of willingness to seek opportunities.

Opportunity-Identification (2): Ss were given additional scenarios where they were asked to identify as many “good” opportunities as they could think of in 5 minutes. These were rated both on (a) quantity and on (b) quality of opportunities identified. This offers a measure of skill at identifying opportunities.

*Sample:* 103 Ss (46 entrepreneurs; 57 non-entrepreneurs), diverse across age, gender, education, ethnicity, and SES, drawn from a population of self-reported intending entrepreneurs seeking training.

(insert Table 1 about here)

## RESULTS AND DISCUSSION

As Table 2 suggests, these measures do appear to be significantly associated with the composite measure of opportunity-seeking, although not completely. Note that the time allocation measures as proposed by Hamel and Prahalad for both external orientation and future orientation was not significant. This may reflect a weak measure or may simply have no association with opportunity-seeking. More interesting perhaps is the significant positive correlation between narcissism scores and opportunity-seeking. (This was confirmed *post hoc* by examining the subscales of the Narcissistic Personality Inventory.) Does being mildly narcissistic aid one in being more opportunity-seeking? Similarly, we notice a significant negative correlation with the

measure of competition versus cooperation. This suggests that a bias toward cooperative approaches to achievement is beneficial for opportunity-seeking. While this might appear to contradict the premise that EO is enhanced by competitiveness, it might also mean that opportunity-seeking is enhanced by cooperation. Thus, opportunity-seeking may benefit from being both competitive and cooperative. Still, the overall picture appears both significant and useful to scholars (and trainers) of entrepreneurship.

## IMPLICATIONS

For practice and teaching, we see evidence that opportunity-seeking is associated significantly with measures that correspond to the dimensions of strategic thinking, especially key dimensions of entrepreneurial orientation. This suggests that we can enhance opportunity-seeking by influencing key components of strategic thinking, as we have chosen attitude measures that are potentially malleable –that is, teachable/learnable. For researchers, the lack of correlation between these measures and a measure of past self-employment suggests that these measures do not predict or explain entrepreneurial behavior per se, rather they are specific to the domain of seeking growth opportunities.

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## *Dimensions of Entrepreneurial Orientation*

| <u>Organizational-Level</u> | <u>Personal-Level Measures</u>                            |
|-----------------------------|---|
| Innovativeness              | Adaptive-Innovativeness (Kirton); Creativity (ACL)        |
| Proactive                   | Action Orientation (Kuhl); Hope (Snyder, et al.)          |
| Risk-taking                 | Venturesomeness (Eysenck)                                 |
| Competitiveness             | Competitiveness-Cooperation , Machiavellianism            |
| Autonomy                    | Desire for Control (Burger); Ambiguity Tolerance (Lorsch) |
| Future Orientation          | 3 measures (Lorsch & Morse; Hamel & Prahalad; Gjesme)     |
| External Orientation        | Items adapted from Hamel and Prahalad;                    |
| Network Orientation         |   |
| Resilience                  | Learned optimism (adapted from Seligman)                  |
| 'Dark Side'                 | Narcissism (Hogan); Constructive Thinking (Epstein)       |

*Table 1.* Basic Variables and Measures

|                               |                      |
|-------------------------------|----------------------|
| <b><i>Innovativeness</i></b>  |                      |
| Innovativeness                | <b>.322</b> (p<.002) |
| Creativity                    | <b>.214</b> (p<.05)  |
| <b><i>Proactiveness</i></b>   |                      |
| Action Orientation            | <b>.310</b> (p<.003) |
| Hope                          | <b>.298</b> (p<.005) |
| <b><i>Risk-Accepting</i></b>  |                      |
| Venturesomeness               | <b>.286</b> (p<.005) |
| Risk-seeking                  | <b>n.s.</b>          |
| <b><i>Competitiveness</i></b> |                      |
| Competitiveness-Cooperation   | <b>-.182</b> (p<.09) |
| Machiavellianism              | <b>.190</b> (p<.09)  |

|  |   |
|--|---|
| <b><i>Autonomy</i></b><br><br>Ambiguity Tolerance<br>Desire for Control                            | <b>.251</b> (p<.02)<br><b>.332</b> (p<.002)       |
| <b><i>Future Orientation</i></b><br>Time Horizon<br>Attitudes toward the Future<br>Time Allocation | <b>n.s.</b><br><b>.177</b> (p<.09)<br><b>n.s.</b> |
| <b><i>External Orientation</i></b><br><br>Time Allocation<br>Network Orientation                   | <b>n.s.</b><br><b>.190</b> (p<.09)                |
| <b><i>Resilience</i></b><br><br>Learned Optimism   | <b>.366</b> (p<.001)                              |
| <b><i>Dark Side</i></b><br><br>Narcissism<br>Constructive Thinking                                 | <b>.181</b> (p<.08)<br><b>.241</b> (p<.03)        |

*EO Constructs*  
PEO Measures

Pearson Correlations with  
Composite Measure of  
Opportunity-Seeking (p-value)

Table 2. Correlations between PEO Measures and Opportunity-Seeking

# **Entrepreneurship Learning Across the Curriculum**

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## **ABSTRACT**

Four faculty members, an artist, a business person, a nurse practitioner, and engineer and a specialist in multicultural affairs, provide ideas on improving learning in Entrepreneurship. This paper offers three examples of things that can be borrowed from other disciplines to use in Entrepreneurial Courses. The Professional Presentation Board, which incorporates visual learning styles; the Source Book which incorporates hands on, visual, and analytical learning styles; and the exciting Reality Opportunity Identification exercise in aging. Here are three tools that can enliven the entrepreneurship learning environment and help it to be more inclusive of people from multiple learning styles and disciplines of study.

## **INTRODUCTION**

Entrepreneurship is an inclusive field of study. This is what makes it so rich as a learning tool for interdisciplinary and multicultural work. In the process of preparing two entrepreneurship courses to be taught to non-engineering and non business students, many new concepts were learned from other disciplines. These concepts were reworked



into tools and techniques to teach the entrepreneurial process. This paper describes three specific concepts and how the concepts are applied to the teaching of entrepreneurship.

The university is committed to offering an Entrepreneurship program to students from any discipline. This commitment arises from the results of a student survey. (1) The results showed that students outside of business and engineering were more likely to have entrepreneurial ideas and ambitions than business and engineering students. In response the survey an entrepreneurship minor was created and marketed to students outside of business and engineering. This paper describes teaching methods that appear in the first two courses in the minor. In the first course entitled “The Entrepreneurial Quest,” students explore the entrepreneurial journey beginning with the myths and realities of entrepreneurs, student self-analysis, creativity and idea generation through to the recognition of a business opportunity as indicated by a customer feedback and the introduction of the concept of a business plan. The second course entitled “New Venture Feasibility”, focuses on the design and development of a product and a preliminary assessment of market entry feasibility. Two of the authors’ team taught the initial offering of these courses and create reusable teaching modules to aid in scaling up the entrepreneurship program. Unfortunately the professors’ backgrounds in business and engineering are not sufficient to develop an effective interdisciplinary course in entrepreneurship. You may ask why?

At 2003 the national conferences of the United States Association for Small Business and Entrepreneurship (USASBE) and the National Collegiate Inventors and Innovators Alliance (NCIIA) the authors learned two important lessons about teaching entrepreneurship. First leading schools in this area draw upon the expertise of many different disciplines to teach the knowledge and skills required to be a successful entrepreneur. Not only did these educators believe that this strategy was successful, they also believed that the approach showed students the value of disciplines other than their own. Second the authors learned that entrepreneurship education could be used to motivate at risk or marginalized students to stay in school by addressing multiple learning styles and tapping into students’ passion for their own ideas.

## **Background**

The lead two authors received a grant which enabled the authors to work with faculty from eight different disciplines outside their own professional areas. Creating a series of week long modules for the entrepreneurship class was the goal of this collaborative effort. The lead two authors spent at least two days with each outside faculty consultant to develop each module. The modules have been documented so that the authors and other faculty who will teach the courses in the future can deliver the modules effectively. During the development of the modules faculty from different fields shared their teaching philosophies, strategies and tactics. This exchange of ideas will not only benefit students in the Entrepreneurship program but also benefit students in other classes taught by participating faculty.

The objective of this grant was to develop eight interdisciplinary learning modules to teach the students how to take an idea from conception to market.

Each learning module consists of the following:

1. Pre-class meeting reading assignment.
2. Blackboard class preparedness assessment.
3. Class presentation material.
4. In class active learning exercise.
5. Out of class assignment.
6. Grading criteria for the out of class assignment.
7. Sample test questions.

Two days of face to face meetings were allotted for the development of each module

### **THREE BORROWED IDEAS**

In the course of this work many things were learned. For the purpose of this paper three borrowed ideas from three disciplines will be shared. Many papers would be required to describe all of the ideas generated with the faculty consultants. The project presentation board, the source book and the exercise in opportunity identification are presented in this paper. The idea of the project presentation board was embraced and modified by the faculty consultant from the office Multi Cultural Affairs. The source book technique was presented by the faculty consultant from the art department and the exercise on opportunity identification was developed with the faculty consultant from the College of Nursing.

#### **Project Presentation Board**

The faculty consultant from the office of Multi Cultural Affairs insisted that the courses address multiple learning styles. This was reinforced by the presentations at the 2004 USASBE meeting and some luncheon table conversations where two of the authors were challenged to think about how to help African American students learn about entrepreneurship. As a direct result the lead authors had developed a visual tool for tracking project progress on a Display Board. The foam core Board has areas devoted to each section of the course and is referred to as a project presentation board (PPD). The PPD contains a sketch of the product, a written description of the product, a description of potential customers, results efforts to gather customer feedback and a place for the student's vision, and mission statements. The PPD board is shown in Exhibit 1. The PPD allows students and faculty to quickly determine the status of a project and what needs to be done next.

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Figure 1 about here

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The staff of the university Multicultural Office enthusiastically embraced the idea of the project presentation board. They believed that the PPB could be a valuable teaching tool but they had two caveats. First the board would have to be reviewed multiple times during the semester to help the students perceive the value of the tool. Second the faculty would have to be willing to let students improve any part of the board each time it was reviewed. Both suggestions have been incorporated into the syllabus for the class.

The PPB has become one of the structural supports for the entire first course and the link to the second course. The second course in the program entitled “New Product Feasibility” and is built around determining what potential customers think about the entrepreneurial idea and whether the product can be made for a price the customers are willing to pay. Here the board continues to fill critical need. It serves as a visual tie throughout both semesters, growing changing, being refined but always reflecting the status of the project. If you track the development of a representation of the product through the semesters, it may start as a rough pencil sketch, or a collage of design pieces. It may progress to a more refined sketch, or a sketch produced on a computer. Then the representation may be further refined to a picture of a foam model or a solid model produced with Computer Aided Design (CAD) software.

Visual learning and other types of learning styles have been integrated into the courses. While those who will guide the entrepreneurship courses are not experts in learning styles, assistance was received from many faculty members who have experience in his area. The growth of the board concept has helped build visual learning as an integral learning style into the new program.

### **Source Book**

The source book idea combines hands-on and visual learning style. The concept was borrowed from field of art. The creative processes and techniques used by artists can be harnessed to generate and improve entrepreneurial ideas. The professor of art who specializes in jewelry design introduced the concept of a source book. Some creative people record ideas related to their project in a source book. These related but different ideas are used to stimulate and refine new ideas. This simple concept grew and grew until it became the creative backbone for the courses in Entrepreneurship.

The idea behind the source book is to use a sketch book (blank pages) to collect anything that might be related to the design of your product, store, website, logo and so forth. It might be as simple as a color. It might be as complex as a technology. It could be a swatch of material, it could be an advertisement from a magazine, or it could be a photograph that you have taken in your travels. It could be something off a competitive website, it could be sketch or tracing, in fact the source book entries are only limited by your imagination. This is a valuable tool for the hands on learner as well as the visual learners. The hands-on learner can get involved in the touch and feel of materials, even physical shapes can be translated by photography, or sketch into the source book.

The power in the source book is that students are constantly thinking about the new product they are trying to develop. At first they are collecting anything they like. After the first review of the source book, the faculty led a discussion about how to synthesize and combine ideas from different sources. While any idea is welcome in the source book as the students move through the entrepreneurial process, they see the benefit of reviewing the source book and begin to focus on their final choices. This review of the source book provides an opportunity to learn its real power. It is far easier to work from a sketchbook full of ideas then to stare a blank paper when thinking about a new idea.

Frequently in the process of developing products, services, or revitalizing organizations customers are consulted. The lucky entrepreneur will find immediate total customer acceptance. Most however will be forced to go through and iterative process. In these cases the source book can be a tremendous asset. When the customer has made it clear they do not like an idea or design, a sourcebook can be consulted to generate new ideas to overcome customer's resistance.

### **Opportunity Identification**

One of the most difficult areas of entrepreneurship to teach is opportunity identification. It became more puzzling when thinking about Entrepreneurship class where the students were supposed to enroll with a product idea. Experience has taught faculty that student's ideas have a marginal success rate. Some excited and passionate students knock you down to get help in going to the next step. Other students have ideas that are clearly not feasible. The problem faced is how to get students to think beyond their product or reevaluate their idea. How can students learn to question their product on their own? How can this be taught without forcing students to move away from their idea?

The answer that has been developed requires students to learn about opportunity identification by thinking about products the baby boom generation may need. There are 77 million people in this category and they are quickly approaching their sixties. What will they need in the way of products? The baby boomers have changed almost everything else how will they change aging? How will they change products? What are their unmet needs? Almost all products can be redesigned to better serve the needs of the aging population. When students think about this scenario, one of three things might happen:

1. Students might see even more benefits of their own product.
2. Students might have an entirely new product idea.
3. Students might learn how to go about thinking about the opportunities for products provided by a macro event.

How can 18-22 year old students learn about developing products design for older people? The nursing professor who was a faculty consultant suggested an in-class aging exercise that would allow students to experience the effects of aging. This hopefully will lead students to think about new products, product modifications, and the ramifications to their own products.

### **Aging in Class – a Reality Exercise**

The exercise simulates the effects of aging and then the students try to perform everyday tasks with familiar tools. This exercise is derived from exercises commonly used in nursing and the health professions to develop a student's empathy toward older patients. Upon entering the class students are asked to take a pair of heavy gloves and keep them on all the time for the class period.

While class is starting a bowl of candies is passed around the room. Unwrapping the candy requires fine motor skills which many older people have lost or are losing. After some more discussion about the difficulty encountered, students are equipped with industrial safety glasses previously sprayed with soap and sawdust. The glasses simulate

impaired vision experienced by older people. Then students are asked to use computers located in the classroom to find and record information from the internet. After the exercise a discussion of the difficulties is lead by the faculty. Students are asked to think about what could be done to make the task easier. Students may learn why older people do not like small gadgets and find surfing the internet frustrating not fun. Next students are provided with industrial ear protection. The students are asked to complete a task requiring communication and cooperation. The one that worked well for students was having them use their cell phone and attempt to email their faculty members.

On the second day of class the students are fitted with the equipment listed above and given several in class projects to complete. The one that seemed to be the most eye opening was sending them across the campus in pairs with walkers, wheel chairs, crutches and other mobility aids to get a cup a drink at the café. It is important to point out that participation in all activities is voluntary. The goal is to allow students to experience what aging might be like.

Students were encouraged to take their own gloves, glasses, and ear plugs, home so that they can experiment safely trying all kinds of things.

Some of the things that students are encouraged to try at home are:

- Buttoning Buttons
- Flossing your teeth (heart health)
- Putting pills in boxes
- Fastening and unfastening jewelry clasp
- Lacing shoes
- Zippping garments
- Eating a meal with family (safety)

In class students will try and develop a longer list. This is added to by conversations with older family members. In fact, students are invited to bring people of their grand parent's generation. These activities are fun and intended to open students' minds to the many unmet needs of a large population. In the next class students brainstorm product ideas to meet the unmet needs identified.

### **Opening the Opportunity Box**

The fun begins when class resumes and the students begin an ideation process to develop product ideas. Students are encouraged to bring friends and family to the ideation session. The authors have found in other classes that diverse participants improve the number, quality and diversity of the ideas generated. What would it be like to have some grandparents or great grandparents join in the educational process? How many ideas would they help generate? What would the internal reward be to the student who would bring a grand parent?

In the ideation session students will be encouraged to freely think up ideas no matter how simple, how seemingly ridiculous. It does not matter. The class starts the process with some of the things learned directly from the aging experience. Then it will progress into ideas for product modifications focusing on some products, for example, cell phones, stoves, automobile sound systems, and so forth.

After the ideation is well underway and many opportunities have been considered then the faculty leader will take volunteers from the class to expose their product idea to the active minds and see what happens.

### **SO WHAT DOES ALL THIS MEAN?**

These three ideas are small set of many that the authors developed working across the disciplines in entrepreneurship. There must be many more ideas to be borrowed and shared at every school. Are you ready to let entrepreneurship be the catalyst?

The Product Presentation Board is a class tool that can bring to life the product or the project. Power points are nice and living without today's amazing technologies would be difficult. These classes reside basically on the web. However, are multicultural consultants and our colleagues with expertise in learning styles have persuasive arguments that the visual learner needs a tool where they can see and grasp the whole product. The Product Presentation Board is an attempt to fill that need. Do you have students who could learn more if they were provided such a visual aid? Do you have employees who would understand more or make better presentations if they had a visual tool like the Product Presentation Board?

The Source Book is a creative tool for everyone. It is of particular help to the hands-on and the visual learners but it is good for everyone to use for collecting ideas. Could you use a shot in the arm in the creativity department? Could your students use a way of collecting all their ideas so they could later go back and sort through them? Would you like to increase the creative productivity of your staff, or of your product design group? The art professor was extremely innovative and full of thought when she handed the faculty team sketch books, and showed them how to go forth and collect ideas. She recognized a way to give us results. Would the source book give your students or workers better results? Would it help you? When a student is stuck paging through the source book can help faculty ignite the fire again.

Opportunity Identification is such an important area. The faculty was stumped as to how to gently work with students and their ideas. How do you encourage them to evaluate their opportunity with their product by comparing to some other ideas? How do you gracefully allow them to change without negative connotation? How do you keep the passion for the new product process and entrepreneurship while changing the product? The answer of all places was in the College of Nursing. The exercises developed allow for a wide range of products, product modifications and evaluations. Could this contextual experience help your students develop better products? Could your work force develop products to meet the needs faster and better with contextualized situations like this?

**Entrepreneurship does span the curriculum and there is synergy to be had.**

Thank you USASBE and other organizations that pull people together who are pioneers in looking beyond their disciplines. Thank you to nameless meal companions at USASBE 2004 who challenged us to look at our colleagues in Nursing, Art, Multi

Cultural Affairs, Writing, Psychology, Communications, Law, and so many more areas. You set us out on a course that has taken on its own life.

Entrepreneurship does have the ability to span the curriculums of many areas. There is much to be learned in an entrepreneurial spirit by consulting those in other disciplines. There is much that can help to guide the wonderful excitement and passion of young entrepreneurs to be found outside the business and engineering schools. Some of this can be imported back for regular use in other courses. With one small grant and sixteen days with colleagues the authors are overwhelmed with ideas and materials. What would happen if this was repeated with more disciplines at more schools? Imagine the inclusiveness that could be Entrepreneurship.

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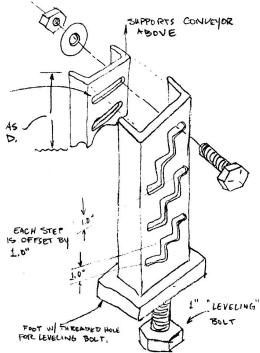
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|--|--|--|
| <p><b>What is the product?</b></p> <p>Product Description:</p>                                       | <p><b>What does it look like?</b></p>  | <p><b>How is it made?</b></p> <p>Materials:</p> <p>Processes:</p>                                  |
| <p><b>Who will buy it?</b></p> <p>Groups:</p> <p>Attributes of members:</p>                          | <p><b>Mission &amp; Vision</b></p> <p>Mission:</p> <p>Vision:</p>  | <p><b>What do others think?</b></p> <p>Key Questions:</p> <p>Statistics:</p>                       |
| <p><b>Who is the competition?</b></p> <p>Competitor 1:</p> <p>Competitor 2:</p> <p>Competitor 3:</p> | <p><b>What is the need?</b></p> <p>Benefit 1:</p> <p>Benefit 2:</p> <p>Benefit 3:</p>                                    | <p><b>How will it get to the customer?</b></p> <p>Method 1:</p> <p>Method 2:</p>                   |
| <p><b>What makes my product different?</b></p> <p>Groups:</p> <p>Attributes of members:</p>          |  | <p><b>What are the next steps?</b></p> <p>Objective 1:</p> <p>Objective 2:</p> <p>Objective 3:</p> |

Exhibit 1. The Project Presentation Board

# **DOWNSIZING, MIDDLE MANAGERS AND THEIR DESIRES TO START ENTREPRENEURIAL BUSINESSES**

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## **ABSTRACT**

The effect of downsizing on middle managers was studied, with the purpose of measuring the desire of middle managers to start entrepreneurial businesses, and to determine whether desire was influenced by the phenomenon of downsizing.

Research considered the effects by examining attitudes of middle managers in companies that have been and have not been downsized. The findings suggest that downsizing is related to other factors, specifically morale and desires to start entrepreneurial ventures.

The study examined 129 middle managers, and separated the findings between those who have and who have not experienced downsizing. Results suggest that entrepreneurial desire increases with age, especially for those over 50 who have experienced downsizing.

## **INTRODUCTION**

An increasing trend in American and European corporations is the phenomenon of downsizing (sometimes related to terms such as cost cutting and mergers) to remain competitive and responsive to industry trends. McKinley and Mone (McKinley, W. & Mone, M. A., 1998) noted that organizations have implemented downsizing as a means of cost containment, especially when faced with financial crises. Indications are that downsizing is now perceived as a way for healthy organizations to become more productive and efficient. These environments require significantly greater corporate speed and efficiency (D'Aveni, R. A., 1994). Downsizing is recommended as a way to create organizations that are more productive and flexible (Hammer, M. & Champy, J., 1993). Some of these studies suggest that there is an increase in the number of middle managers leaving their positions to start entrepreneurial businesses. It appears that downsizing might have some direct impact on the desire of people to start their own businesses.

Remaining employees must develop flexibility and adaptability to survive (Dunford, R., Bramble, T., & Littler, C. R., 1998).

According to Kozlowski, Chao, Smith, and Hedlund (1993), downsizing is a "deliberate organizational decision to reduce the workforce that is intended to improve organizational performance" (p. 267). Research suggests that the benefits include improvements in quality, and increased efficiency and productivity (Freeman & Cameron, 1993; Tomasko, 1990). But, there is



considerable evidence that downsizing does not reduce expenses as much as desired, and that expenses may actually increase. A survey by Slocum et al. indicated that companies using restructuring as a method of achieving superior financial performance did not outperform companies in their industries (Slocum, Morris, Cascio, & Young, 1999).

Tomasko (1992) noted that only one-fourth of the firms that downsized achieved these benefits. Downsizing is now viewed as having unintended negative consequences for staff personnel, managers, and the organization as a whole (Cameron, 1994; Cascio, 1993; Kozlowski et al., 1993).

## **PROBLEM BACKGROUND AND PURPOSE OF THE STUDY**

Little research was found that specifically examined employee attitude towards outcomes of downsizing such as future employment within the company, with another company, or in starting entrepreneurial ventures. Even less was found that specifically focused on middle managers. Specifically, the purpose of the study was to explore how middle managers are affected by such efforts, and the associated stress and morale problems that may occur. The purpose of the study examined possible and potential reasons why middle managers are leaving their current positions, and how those reasons may be related to their desire to start entrepreneurial businesses. This study further examined the desire of middle managers to leave and start their own businesses, and how that desire might be affected by morale, stress, and other related demographic variables.

## **RESEARCH QUESTIONS**

In light of the purpose of the study and the statement of the problem, a number of research questions were posed by the present study. These are stated as follows:

1. For middle managers, is the desire to start an entrepreneurial business influenced by the phenomenon of downsizing, while controlling for morale, stress, and related demographic variables (age, gender, marital status, and race?)
2. For middle managers, is the desire to start an entrepreneurial business influenced by morale?
3. For middle managers, is the desire to start an entrepreneurial business influenced by stress?
4. For middle managers, is the desire to start an entrepreneurial business influenced by related demographic variables (age, gender, and marital status?)

## **LIMITATIONS AND ASSUMPTIONS**

Note should be made of several limitations within the present study. First, the sample of the study was limited to only middle management employees. The adult student population of a major university provided the subject sample and is comprised of adults who are returning to college during mid-life to work towards higher-level positions requiring further education. University records indicated that the majority of these students were employed in middle management positions, most similar in size. The questionnaire was also administered to a group of middle managers who were not attending college classes, but who were on the campus for a

corporate-sponsored sales and management training seminar during the Summer. There were two major companies participating in this study, in addition to the adult students on campus attending regular classes. All of the participants in the present study were middle managers.

## **RESEARCH APPROACH**

The research was accomplished through dissemination of a survey questionnaire instrument to a sample. Quantitative research data was collected, employing a survey, regarding the perceptions of middle managers' levels of morale, job-related stress, and desire (or motivation) to leave the corporate environment to start an entrepreneurial business, under downsizing, or about to be downsized, conditions.

Comparisons were made between middle manager respondents who have and have not been employed in organizations that have downsized or are about to downsize.

## **RESEARCH STEPS**

The research used a cross-sectional analysis design. Six steps comprised the method of the study, which will be discussed in greater detail in following sections:

1. The sample is defined.
2. The procedure for collecting data from two research groups (middle managers with experience of downsizing and middle managers without experience of downsizing) is discussed.
3. The survey instrument (MAQ) is described, and reliability and validity testing are discussed.
4. Hypotheses are proposed.
5. Statistical analyses are discussed.

## **DESCRIPTION OF THE SAMPLE**

The targeted sample of the study consisted of 200-300 middle management personnel drawn from an adult university population. The actual sample size used was 129. The survey instrument was administered to another sample of middle managers who were on the same campus, but were not college students, and they fit the profile of middle managers needed for this study.

## **THE RESEARCH INSTRUMENT**

A survey questionnaire, the *Managerial Attitudes Questionnaire*, (MAQ), was specifically designed by this researcher to collect data pertinent to the attitudes of middle managers concerning such issues as downsizing, the desire to start an entrepreneurial venture, morale, stress, and related demographic variables. The instrument was tested for reliability and validity.

Reliability was established using coefficient Alpha as a measure of internal consistency of the instrument, after the data were collected.

## **HYPOTHESES**

For the purposes of statistical analysis, the research questions, were combined, translated into hypotheses, and presented in the null form.

Null Hypothesis 1: For middle managers, the desire to start an entrepreneurial business is not related to downsizing when controlling for morale, stress, and demographic variables (sex, age, marital status, and race).

Null Hypothesis 2: For middle managers, the desire to start an entrepreneurial business is not related to morale.

Null Hypothesis 3: For middle managers, the desire to start an entrepreneurial business is not related to stress.

Null Hypothesis 4: For middle managers, the desire to start an entrepreneurial business is not related to demographic variables (sex, age, marital status, and race.)

## **DATA ANALYSIS**

The statistical tool chosen for analyzing Hypothesis One was ANCOVA (Analysis of Covariance). This procedure tested for differences in the means between the two groups examined. The analysis examined the differences in the desire to start an entrepreneurial business. In addition, it tested for the differences after the means have been adjusted for any difference in stress, morale, and the related demographic variables.

The study adjusted the mean desire for the group who has experienced downsizing versus the group who has not experienced downsizing, as if they had the same morale, same stress, and same demographics.

The statistical test for Hypotheses Two and Three utilized correlation to determine the relationship.

The statistical test for Hypothesis Four used One-Way ANOVA (Analysis of Variance) to see if there was a difference in the averages.

## **HYPOTHESES RESULTS**

H1<sub>0</sub>: For middle managers, the desire to start an entrepreneurial business is not related to downsizing when controlling for morale, stress, and demographic variables (sex, age, marital status, and race).

H2<sub>0</sub>: For middle managers, the desire to start an entrepreneurial business is not related to morale.

H3<sub>0</sub>: For middle managers, the desire to start an entrepreneurial business is not related to stress.

H4<sub>0</sub>: For middle managers, the desire to start an entrepreneurial business is not related to demographic variables (sex, age, marital status, and race).

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Figure 1 about here

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Figure 2 about here

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*Figure 1.* Adjusted means for desire to start one's own business (grouped by marital status and gender).

*Figure 2.* Adjusted means for desire to start one's own business (grouped by marital status and age).

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Figure 3 about here

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*Figure 3.* Adjusted means for desire to start one's own business (grouped by experience with downsizing and age).

Of interest was the fact that this difference was not as great for those managers who are separated. The second figure shows a decreasing trend in entrepreneurial desire among single managers as they grow older. Married and singles generally had greater entrepreneurial desire. The third interaction (Figure 3) indicates that, for all age groups (except those over 50), managers who have not had experience with downsizing had greater entrepreneurial desire. Managers over 50 who had experienced downsizing, however, indicated greater entrepreneurial desire. The managers who had not experienced downsizing tended to show less entrepreneurial desire as they aged. For those who have experienced downsizing, entrepreneurial desire increased in the 50+ age group.

## **SUMMARY, CONCLUSIONS, AND RECOMMENDATIONS**

Previous portions of the investigation presented modular components of the study. The purpose of this section is to bring together these separate components into a unified whole. The following portion presents conclusions based on the findings. The final section concludes with recommendations for future research.

### **CONCLUSIONS**

1. Findings showed that downsizing could have a positive side and could be the reason why the morale of downsized respondents increased with age.
2. The study also concluded that research linking downsizing effects on managers with increased stress, decreased job satisfaction, and morale needs to take other factors into consideration.
3. When the morale, stress, and demographic variables were controlled, there was no significant difference in entrepreneurial desire between those who experienced downsizing and those who did not. Entrepreneurial desire did decrease with age for those who had not experienced downsizing, but increased with age for those who had been downsized.

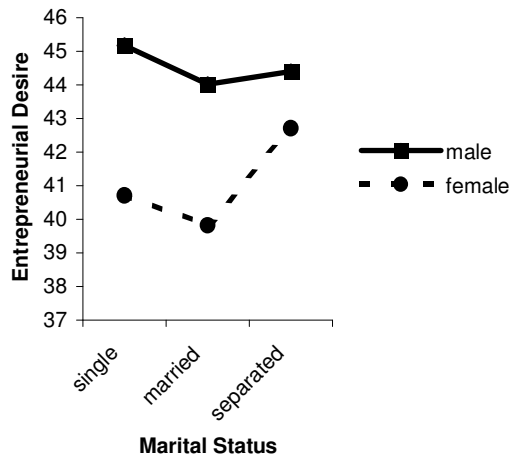
### **RECOMMENDATIONS**

1. To support the empirical findings of the present investigation, future research should conduct follow-up studies, in regard to a broader sample size and diversity, and number of factors associated with the psychological, physical, and cognitive effects of downsizing.
2. Replication of the present investigation should be made at future intervals in an effort to empirically detect changing trends related to age, morale, and the desire of downsized middle managers to start their own entrepreneurial businesses.

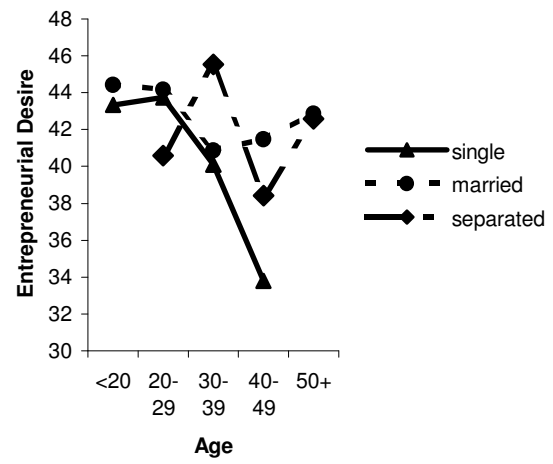
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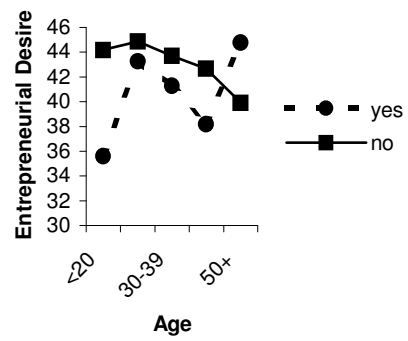
**Figure 1**



**Figure 2**



**Figure 3**



## **HETEROGENEITIES IN ENTREPRENEURIAL PERCEPTIONS: DOES PREVIOUS LINE EXPERIENCE MATTER?**

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### **ABSTRACT**

Entrepreneurship theories often focus on entrepreneurial individuals, environment where entrepreneurs are found, or some combination between the two. Researchers are still trying to put pieces of puzzles together to construct a unique domain of understanding entrepreneurship and its impact on our economy. Starting a new venture is often more complicated and challenging than entrepreneurs and their families have imagined, while entrepreneurs' perceptions on personal goals, business performance, and family issues need more exploration. This article presents results of an on-going study to explore the differences and hierarchical structures of entrepreneurial perceptions related to impacts of starting and managing new manufacturing ventures on entrepreneurs and their families in the United States, by comparing those entrepreneurs who have previous line experience to those who do not. The findings uncover different levels of assessment in personal, business, and family objectives before and after new venture formation. Those entrepreneurs with previous line experience reveal more conservative expectations before embarking in new ventures, which also yield more satisfactions after starting businesses. While personal characteristics seem to be common among all entrepreneurs, financial goals and family welfare are valued at different levels between experienced and inexperienced entrepreneurs. Ultimately diverse entrepreneurial perceptions lead to various learning procedures that entrepreneurs would apply to modify decisions of future new venture formation.

### **INTRODUCTION**

A common argument usually exists between parents and children: "Child, I just know your decision is wrong, because I have been there and done that!" It seems natural to assume that someone with previous experiences in any event would understand this event and its associated consequences better, either to avoid reoccurring errors or to recapture glories. But will this assumption hold when we deal with entrepreneurs in all perspectives and all developmental stages? Researchers have argued about different approaches to formulate entrepreneurship theories based on some necessary, may not be sufficient, conditions to define entrepreneurship from either personal characteristics about who she/he is, or business actions oriented by exogenous factors such as environment and opportunities (Shane & Venkataraman, 2000). It is critical to distinguish the studies of entrepreneurship from other economic theories, due to the complexity of understanding entrepreneurship. Researchers recognized the lack of a unique conceptual domain in entrepreneurship theory, and previous studies seemed to have two



divisive views in the field of entrepreneurship – either to focus on individuals who are “entrepreneurs”, or to focus on external forces that support that creation of the entrepreneurship (Shane, 2003). This paper presented results of an on-going study to explore entrepreneurial perceptions related to business decisions and family issues, as an attempt to contribute to the discovery of a unique domain of entrepreneurship theory.

More specifically this paper provided discussions of the potential heterogeneities existed in manufacturing entrepreneurs’ assessment of the impact of the new venture creation on business objectives and family relationship, by comparing those entrepreneurs with previous line experiences to those entrepreneurs without previous line experiences. The review of literature found very few studies that examined the impact of new manufacture venture creation on entrepreneurs by comparing those with experience in the line of business to those without (Liang & Dunn, 2002; Liang, 2002). Some questions remain undiscovered in other literature - Are there differences between experienced and inexperienced entrepreneurs in the perceptions and decisions of the new venture creation? What are the feelings and expectations of experienced and inexperienced entrepreneurs and their families before they start the new venture? How does the new venture impact family relationships given some entrepreneurs have more experiences than others? Do entrepreneurs and their spouses realize the same reality as the results of the business given some entrepreneurs have more experiences than others? These are a few questions that this article would explore and hope to build a bridge between individualization theories and outcome based theories in other entrepreneurship studies.

The results of this exploratory study will be presented in two ways. First, entrepreneurs’ perceptions on business performance will be discussed based on the survey results from manufacture entrepreneurs in the United States. Some comparisons in personal profiles and in business profiles will be discussed between entrepreneurs who have line experience and those without. Second, heterogeneities of entrepreneurs’ perceptions on business decisions and family relationships will be discussed and compared between entrepreneurs who have line experience and those without. These results would be beneficial to other researchers and professionals who work closely with entrepreneurs and their families and attempt to better understand personal and family issues. Several assumptions need to be introduced in this study: (1) the focused businesses in this study are “new ventures” that have high potential in job creation and wealth accumulation from the societal perspective, instead of “micro-businesses” that are generally defined as small scales in operation or organization (Friar & Meyer, 2003). (2) Wealth creation, sustainable profitability, personal satisfaction, and family welfare are simultaneously valued by entrepreneurs, not necessarily in any particular ranks or with equal share of the importance. (3) Both “entrepreneurial individuals” and “environment in which entrepreneurs have been found” contribute to the success or failure of the new venture creation, so as to the entrepreneurs’ perceptions of success or failure.

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 would 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 relationship, this article hopes to present some outcomes that would be interested by 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 (Glaser & Strauss, 1967).

## REVIEW OF THE LITERATURE

There seemed to be three different approaches in studying entrepreneurship – individual-centric approach that focuses on entrepreneurial people themselves; environment-centric approach that examines situations in which entrepreneurial activities is more likely to occur; and individual-opportunity nexus that examines the characteristics of opportunities, the individuals who discover and exploit them, the processes of resource acquisition and organizing, and the strategies used to exploit and protect the profits from those efforts (Shane, 2003). There has been limited discussion about the interactions between entrepreneurs and their family members in previous theories. In reality, entrepreneurs usually start new ventures based on their own assessment of the situation, may or may not consult and involve their spouses and children in the planning, start up and management process. The family's assessment of the new venture possibilities is usually based on trust in and feelings for the entrepreneurs (Liang, 2002; Liang & Dunn, 2002). As a result of potential variations in perspectives, entrepreneurs with the tacit consent of their families could expose themselves and their families to a future that they might not anticipate.

The typical list of entrepreneurial traits include high achievement drive, action orientation, an internal locus of control, a tolerance for ambiguity, calculated or moderate risk taking, and entrepreneurial commitment, optimism, opportunism, initiative and independence, personal values, work experience, family background, education and some or all of these. (Stevenson, Grousbeck, Roberts, & Bhide, 1999; Longenecker, Moore, & Petty, 2000; Scarborough & Zimmerer, 2000; Bhide, 2000; Bygrave, 1999; Kuratko & Hodgetts, 1998; Vesper, 1996; Hodgetts & Kuratko, 1995; Timmons, 1999; Jennings, 1994; Lambing & Kuehl, 1997; Liang & Dunn, 2002; Liang, 2002). The motivation of entrepreneurs examined in other studies include the desire for control over their lives/independence, profits/financial rewards, enjoy what they are doing, achieve their personal goals and recognition, to make a difference/contribute to society (Stevenson, Grousbeck, Roberts, & Bhide, 1999; Longenecker, Moore, & Petty, 2000; Scarborough & Zimmerer, 2000; Bhide, 2000; Bygrave, 1999; Kuratko & Hodgetts, 1998; Vesper, 1996; Timmons, 1999; Liang & Dunn, 2002; Liang, 2002). Pinfold (2001) discovered that entrepreneurs, optimistic as they were, probably overestimated their chances of success and expected rate of return. In addition, he concluded that financial incentives were ranked fourth in motivation. Entrepreneurs ranked employment, independence, and family and community welfare above “instrumentality of wealth.” (Pinfold, 2001) These studies primarily focused on the entrepreneurs – who they are and what they are like, yet failed to link the personal traits to consequences of business decisions in new venture creation.

There is some literature that discusses the impact of starting and early stage development on the entrepreneurs and their families (Liang, 2002; Liang & Dunn, 2000). Some literature discusses the negative side of entrepreneurial behaviors from the family's perspective, such as lose of quality time, uncertain or lower income, risk of loss of family financial resources, long hours and hard work, lower quality lifestyle, high stress, and overwhelming responsibility (Liang, 2002; Longenecker, Moore, & Petty, 2000; Scarborough & Zimmerer, 2000; Hodgetts & Kuratko, 1995). Older entrepreneurs have more difficulties in starting as a result of marital obligations, children, mortgages, car payments, and a good current source of income (Bygrave, 1999). Often entrepreneurs must choose between business and family obligations and interests. However there has not been enough information to show how experienced entrepreneurs deal

with the intertwined relationship between businesses and family issues compared with inexperienced entrepreneurs.

Watson (2003), in a study of discontinuances among male and female owned SME firms in Australia, discovered that discontinuance rates among manufacturing and other more technical and higher capitalization firms might be lower because they had to spend more preparation time required to get the needed financial and other collaborative support needed to start. If that is true, manufacture entrepreneurs with experience in the line of business should have a better match between expectations and reality. Career experiences, general business experiences, functional experiences, industry experiences, and start-up experiences all contributed to some forms of information development, skill development, and exploitation of entrepreneurial opportunities (Shane, 2003). These different varieties of experiences would assist entrepreneurs to develop information and skills that facilitate the formulation of the entrepreneurial strategies, the acquisition of resource, and the process of organizing (Shane, 2003). Various studies in the United States and other countries also agreed that these experiences would reduce uncertainty in new venture creation process, reduce the likelihood of failure, increase a person's intention to start a business, increase new venture performance, and improve the potential for growth and expansion of the businesses (Shane, 2003). It seems that any experiences in previous career and business functions would lead to a more prosperous future for entrepreneurs. However there has no sufficient information to relate the "factor of experiences" to the "factors of expectations, reality, and learning" in new venture creation theories.

To summarize, previous studies provided a rich background of this study that identified several critical variables in studying entrepreneurship – personal traits, cognition, and economic and non-economic factors influencing entrepreneurial decisions. This study was designed to further understand and explore the impact of experience in the line of business on manufacturing entrepreneurs' expectations, reality, and learning from starting and early stage development of their new ventures.

## **MAILED SURVEY AND SAMPLE**

A probability sample of 1009 manufacturing 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, 2000. This database has been commonly utilized by the Small Business Development Centers and other institutions to study entrepreneurship development in the United States. The questionnaire was developed, pre tested, and revised for data collection. There were two kinds of measurements used to gather entrepreneurs' responses – (1) one was a "level category" such as years of experience in the line of business versus no experience in the line of business, male or female, or white or minority; and (2) the other was "perceptive category" where entrepreneurs could either agree or disagree with specific statements, such as "I was optimistic before starting the business", or "My family would support me to start a new venture again".

Four sets of questions were asked in the questionnaire. The first set of questions was to determine the business situation such as business location, sales, profits, and costs and the entrepreneur's demographics such as age, gender, marital situation, business experience, and family involvement. The second set of the questions asked about the "entrepreneurial drivers" or "expectations" before starting – for example, how they started the new venture, their financial expectations, their expectations in sales and profits, their expected goals and achievement, their perceptions of expectations of family members, and their expectations of personal and family

happiness. The third set of the questions was to determine the entrepreneurs' perceptions of the "consequences" or reality as a result of starting the businesses - for example, their perceptions of real sales and profits, their perceptions about the reality of working together, and their perceptions of personal and family happiness after starting the new ventures. The last set of the questions related to the "learning experience" including changes in business strategy or tactics and if they would start again, and their expectations of family support in future ventures.

The survey was designed for the entrepreneurs to answer only. There was no expectation that family members would respond because family members might not live in the business addresses for manufacturing businesses, where the questionnaires were mailed to in 2002. The responses reflected the owner's personal view regarding her/his personal perceptions for themselves, their spouse, and children. From the 1009 questionnaires mailed to manufacture entrepreneurs, 258 were returned as not deliverable. One hundred thirty-seven completed manufacture questionnaires were returned. This resulted in a 14 percent response rate

Here is a summary of the sample profile: out of 137 respondents - 107 people were male and 27 were female; 120 people were white and 13 were non-white; 82 businesses were in urban area and 49 were in rural area; 102 people were married with children; 61 people had not worked with spouses in businesses and 53 had spouse worked in businesses either full-time or part-time; 71 people had not worked with children in businesses and 38 had children worked in the businesses either full-time or part-time; 51 businesses had less than 5 paid employees and 69 had more than 5 paid employees other than family members; 42 people started business less than 5 years and 83 had been in businesses for more than 6 years; 65 people used personal savings to start businesses and 66 used other fund. Notice that the summation of each category may not add up to 137 due to missing values.

### **LINE EXPERIENCES RELATE TO ENTREPRENEURS' PERCEPTIONS OF BUSINESS PERFORMANCE**

More male respondents (88 percent of 83 people who had previous line experience) had line experience than female respondents, and those with line experience tended to use personal savings and loans more than those without line experience. White respondents (91.6 percent of 83 people who had previous line experience) tended to be more likely to have line experience, as did urban respondents (66.7 percent of 83 people who had previous line experience), younger entrepreneurs (57 percent of 79 people who had previous line experience) and those with less full-time employees (39.7 percent of 78 people who had previous line experience).

Out of 76 respondents who had previous line experience, 90.8 percent had at least one year operational experience in other businesses while 9.2 percent did not have any operational experience at all. Out of 72 respondents who had previous line experience, 75 percent had more than one year of managerial experience in other businesses and 25 percent did not had any managerial experience. It would not be a surprise to know that those respondents with line experience had more managerial and operational experiences. However it was interesting to discover some manufacture entrepreneurs did not have any line experience and did not have any other operational or managerial experiences at all before they started the new ventures.

If experience matters, certainly having more managerial and operational experiences should make a difference among entrepreneurs in their expectations and performance of the new ventures. Most of our sample entrepreneurs with line experience did not think that their sales and profits were higher than expected (70 percent to 80 percent of 83 people who had previous

line experience). The actual sales were higher for those with previous line experiences with 55.4 percent of 83 people who had previous line experience earning more than \$500,000 annually. Ninety percent of respondents of 83 people who had previous line experience believed that their businesses were up and running well, while only 76.5 percent of the respondents out of 51 people who did not have line experience believed that their businesses were up and running well. Interestingly, at least 50 percent of respondents thought starting the business was harder and took longer than they had expected, no matter they had line experience or not.

Out of 80 respondents who had previous line experience, 71.3 percent expected to be happier before starting the new ventures. Sixty-four percent of the 47 respondents who had no previous line experience expected to be happier before starting the new ventures. After starting and running the new ventures, 88.9 percent of 81 respondents who had previous line experience believed that they were happier and 76.5 percent of 51 respondents who had no previous line experience agreed that they were happier. Those with line experience seemed to have more confidence regarding personal happiness and more were personally happier. Two-thirds of our respondents expected their families to be happier, and an even larger portion (72.6 percent of 73 people) of those who had previous line experience felt their families were actually happier as a result of starting the new venture compared with those without line experience.

Eighty-six percent of respondents, with line experience or without line experience, indicated that their income was good before starting the new ventures. A significantly larger proportion of those without experience, 80.4 percent of 51 respondents, expected the new ventures to improve personal financial situations before starting. Fewer respondents with line experience (72.2 percent of 79 respondents) expected new ventures to improve their personal financial situations. Interestingly 64.9 percent of 77 respondents with line experience versus only 34.7 percent of 49 respondents without line experience agreed that their family income was better after starting the new ventures. What was even worse showed in the personal financial goals – only 46.9 percent of 49 respondents who did not have any line experiences agreed that their personal financial goals were achieved after starting and running the new ventures. It was possible for those without line experience to have higher expectations about being financially better off, therefore inexperienced entrepreneurs revealed less satisfaction in reality.

## **LINE EXPERIENCES RELATE TO ENTREPRENEURS' PERCEPTIONS OF FAMILY RELATIONSHIPS**

Literature had discussed the relationship between new venture creation and quality of life for entrepreneurs and their families (Liang, 2002). One of the motives for entrepreneurs to start businesses was to improve families' wealth and welfare. According to our sample, approximately 60 percent of the respondents, either with or without line experiences, hoped the new ventures to improve the welfare of the families. Entrepreneurs with line experience, 62.9 percent, concurred that their families felt better off compared to those without line experience, 46.9 percent. Even though most entrepreneurs with line experience felt positively about starting the new venture, 37.1 percent felt their families did not feel better off. The new ventures obviously did not excite most of the family members of inexperienced entrepreneurs in our sample. This data seemed to indicate that entrepreneurs with line experience had a better match between expectations and reality than entrepreneurs without line experience.

Given some negative feedback of the new venture creation from our sample related to business performance and welfare, what was the further impact of starting the new venture on

family relationships? Almost 60 percent of 75 respondents with line experience revealed that they had less time for themselves, and 47.3 percent of 74 respondents with line experience felt that they did not spend enough time with their spouses. Interestingly less inexperienced respondents reported that they did not have time for themselves (52 percent of 50 people) and did not spend enough time with their spouses (35.6 percent of 45 people). Over 55 percent of the respondents, either with or without line experiences, still believed that they had spent enough time with their children.

Those without line experience were more likely to feel that the new venture had no effect on their marriage (64.6 percent of 45 respondents), compared to those with line experience (56.2 percent of 73 respondents). The specific impact on their marriage tended to indicate that while entrepreneurs with line experience had some problems in their marriage, those without line experience seemed to be more optimistic about their marriage situation. While answering if they would start new ventures again, the responses were extremely positive from everyone, regardless with or without line experience. Our sample entrepreneurs had revealed many negative perceptions in new venture creation - lower sales, lower profits, more challenges in start-up process, unfulfilled personal and families' dreams, and less satisfying experiences in quality of life. Most respondents, however, would start again and almost 90 percent felt their families would still be supportive.

### **LINE EXPERIENCES RELATE TO ENTREPRENEURS' PERCEPTIONS OF ENTREPRENEURIAL LEARNING**

Entrepreneurial learning has been discussed in recent literature (Liang, 2002) and still needs more attention to be included in the entrepreneurship theories. Entrepreneurs learn from both success and failure, while failure might lead to a more dramatic perspective change in future venture decisions and strategies. When asked what they would do differently, our sample respondents with line experience tended to be more inclined to have more cash, followed by writing a better business plan, and getting more training in business skills. Those without line experiences, on the other hand, were more inclined to have more cash, better define target market, prepare for a better business plan, and conduct more research about their market. Surprisingly only 3.9 percent of the inexperienced respondents would not involve family members in the venture process, while 12.2 percent of experienced respondents would not involved their families if they were to start again. A large portion of both groups would involve their families in the next new venture. Some literature had discussed positive interactions in entrepreneurial families that could reduce stress of work, improve communications, and share responsibilities (Liang, 2002). It seemed that our respondents highly value family's inputs and reactions in the process of new venture creation.

### **CLUSTER ANALYSIS OF ENTREPRENEURS' PERCEPTIONS**

With or without previous line experiences seemed to differently influence entrepreneurs' assessment of business performance, personal goals, and family relationship given our sample information in previous sections. Literature often discussed entrepreneurial traits and cognition that related to decision making process and business strategies (Liang & Dunn, 2001; Liang, 2002). There has little information on heterogeneities in entrepreneurial perceptions – Do entrepreneurs evaluate themselves in the same way, such as who they are and how they assess

the new venture creation process? Does it make any difference in this entrepreneurial self-assessing process whether entrepreneurs have previous line experience or not? Cluster Analysis was applied in this study to further explore any potential differences in entrepreneurial characteristics, business performance, and business decisions corresponding to personal and family evaluations. Cluster Analysis, or Grouping Technique, could provide an informal means for assessing dimensionality, identifying outliers, and suggesting interesting hypotheses concerning relationships among the variables (Johnson & Wichern, 1992). Cluster is distinct from the classification methods. Cluster analysis is a more primitive technique in that no assumptions are made concerning the similarities (or dissimilarities). There are several algorithms that can be applied to group data or observations. Our study applied Hierarchical Clustering technique which proceeded by a series of successive mergers. We started with the individual responses of entrepreneurs corresponding to each question. The most similar responses were first grouped by questions, and these initial groups were merged according to their similarities in each question calculated by Euclidean distance. The results of this merging process were displayed in the form of a two-dimensional diagram known as a “dendrogram”. A dendrogram illustrated the merging process by the relative distances between different clusters.

Our sample entrepreneurs who had previous line experiences tended to provide the most similar responses by identifying themselves as being creative and being willing to take risks. These experienced entrepreneurs also provided similar responses to questions related to wanting to be in control and to be independent (Table 1 and Figure 1). These experienced entrepreneurs seemed to have quite diverse responses to questions regarding whether business was up and running well, whether their spouses involved in businesses, and where they received the funding from to start the businesses (Table 1 and Figure 1).

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Table 1 and Figure 1 about here

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Our sample entrepreneurs who had no previous line experience before starting the business had the most similarities when responding to questions related to wanting to be in control and to be independent as the motives to start new ventures (Table 2 and Figure 2). These inexperienced entrepreneurs also showed some similar patterns in their answers to questions such as they were creative and they were willing to take risks in the process of new venture creation. Just like those sample entrepreneurs with line experiences, inexperienced entrepreneurs seemed to have various perceptions on whether business was up and running well, whether spouses were involved in the businesses, and how they acquired start up fund (Table 2 and Figure 2).

Although creativity and risk factors seemed to have the most similar perceptions to those entrepreneurs with previous line experience, inexperienced entrepreneurs were more closely to hope that the new ventures would assist them to be in control and to be independent in their career locus. These four factors – creativity, risk taking, being in control, and being independent – have been discussed extensively in previous literature. Our results agreed with other researchers, yet also revealed some discrepancies between experienced entrepreneurs and inexperienced entrepreneurs.

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Table 2 and Figure 2 about here

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Experienced and inexperienced entrepreneurs in our sample both revealed most similar patterns in their answers to questions regarding personal happiness and family happiness before they started new ventures (Table 3, Table 4, Figure 3, and Figure 4). It would be reasonable to conclude that our sample seemed to expect the new ventures to improve personal happiness and family happiness, thus these two factors were evaluated by entrepreneurs extremely closely. Another two factors that seemed to have some consistent similarities in entrepreneurs' responses, with or without line experience, were related to expectation in improvement of family welfare and family financial situation (Table 3, Table 4, Figure 3, and Figure 4). However, entrepreneurs with previous line experience also showed higher potential to have similar answers towards questions regarding pre-business income issues and personal enthusiasm of creating the new ventures (Table 3 and Figure 3). Presumably entrepreneurs with previous line experience in our sample would understand new venture creation better, and would be more enthusiastic in the new venture creation process that linked to expectations on personal/family income issues.

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Table 3, Table 4, Figure 3, and Figure 4 about here

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After having started and run the business, experienced entrepreneurs who had previous line experience revealed quite different patterns in their responses about the reality of new venture creation compared with those without any line experience according to our sample information. Those with previous line experience presented the most consistent responses in questions related to improvement in the reality associated with family income and personal/family financial situation (Table 5 and Figure 5). Entrepreneurs with line experience also had some similar responding patterns in willingness to start again and assessment of family support, also somewhat linked to personal happiness, family happiness, and time constraints in family life (Table 5 and Figure 5). Those entrepreneurs with previous line experience in our sample revealed quite diverse perceptions in issues such as optimism towards new venture creation, quality of family life, and the assessment of the challenges in start up process.

To those entrepreneurs who did not have previous line experience before starting the new ventures, they showed highly consistency when responding to questions regarding willingness to start again and family support (Table 6 and Figure 6). Personal and family happiness were the next two factors that inexperienced entrepreneurs would evaluate closely. Inexperienced entrepreneurs did not seem to assess the personal/family financial goals as consistently as experienced entrepreneurs. However time constraints, challenges in the start up process, and impacts of new venture creation on the quality of family life were also closely related according to those inexperienced entrepreneurs (Table 6 and Figure 6).

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Table 5, Table 6, Figure 5, and Figure 6 about here

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## **CONCLUSIONS AND IMPLICATIONS**

Researchers have attempted to construct various models to simulate entrepreneurial activities from either micro or macro perspectives. It might be a danger of implicitly promoting a particular business model without a comprehensive understanding entrepreneurial paths that should include individualization, environment, and organization (Quince & Whittaker, 2003). Working experiences could become an important intangible asset to entrepreneurs who decide to



develop and implement new venture ideas. Entrepreneurs who have had previous working experience could be found in high-growth ventures, where these entrepreneurs utilize their experience to nurture business decisions or to create innovative strategies that leads to continuation of growth (Friar & Meyer, 2003).

The outcomes of the new venture creation had different impacts on personal goals, family relationship, and business strategies for future ventures. According to our sample, entrepreneurs who had previous line experience tended to have some operational or managerial experiences in other businesses. These experienced entrepreneurs probably understood the process of new venture formation better, such as time constraints and personal sacrifice. Their experiences linked to more conservative expectations before they started the new ventures in personal satisfaction, family welfare, wealth accumulation, and future outlook. Eventually these experienced entrepreneurs would be more likely to realize positive consequences after starting the new ventures. For inexperienced entrepreneurs in our study, they seemed to have more optimistic expectations before starting the new ventures, expected new ventures to improve personal and family welfare, and expected new ventures to improve personal and family financial situations. However the reality of the new venture creation also brought more disappointment to inexperienced entrepreneurs. Without previous line experience, these entrepreneurs realized that the business process was more complicated than they thought, and there was a significant trade-off between business and quality of life to their families.

Our study also discovered some hierarchical structures in entrepreneurs' perceptions of personal characteristics, business performance, and family relationship. These hierarchical perceptions have been overlooked in other literature, and would deserve more expensive studies in the future. Experienced entrepreneurs in our sample had very close perceptions in creativity and willingness to take risks, while inexperienced entrepreneurs had very close perceptions in being in control and being independent. Personal happiness and family happiness were two most common factors that all entrepreneurs agreed upon before embarking in the new ventures, regardless they had previous line experience or not. However experienced entrepreneurs believed that personal enthusiasm very closely related to income that was a major indicator of business performance. More interestingly, inexperienced entrepreneurs were still very optimistic after they encountered challenges, uncertainty, and sacrifice in personal and family life – they still firmly believed that family support would continue in future new venture formation process for those who would start new businesses again. For those entrepreneurs who had line experience, they seemed to evaluate family income and other financial objectives more closely than other factors such as happiness and trade-offs between business and quality of life.

It is true that entrepreneurship theories cover a wide spectrum of underpinning subjects – existence of opportunities, discovery of opportunities, individual differences, psychological factors, decisions to exploit entrepreneurial activities, industry differences, environment, resource acquisition, strategies, organizing process, and other “white noises” in our economy. The intricacy remains in entrepreneurial world. Our study provided an example to uncover potential interactions between individual factors, business factors, and family factors; and how these interactions influenced entrepreneurs' perceptions of the process and consequences of new venture formation. Using previous line experience as one component to examine entrepreneurs' perceptions, it is refreshing to see how entrepreneurs evaluate a group of economic and non-economic factors differently. Future studies should be expanded to several industries beyond manufacturing, sample size should be enlarged, and long term studies should be established to capture any continuities (or discontinuities) across time. Does previous line experience matter?

The answer seems to be “yes” – it matters to entrepreneurs who hope to establish reachable goals, to create a more fruitful career, and to achieve the balance between business and family life.

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Table 1. Personal Characteristics - Hierarchical Cluster Analysis For Experienced Manufacturers

### Agglomeration Schedule

|       | Cluster Combined |           | Coefficient | Stage Cluster First Appears | Next Stage |   |
|-------|------------------|-----------|-------------|-----------------------------|------------|---|
| Stage | Cluster 1        | Cluster 2 |             | Cluster 1                   | Cluster 2  |   |
| 1     | 5                | 6         | 4.000       | 0                           | 0          | 2 |
| 2     | 4                | 5         | 5.000       | 0                           | 1          | 3 |
| 3     | 3                | 4         | 5.667       | 0                           | 2          | 4 |
| 4     | 3                | 7         | 13.250      | 3                           | 0          | 5 |
| 5     | 2                | 3         | 101.800     | 0                           | 4          | 6 |
| 6     | 1                | 2         | 153.833     | 0                           | 5          | 0 |

Note: The Agglomeration Schedule shows the values of the Euclidean distances, indicated by "coefficient" in the table, between two factors. Number of stages represents the number of steps to cluster observations. Numbers under cluster 1 and cluster 2 represent the specific factors that have been combined into one cluster. These factors are also labeled by their corresponding numbers in the dendrogram.

Figure 1. Personal Characteristics—Dendrogram Using Average Between Group Linkage For Experienced Manufacturers

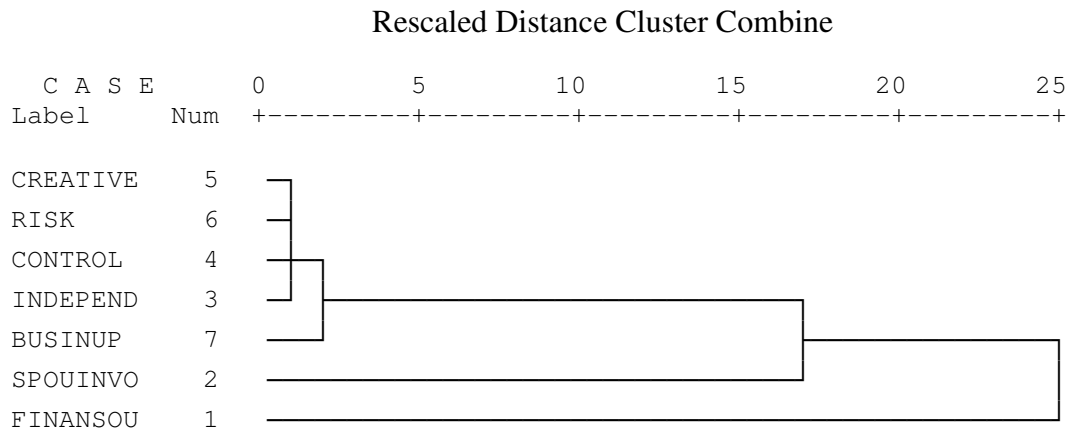


Table 2. Personal Characteristics - Hierarchical Cluster Analysis For Inexperienced Manufacturers

Agglomeration Schedule

|       | Cluster Combined |           | Coefficients | Stage Cluster First Appears |           | Next Stage |
|-------|------------------|-----------|--------------|-----------------------------|-----------|------------|
| Stage | Cluster 1        | Cluster 2 |              | Cluster 1                   | Cluster 2 |            |
| 1     | 3                | 4         | 3.000        | 0                           | 0         | 2          |
| 2     | 1                | 3         | 5.500        | 0                           | 1         | 3          |
| 3     | 1                | 2         | 9.667        | 2                           | 0         | 4          |
| 4     | 1                | 5         | 13.250       | 3                           | 0         | 5          |
| 5     | 1                | 6         | 80.400       | 4                           | 0         | 6          |
| 6     | 1                | 7         | 103.333      | 5                           | 0         | 0          |

Figure 2. Personal Characteristics—Dendrogram Using Average between Group Linkage For Inexperienced Manufacturers

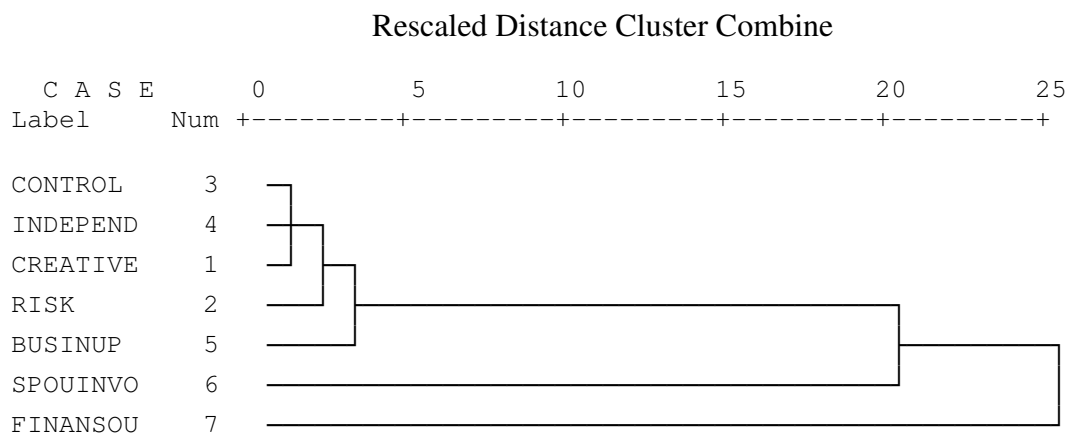


Table 3. Expectations Before Starting Businesses - Hierarchical Cluster Analysis For Experienced Manufacturers

### Agglomeration Schedule

|       | Cluster Combined |           | Coefficient | Stage Cluster First Appears |           | Next Stage |
|-------|------------------|-----------|-------------|-----------------------------|-----------|------------|
| Stage | Cluster 1        | Cluster 2 |             | Cluster 1                   | Cluster 2 |            |
| 1     | 5                | 6         | 8.000       | 0                           | 0         | 3          |
| 2     | 1                | 2         | 8.000       | 0                           | 0         | 4          |
| 3     | 5                | 7         | 9.000       | 1                           | 0         | 5          |
| 4     | 1                | 3         | 14.000      | 2                           | 0         | 6          |
| 5     | 5                | 8         | 14.333      | 3                           | 0         | 7          |
| 6     | 1                | 4         | 16.667      | 4                           | 0         | 7          |
| 7     | 1                | 5         | 20.750      | 6                           | 5         | 0          |

Figure 3. Expectations Before Starting Businesses – Dendrogram Using Average Between Group Linkage For Experienced Manufacturers

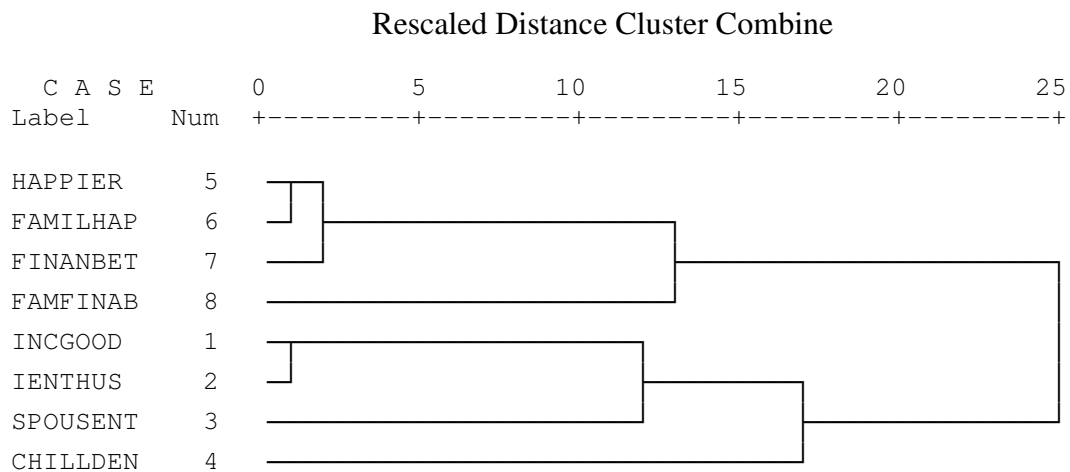


Table 4. Expectations Before Starting Businesses - Hierarchical Cluster Analysis For Inexperienced Manufacturers Expectations

Agglomeration Schedule

|       | Cluster Combined |           | Coefficients | Stage Cluster First Appears |           | Next Stage |
|-------|------------------|-----------|--------------|-----------------------------|-----------|------------|
| Stage | Cluster 1        | Cluster 2 |              | Cluster 1                   | Cluster 2 |            |
| 1     | 5                | 6         | 3.000        | 0                           | 0         | 2          |
| 2     | 5                | 7         | 7.500        | 1                           | 0         | 5          |
| 3     | 3                | 4         | 9.000        | 0                           | 0         | 6          |
| 4     | 1                | 2         | 10.000       | 0                           | 0         | 6          |
| 5     | 5                | 8         | 11.667       | 2                           | 0         | 7          |
| 6     | 1                | 3         | 14.500       | 4                           | 3         | 7          |
| 7     | 1                | 5         | 16.500       | 6                           | 5         | 0          |

Figure 4. Expectations Before Starting Businesses – Dendrogram Using Average Between Group Linkage For Inexperienced Manufacturers

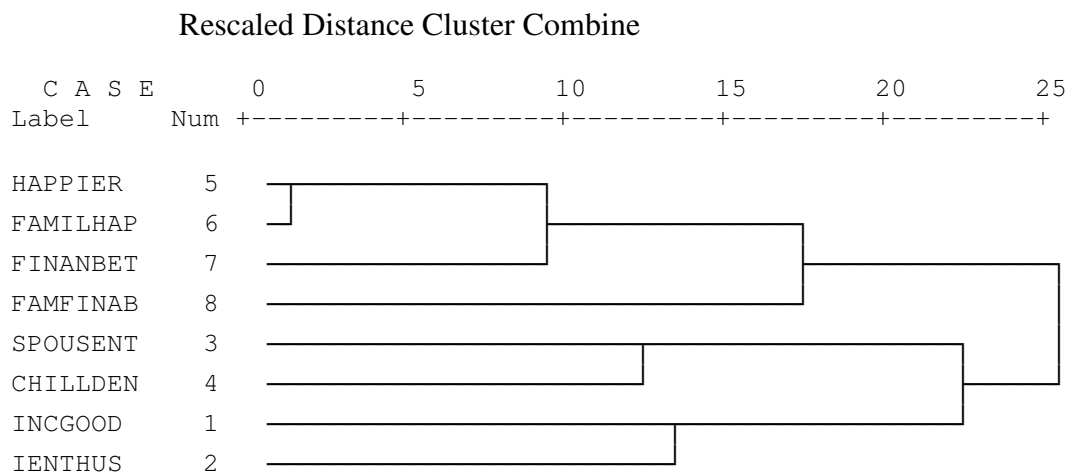


Table 5. Results After Starting A New Venture - Hierarchical Cluster Analysis For Experienced Manufacturers

Agglomeration Schedule

|       | Cluster Combined |           | Coefficient | Stage Cluster First Appears |           | Next Stage |
|-------|------------------|-----------|-------------|-----------------------------|-----------|------------|
| Stage | Cluster 1        | Cluster 2 |             | Cluster 1                   | Cluster 2 |            |
| 1     | 6                | 9         | 4.000       | 0                           | 0         | 5          |
| 2     | 11               | 12        | 7.000       | 0                           | 0         | 3          |
| 3     | 8                | 11        | 8.500       | 0                           | 2         | 7          |
| 4     | 2                | 13        | 9.000       | 0                           | 0         | 10         |
| 5     | 6                | 10        | 11.000      | 1                           | 0         | 8          |
| 6     | 4                | 5         | 13.000      | 0                           | 0         | 11         |
| 7     | 7                | 8         | 14.000      | 0                           | 3         | 8          |
| 8     | 6                | 7         | 15.833      | 5                           | 7         | 12         |
| 9     | 1                | 3         | 16.000      | 0                           | 0         | 10         |
| 10    | 1                | 2         | 20.500      | 9                           | 4         | 11         |
| 11    | 1                | 4         | 24.500      | 10                          | 6         | 12         |
| 12    | 1                | 6         | 27.476      | 11                          | 8         | 0          |

Figure 5. Results After Starting A New Venture – Dendrogram Using Average Between Group Linkage For Experienced Manufacturers

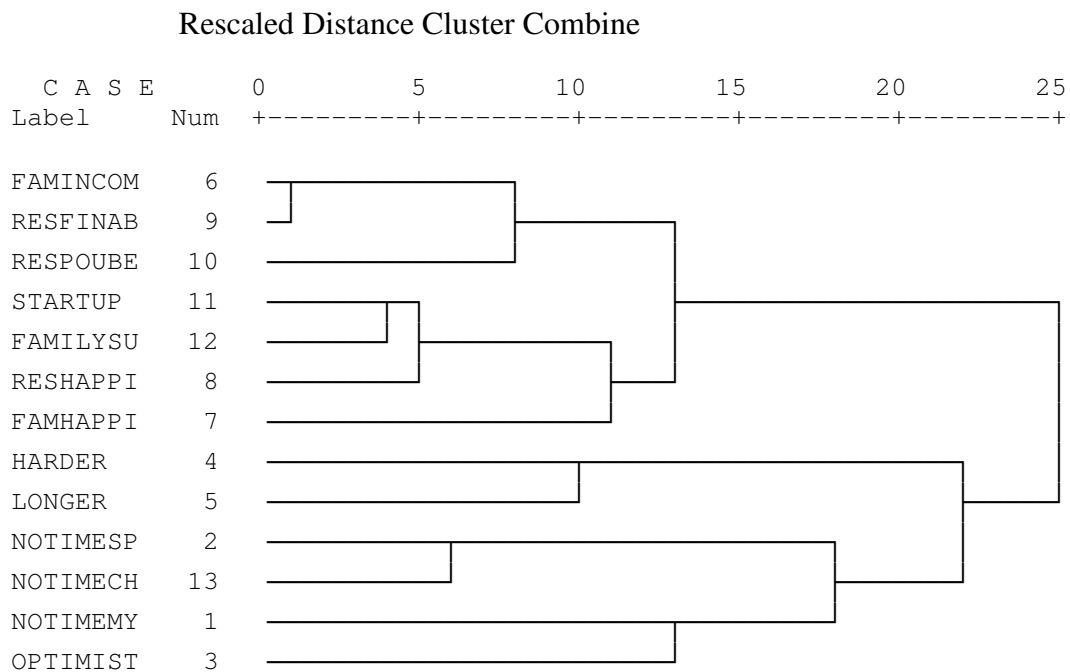
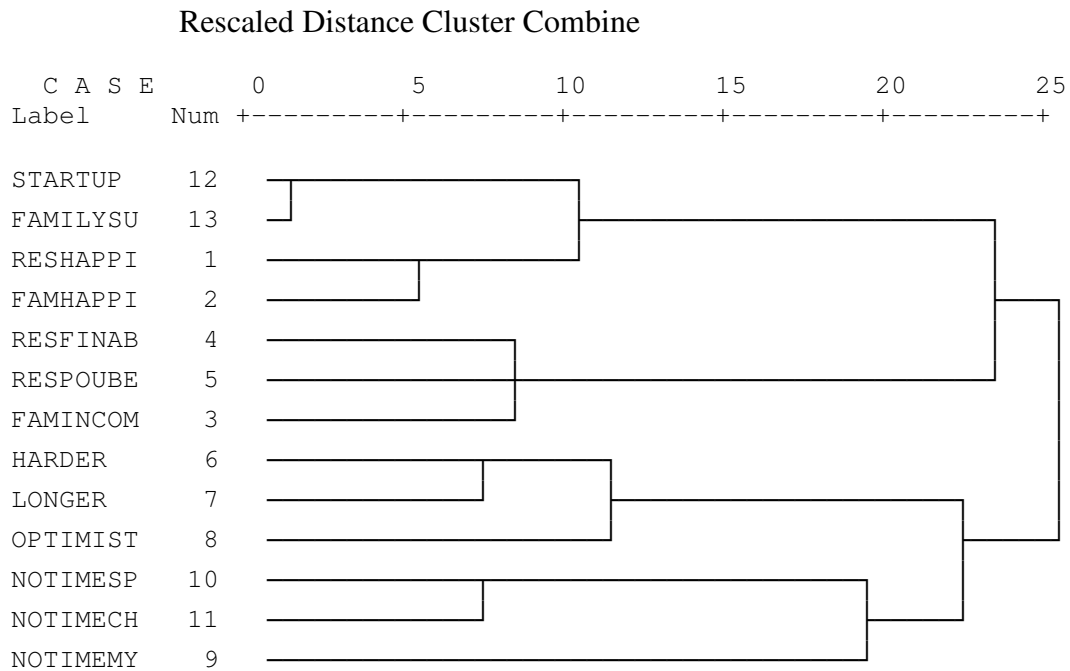




Table 6. Results After Starting A New Venture - Hierarchical Cluster Analysis For Entrepreneurs Without Experience

| Agglomeration Schedule |                  |           |              |                             |           |            |
|------------------------|------------------|-----------|--------------|-----------------------------|-----------|------------|
|                        | Cluster Combined |           | Coefficients | Stage Cluster First Appears |           | Next Stage |
| Stage                  | Cluster 1        | Cluster 2 |              | Cluster 1                   | Cluster 2 |            |
| 1                      | 12               | 13        | .000         | 0                           | 0         | 7          |
| 2                      | 1                | 2         | 4.000        | 0                           | 0         | 7          |
| 3                      | 10               | 11        | 5.000        | 0                           | 0         | 9          |
| 4                      | 6                | 7         | 5.000        | 0                           | 0         | 8          |
| 5                      | 4                | 5         | 6.000        | 0                           | 0         | 6          |
| 6                      | 3                | 4         | 6.000        | 0                           | 5         | 11         |
| 7                      | 1                | 12        | 8.000        | 2                           | 1         | 11         |
| 8                      | 6                | 8         | 8.500        | 4                           | 0         | 10         |
| 9                      | 9                | 10        | 14.500       | 0                           | 3         | 10         |
| 10                     | 6                | 9         | 17.000       | 8                           | 9         | 12         |
| 11                     | 1                | 3         | 18.000       | 7                           | 6         | 12         |
| 12                     | 1                | 6         | 20.119       | 11                          | 10        | 0          |

Figure 6. Results After Starting A New Venture – Dendrogram Using Average Between Group Linkage For Inexperienced Manufacturers



# **AN IMMERSION INTO THE DYNAMIC CAPABILITY MODEL OF INNOVATION: AN EMPIRICAL TEST INVOLVING E-ENTREPRENEURS**

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## **INTRODUCTION**

Traditionally, entrepreneurs rest their competitive advantage on mainstream variables such as efficiency, quality, customer responsiveness and speed. However, in recent years, control over these variables represents the minimum threshold to stay and play in the game. Today's entrepreneurial firms are increasingly facing additional challenges – to be continuously innovative. As a result, the innovativeness in the design of products/services and the implementation of key processes become the critical sources of competitive and sustainable advantages.

This is especially true for e-commerce based firms. The characteristics of the e-business environment, combined with accessing the technology required to capitalize on new opportunities, have created one of the most challenging environments for entrepreneurs across industries (Vachani, 2002). In particular, e-commerce technology has pressed many entrepreneurs to engage in careful assessment of how their firms gather, synthesize, utilize, and disseminate information across customers, employees, and supplier networks, while also being innovative in their ability to create business models and deliver value effectively and efficiently to all parties. Past research has demonstrated that entrepreneurs who are willing to provide innovative product and service offerings will be positioned to compete most effectively (Hodgetts, Luthans, and Slocum, 1999).

From the perspective of dynamic capability, this study contends that entrepreneurial innovative capabilities in internet-based firms come from their ability to create, deploy, integrate and reconfigure organizationally embedded and rent-generating resources. We distinguish three types of capabilities based on the type of knowledge they contain: functional, integrative and innovative capabilities (Verona, 1999). Functional capabilities allow a firm to develop technical knowledge within an organization (Amit & Schoemaker, 1993; Pisano, 1997). Integrative capabilities allow a firm to acquire, absorb and assimilate internal and external sources of knowledge (Cohen & Levinthal, 1990; Henderson & Clark, 1990). Innovative capabilities, as a higher-order of integrative capabilities, refer to a firm's ability to develop new products, services and/or processes.

Specifically, we focus on two inter-related research questions that focus on e-entrepreneurs and their organizations. First, to what extent, do organizational capability possession affects its internal and external integrative capabilities? Second, to what

extent, do organizational capability possession and capability integration affect its innovative capabilities? By analyzing these two interrelated questions, we extend the current entrepreneurial literature in two significant ways by:

1. *Testing the differential impact that an entrepreneur's firm core capabilities has on its ability to integrate its internal and external sources of knowledge in its pursuit for innovation and,*
2. *Examining the relative importance and link that these sources of knowledge have on the firm's innovation capabilities.*

## **THEORETICAL FRAMEWORK & HYPOTHESIS DEVELOPMENT**

### **The Role of Innovation in E-Entrepreneurship**

The e-commerce industry is a hypercompetitive environment. This hypercompetitive environment is characterized by rapid changes in technology, relative ease of entry and exit, ambiguous and uncertain consumer demands, short-term competitive advantage and blurry industry boundary. These competitive conditions fuel a demand for innovation and speed while digital networks offer both speed and an opportunity for innovation.

In the absence of unique or new bundles of resources, the internet-based firms cannot mitigate their liability of newness and smallness. Whereas the liability of newness concerns the extra commitments (to product, market and technological development) a newly internet-based firm must make to compete against older firms already operating in the market, the liability of smallness involves the extra costs an internet-based firm must incur due to lack of scale and resources. To survive and grow in the highly competitive Internet business environment, these firms have to search beyond the resources-based competitive advantages. Possessing, deploying and upgrading capabilities is a primary driver of success in the Internet space and an important predictor of sustainable competitive position. Thus the dynamic capability perspective has vital implications for e-entrepreneurs.

### **A Dynamic Capability Model of Innovation for E-Entrepreneurship**

In the theory of RBV, organizations are viewed as “bundles of resources,” which are defined as both tangible and intangible assets that are tied to the firm in a relatively permanent fashion (Caves, 1980; Wernerfelt, 1984). These resources confer competitive advantages in and of themselves (e.g., Barney, 1991; Hall, 1992). According to Barney, “firm resources include all assets, capabilities, organizational processes, firm attributes, information, knowledge, etc. controlled by a firm that enable the firm to conceive of and implement strategies that improve its efficiency and effectiveness” (1991: 101). Resources are categorized into several specific typologies, including human, physical, capital and technological (Grant, 1991). According to this perspective, sustainable competitive advantage exists when the resources possess value, uniqueness, nonsubstitutability and inimitability (Barney, 1991; Wernerfelt, 1984). As a result,

performance differences across firms are due to differences arising from valuable, rent-generating, firm specific resources and capabilities.

However, accumulating valuable resources is not enough to support a sustainable competitive advantage (Teece, Pisano & Shuen, 1997), especially for the internet-based firms. The ever-changing competitive Internet environments render seemingly sustainable competitive advantage obsolete. Instead, competitive advantages arise from a firm's capability to constantly redeploy, reconfigure, rejuvenate and innovate its capabilities in responding to the changing environmental conditions, which is what Teece and Pisano (1994) called dynamic capabilities. Teece & Pisano (1994: 541) propose dynamic capability theory as the "subset of the competences/capabilities which allow the firm to create new products and processes and respond to changing market circumstance." As a result, competitive advantages rest on distinctive processes, shaped by the firm's asset positions and the evolutionary paths followed. Dynamic capability requires the capacity to extract economic benefits from current resources and capabilities and to develop new capabilities.

Consistent with the dynamic capability perspective, e-commerce can be considered to be a dynamic capability (Zhu & Kraemer, 2002). Internet-based organizations continually reconfigure their internal and external resources and capabilities to employ digital networks to exploit business opportunities through continuous innovation. We contend internet-related firms have three distinctive but closely connected organizational capabilities – capability possession, capability integration and capability innovation.

*Capability Possession.* Capability possession concerns with a firm's established distinctive capabilities that are firm specific and can generate economic returns and a competitive advantage. Verona (1999) classified these capabilities into functional capabilities, such as information technology, strategic planning, strategic alliance to name just a few. This classification is also consistent with the first type of organizational routine argued by Zollo and Winter (2002), which they refer as to involving "the execution of known procedures for the purpose of generating current revenue and profits" (Zollo and Winter, 2002: p. 241).

*Capability Integration.* Capability integration concerns with a firm's capability in scanning external environment and recognizing business opportunities, with which organizations align their capabilities. It is consistent with Zollo and Winter (2002)'s second type of organizational routine. Routines of second type are traditionally identified as search routines in evolutionary economics (Nelson and Winter, 1982). Verona (1999) further defined these capabilities as internal integrative capabilities and external integrative capabilities. External integrative capabilities are associated with the dimensions of managerial processes, structures, information and managerial systems, and networks, through which external information and knowledge can be identified and imported across organizational boundaries. These external integrative capabilities are especially mission critical, given the pace of change in the internet-related businesses in terms of technology and competition. Once required informational, technological and

market knowledge has been acquired, internal integrative capabilities organize its use and recognize potential business opportunities and subsequently align and reconfigure organizational capabilities to exploit these opportunities.

*Capability Innovation.* Capability innovation is defined as the firm's ability to upgrade and create new capabilities. The success of an internet-based firm depends not merely on possessing and integrative capabilities but also on learning and acquiring new knowledge and capabilities. An innovative capability is defined as the ability to continuously transform recognized opportunity into new products and processes. The ultimate purpose of organizational capabilities is to innovate toward the creation of customer value in the forms of new services and new products. Figure 2 depicts the relationships among the three distinctive capabilities.

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Insert Figure 2 about Here  
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The possession of technological, informational, and strategic planning capabilities by an internet-based firm would affect not only its external integrative capabilities, but also its internal integrative capabilities – to combine organizational capabilities with desirable and feasible business opportunities. An opportunity is more than an idea. Deciding whether an idea is an opportunity or not involves judgments made under conditions of uncertainty and complexity (Das & Teng, 1997). These judgments mainly concerns with perceived risks and returns. The possession of organizational capabilities in internet-related business would most likely mitigate the perceived risks, while increasing the perceived potential returns at the same time. As a result, organizations are more likely to commit themselves to explore these business opportunities. Based on these discussions, we argue:

*H2: Capability possession of an internet-based firm is positively related to its internal integrative capabilities.*

### **Capability Possession and Capability Innovation**

A firm's possession of capabilities in technology, alliance, strategic planning and human resource would have a direct impact on its innovative capabilities. Specifically, technological capabilities are an important determinant of a firm's innovative capabilities. For example, in their empirical research of firm competence in pharmaceutical industry, Henderson and Cockburn (1994) report a positive link between R&D capabilities and the productivity of new drug development. In a similar vein, Pisano's (1996) study of pharmaceutical and biotechnology firms also reports a positive relationship between the lead time of new molecular development projects and the manufacturing capability. In the internet business, the dominant business configuration is a network, web or hub connected via information technology. Suppliers, customers, complementors, and alliance partners engage in "coopetition" as they collaborate via alliance and compete via coalitions (Brandenburger and Stuart, 1996; Afuah, 2000).

Competitive advantages for these internet-based firms may rest on tacit, inimitable collaborative relationships with various players within the network. These network of relationships provide a critical source of innovations (Ahujah, 1996). Based on the foregoing arguments, we suggest:

*H3: Capability possession of an internet-based firm is positively related to its capability innovation.*

### **Capability Integration and Capability Innovation**

External integrative capabilities and internal integrative capabilities are not mutually exclusive. Instead, they are closely connected. Specifically, external integrative capabilities refer to a firm's capability to identify and acquire externally generated knowledge that is critical to its operation (Zahra & George, 2002). Acquisition of external knowledge reflects the identification function, which represents the 'generator' of intelligence for the organization. External environmental signals are identified, and information on those signals is gathered and transmitted across the organizational boundary.

The more external knowledge and information that can be collected over a given period, the better the external integrative capabilities work. Subsequently, the internet-based firms avail with a wider range of ideas, among which lead to more business opportunities. In a similar vein, limited external integrative capabilities may constrain an organization's internal integrative capabilities as well. Given these discussions, we suggest:

*H4: External integrative capabilities of an internet-based firm are positively related to its internal integrative capabilities.*

External integrative capabilities also represent a construct that refers to "active listening." Information and knowledge can be obtained from a wide variety of sources, using a variety of media. The generation of external information should not be the monopoly of any one department but rather an organization-wide activity. Additionally, firms need to scan frequently and broadly. Although there is some indication that the most important areas of knowledge come from competitors and customers, the organization uses many more than the usual data collection sources from competitors and customers. The more information the organization gathers through the search process, the more options there are for identifying changes in the competitive and market environment, and therefore, the better chance of a firm to reconfigure or upgrade its capabilities to external demands.

*H5: External integrative capabilities of an internet-based firm are positively related to its capability innovation.*

The recognition of business opportunities would drive internet-based firms to re-examine their organizational capabilities and to re-deploy relevant knowledge and

technology possessed internally into new technologies and processes designed to meet the organization's specific, emerging needs. This is an internally opportunity-driven process that aids in the extension of existing competitive advantages and the creation of new and more effective and efficient process and services. Based on these rationales, we hypothesize:

*H6: Internal integrative capabilities of an internet-based firm are positively related to its capability innovation.*

## **RESEARCH METHOD**

### **Sampling Procedures**

Participants were one hundred twenty entrepreneurs of e-commerce organizations whose business activities encompass the Internet. The entrepreneurs and their respective firms were randomly sampled by the Internet sector of the CorpTech<sup>®</sup> Company Profiles Database. The majority of the entrepreneurs were male (92 percent), with over 19 years of business experience and 15 years of industry experience. All information was gathered from the entrepreneurs over a three-week period, utilizing a new methodology for data collection: on-line survey completion. E-mails were sent to the entrepreneur of the e-commerce organization, asking for their participation in the study. Within the text of the email was a hyperlink that would direct them to our on-line questionnaire. The entrepreneurs were told that we were conducting research to better understand top managerial roles and practices in Internet-based organizations.

### **Measures**

*Capability Possession.* To assess the entrepreneurial firm's functional capabilities, we used the Hartman, Sifonis, and Kador's (2000) Internet Readiness Measure. Entrepreneurs indicated how much they agree or disagree with the statements on a five-point Likert scale (1 = 'strongly disagree'; 5 = 'strongly agree'). Cronbach's alpha of this scale was .85.

*External Integrative Capabilities.* To measure external integrative capabilities, we adapted four items from Hills et al. (1997) scale on opportunity identification/recognition. Entrepreneurs used a five-point Likert scale (1=Not a source; 5=Significant source). Cronbach's alpha of this scale was .90.

*Internal Integrative Capabilities.* To measure internal integrative capabilities, we adapted four items from Simon, Pelled, & Smith's (1999) scale. These items assessed how top management teams recognizes new ideas or opportunities. Internal consistency (Cronbach's alpha) of this scale was .78.

*Innovative Capabilities.* In order to measure the types of innovative managerial practices implemented in our sample of e-commerce firms, we again used items from Hartman, Sifonis, and Kador's (2000) Internet Readiness Measure. Entrepreneurs

indicated how much they agree or disagree with the statements on a five-point Likert scale (1 = ‘strongly disagree’; 5 = ‘strongly agree’). Cronbach’s alpha of this scale was .87.

### **Control Variables**

We chose four control variables that can have an influence on an entrepreneurial firm’s innovation capabilities: business strategy, type of business (business to business vs. business to consumer model), diversity on top management team, and the proactivity of the entrepreneur.

### **Statistical Models**

Zero-order correlations as well as the mediated regression approach recommended by Baron and Kenny (1986) was used to test our hypotheses and proposed model. In the mediational approach, three separate regression equations are estimated. First, the mediators (external and internal integrative capabilities) are regressed on the independent variable (capability possession). Second, the dependent variable (capability innovation) is regressed on the independent variable. In the last equation, the dependent variable is regressed simultaneously on both the independent and mediational variable. Mediation is indicated when these conditions are met: the independent variable must affect the mediator in the first equation; the independent variable must affect the dependent variable in the second equation; the mediator must affect the dependent variable in the third equation; and lastly, assuming that all of these conditions are in the proper direction, the effect of the independent variable on the dependent variable must be less in the third equation than in the second equation. Full or perfect mediation is supported when the independent variable has no significant effect when the mediator is controlled, while partial mediation is indicated if the effect of the independent variable is reduced in magnitude but still significant when the mediator is controlled (Baron and Kenny, 1986).

## **RESULTS**

The means, standard deviations, zero-order correlations and reliabilities for our constructs are reported in Table 1. The reliabilities of the measures used were all over the .70 minimum established by Nunnally (1978). In analyzing the relationships, we found support for each of our hypothesized relationships. More specifically, capability possession was positively related to both external (hypothesis 1) and internal integrative capabilities (hypothesis 2) as well as capability innovation (hypothesis 3). Support was also found for hypothesis 4 in that external integrative capabilities were related to internal integrative capabilities. Finally, external integrative capabilities and internal integrative capabilities were related to capability innovation (hypothesis 5 and 6, respectively).

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Insert Table 1 about Here  
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While our hypotheses were supported at a one-to-one relationship (zero-order correlations), we wanted to utilize the mediational approach to better understand and evaluate the dynamic capability model within the context of our entrepreneurial e-commerce firms. Table 2 displays the approach and results to test this more stringent innovation model by including our control variables, capability possession, and the dual mediators of external and internal integrative capabilities. Results revealed that capability innovation is fully mediated by an entrepreneurial firm's capability integration. (relationship between possession and innovation was no longer significant when accounting for external and internal integration). That is, capability integration serves as an important link between a firm's possession of technological, strategic, human resources, and strategic planning activities and its ability to innovate and bring new value to its product/service offerings.

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Insert Table 2 about Here  
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## **DISCUSSION & CONCLUSIONS**

The model tested in this study, based on responses from 120 entrepreneurs of e-commerce firms, disclosed that the building of technology infrastructure serves an important role as an antecedent to the development of innovations related to new product/service improvements in the firms sampled. This investigation may provide insight as to which factors are potentially more important in determining how e-entrepreneurships can implement e-commerce technologies successfully to achieve greater innovations.

Our findings suggest resources and capabilities are important, but only to a certain extent. Our sample of Internet-based firms demonstrates that resources and capabilities are dynamic as these firms must continually build, adapt and reconfigure the internal and external competence to be continuously innovative. They exemplify the characteristics of dynamic capabilities as they engage routines, prior and emergent knowledge, integrative and analytic processes to turn IT into customer value in the forms of innovative products and services.

Additionally, our findings provide additional insight into the innovation process of internet-based firms. Specifically, our results illuminate the fact that organizational integrative capabilities play a critical role in a firm's innovate capability. By contrast, functional capabilities play an indirect role in the innovation process, through a firm's integrative capabilities. The primary constraint preventing these firms from growing through innovation is not the lack of resources as suggested by the resource based theory, but the lack of organizational integrative capabilities – routines for integrating external knowledge and identifying business opportunities.

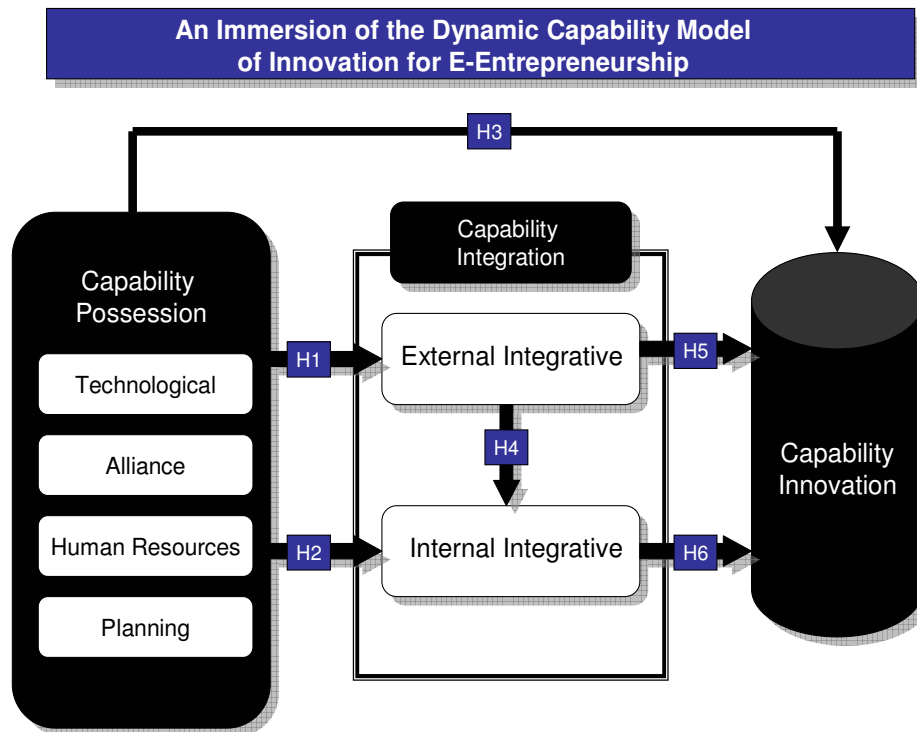
Our study highlights the importance of developing routines and capabilities in boundary spanning and opportunity recognition in the internet-related firms. Although the development of these integrative capabilities may incur additional bureaucratic costs, the gains from such routines would more than offset any adverse consequence of bureaucratization, as presumed by Stinchcombe (1965).

Within an entrepreneurial organization, the adoption of new technology to increase competitive advantage has been hindered by issues surrounding potential costs, risks of failure, and an inherent lack of innovative awareness (Maxwell & Westerfeld, 2002). By analyzing the benefits, as has been attempted in this study, many of these issues are outweighed by the diversity of opportunities, process innovations, firm effectiveness and growth. With the alignment of information and computer technology, knowledge, and resources, successful entrepreneurs can further seek out and act upon the demands of the market, differentiating themselves through customer management, relationship marketing, and community building. By exploring and incorporating new technology within their business models, entrepreneurs can leverage the information and experience they already have and deftly apply new intelligence and knowledge within the framework and structure of their firms.

## REFERENCE

References will be provided upon request.

**Figure 2**



**TABLE 1. DESCRIPTIVE STATISTICS AND CORRELATIONS**

|                                   | Mean  | SD    | 1     | 2     | 3     | 4     | 5     | 6     | 7     | 8     |
|-----------------------------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| Business Strategy                 | 3.12  | 1.25  | (---) |       |       |       |       |       |       |       |
| Type of Business                  | 29.61 | 30.43 | .13   | (---) |       |       |       |       |       |       |
| Diversity on Management Team      | 3.80  | 1.93  | -.21  | -.33  | (---) |       |       |       |       |       |
| Proactivity of Entrepreneur       | 4.37  | 0.82  | .15   | .04   | .10   | (.91) |       |       |       |       |
| Capability Possession             | 3.59  | 0.72  | .58   | .13   | -.13  | .20   | (.85) |       |       |       |
| External Integrative Capabilities | 4.53  | 0.89  | .09   | .00   | -.13  | .02   | .25   | (.90) |       |       |
| Internal Integrative Capabilities | 4.05  | 0.76  | .22   | .12   | -.05  | .43   | .41   | .32   | (.78) |       |
| Product/Service Innovations       | 4.06  | 0.90  | .59   | .17   | -.04  | .03   | .71   | .32   | .28   | (.87) |

Note:  $r > .20$  is significant at .05 level.

**TABLE 2 MEDIATED REGRESSION ANALYSIS**

| Equation                 | Summary   | Dependent Variable<br>Product/Service Innovations ( $\beta$ ) |
|--------------------------|---|---|
| <b>Control Variables</b> | Business Strategy   | .66   |
|                          | Type of Business  | .04   |
|                          | Diversity on Management Team                              | .11   |
|                          | Proactivity of Entrepreneur                               | .07   |
| <b>(1)</b>               | Capability Possession→External Integrative Capabilities   | .25*  |
|                          | Capability Possession→Internal Integrative Capabilities   | .41*  |
| <b>(2) and (3)</b>       | Capability Possession→ Capability Innovation              | .19   |
|                          | External Integrative Capabilities → Capability Innovation | .56**   |
|                          | Internal Integrative Capabilities → Capability Innovation | .25*  |
| <b>R<sup>2</sup></b>     |   | .88   |
| <b>F</b>                 |   | 8.62**  |

Note: ( $\beta$ ) = Standardized Beta Weight; The  $R^2$  and F value results are for the last equation in the test for mediation. \*\* $p < .01$  \* $p < .05$

**THE INFLUENCE OF FAMILY BUSINESS SIZE ON  
MANAGEMENT ACTIVITIES, STYLES AND CHARACTERISTICS:  
AN INTERNATIONAL ANALYSIS**

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**ABSTRACT**

An analysis of an international sample of micro, small, medium and large family businesses found both similarities and differences between these categories with regard to a variety of management activities, styles and characteristics. Given the very limited prior research findings and theory on family firm size, the value of these findings is not that they provide definite conclusions about the nature of family business, but rather that they lay some groundwork for further research in this area, with the objective of answering these questions: Is size a significant factor with regard to family business? Should size be an analytical tool used by family business managers, researchers and/or consultants?

**INTRODUCTION**

Family businesses are a central component of the world's economies. While in most countries exact figures are difficult to obtain, it is estimated that 80% of American businesses are family-owned (Carsrud, 1994; Kets de Vries, 1993), that these businesses contribute 40% to 60% of the Gross National Product (Gomez-Mejia, Nunez-Nickel & Gutierrez, 2002; McCann, Leon-Guerro & Haley, 1997), and that 35% of *Fortune 500* businesses are family owned (Carsrud, 1994). In many other countries, such percentages are comparable (European Group, 2004). Although family business is important, the majority of studies have been qualitative rather than quantitative (Dyer & Sánchez, 1998; Litz, 1997), and there is a need for more empirical statistical analyses.

Furthermore, most family business studies have focused on family firms in the United States and sometimes Canada, with only an occasional study directed at family businesses in other countries. Only very recently have a few researchers postulated that family businesses in other countries may be different from those in North America (Morck & Yeung, 2003; Hoy, 2003).

Within this body of family business literature, there have been some attempts to categorize such firms, so as to develop typologies. Do different types or groups of family firms exhibit significantly different characteristics and behave differently? Can such a categorization lead to meaningful implications with regard to family firm management, research and assistance? One area of recent analysis has been with regard to possible *stages* of family firm growth. Work by Gersick, Davis, Hampton & Lansberg (1997) and others has led to a proposed model of such stages, each with different family firm characteristics and implications for the management of such firms.

Another recent family business categorization has been a focus on *generations* by Sonfield & Lussier (in press). This research compared first, second and third-generation family firms in light of various researchers' earlier investigations and, in contrast to these earlier studies, found few differences in managerial characteristics and activities.

The objective of this current study was to investigate, at an international level, another possibly meaningful family business typology: that of company size as measured by the number of the firm's employees. As family businesses grow in terms of number of employees, do managerial activities, styles and characteristics change? While *stages* may be a difficult measure for family firm owners, advisors and researchers to use, and *generations* may be an easier way to categorize such firms, the *number of employees* is certainly a still simpler measure. If it may have value as an analytical tool for evaluating companies, then this possibility should be explored.

## LITERATURE REVIEW

Searches of the family business literature find little prior investigation of issues of firm size, as measured by number of employees or any other measure. Even a broader search of the literature in business and management in general generates only modest results. Various researchers have attempted to find relationships between firm size (as measured by the number of employees in the firm) and that firm's characteristics, behavior and performance. For example, Watson (1996) investigated whether firm size related to failure, Ettlie and Rubenstein (1987) examined the relationship of firm size to product innovation, Goetz, Morrow and McElroy (1991) and Brush and Chaganti (1999) explored the relationship of size to management styles and effectiveness, Edmunds (1979) studied size effect on management competence, and Bates (1989) firm size and its effect on business failure. All of these studies were preliminary investigations, and the total set of quite mixed results underline the complexity of this basic issue. While a company's number of employees may influence managerial and firm activity and performance, considerably more research is needed before firm conclusions and meaningful implications can be reached, and theories can be generated.

Thus, given this lack of *size-related* research, theory, and established findings in family business, the hypotheses used for this current study derive from prior studies of *generational* issues in family business, an area where a moderate number of findings can be found. And if family firms generally grow with succeeding generations, then *generations* can be considered a reasonable surrogate for *number of employees* for the purposes of hypotheses generation for this study.

## HYPOTHESES

The eleven hypotheses used for this study are based on Sonfield and Lussier (2002) hypotheses, findings and propositions developed by earlier researchers who investigated similarities and differences between family firms. Because there are minimal and mixed prior findings with regard to firm size as measured by number of employees, the null hypothesis is used throughout.

H1: Larger family businesses are neither more nor less likely than smaller family businesses to include non-family members within top management.

H2: Larger family businesses are neither more nor less likely than smaller family businesses to have women family members working in the firm.

H3: Larger family businesses are neither more nor less likely than smaller family businesses to use a “team-management” style of management.

H4: Larger family businesses are neither more nor less likely than smaller family businesses to have conflict and disagreement between family members.

H5: Larger family businesses are neither more nor less likely than smaller family businesses to have formulated specific succession plans.

H6: Larger family businesses are neither more nor less likely than smaller family businesses to use outside consultants, advisors and professional services.

H7: Larger family businesses are neither more nor less likely than smaller family businesses to spend time engaged in strategic management activities.

H8: Larger family businesses are neither more nor less likely than smaller family businesses to use sophisticated methods of financial management.

H9: Larger family businesses are neither more nor less likely than smaller family businesses to be influenced by the original business objectives and methods of the founder.

H10: Larger family businesses are neither more nor less likely than smaller family businesses to have considered “going public.”

H11: Larger family businesses are neither more nor less likely than smaller family businesses to use equity financing rather than debt financing.

## METHODS

### Sample

Four countries were chosen to provide a broad geographic scope to the study, and to furthermore include countries with different sized populations, different cultures, different economic characteristics and histories, and different *GEM* rates of entrepreneurial activity (Croatia = 3.6, France = 3.2, India = 17.9 and U.S.A. = 10.5). The following country information may be of value.

*Croatia.* In 1991, the Republic of Croatia declared its independence from Yugoslavia, and is today a parliamentary democracy with a population of about 4.4 million, about 57 percent of which is urban. Gross domestic product was estimated to be \$24.9 billion in 2000. Of a total 148,000 business enterprises in Croatia, about 90,000 are one-person operations and another 54,000 are small (annual sales of 2 million U.S. dollars or less) (World Almanac 2003). Family-controlled businesses in Croatia have a long history in the country, prior to the institution of a

socialist Yugoslavia following World War II. Today, most family firms are single-generation small businesses, oriented toward autonomy, self-employment and stability. Only since the 1991 independence have growth-oriented family-controlled businesses become a significant factor in the economy (Denona and Karaman-Aksentijevic 1995; Galetic 2002).

*France.* France has a population of about 60 million people. Seventy-five percent of the population live in urban areas. In 2000, the gross domestic product was estimated at \$1.448 trillion (World Almanac 2003). Family-owned and controlled businesses in France, called “patrimonial” businesses, play a major role in the economy: 98 percent of companies with less than 100 employees, 75 percent of those with 100 to 3000 employees, and 20 percent of those with over 3000 employees (Gattaz 2003; Lyagoubi 2002; Mahérault 1999).

*India.* Home to one of the oldest civilizations in the world, Britain relinquished control of the Indian subcontinent following World War II, and the Republic of India was established in 1950. India has a population of over one billion people and had an estimated gross domestic product of \$2.2 trillion in 2000 (World Almanac 2003). The economy consists of a large state sector with a number of very large state enterprises, a relatively small number of multinational companies, and a large private sector. The private sector, with few exceptions, is controlled by families who may or may not hold large shareholdings in their companies. Thus, most of the large Indian companies, though they may be publicly traded, are controlled by families and their management succession is generally maintained within the family. Members of their boards of directors also hold their positions at the pleasure of the controlling family (Centre for Monitoring Indian Economy 2004; Manicuttu 2000).

### **Survey Instrument Distribution and Responses**

In the United States, survey instruments were randomly mailed or hand-delivered to a variety of New York and Massachusetts companies, which had been identified as family businesses. A net distribution of 550 surveys yielded 159 usable returned, a 28.9% return rate.

In Croatia, a sample of family businesses was developed by contacting the clients of Entrepreneurship Centers in four geographically diverse cities: Osijek, Pula, Split, and Varazdin. Seventy businesses were contacted by telephone, and a written survey was then sent to them. Fifty usable responses were received for a response rate of 71.4%

In France, a sample of family businesses was identified from a prior study's database, and 800 companies were sent a survey via mail. A total of 116 usable responses were received with four other respondents replying that they were not a family business. Thus the response rate was 14.5%.

In India, from that country's primary business data base (maintained by the Center for Monitoring the Indian Economy [CMIE]), 312 companies representing a range of sizes and business sectors were selected for a survey mailing. Follow-up mailings and telephone calls were made to all non-respondents. Forty usable responses were received and another 17 respondents stated that they were not family companies, thus providing a net response rate of 13.6%.

Thus, in the four countries combined, a total net distribution of 1715 survey instrument resulted in a usable return of 365 surveys, for a return rate of 21.3%.

Identifying family firms from various listings is consistent with that of other family business researchers, who have been constrained by the lack of national databases of family firms (Chua, Chrisman and Sharma 1999; Teal, Upton and Seaman 2003). This is an acceptable sample size and response rate for family business, as it has been reported that 62 percent of prior family business studies included no sample at all, or a sample with less than 100 family businesses, and 66 percent of these were convenience samples (Bird, Welsch, Astrachan and Pistrui 2002). In the top three small business or entrepreneurship-oriented journals (*Entrepreneurship Theory and Practice*, *Journal of Business Venturing*, and *Journal of Small Business Management*) around one-third of the articles had a response rate of less than 25 percent (Dennis 2003).

The survey instrument provided a variety of descriptive information about each respondent family business, including the number of employees. While there are no universally accepted employee number breakpoints for company size (and the U.S. Small Business Administration [2004] uses different breakpoints for different industries), the European Community has developed some guidelines (European Union, 2004). The respondent firms were categorized into these four EU categories:

| <u>Enterprise Category</u> | <u>Number of Employees</u> | <u>Sample (N = 365)</u> |
|----------------------------|----------------------------|-------------------------|
| Large                      | ≥ 250 (250 +)              | n = 69 / 19%            |
| Medium                     | < 250 (50-149)             | n = 97 / 27%            |
| Small                      | < 50 (10-49)               | n = 120 / 32%           |
| Micro                      | < 10 (0-9)                 | n = 79 / 22 %           |

## **Measurement**

The independent variable was size with four levels, as shown above. The dependent variables to test Hypotheses 1-11 were as follows: (1) the percentage of family to non-family managers. (2) The percentage of male and female family members involved in the operation of the firm. Hypotheses 3-10 were Likert interval scales of: “Describes our firm” 7 to 1 “Does not describe our firm.” (3) full family involvement in decisions, (4) level of family conflict, (5) formulation of succession plans, (6) use of outside advisors, (7) long-range planning, (8) sophisticated financial management tools, (9) influence of founder, and (10) going public. (11) The use of debt or equity financing was a nominal measure of one or the other. Descriptive statistical data included number of years the firm was in business, the number of employees, industry (product or service), number of generations, and form of ownership.

## **Statistical Analysis**

Hypotheses 1-10 compared the dependent variables by size using one-way ANOVA. Hypothesis 11, having nominal measured variables, compared debt to equity by size using chi-square.



## RESULTS

See Table 1 for a summary of descriptive statistics.

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[table 1 about here](#)

See Table 2 for a summary of hypotheses statistics testing. Of the eleven hypotheses, three were accepted and eight were rejected by the statistical analysis. There were no significant differences between the size categories of family businesses with regard to 1) the number of women family members working in the firm, 2) the use of team-management style, and 3) the formulation of specific succession plans. There were statistically significant differences, with a clear pattern from smaller to larger firms as follows: 1) larger firms were more likely to use non-family members within top management and 2) larger firms were more likely to use sophisticated methods of financial management. Furthermore, there were also significant differences, but *without* a clear pattern from smaller to larger firms, for the following: 1) having conflict between family members, 2) the use of outside consultants, advisors and professional services, 3) the time spent in strategic management activity, 4) the degree of influence by the original business objectives and methods of the founder, 5) consideration of going public, and 6) the use of debt versus equity financing.

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[table 2 about here](#)

## VALUE OF FINDINGS

Given the very limited prior research findings on family firm size, the value of these findings is not that they provide definite conclusions about the nature of family business, but rather that they lay some groundwork for further research and theory development in this area. Is size a significant factor with regard to family business? Should size be an analytical tool used by family business managers, researchers and/or consultants? Clearly, considerably more family business studies must be conducted before answers to these questions can be suggested.

## CONCLUSIONS

The findings of this study indicate that firm size may be a relevant factor in the analysis of family businesses. A limitation of this study is the variation between the four country samples, both in sample size and the distribution of the company sizes within each country, based on the histories and positions of family businesses within each country's economy. To strengthen our understanding of the relevance and importance of family business size, further studies should attempt to increase sample sizes, obtain more even firm size distributions within samples, and to obtain data from additional countries so as to reduce the impact of varying economic and family business characteristics from country to country.

## REFERENCES

A list of 34 references is available from the first author

Table 1  
Descriptive Statistics by Size of Business (number of employees)

| Variable                    | Micro (0-9)<br>n = 79 / 22% | Small (10-49)<br>n = 120 / 32% | Med (50-249)<br>n = 97 / 27% | Large (≥ 250)<br>n = 69 / 19% | Total<br>(N = 365)     |
|-----------------------------|-----------------------------|--------------------------------|------------------------------|-------------------------------|------------------------|
| Generation (n/ %)           |                             |                                |                              |                               |                        |
| 1 <sup>st</sup>             | 34 / 43%                    | 39 / 32%                       | 28 / 29%                     | 14 / 20% <sup>1</sup>         | 115 / 32%              |
| 2 <sup>nd</sup>             | 29 / 37%                    | 50 / 42%                       | 43 / 44%                     | 27 / 39%                      | 149 / 40%              |
| 3 <sup>rd</sup>             | 16 / 20% <sup>1</sup>       | 31 / 26%                       | 26 / 27%                     | 28 / 41%                      | 101 / 28%              |
| Years in business<br>(mean) | 24.84 <sup>2</sup>          | 35.37 <sup>2</sup>             | 45.44                        | 45.20                         | 37.62                  |
| Industry ( n / %)           |                             |                                |                              |                               |                        |
| Product                     | 22 / 28%                    | 58 / 48%                       | 48 / 49%                     | 39 / 57%                      | 167 / 46%              |
| Service                     | 57 / 72% <sup>3</sup>       | 62 / 52%                       | 49 / 51%                     | 30 / 43%                      | 198 / 54%              |
| Ownership (n/ %)            |                             |                                |                              |                               |                        |
| Corporation                 | 31 / 39%                    | 71 / 59%                       | 79 / 81%                     | 67 / 97%                      | 248 / 68% <sup>4</sup> |
| Partnership                 | 11 / 14%                    | 19 / 16%                       | 9 / 9%                       | 0 / 0%                        | 39 / 11%               |
| Sole proprietorship         | 37 / 47%                    | 30 / 25%                       | 9 / 9%                       | 2 / 3%                        | 78 / 21%               |
| Country ( n / %)            |                             |                                |                              |                               |                        |
| USA                         | 44 / 56%                    | 57 / 48%                       | 34 / 35%                     | 24 / 35%                      | 159 / 43% <sup>5</sup> |
| France                      | 5 / 6%                      | 46 / 38% <sup>5</sup>          | 57 / 59%                     | 8 / 12%                       | 116 / 32% <sup>5</sup> |
| Croatia                     | 30 / 38% <sup>5</sup>       | 17 / 14%                       | 3 / 3%                       | 0 / 0%                        | 50 / 14%               |
| India                       | 0 / 0%                      | 0 / 0%                         | 3 / 3%                       | 37 / 53% <sup>5</sup>         | 40 / 11%               |

<sup>1</sup> Micro businesses have significantly less 3<sup>rd</sup> generation firms, and large firms have significantly less 1<sup>st</sup> generation businesses (p = .044).

<sup>2</sup> Micro and small firms have been in business for significantly less years than medium and large businesses (p = .000).

<sup>3</sup> Significantly more micro firms offer a service (p = .003).

<sup>4</sup> There are significantly more corporations, and the percentage increases with size, as in the business population.

<sup>5</sup> There are significantly more firms from the USA and France (p = .000). As in the business population, in the USA there are more smaller firms than larger firms, and Croatia has more micro and small firms. The France participants have more small and medium size firms. India participants have more large firms.

Table 2

Hypotheses One-Way ANOVA Comparison by Size (N = 365)

| Hypotheses  | Micro<br>(0-9)<br>n = 79 | Small<br>(10-49)<br>n = 120 | Medium<br>(50-249)<br>n = 97 | Larger<br>(250+)<br>n = 69 | p-<br>value             |
|---|--------------------------|-----------------------------|------------------------------|----------------------------|-------------------------|
| 1. Use of non-family members within top mgt (% non-family)                              | 6.07                     | 23.05                       | 44.38                        | 66.51                      | <b>.000</b>             |
| 2. Women family members working in firm (% of women)                                    | 36.16                    | 34.48                       | 21.37                        | 27.85                      | .178                    |
| 3. Use of team-management style (7-1 <sup>1</sup> )                                     | 4.68                     | 4.64                        | 4.18                         | 4.17                       | .267                    |
| 4. Having conflict between family members (7-1)   | 2.86                     | 2.90                        | 2.67                         | 2.10                       | <b>.041</b>             |
| 5. Formulation of specific succession plans (7-1)                                       | 3.32                     | 3.50                        | 3.24                         | 3.72                       | .600                    |
| 6. Use of outside consultants, advisors, and professional services (7-1)                | 3.90                     | 4.49                        | 5.27                         | 4.75                       | <b>.000</b>             |
| 7. Time spent in strategic mgt activity (7-1)   | 3.14                     | 3.04                        | 3.14                         | 3.78                       | <b>.036</b>             |
| 8. Use of sophisticated methods of financial mgt (7-1)                                  | 2.91                     | 3.53                        | 4.15                         | 5.48                       | <b>.000</b>             |
| 9. Degree of influence by original business objectives and methods of the founder (7-1) | 4.97                     | 4.16                        | 3.85                         | 4.52                       | <b>.003</b>             |
| 10. Consideration of going public (7-1)   | 1.68                     | 1.44                        | 1.39                         | 4.25                       | <b>.000</b>             |
| 11. Use of debt financing rather than equity (proportion debt/equity)                   | 39 / 40<br>49/51%        | 80 / 39<br>67/33%           | 76 /18<br>81/19%             | 49 / 19<br>72/28%          | <b>.000<sup>2</sup></b> |

<sup>1</sup> Likert scales—Mean of Describes our firm 7 6 5 4 3 2 1 Does not describe our firm<sup>2</sup> Chi-square, not F value.

# **FIRST-GENERATION, SECOND-GENERATION AND THIRD-GENERATION FAMILY BUSINESS: A MANOVA COMPARISON**

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## **ABSTRACT**

This study compared first-generation, second-generation and third-generation family firms in terms of a variety of family business management activities, styles and characteristics. Only two of eleven hypotheses were accepted. As supported by the literature, subsequent-generations are more likely than first-generation firms to formulate specific succession plans, and top management styles and decisions in subsequent-generation family firms are no less likely than in first-generation family firms to be influenced by the original business objectives and methods of the founder. Thus, contrary to much of the current literature, there are few significant differences. However, the eleven variables in combination do provide an overall multivariate analysis of variance (MANOVA) model that does find differences between generations.

## **INTRODUCTION**

The objective of this study was to examine First-Generation Family Firms (1GFFs), Second-Generation Family Firms (2GFFs) and Third-Generation Family Firms (3GFFs) in a multi-factor and multi-dimensional analysis, building upon the more limited-focused hypotheses, propositions and findings of previous researchers, and also upon an earlier study (Sonfield & Lussier, 2002). Sonfield and Lussier used a smaller and less-evenly distributed sample, only 13 1GFF, and a univariate one-way ANOVA statistical analysis. The findings of this study should expand our understanding of possible similarities and differences between first-generation and subsequent-generation family businesses. This in turn might enable family firm owner-managers to better understand and administer their businesses, might allow researchers to better focus their future investigations into generational categories as separate entities, and also might strengthen the effectiveness of advisors, consultants, and others who assist family businesses by allowing them to better differentiate between their 1GFF, 2GFF and 3GFF clients.

The existing literature occasionally compares first-generation versus subsequent generation family firms, but very rarely differentiates between second, third or further generations. This study extends this limited theoretical analysis further. If a 2GFF differs from a 1GFF, then does a 3GFF differ from a 2GFF in the same manner and to a further degree?

## BACKGROUND AND HYPOTHESES

Dyer (1988) found that 80% of 1GFFs had a “paternalistic” management culture and style, but that in succeeding generations more than two-thirds of these firms adapted a “professional” style of management. “Paternalistic” management was characterized by hierarchical relationships, top management control of power and authority, close supervision, and distrust of outsiders. “Professional” management involves the inclusion, and sometimes the predominance, of non-family managers in the firm.

McConaughy and Phillips (1999), studying large publicly owned founding-family-controlled companies, concluded that descendent-controlled firms were more professionally run than were founder-controlled firms. These researchers postulated that first-generation family managers are entrepreneurs with the special technical or business backgrounds necessary for the creation of the business, but the founder’s descendents face different challenges—to maintain and enhance the business—and these tasks may be better performed in a more professional manner, often by non-family members. Both Dyer (1988) and McConaughy and Phillips (1999) found an earlier basis in Schein (1983), who also suggested that subsequent generations in family firms tend to utilize more professional forms of management. These findings lead to:

*Hypothesis 1. Subsequent-Generation Family Firms are more likely than First-Generation Family Firms to include non-family members within top management.*

(For this and the following hypotheses, this phrasing means that 3GFFs are more likely than 2GFFs, and 2GFFs are more likely than 1GFFs.)

Studying gender issues in family firms, Nelton (1998) stated that daughters and wives are rising to leadership positions in family firms more frequently than in the past, and that the occurrence of daughters taking over businesses in traditionally male-dominated industries is increasing rapidly. Cole (1997) found the number of women in family businesses increasing, but did not focus on generational differences. More generally, U.S. Census Bureau data showed women-owned firms growing more rapidly than those owned by men (Office of Advocacy, 2001). Thus:

*Hypothesis 2. Subsequent-Generation Family Firms are more likely than First-Generation Family Firms to have women family members working in the firm.*

Another aspect of family business behavior is the distribution of decision-making authority in the firm. Dyer (1988) found decision-making to be more centralized in first-generation family firms than in subsequent-generation family firms. Aronoff (1998) developed this suggestion further and postulated that subsequent-generation family firms are more likely to engage in team management, with parents, children and siblings in the firm all having equality and participative involvement in important decision-making, even if one family member is still the nominal leader of the business. Aronoff furthermore reported that 42% of family businesses are considering co-presidents for the next generation. This leads to:

*Hypothesis 3. Subsequent-Generation Family Firms are more likely than First-Generation Family Firms to use a “team-management” style of management.*

Interpersonal dynamics, including conflict and disagreement among family members, has been a major focus of family firm research. Conflict can exist in first-generation family firms, when siblings, spouses or other relatives participate in management and/or ownership, and conflict can also arise between members of different generations in subsequent-generation family firms. Beckhard and Dyer (1983) found that conflict among family members increases with the number of generations involved in the firm. Conversely, Davis and Harveston (1999, 2001) concluded that family member conflict increased only moderately as firms moved into the second-generation stage, but there was a more sizable increase from second to third-generation. This leads to:

*Hypothesis 4. Subsequent-Generation Family Firms are more likely than First-Generation Family Firms to have conflict and disagreement between family member managers.*

A major focus of the literature on family business has been succession. The primary issues here involve the difficulties founders have in “letting go” and passing on the reins of control and authority, the lack of preparation for leadership next-generation family members often receive, and thus the need for, and importance of, succession planning (Davis, 1983; Handler, 1994; Upton & Heck, 1997). Dyer (1998) investigated “culture and continuity” in family firms, and the need for firm founders to understand the effects of a firm’s culture, and that culture can either constrain or facilitate successful family succession. Fiegener and Prince (1994) compared successor planning and development in family and non-family firms, and found that family firms favor more personal relationship-oriented forms of successor development, while non-family firms utilize more formal and task-oriented methods. Building upon these and other studies of succession in family firms, Stavrou (1998) developed a conceptual model to explain how next-generation family members are chosen for successor management positions. This model involves four factors which define the context for succession: *family, business, personal* and *market*.

While these and other studies have dealt with various aspects of succession, none have specifically investigated succession planning and practices in first-generation versus subsequent-generation family firms. Still, given that the importance of succession has been well established and publicized, and that family firms often experience the trials of succession as they move from one generation to the next, it would be expected that subsequent-generation family firms are more likely to recognize the importance of succession than are first-generation family firms and respond accordingly. Thus:

*Hypothesis 5. Subsequent-Generation Family Firms are more likely than First-Generation Family Firms to have formulated specific succession plans.*

Several observers of family firms have postulated that, as these firms age and/or move into subsequent-generation family management and ownership, they also progress from

one style of management to another. Informal, subjective and paternalistic styles of leadership become more formal, objective and “professional” (Aronoff, 1998; Cole & Wolken, 1995; Coleman & Carsky, 1999; Dyer, 1988; Filbeck & Lee, 2000; McConaughy & Phillips, 1999; Miller, McLeod & Oh, 2001; Schein, 1983). “Professional” management may involve the following: (a) the use of outside consultants, advisors and professional services, (b) more time engaged in *strategic* management activities, and (c) the use of more sophisticated financial management tools. These conclusions lead to several hypotheses:

*Hypothesis 6. Subsequent-Generation Family Firms are more likely than First-Generation Family Firms to use outside consultants, advisors and professional services.*

*Hypothesis 7. Subsequent-Generation Family Firms spend more time engaging in strategic management activities than First-Generation Family Firms.*

*Hypothesis 8. Subsequent-Generation Family Firms are more likely than First-Generation Family Firms to use sophisticated methods of financial management.*

Another issue of interest in the investigation of family business is “generational shadow” (Davis & Harveston, 1999). In a multi-generation family firm a generational shadow, shed by the founder, may be cast over the organization and the critical processes within it. In such a situation, “succession” is considered incomplete, may constrain successors, and may have dysfunctional effects on the performance of the firm. Yet this “shadow” may also have positive impact, by providing a clear set of direction and standards for subsequent firm managers. Kelly et al. (2000) similarly proposed that a family firm founder’s “legacy centrality” will influence the strategic behavior of succeeding generations’ family member managers, with both positive and negative impact. Davis and Harveston (1999) also investigated generational shadow, but reached mixed conclusions regarding its impacts. Thus management in both first-generation family firms and subsequent-generation family firms should be influenced by the objectives and methods of the founder:

*Hypothesis 9. Top management styles and decisions in Subsequent-Generation Family Firms are no less likely than in First-Generation Family Firms to be influenced by the original business objectives and methods of the founder.*

Family firms need not always be privately owned. As they grow and/or as they move into subsequent generational involvement, opportunities and needs for “going public” may arise. The family may not be able, or may not choose, to provide sufficient management or financial resources for growth, and outsider ownership can resolve this situation. And even publicly owned companies can continue as “family businesses,” if management or financial control is maintained by the family. McConaughy (1994) found that 20% of the *Business Week 1000* firms are family-controlled. Thus:

*Hypothesis 10. Subsequent-Generation Family Firms are more likely than First-Generation Family Firms to have considered “going public.”*

Following from the preceding discussion, it is correspondingly more likely for subsequent-generation family firms to use equity financing rather than debt financing. Cole and Wolken (1995) and Coleman and Carsky (1999) found that older and larger family firms use more equity financing and less debt financing than younger and smaller family firms. This leads to:

*Hypothesis 11. Subsequent-Generation Family Firms are more likely than First-Generation Family Firms to use equity financing rather than debt financing.*

Note that ten of the hypotheses predict differences, and only Hypothesis #9 predicts no differences. Also, new to this follow-up study, with the use of multivariate analysis of variance (MANOVA):

*Hypothesis 12. Together the 11 dependent variables provide a MANOVA model that finds significant differences between generations of family firms.*

## **METHODS**

As stated, this paper is a follow-up study to the Sonfield and Lussier (2002) survey research study. Differences in the methodology between the two studies are discussed.

### **Sample**

Survey instruments were randomly mailed or hand-delivered to a variety of New York and Massachusetts companies which had been identified as family businesses. A net distribution of 550 surveys yielded 159 usable returned, a 29% return rate. To improve the earlier study (Sonfield & Lussier, 2002), the sample size was increased from 109 in that study to 159 in this study, with the majority of the additional family firms being first generation, which increased from 13 to 50, increasing reliability and validity of this current study.

### **Variables Measured**

The independent variable was the number of generations involved in the operations of the family business. The nominal measure was one, two or three or more generations.

From Sonfield and Lussier (2002), the dependent variables to test Hypotheses 1-11 were as follows. (1) The percentage non-family managers. (2) The percentage of female family members involved in the operation of the firm. Hypotheses 3-10 were 7-point Likert interval scales of: “describes our firm” to “does not describe our firm”: (3) degree of all family members involved in decision-making, (4) level of family conflict, (5) formulation of succession plans, (6) use of outside advisors, (7) amount of long-range/strategic thinking, (8) use of sophisticated financial management tools, (9) influence of founder, and (10) consideration of going public. (11) The use of debt or equity financing was a nominal measure of one or the other. Descriptive statistical data included number of



years the firm was in business, the number of employees, industry (product or service), and form of ownership.

## **Analysis**

The earlier study used univariate statistical testing, one-way ANOVA. This current study uses the strong multivariate test multivariate analysis of variance (MANOVA). Hypotheses 1-12 were tested by using MANOVA, which provides a multivariate test of the 11 dependent variables together as a model by generation (H12). It also provides tests of between-variable effects to test H 1-11. Thus, MANOVA is similar to one-way ANOVA in that it tests each variable for significant differences between generations; however, it is a stronger test as each individual test also takes into consideration the other test for interaction effects.

## **RESULTS**

Of the sample of 159, the number of first generation firms was 50 (31%), second generation 60 (38%), and three or more 49 (31%). The mean number of years the sample family firms were in business was 39 (1GFFs = 13, 2GFFs = 34, 3GFFs = 67). As can be expected, the more generations, the longer the firm has been in business. The mean number of employees was 195 (1GFFs = 51, 2GFFs = 228, 3GFFs = 310), with a s.d. of 662 and range from 1 to 6,454. As in the population, more businesses were in the service section 117 (74%), [1GFFs = 78%, 2GFFs = 71%, 3GFFs = 76%] with 42 (26%) offering products. More firm ownership was corporation 118 (74%), followed by sole proprietorship 24 (16%), and partnership 17 (11%).

### **Hypotheses Testing 1-11**

See Table 1 for hypotheses 1-11, two can be accepted. There was a significant difference in (H5) the formulation of specific succession plans ( $p = .000$ ). The 1<sup>st</sup> generation firms do less succession planning than the 2<sup>nd</sup> and 3<sup>rd</sup> generation ( $m = 1.96, 3.80, 3.16$ ). Also, as hypothesized, there was no difference among generations regarding the (H9) influence of the founder of the firm ( $m = 5.12, 5.35, 4.59$ ;  $p = .139$ ).

[table 1 about here](#)

Thus, seven hypotheses can be rejected because there were no significant differences among generations: (H1) the percentage of non-family managers, (H3) degree of family involvement in decision-making, (H4) presence of conflict, (H6) use of outside advisors, (H7) use of strategic planning, (H8) use of sophisticated financial management tools, and (H10) consideration of going public.

Two other hypotheses are also rejected because there were significant differences that were *not* predicted by the hypotheses: (H2) There was a difference in the percentage of female family members involved in the operation of the firm ( $p = .035$ ). First-generation firms had a higher percentage of females than 2<sup>nd</sup> and 3<sup>rd</sup> generations (38%, 26%, 26%).

(H11) There was a difference in the use of debt to equity financing ( $p = .000$ ). The 1st generation firms had the highest use of equity with 61% to 39% debt. 2nd generation firms had 88% debt and 12% equity. 3rd generation firms had 67% debt and 33% equity. There was also a significant difference between the 2nd and 3rd generation debt to equity ( $p = .014$ ) financing.

### **Hypotheses 12 Testing**

The MANOVA multivariate tests (Pillai's Trace, Wilks' Lambda, Hotelling's Trace, and Roy's Largest Root) indicated that the 11 dependent variables together form a model that has significant differences between generations ( $p = .000$ ), which supports the hypothesis (H12). However, there is a limitation to this finding. As with regression, if you include enough variables, with a large sample size, there is a good chance that the model will be significant. Only 3 of the 11 variables (27%) are significantly different between generations. The model also has poor explanatory power, as the largest adjusted R square for the 11 variables is only .131. So the model may be significant, but it may not be very meaningful.

## **IMPLICATIONS AND CONCLUSIONS**

The issue of possible generational differences among family businesses, and this study of that issue, are important because family business owner-managers and both those who research and those who assist family firms need to know whether it is of value and perhaps necessary to differentiate between generational categories within the total population of such firms. Are there significant differences which should be studied more fully, and would these differences in turn mean that different forms of management and of assistance would be most effective for first-generation versus subsequent-generation family firms?

Clearly, much of the existing literature regarding possible generational differences among family firms is not supported by this current research study. In most respects, 1GFFs, 2GFFs and 3GFFs share the same management activities, styles and characteristics. Most prior studies' examinations of generational issues were only a small or tangential part of a larger focus on other or broader family business issues. Thus, the hypotheses formulated for this study were based on limited research conclusions. Even though this current study provides a stronger testing of these issues than earlier studies, these current findings still indicate a need for more focused and more extensive analysis of generational similarities and differences among family firms.

## **REFERENCES**

Sonfield, M. & Lussier, R. (2002). First-Generation and Subsequent-Generation Family Firms: A Comparison. *Proceedings of the Small Business Institute Directors Association National Conference*, February, pp. 153-161.

Due to space limitations, the other 41 references available from the first author

Table 1  
MANOVA Test Between Variables Effects Comparison by Generation (N = 159)

| Hypotheses   | 1GFF<br>(n=50) | 2GFF<br>(n=60) | 3GFF<br>(n=49) | Adj<br>R <sup>2</sup> | p-<br>value |
|--|----------------|----------------|----------------|-----------------------|-------------|
| 1. Use of non-family members within top mgt (mean % non-family)                        | 28             | 30             | 36             | -.002                 | .434        |
| 2. Women family members working in firm (mean % of women)                              | 38             | 26             | 26             | .030                  | <b>.035</b> |
| 3. Use of team-management style (mean 7-1 <sup>1</sup> )                               | 3.66           | 4.33           | 3.71           | .005                  | .241        |
| 4. Having conflict between family members (mean 7-1)                                   | 2.40           | 2.65           | 2.22           | -.003                 | .467        |
| 5. Formulation of specific succession plans (mean 7-1)                                 | 1.96           | 3.80           | 3.16           | .100                  | <b>.000</b> |
| 6. Use of outside consultants, advisors, and professional services (mean 7-1)          | 3.54           | 4.38           | 4.53           | .022                  | .064        |
| 7. Time spent in strategic mgt activity (7-1)  | 3.04           | 3.25           | 3.20           | -.010                 | .794        |
| 8. Use of sophisticated methods of financial mgt (7-1)                                 | 3.06           | 3.77           | 3.16           | .011                  | .162        |
| 9. Degree of influence by original business objective and methods of the founder (7-1) | 5.12           | 5.35           | 4.59           | .013                  | .139        |
| 10. Consideration of going public (mean 7-1)   | 1.42           | 1.45           | 1.22           | -.001                 | .402        |
| 11. Use of equity financing rather than debt (proportion equity/debt)                  | 61/39          | 12/88          | 33/67          | .131                  | <b>.000</b> |

<sup>1</sup> Likert scales—Mean of Describes our firm 7 6 5 4 3 2 1 Does not describe our firm

**SESSION: E-BUSINESS, INFORMATION SYSTEMS, & TECHNOLOGY ISSUES**

**ENTREPRENEURIAL ASSESSMENT OF TECHNOLOGY COMMERCIALIZATION  
AND NEW VENTURE FORMATION USING A DECISION MATRIX TO DIRECT  
COMMERCIALIZATION STRATEGIES**

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**ABSTRACT**

An integrated, inter-disciplinary graduate course entitled *Strategic Market Assessments for New Technologies* has been described previously. Working in inter-disciplinary teams (business, engineering, legal, science/medicine), graduate students develop: 1) evaluations of the strengths and weaknesses of the technologies, 2) competitive analyses of products and/or services currently in the marketplace, and 3) strategies for further development and commercialization of the technologies under evaluation.

Technology and market assessment tools were developed and utilized to assist in the technology evaluation and in the market analysis. There remained a difficulty in the development of appropriate strategies for commercialization and scoring schema and decision matrices were developed. These matrices were instituted in spring 2004 with significant success. Subsequently, the matrices were used to retrospectively evaluate the 20 projects completed during 1999-2003 to assess these projects in a similar manner and to validate the utility of the matrices. Use of the tools and matrices aided the development of strategic alternatives by identification and

categorization of areas of needed focus and strength. The use of the matrices, with the assessment tools, resulted in appropriate strategies for commercialization. The commercialization matrices were demonstrated, in a small retrospective evaluation, to have usefulness in the evaluation of technologies for commercialization and development of potential new ventures. More evaluation of the assessment tools is necessary, however, before final definitive conclusions can be drawn and recommendations made. The tools and matrices are unable to quantitate the commitment, hard work, drive, and tenacity of the entrepreneur so vital to the success of technology commercialization and new venture formation.

## INTRODUCTION

Technology transfer and commercialization is generally defined as a process designed to apply and share scientific information available to other organizations. The historical paradigm for technology commercialization has typically been for an idea or question to be investigated and answered in the laboratory by the scientist; translation of the laboratory results/output or process to a scalable, repetitive, reproducible level by the engineer; followed by the creation of an appropriate venture for the marketing and sales of the technology/product through the expertise of the business professional. To expand and paraphrase an old adage: “Science creates ideas, engineering creates products, and...*business creates companies and sales.*” This interdisciplinary schema, when successful, results in wealth creation for all stakeholders and for society. In the case of a university technology transfer program, the objective is to make university research available to private industry, including start-up companies, venture capitalists, and state and local governments. (Snyder, 2003)

Entrepreneurship results in the creation of economic value by utilization of research, technical information, and knowledge in inter-disciplinary projects and ventures to commercialize unique and innovative technologies and products. Entrepreneurs have been shown to be characterized by innovative behavior and to employ strategic management practices; the main goals being profit and growth. (Sexton, 1984) Opportunity assessment is the initial step in successful entrepreneurship. In technology ventures, knowledge and information regarding the specific technology are implicit in the opportunity assessment and usually not a significant issue for the entrepreneur. However, knowledge, and preferably a deep understanding of potentially competitive technologies, are also vital and may not be apparent to the investigator/entrepreneur, or even to the technology transfer professional. Shane has shown that knowledge of markets and ways to serve markets and customer’s needs influence opportunity discovery. (Wright, 2004; Shane, 2000) This market-related information and knowledge may be lacking in the academic investigator/entrepreneur, and even in the technology transfer professional, especially with regards to specific technologies and markets. It can be extremely difficult, even for experienced professionals, to successfully identify those technologies/products which will be successfully commercialized, especially early in the research or developmental processes, due to uncertainty and risks that are difficult, if not impossible, to quantify and measure. As noted by Wright, et. al., “there is an imperative to deal with the uncertainty surrounding the technology in its primitive state” (Wright, 2004), and “the uncertainty arises...due to a lack of information and the lack of an obvious market...” (Miller, 1984)

Unsuccessful commercialization can result from technologies that are premature, dysfunctional, too expensive, do not meet customer’s requirements, or from markets where there is poor

demand, excessive competition, or lack of adequate financial return. Therefore, it becomes imperative that any technology assessment include detailed market assessment and analysis. Additional in-depth assessment is often necessary to determine whether a successful business venture can then be created around a novel technology or product. Unsuccessful transfer and/or commercialization can be costly for all stakeholders; therefore, it is critical the technology transfer and commercialization processes be efficient, effective, and optimal. The Kauffman Foundation Report identified that there was no comprehensive source of professional development and training for technology transfer and commercialization, and recommended “support for the next generation of technology transfer leaders”. (Snyder, 2003) The graduate educational process can be used to address this apparent deficiency, and has been a driving impetus for the development of the course which is the basis of this study.

To assist in the resolution of these issues, an integrated, semester-long (16 weeks), graduate course entitled *Strategic Market Assessments for New Technologies (SMA)* was developed and instituted and has been previously described<sup>7</sup>. Working in inter-disciplinary (business, engineering, science/medicine) teams, graduate students develop: 1) evaluations of the strengths of intellectual property portfolios of USF investigators, 2) competitive analyses of products and/or services currently in the marketplace and 3) strategic alternatives for commercializing the technologies. The teams work in conjunction with the University investigators and under the guidance of an inter-disciplinary faculty (business, engineering, science/medicine) that has experience and expertise as academicians, practitioners, and entrepreneurs within their fields of expertise. The projects were obtained following discussions with the University of South Florida Research Foundation, the USF Division of Patents and Licensing, and senior administration and faculty. These projects were selected as “cutting edge”, high profile, and with significant potential for technologies appropriate for transfer and ultimate commercialization.

To assist in the intellectual property and technology evaluation, and in the competitive market analysis, technology and market assessment tools were developed and utilized. There remained, however, a difficulty in the instructional process regarding development of appropriate strategies for commercialization. Therefore, scoring schema and decision matrices were developed to help alleviate “the absence of information that creates decision uncertainty and decision complexity” (Wright, 2004; Busenitz, 1997) for students. The use of these matrices was instituted in the spring 2004 with significant success from the standpoints of all stakeholders. Subsequently, the matrices were used to retrospectively evaluate the projects completed, and new ventures formed, during 1999-2003 in order to assess these projects in a similar manner and to attempt to validate the strategy matrices and their utility. The ultimate goal of the development of these tools and matrices was to standardize and streamline the processes of opportunity recognition, technology and market assessment, and strategy formation for appropriate technology transfer and commercialization, in addition to transfer of this knowledge and these techniques to graduate students for use in their subsequent careers.

## **METHODS AND MATERIALS**

The strategic decision matrices were developed in the Spring semester 2004. The matrices were presented to the students for use during the semester, and were used to assist in the strategy development for the 2003-2004 *SMA* projects. The matrix scores used in the current study for the year 2004 were the scores developed by the student teams, which had been reviewed during

course meetings. The 20 projects during 1999-2003 were evaluated independently and blindly. The scores of each evaluator for each project were tabulated and averaged to determine an average technology and market assessment score for each project. The technology and market scores were summed to determine recommendations regarding commercialization strategy and compared to the outcome regarding technology commercialization and/or new venture formation.

The project scores were tabulated at the decision “breakpoints” to determine the predictive ability of the individual technology and market assessment tools:

|        |  |
|--------|--|
| <40    | (Very Weak—Abandon/Further R&D),           |
| 40-54  | (Weak—Further R&D/Build Value),            |
| 55-69  | (Moderate—Build Value/License/New Venture) |
| 70-100 | (Strong—Joint Venture/New Venture)         |

The technology and market scores were totaled and tested against the combined total decision “breakpoints” for predictive ability related to successful new venture formation.

For the combined score, the designated breakpoints, and concomitant recommendations were:

|         |  |
|---------|--|
| <80     | (Very Weak—Abandon/Further R&D),                     |
| 80-109  | (Weak—Further R&D/Build Value),                      |
| 110-139 | (Moderate—Build Value/License/New Venture Formation) |
| 140-200 | (Strong—Joint Venture/New Venture Formation)         |

The potential recommendations from the matrices were: 1) abandon, 2) build value with further research and development (R&D), 3) license the technology, 4) joint venture, and 5) new venture formation, and were compared to the plans for the technology as determined by the USF Division of Patents and Licensing (DPL), the research investigator, and/or whether there was formation of a new venture.

## **RESULTS**

Of the 20 projects retrospectively reviewed, 16 had enough data to determine technology and market assessment scores using the matrices developed in 2004. The projects without adequate data were removed from further evaluation (one project removed was an internal, related project and new venture formation was not an option). With the 6 projects from 2003-2004, there were 22 total projects to evaluate the scoring matrices. From these 22 projects, there were 19 potential new ventures (3 projects were internal, related projects from previously formed new ventures where new venture formation was not an option and were not included in the analysis regarding new venture formation, but were included in the assessment of the matrices).

Based solely on the technology assessment score, three projects would have been recommended to be abandoned (very weak), while only one was felt strong enough to proceed with recommendation for early new venture formation. Eight were in the weak category, and ten were in the moderate category. These eighteen would have been given a recommendation to build value through additional research and development, or to consider licensure where the additional R&D could have been performed by the licensee. Based solely on the market assessment score, only one project was felt to have an inadequate market present or that could be developed (very weak). Again, only one project was felt to have strong potential markets. Five were in the weak category and fifteen in the moderate category. These twenty would have been

recommended to further define their potential markets or focus in a different area in order to build value for the project. The utility of the combined total score is demonstrated by the decrease in very weak projects to only two, but conversely, there were no longer any strong projects, since each project felt to be strong in either the technology or market area was significantly weaker in the other area. Again, most projects were in the weak or moderate categories.

Over the five years, 26 projects were evaluated, and four were deleted from the analysis due to a lack of adequate data (one of which was a second project for the same investigator). Of the remaining 22 projects, there were 19 potential new ventures (3 investigators had two different, but related, projects evaluated), and thirteen firms were formed (4 technologies were recommended for licensure, the investigator preferred to proceed with further R&D after evaluation in two separate projects, and 1 technology ultimately failed during further development. Despite recommendations to build value through additional R&D, thirteen investigators proceeded to form new ventures. Of these thirteen new ventures, twelve are still in existence or were acquired or merged—all outcomes that would be considered successful. The firm no longer in existence decided to develop its technology within an academic/government consortium. Of note, four new ventures were also formed from the four projects deleted from the analysis due to a lack of adequate data.

## DISCUSSION

This is a primarily a retrospective analysis with attempted validation of a newly developed analytic tool. The fact that this analysis includes only 26 projects, four of which were excluded from the analysis due to a lack of data, and is done with only three reviewers could raise debate about the relevance of the results of the study. However, because of: 1) the unique nature of the analytic tools and the analysis, 2) to hopefully entice and encourage other programs to assess the tools/matrices and their utility, and 3) to open the discussion and possibility of development of appropriate quantitative methodology for this issue within academic and applied forums, it was felt appropriate to present this data and study at this time.

One major difficulty in the evaluation of new technologies/products and markets is that *any evaluation is only a snapshot in time*, and the results can be quite variable depending on the corporate, economic, financial, and competitive conditions at the time of the evaluation. At any given point, a technology or product may receive a poor evaluation because it needs further research, further development, or more time for a market to develop or become recognized. This is particularly true for new, innovative, technologies such as were being evaluated in this course. Powell and Moris<sup>9</sup> have studied these issues and demonstrated that there are different timelines for commercialization across different technologies, which supports the likely variability in any specific temporal technology/market evaluation. An evaluation, however, may provide the investigator/entrepreneur direction and focus both in technology assessment and development, and in market assessment and determination, even if the evaluation results in a relatively “weak” assessment or recommendation, and may also provide support for the investigator/entrepreneur’s commitment to the project.

The technology assessment is straight forward and reasonably quantitative, consisting of a tabulation of the investigator’s publications, patent disclosures, issued patents, patent position



within the field (i.e., competitive patents), and grant support (government, industry, or both). The major “subjective” area of this assessment is the team assessment of the investigator/entrepreneur with regards to business acumen and interest in starting a new venture. This is a major issue for technology transfer and commercialization, and even more so for joint ventures or new venture formation as discussed succinctly by Wright, et. al. (Wright, 2004; Wright, 2004). Many of the projects received “weak” to “moderate” scores and recommendations at the time of the assessment of the technology. It would appear that this level of scoring in the technology assessment was due to a number of factors, most of which have to do with the early stage of development of the technology. All of the investigators were well recognized in their field of expertise with numerous publications, which would give a high score in this category. However, the number of patents disclosed and/or issued tended to be low (with resultant low scores) which would be expected with early stage technologies. Further, grant support (particularly SBIR/STTR) tended to be low and result in low scores; again to be expected with new and developing technologies that had not yet earned academic respect or industry interest. The achievement of higher scores would be expected after further development, which may well require significant commitment of time, effort, resources, and money. The issue may then be a “chicken/egg” situation. Unless the technology has extra-ordinarily high scores (i.e., 70+), significant commitment (additional research and/or grant support, “bootstrap finance, etc.) may be required by the investigator/entrepreneur to move forward; with the full recognition that there may be significant risk to further development of the technology.

Optimal scores in the marketing assessment are to be found with technologies that are focused on potentially large, well-defined markets, with the expectation of significant growth. This was not the case with all technologies being assessed, and this alone would skew the market scores to the lower end. The number of competitors can be important, but often for conflicting reasons. If technology licensure is planned, a large number of competitors (or potential licensees) may be useful. A large number of competitors, each with small market share, may also allow more easy entry into a market. However, if a new venture is planned, a small number of competitors may be preferable, unless there are one or two very dominant competitors. These contradictory characteristics are often present in other categories of the market assessment. It becomes rapidly apparent that the market assessment is much more subjective, requires more experience, requires more definition of reference points, expectations, and goals, and could potentially be open to more manipulation.

Use of the total scores (technology plus market) resulted in better analysis of the overall technology commercialization potential. This demonstrates that it is vitally important to assess both technology and markets to optimize commercialization potential. In fact, it is imperative to evaluate any potential new technology/product within the context of the market—it is impossible to assess a technology except as to how it will compete within the marketplace. The difficulty is in identification of the appropriate market or potential market—this is particularly true for potential “life/world-changing” technologies. But, it must be remembered that significant possibilities and returns exist even in relatively small niche markets if the technology is dominant, can be protected for a significant period of time, or develops significant market “pull”.

The likely recommendations in most of these projects based on the tools and matrices as developed would have been to build value or consider licensure of the technology and delay any

new venture formation, if a new venture would ever be formed at all. It is, however, difficult to be totally sure of the expected recommendations since the reviewers were looking only at documents and were not able to address the investigator/entrepreneur at the time of the analysis. A further difficulty is that the course and required documentation have evolved over the five year period. It was very apparent to the reviewers that the documentation was much better and present in significantly greater detail in the later years. This also made the evaluation of the later projects significantly easier and probably more consistent and representative. As noted above, these types of assessments are very time-dependent and dependent on many and varied external factors at the time in question. It is impossible to re-create these factors in a retrospective analysis. This is critically important in the assessment of new venture formation since the most critical determinant in any new venture is the management team.

The relatively low scores and weak recommendations are, however, primarily a function of the early stage of development of the technology and the markets, and may also account for the significant clustering of the results in the “weak” and “moderate” categories. This outcome, however, does identify the need for further development of the assessment matrices for better differentiation within the weak and moderate categories. Detailed assessment of the individual categories within the assessment matrices demonstrated a trend to a mean and median score of three—both in the retrospective portion of the study, and in the prospective portion completed by the student teams. This resulted in clustering of the scores in the mid-range (weak and moderate), and obviously contributed to the difficulty in differentiation of the projects. There may be explanations for this tendency, including:

- a difficulty in assessing the early stage of the projects,
- a scoring system without enough options for differentiation,
- a need for further differentiation factors/categories,
- a need for longer term follow-up to identify the appropriate differentiation factors or categories.

The first, easiest modification would be to adjust the scoring option scale from 1-5 to 1-10. This should expand the scoring and allow some further differentiation early on. We plan to make this modification immediately. On-going analysis and follow-up of the data regarding additional factors continues.

These tools and matrices represent an attempt to quantitate and objectify what are often qualitative assessments and subjective decisions. These efforts are still preliminary and will require further development of the tools and matrices, a larger sample of technologies and markets, and more time to evaluate the full result of their use. *In toto*, it would appear that these tools and assessment matrices are useful first steps. They provide a rough quantitative assessment of a technology and potential markets (even very early technologies), they are easily taught and understood, and generally provide consistent results between observers. An area, in which the tools and matrices are unquestionably deficient, and where they may well remain deficient, are measurement of the drive, commitment, and tenacity of the entrepreneur. This is obvious since, despite recommendations to the contrary, at least 13 investigators, and likely all 17, proceeded to form new ventures and did whatever was necessary to succeed. It is these qualities, in conjunction with viable technologies and sufficient markets (or adaptation of one to the other), that result in successful entrepreneurial ventures. Identification and determination of the correct combination and mix of all these factors remain the ultimate challenge.

This project is an attempt to begin the collection of standardized data on technology transfer and commercialization at USF as has been recommended by multiple authors. (Sexton, 1984; Morgan, 2001) The data is being entered into a computerized database where it will be readily available for retrieval and analysis. It is anticipated that the prospective collection, analysis, and use of this type of data and information will be of great use to the USF administration, faculty, and students. This is an on-going project at the USF Center for Entrepreneurship, and we would welcome utilization and assessment of our tools and matrices by other groups.

## SUMMARY

Decision matrices for the development of strategies for the assessment and commercialization of technologies have been developed and utilized in an inter-disciplinary graduate class focused on the strategic assessment of technologies at the University of South Florida. The results of the use of these matrices have been reviewed and analyzed. The use of the commercialization matrices, in conjunction with technology and market assessment tools, has resulted in appropriate conclusions and recommendations in the assessment of the technologies and the markets, in addition to appropriate strategies for commercialization. However, the matrices need additional development to better differentiate those technologies likely to become successful new ventures.

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# ENTREPRENEURS' STORYTELLING: PRELIMINARY EVIDENCE OF ENTREPRENEURS' USE OF ORAL NARRATIVE

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## ABSTRACT

Do entrepreneurs use storytelling to exchange important information? This study reports the analysis of oral histories of 25 entrepreneurs and describes the ways in which entrepreneurs use storytelling to exchange information. The study found evidence that entrepreneurs use storytelling to exchange important information including the processes of: organizing, opportunity identification, sales and financing. Entrepreneurs may find that development of specific skills for the use of storytelling could lead to improved performance in each of the functional areas. Entrepreneurship scholars may find the ability of entrepreneurs to tell stories provides a unique means for differentiating between entrepreneurs and non-entrepreneurs.

## INTRODUCTION

The popular press is full of stories successful entrepreneurs. The field of business management has a long history of utilizing storytelling in the form of case studies as a pedagogic tool (Alvarez & Merchan, 1992, p.29) and more recently has begun to utilize case studies in research (Chetty, 1996; Eisenhardt, 1989, p.534; Kanter, 1983). However, research that investigates storytelling as a practice of entrepreneurs is relatively rare in the field of entrepreneurship.

Storytelling or, more formally, oral narrative is defined as the verbal presentation of a series of events meaningfully connected in a temporal and causal way (Onega Jaén & García Landa, 1996, p.3). The collection and analysis of the stories that entrepreneurs tell allows researchers to view the phenomenon of entrepreneurship through the subject's eyes (emic point of view), rather than from the more limited viewpoint of an outsider (etic point of view) (Hansen & Kahnweiler, 1993, p.1401).

This study reports the collection and analysis of oral histories of self-identified entrepreneurs and describes new understanding of the way in which entrepreneurs use storytelling to exchange information. The specific research question of this study is: "Do entrepreneurs use storytelling to exchange important information?"

## DATA COLLECTION

Approximately 22 hours of interviews with 25 self-identified entrepreneurs were recorded in the course of this research project. Each interview consisted of an entrepreneur recounting his or her life story. The interviews were collected in 2002 throughout the southwest of Canada and the

northwest of the United States, an area chosen because it provided a relatively homogenous cultural heritage. The entrepreneurs who agreed to be a part of this study were from a wide variety of industries: clothing, communications, consulting, health care, hospitality, manufacturing, retail, software development, trading and yachting. They ranged in age from 27 years to 76 years. Thirteen of the entrepreneurs were American, eight were Canadian and four were immigrants to Canada from other countries. Male entrepreneurs made up 68% of the population of this study. This approximates the finding of the Global Entrepreneurship Monitor study, which found males made up 62% of the total number of entrepreneurs in the US and 67% of the total entrepreneurs in Canada (Reynolds, Hay, & Camp, 1999, p.24).

### Data Quality

Data quality is usually measured in terms of *validity* and *reliability*. Validity is defined as measurement of the accuracy of information and its generalizability (Creswell, 1994, p.158). In qualitative research, the construct of validity is generalized to truthfulness of investigation (Kvale, 1995, p.25). Reliability has been defined as a measurement of the likelihood of similar conditions giving rise to similar observations (Aunger, 1995, p.99). In qualitative research, the construct of reliability is generalized to craftsmanship on the part of the researcher (Mays & Pope, 1995, p.110).

Validity can be broken down into two constructs: *internal validity*, which concerns the accuracy of information and *external validity*, which concerns the generalizability of findings. The construct of internal validity in positivist science corresponds to veracity or the degree of correspondence with objective (Kvale, 1995, p.23). Postmodern philosophy of science disputes the notion of objective reality (Feyerabend, 1975, pp.81-92) and substitutes “spirit of truth” (Ricoeur, 1965, pp.189-190) as the measurement of veracity. In this study, veracity has been tested by comparing the events described in the actuality for conformity with printed records (Allen & Montell, 1981, p.85). The construct of external validity in positivist science corresponds to generalizability and is generally treated as a sampling issue in interpretive inquiry (Zikmund, 1994, p.259).

This study utilized a process of *theoretical sampling* (Glaser & Strauss, 1967, p.45) in the determination of the number and types of candidates to be interviewed. Simply stated, theoretical sampling means that the ethnographer chooses the next people to interview when he or she feels the need for data to compare to the data already collected (Agar, 1980, p.124). Barney Glaser and Anselm Strauss refer to this point as *theoretical saturation* (Glaser & Strauss, 1967, p.61). Overall theoretical saturation was tested by comparing the data collected to a typology of eight entrepreneurial archetypes described by William Gartner (Gartner, 1982).

### ANALYSIS OF DATA

The specific research question, which the study investigates, is: “Do entrepreneurs use storytelling to exchange important information?” Statements of entrepreneurs describing their use of narrative were collected from the entrepreneurs’ recorded life stories. Table 1 classifies these statements into a typology based on the ways that the entrepreneurs of this study described their use of storytelling.

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Table 1 about here

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It is interesting to note that the female entrepreneurs of this study reported using storytelling as a tool for organizing and as a sales tool more frequently than male entrepreneurs. However, the male entrepreneurs reported using storytelling as a tool for opportunity identification more frequently than the female entrepreneurs.

#### Storytelling as a Tool for Organizing

Entrepreneurs in this study referenced storytelling 19 times as a tool used for organizing. Management researchers Mills, Boylstein and Lorean have suggested that storytelling can be seen as “explanatory mythmaking or conceptual construction that interpret and frame organizational situations” (Mills, Boylstein, & Lorean, 2001, p.118). The entrepreneur, Tom Keffer provided an example of how he used storytelling to create an organizational myth:

I wrote a company history up. And one of the anecdotes I gave in that is how when you were trapped at the phone all day long you couldn't go anywhere. This was before cell phones. So even something simple like taking a shower was a problem. And more than once the phone would ring when I was in the shower. I would take the phone in with me and when it would ring, and I would shut the water off and wait a few seconds for the gurgling noise to stop; pick up the phone and as calmly as I could, I would say: “Rogue Wave Software.” (Keffer & McKenzie, 2002, 14:45-15:16)

This particular myth frames the importance of customer service at Rogue Wave Software. To Keffer, customer service is so important that he would allow a customer to interrupt his bathing. Entrepreneurs in this study used storytelling in organizing in a wide variety of ways: to share best practices amongst organization members, as a way of documenting organizational structure, to learn business practices in a family setting, as a way of articulating the entrepreneur’s vision to organization members, to describe a business model and as a way of explaining complex relationships within the organization. In all of these cases, narrative appeared to have been used as a vehicle for the exchange of complex and rich information.

Organization theorist Ellen O’Connor views organizational decision making as the convergence of oral narratives claiming that the narrative’s power comes from its ability to simultaneously render information and the meaning of that information (O'Connor, 1997, p.309). Jan Kelly found that stories were used in high-tech firms to address equality, security and control (Kelly, 1985, p.57). David Boje has observed that storytelling in organizations has two intertwined components, stories as texts and stories as performance (Boje, 1991, pp.123-124). The majority of references that the entrepreneurs in this study made to storytelling used as a way of organizing referred to stories as text. This would explain the logic of Keffer’s writing down his narrative of the history of Rogue Wave. By solidifying the story, he hoped to create a stable, predictable organizational culture.

#### Storytelling Used to Identify and Communicate Opportunities

The entrepreneurs in this study reported 16 instances of the use of storytelling for opportunity

identification. The entrepreneur, Peter Newman provided an account of how he used storytelling to identify the opportunity associated with the founding of Progressive Plastics:

We were running a campsite, which was a learning experience. We were running a campsite and we were running this fabricating shop in Prince George and doing all the estimating and everything else and Brad was looking after the shop. And, in the meantime, one of our plastics suppliers, one of the guys I knew there well. Him and I went for a beer one night and he was complaining about this company. And I said 'well why don't we start up our own plastics company?' So we started up a plastics...an industrial plastics supply company which he ran, and I was the joint partner with him. (Newman & McKenzie, 2002, 30:06-30:39)

Throughout the interviews of this study, it was common for entrepreneurs to place their visions of opportunities into the context of a performance narrative. Often the product or market or combination of product and market that formed the basis of the opportunity did not exist at the time the entrepreneur envisioned the opportunity.

Not only did the entrepreneurs in this study use storytelling to uncover opportunities, but they also tended to use versions of the narratives they had created to convey the opportunity to others. This is a clear example of storytelling as performance. The entrepreneur, Nathan Rothman was explicit in describing the importance he placed on exchanging information about new business ideas with other people when he said, "I'm a big advocate about talking to people about your business idea and getting other ideas from people" (Rothman & McKenzie, 2002, 25:33-25:38). The entrepreneur, Tim Vasko's description of his identification of the opportunity in investment banking provided a simpler example of how a narrative can contain the interplay of characters, needs and desires and time:

I've always been interested in the stock market. It's always fascinated me as a kid and everything. So I got my license to sell mutual funds and...I made one sale. And so I was basically as salesman and I made one sale for...and the guy who sponsored me...the sale I made was a \$30,000 bond fund. And so I was expecting to get, the commission was four percent, so I was expecting to get \$1,200 or something less, maybe \$1,000. And I got a cheque for \$600. And I called the guy who had sponsored me to get my license and he goes, "Well half of it is mine". And I said, "You mean, I went out, I found the person, you don't give me an office, you don't give me anything, you don't pay any of my bills, you don't pay for my gas and you're going to keep 50% of my money." And he said, "Yeah, that's the way it works." And I said, "Not for me it doesn't." And so I decided that...I said, "Well, I'll just go and start my own company." And the guy said. "Good luck." (Vasko & McKenzie, 2002, 07:05-09:08)

Contained within this brief oral narrative are a host of details about the operation of the marketplace in 1983, the prevailing attitudes of competitors, and the intentions of the storyteller. These details would be difficult to portray so concisely through a medium other than storytelling.

## Storytelling as a Sales Tool

The ability of narrative to carry richness of detail suggests that it is well suited to use as a sales tool. The life stories collected in this study make 12 references to storytelling being used as a tool to exchange information in the process of sales or marketing. Nathan Rothman tells this story about how he used oral narrative to sell a number of sailboats before he had built even one:

So I went out and actually pre-sold a couple of boats...And I showed the boat to Bill Black and I said, "Bill, you know, here's the design and thousand bucks holds you a spot in line." And I had another friend, at the time Stan Dabney. Stan and Sylvia Dabney, who are still in the boat business...Stan Dabney ran a printing company, later became our sales manager. But ran a printing company, but he was a good friend of mine. And I said, "Stanley, before I can go to Bill Black, I need to have somebody on the list, you know I need to have sold a boat to somebody else. So put your name on the list. You bought hull number three and we'll go to Bill and we'll go to other people and we'll tell them look three are sold already you'd better get on the line you better get on the list, or you know you're not going to get one, you know." And so we went to Bill, and Bill Black wrote a cheque for a thousand bucks. And we went to a fellow by the name of Sever Murphy who ran the Indoor Sun Shop, which was a florist and plant shop in the University District. And he wanted one, and we put him on the list, and we got a thousand bucks from him so we sold four or five boats. (Rothman & McKenzie, 2002, 23:53-25:14)

Rothman's narrative builds tension within the prospective purchaser's mind that replaces their concern over not being able to see a boat with a new concern that the boats might all be gone by the time they actually get to see one. This tension could not have been built with facts and figures, since no boats actually existed nor had any actually had been sold. This tension could not have been created using print media, since the delay caused by writing a report, delivering it and then waiting for it to be read takes too much time for the deft interplay between the characters that Rothman was manipulating. Rothman's use of narrative in sales took advantage of the difficulty the purchaser had in searching for accurate information. Clifford Geertz described the process of information search in the primarily oral bazaar economy as being "laborious, uncertain, complex and irregular" (Geertz, 1992, p.227). Marc Weinstein's account of the used book trade in Gardena, California reveals similar characteristics in a North American setting (Weinstein, 1999, pp.9-15). Rothman's clients were intent upon the purchase of a safe, reliable, fast and stylish sailboat, characteristics that were not necessarily mutually compatible. Rothman's narrative, like the bazaaris multidimensional bargaining, allowed each client to feel he was getting the best deal possible.

## Storytelling Used in Financing Ventures

The entrepreneurs in this study referenced storytelling eight times as a tool used for financing their ventures. Ellen O'Connor has described the use of narrative by entrepreneurs seeking venture capital financing as the creation of generic stories (O'Connor, 2002, p.45). Generic stories tend to be easy to tell and make intuitive sense with prospective investors. Tom Keffer described his experience touring the US to meet with investment professionals prior to Rogue



Wave Software's Initial Public Offering (IPO) in these words.

It's the road show that's got this mythic vision. But I don't know, I found the road show kind of boring. Because you have this presentation that you fix up and tune so that it's just...Oh...perfect. And you go out on the road and I gave that damn presentation 65 times in a row over two weeks. That's pretty dull, I'll tell you. It's not exciting or anything like that. It's just dull. (Keffer & McKenzie, 2002, 24:48-25:30)

Keffer offered the only example of this level of financing sophistication amongst the entrepreneurs interviewed in this study. However, other entrepreneurs used less heavily scripted narratives for the same purpose. We have already seen how Rothman pre-sold boats (Rothman & McKenzie, 2002, 23:53-25:14) so he could attract investors to Valiant (Rothman & McKenzie, 2002, 22:28-23:02).

### Other Uses of Storytelling by Entrepreneurs

The entrepreneurs in this study have also referenced storytelling three times as a form of recreational socializing. However, there is no evidence within any of these references differentiating them from the normal use of storytelling by non-entrepreneurs in recreational socializing.

## IMPLICATIONS

This study has provided preliminary evidence that entrepreneurs use storytelling to exchange important information. This evidence suggests an important role for future study of the stories that entrepreneurs tell. Further empirical investigation of the use of storytelling by entrepreneurs could provide evidence, useful both to entrepreneurs and to entrepreneurship scholars.

Entrepreneurs are likely to gain confidence from the realization that their storytelling ability is vital to their profession. The development of specific skills for the use of storytelling for organizing, opportunity identification, sales and financing could lead to improved performance in each of these functional areas. Entrepreneurship educators could integrate storytelling into their curriculum both as a way of passing along the heuristics of entrepreneurial expertise and as an entrepreneurial skill.

Entrepreneurship scholars may find the ability of entrepreneurs to tell stories provides a means for differentiating between entrepreneurs and non-entrepreneurs. Media scholars such as Marshall McLuhan (McLuhan, 1964) and Walter Ong (Ong, 1977) have differentiated between oral cultures and literate cultures. It is possible that an individual's ability to communicate using storytelling is related to his or her ability to identify opportunities, to create organizations and to make sales; all key entrepreneurial activities. McLuhan describes oral communication as a cool medium because the listener must fill much of the information passed in oral communication. On the other hand, he describes print as a hot medium because the author, impacts one single sense of the reader with densely packed information (McLuhan, 1964, p.36). While all of the entrepreneurs examined in this study were extremely proficient in oral narrative, only 7 of the 25 entrepreneurs of this study appeared to have the same proficiency in written narrative.

## CONCLUSIONS

This study has found evidence that entrepreneurs use storytelling to exchange important information. All the entrepreneurs whose life stories were collected in this study made some use of storytelling to exchange important information. The analysis of the 25 oral histories contained in this study has found that the entrepreneurs interviewed used storytelling both as a text and as a performance as suggested by Boje (Boje, 1991). Storytelling was used in the identification of opportunities, in the development of new organizations, in the arrangement of financing and in the process of making sales.

The evidence of entrepreneurs using storytelling to exchange important information presented in this study is preliminary in nature. It must be noted that the unstructured interview process used in the study limits the ability to generalize this finding to larger populations. Participants were asked to tell their life stories and questions were intended only to add clarification or to enhance the conversation that the memoirist had initiated. None of the participants were specifically asked if they used storytelling to exchange important information or what kind of information they exchanged using storytelling. Further research into the use of storytelling by entrepreneurs will be required to substantiate our understanding of the links between storytelling and the creative processes of organizing, opportunity identification, sales and financing.

## FIGURES AND TABLES

Table 1  
Classification of Entrepreneurs' Use of Storytelling

| Use of Storytelling        | Frequency | Male | Female |
|----------------------------|-----------|------|--------|
| Organizing                 | 19        | 29%  | 40%    |
| Opportunity Identification | 16        | 32%  | 20%    |
| Sales                      | 12        | 18%  | 25%    |
| Financing                  | 8         | 13%  | 15%    |
| Other                      | 3         | 8%   | 0%     |

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DIXON'S FAMOUS CHILI  
A WOMAN-OWNED, FOURTH GENERATION, FAMILY BUSINESS CASE STUDY

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Abstract

Dixon's Famous Chili is the oldest, continuously operating, family owned restaurant in Kansas City, Missouri. From the early 1900's, women have played pivotal roles. The societal pressures and life events that impacted these women and their families are presented to exemplify the struggles women have faced when operating a small business. The case begins and ends in the present day with the current owner facing divorce, raising three school aged children, and having no means of support except the failing family restaurant.

The teaching note uses current research on both woman-owned and family-owned small businesses to present a real world context for theory and model application. The teaching note also offers various combinations of theory, models and discussion points to bring the theoretical into a real world context. Practitioners and students enjoy seeing the relevancy of their studies and in turn, the impact of entrepreneurial decisions.

Case studies in both a woman-owned and family business context are increasing, but are still rare. The examples set by the three generations of women in the Dixon's Famous Chili case study are powerful, not only for aspiring women entrepreneurs, but for men as well to understand the dynamics of marriage, family and partnership.

The women, men and families in the Dixon's Famous Chili case faced real world situations that can be seen and understood with the use of entrepreneurial and small business theory providing students a bridge between their course work and their future.

Introduction

Kansas City, Missouri's oldest family owned restaurant was going to close; it was inevitable. The new owner was a freshly divorced, single mother with three school age children and no business experience. Her only asset was a business that was pest infested, in debt and without suppliers. The third generation to own Dixon's Famous Chili was doomed to be the last. As the owner looked at the young faces of the fourth generation, she realized she would pass nothing of the family legacy down to them except memories. Was there any way to save her self, her family and her family legacy?

Founding History

Vergne Dixon started selling chili out of a cart in the early 1900's in downtown Kansas City, Missouri. The business and recipe were little more than a hobby and a passing curiosity for both owner and client. The uniqueness, however, soon settled into a regular money making business and a permanent location was soon a goal. By 1919, Dixon's Chili was located in a permanent building in downtown Kansas City. Interestingly, all the waiters were male due to a unique hiring system; Vergne hired recently paroled convicts and the homeless as labor, paying them in food. And so another unique feature of Dixon's came to be. The men were so moved by Uncle Vergne's support that many worked for decades after Uncle Vergne's death in 1963, with the last parolee retiring from Dixon's in the early 1980s.

During the lunch hour, the busiest time for Dixon's, Aunt Lela took all the cash home. As Vergne's wife, she quickly assumed the multi-role responsibilities of bookkeeper, accountant, and homemaker. Still, the family missed the freedom of the old cart. Realizing that the hot and humid Missouri summer months had a direct impact on chili sales, the Dixon's decided to close for the summer, and if the result was an extended summer vacation for the family as well, all the better. This tradition held until 1970 and the addition of air conditioning.

For the first 50 years, the menu never changed, including Uncle Vergne's rule of no ketchup. In fact, while customers would sneak in ketchup, Uncle Vergne would fine them 10 cents if he caught anyone using ketchup on his unique chili. To this day, while ketchup is on the menu, the price is still 10 cents in honor of Uncle Vergne. The chili powder was so unique and sought after that the chili powder is patented and Dixon's chili recipe has remained unchanged since the early 1900's.

Through two world wars and a great depression, Dixon's Chili managed to survive. Thriving was a different question, but the family was able to make a decent living through good times and bad and no one complained or sought to change the business. That was until 1952, when President Truman came in for lunch. President Truman, being from the Kansas City area, had always liked Dixon's Chili and was a frequent customer. But when you are President of the world's most powerful country and have just won a contentious election, the American press follows you everywhere. Such was the case when Life magazine published a photo of President Truman enjoying a bizarre looking concoction that no one would ever mistake for chili anywhere else in the country. You see, Dixon's chili is not served in a bowl, but on a plate. The meat, juices and all the fixings are served and billed separately (remember the ketchup, as well as onions, cheese, sour cream and so on). The photo put Dixon's on the tourist map of where to eat in Kansas City and business began a steady growth. As a result, the "Famous" was added to the restaurant name. As a side note, what the Life photo did not show was the owner going across the street to get President Truman a beer. Dixon's had never applied for a liquor license and President Truman preferred beer with his chili. Dixon's Famous Chili hand delivered a bowl of chili every year to President Truman for his birthday and received a hand written thank you note every year as well.

### The Second Generation

In 1961, Uncle Vergne and Aunt Lela retired without having had children. Their sole extended family member was Aunt Lela's sister, Edith and her son, Leonard. Leonard's wife was Virginia, who had a particularly close relationship to both Uncle Vergne and Aunt Lela, who regarded Virginia as the daughter they never had. Wanting to keep the business in the family, Uncle Vergne decided to sell the restaurant at a dramatically reduced price of \$10,000 to Leonard. But Uncle Vergne had one condition; that Aunt Lela be paid a stipend of \$500 per month for the rest of her life after his death. Uncle Vergne died in 1963, while Aunt Lela lived on another 15 years, always receiving her \$500 monthly Dixon's stipend.

Leonard did not sit still on the original Dixon's, as he felt Uncle Vergne had been doing. Leonard expanded to nearly a dozen different locations; two in Kansas, one in Minnesota and the rest in Missouri. All these sites Leonard kept in the hands of family and friends. In 1970, Leonard formed a corporation, selling shares only to family and friends. That same year, Leonard closed the original location, placing the headquarters in the second oldest restaurant located in Independence, the first major suburb of Kansas City, directly east of the city.

Unfortunately, while Leonard was good at initially spreading the wealth among family and friends, he was not a good manager of these same family and friends. Nor were these new

owners and operators selected on the basis of their business skills, restaurant knowledge or customer service skills. The only qualification required to operate a Dixon's was your personal relationship to Leonard.

Yet, the Dixon's name and originality carried the budding chain for years, as well as Leonard's contagious enthusiasm for customer service and the value of the Dixon's Famous Chili name. Today, people still reflect back on Leonard's smile requirement of all his employees and how their faces ached at the end of the day from always smiling. Leonard believed in knowing customers on a first-name basis and training the staff on all the possible combinations of Dixon ingredients. However, despite Leonard's obvious enthusiasm, he could not be in all dozen stores at once and the long term prospects for Dixon's remained in question. The sudden death of Leonard in 1973 at the age of 52 put the future of Dixon's in even greater doubt.

### The Third Generation

Virginia, Leonard's wife, inherited the Dixon's Famous Chili business and immediately appointed her son Vince to run it. Vince opened several more stores taking Dixon's to 16 total locations, which did not change until the mid 1980s. But the same issues facing his father quickly faced Vince as well; lack of central control and inexperienced manager/owners. Vince had all he could handle battling the continual deterioration of Dixon's hard-won quality, service and reputation. The 16 store expansion was in danger if imploding from within.

Virginia and Leonard's other child, Terri, worked the restaurant after school, weekends and summers to earn some spending money, but was not involved nor interested in any aspect of Dixon's. Terri's goal, after meeting and marrying her husband Steve, was to be a full time mother to her three children. Steve had other ideas.

### The Third Generation Part 2

By 1982, after a decade of Vince's control, Steve envisioned greater things for Dixon's. While profits were fine for a family lifestyle business, no one was getting rich. Steve, involved as a manager for the chain under Vince, was chafing at the family control and their supposed lack of vision. Steve believed he could expand Dixon's and make the restaurant work as a regional, if not national, franchise, with professional managers and even greater cash flows and profits. However, standing in his way was his mother-in-law, the sole owner. As luck, or unluck, depending on your perspective, would have it, Virginia developed a drinking problem. Steve saw an opportunity to gain influence over Virginia and began a campaign to discredit her son, Vince. And he was good at it. One day mom walked in, fired her own son by simply saying, "You're out!", and put Steve in charge. Terri was now married to the president of Dixon's Famous Chili and the sister of the former president.

What was going through Terri's mind? She had been raised by Leonard and Virginia to be a wife and mother, with her parents never voicing a strong opinion that she continue her education after high school or learn the family business. The assumption must have been that Terri, like Aunt Lela, Edith and Virginia, would simply work tirelessly behind the scenes on the home front in support of the family business. In all honesty, Terri stated, she was simply ignorant of the business side of Dixon's and only cognizant of the family side. Terri's goal in life at that time, she stated, was to stay home and raise her children.

In regards to family relationships, even there Terri was not really involved if Dixon's was involved. The family was very adept at keeping family and business separate. As far as her

mother working with her brother or her husband, or Steve working with Vince; Terri, by her own admission, was just thinking about her children. And the others were comfortable with that role.

Terri's life would only be comfortable for three short years. By 1985, Dixon's was imploding and was down to two franchises and the original in Independence. Steve's grand design was fatally flawed, and just how flawed would soon become apparent. In 1985, at the age of 30, with three children ages 4, 6, and 8 and a mother who was dying, Terri (for reasons not related to Dixon's, of course) filed for divorce. However, during this process, Virginia dies, leaving Dixon's to Terri and Steve. The family's way of life in Dixon's and Terri's marriage were now both falling apart and her mother was gone.

### The Third Generation Part 3

Terri's demand in the divorce was twofold; first, that she get her children and second, her family legacy, Dixon's Famous Chili. Terri really can not quite explain why this sudden need to possess Dixon's, except that she was staring at three children under 10, she felt strongly that Dixon's should stay in the family as a legacy of her father, and Dixon's was the only way she knew to support her family. Steve drove a hard bargain; Terri gave up her home, financial support and the two franchises to keep her children and Dixon's Famous Chili.

Literally, Steve walked out of Dixon's one day and Terri walked in the next. Yet Terri knew nothing of the restaurant business or even business in general, management or accounting. Vince, her brother, did come back to help some, mostly over the phone, as Terri worked her way through the office. The few things Terri did bring to Dixon's she learned from her dad; customer service and Dixon's quality. Leonard always set as a goal for the wait staff to learn ten new customer names each week. To this day, returning customers that used to ask Leonard about Terri now ask Terri about her children.

And what Terri inherited from her divorce was not a successful business, not even one in good operation. The business was rundown and dirty, bills and taxes were all unpaid, the air conditioning was broken and the whole building was infested with bugs. Suppliers had written off Dixon's and were on a cash-only basis. Yet Terri would not let Dixon's go. She started cleaning, she started organizing bills, and she began working with suppliers, creating those relationships all over again. Terri began by working deals where she could, since she had no cash, but she paid on time and added extra to make up for any debt. Eventually she won them all over. The bottom line for Terri, and she communicated this to anyone who would listen, was that Dixon's was her family business and she and her children were the family.

Key to Dixon's continued survival was Sunday beer sales. At that time, there were no Sunday retail liquor sales so on Sunday's, Dixon's would line up coolers in the front window and sell beer at a 60% profit, making \$3000 per Sunday. Again, however, Terri's continued bad luck would plague her. In 1985, the year of Terri's divorce and her mother's death, the state of Missouri passed a law that all business taxes must be paid and verified to keep a liquor license. Since Steve had not been paying Missouri business taxes, Dixon's lost their license for 1985. Terri fought all year to regain the Dixon liquor license, going to the state capital city of Jefferson City to continually monitor and get the taxes caught up and paid.

In addition to the three hour one way drive to Jefferson City, Terri concentrated on cleaning and maintenance, learning as she went. A key success factor here was her landlady, a widow who admired Terri and enjoyed Terri's three kids. Terri had no choice, but to always have the children with her at Dixon's. The landlady decided to keep the Dixon's rent the same, \$1300 per month, while Terri owned the business. So, from 1985 until the landlady's death in

2001, the rent never changed. Upon the landlady's death, she and Terri had an agreement that Terri could buy the building at fair market value and that is exactly what Terri did.

Interestingly enough, when Terri looks back on these days, she felt like no major mistakes were made; she felt like she and Dixon's were always moving forward. Admittedly, the progress may not have been dramatic at times, but Terri never felt like she was moving backwards. Throughout this time, she also felt the presence of her father beside her, encouraging her, and that what she was doing was best for her family. Dixon employees, for the most part, were behind her. Given the length of employment for many of the Dixon employees, many had known Terri since she was a child. Working on a new relationship of employer/employee was interesting, Terri said, for both sides, but Terri never felt any hostility. More curiosity from the employees than anything as everyone was anxious to see how Dixon's would turn out, so the employees gave Terri the benefit of the doubt and stayed out of her way. In return, Terri has rewarded them with continued employment.

With Dixon's Famous Chili still open for business, Terri just started working, kids in tow, while living out of a duplex. Not making money really, just treading water financially, the entire family usually ate two out of three meals a day at Dixon's. By the 4<sup>th</sup> grade, the kids were busing tables and dishwashing. Moving forward, never moving back, paid off for within five years, Terri and kids were living in a wealthy subdivision in the suburbs and lunch receipts had grown from \$300 per day to over \$3000 today.

#### The Fourth Generation

Today, Terri's oldest daughter is an elementary teacher and has never regarded Dixon's as anything but a way to pay for college and launch her own career. A happy member of the extended Dixon's family, Terri's eldest is happy to watch her younger siblings carry the full time Dixon's legacy. Julie, the second child, also never expressed any long-term interest in working at Dixon's. She too worked Dixon's all her teen years and through her bachelor's degree from Northwest Missouri State University. Stephen, the youngest and only son, has always expressed a very strong interest in carrying on the family business. But he was soon to be joined by another.

When Julie was a senior at Northwest, Terri called and told Julie that she needed some time off; some time away from Dixon's. Terri asked Julie to find a new grad from Northwest, someone the family could trust, to operate the business under Terri. Even with her network of eager young grads at Northwest, Julie was unable to find someone she felt Terri would approve of, train and work with. So Julie came home and did the job herself, while looking for a full time job in the greater Kansas City area. Realizing she enjoyed Dixon's, Julie asked Terri/mom if she could apply for the new manager job. Terri trained Julie for a month and then took some time off. Interestingly, three employees that had been at Dixon's for over 20 years were not interested in the manager position.

In September, 2003 Dixon's crossed a milestone with the opening of their 2<sup>nd</sup> location in Lee's Summit, Missouri, the fastest growing Kansas City suburb on the Missouri side. Terri's goal is for this newest operation to be run exclusively by Stephen while Julie maintains control of the Independence location.

Julie has already started making changes to the Dixon's traditional menu. Since tamales have always been the most popular option with Dixon's Famous Chili, adding tacos was an easy transition given that most of the chili fixings can also be used on tacos. Julie started all you can



eat Taco Tuesday's in the winter and all you can eat taco summers, with sales dramatically increasing for the summer months when traditionally sales were nearly cut in half.

Yet, Terri has kept control of all bookkeeping and banking relationships. She taught her self all financial aspects of running a business with no one to ask and no one to help. Her ex-husband had destroyed all these relationships and her brother preferred to keep his distance. While she involved both children in the finances, Terri maintains strict control and plans on maintaining control for the foreseeable future.

Long term, Terri and children would like to return Dixon's to franchising. In their favor is a relatively simple menu and the prep is also easy to master. Currently, Stephen, a recent business graduate from Missouri Western State College, will be responsible for exploring franchising. Terri emphasized the word, "exploring". She has had many offers by potential franchisees, but she has been frustrated by the complexity of franchising. Terri maintains that franchising is a goal, but is simply not in process right now. For Terri, franchising is "scary and expensive" which seems to reflect her past history with Dixon's and franchising. So wisely, Terri is waiting for the kids to come on board, learn the business and then when the family, i.e. Terri, is comfortable with expanding, she will consider the options.

One issue facing the Independence location is Julie's desire for a family of her own and her plan on only working part time once she has children. This will be a staffing issue that so far has been tabled until children are expected.

In regards to her extended family, Terri has always stressed family comes first; friends come and go. Terri did eventually remarry and her second husband gutted and rebuilt the Lee's Summit Dixon's location. Granted, like all families, Terri's has their moments of disagreement, but with Dixon's Famous Chili, the sole owner, Terri, has the final word. Both Julie and Stephen are Vice Presidents in the Dixon's corporation, but they have no voting shares.

In family matters, discussions are held and Terri does not have absolute power like she did when the children were young and she was single. Vince, her brother and previous owner, has never left the family, but he has moved on from Dixon's and is successful in the insurance industry. Terri's second husband will soon be joining Vince in his business, leaving Terri and her children in sole control of Dixon's. Now that the Lee's Summit location is up and running with newly graduated Stephen in control, Terri is concerned with business communication; she wants a formalized way of getting together instead of simply over the phone or dinner at home. And with the growth of the business, she stresses that she wants Dixon business talk to stay at Dixon's and dinner at home to be over other family life events.

Terri's exit strategy is to sell Dixon's Famous Chili to the children and go on a monthly stipend just like Aunt Lela.

## DIXON'S FAMOUS CHILI TEACHING NOTE

### Family Business Structure

Family businesses move through five stages (Gallo, 2002) which are presented and discussed.

### Family Business Structure Discussion Part 2

Building upon the issue of generational time, the influence of the founder, while powerful and oftentimes ongoing (Kelly et al, 2000) will be reinterpreted and adjusted by succeeding generations.

### Reputation

Even worse than a newly founded business (discussion could start here with the “liability of newness” as first presented by Stinchcombe in 1965), Dixon’s Famous Chili under Terri’s new ownership found itself not only facing reputation building, but starting with a negative reputation from both suppliers, customers and government. In contrast, a positive reputation is seen as proof of a firm’s overall success with all the above as well as other stakeholders (Goldberg et al, 2003). The cost of supplies, terms of contracts, ease of operating within a regulatory environment, attractiveness to customers and investors, and the ability to attract talented personnel are all indicative of a firm’s reputation (Goldberg et al, 2003).

### Succession

The majority of family owned firms do not survive intact through the second generation; only 30% survive the second generation while only 15% of family owned firms survive the third generation (Beckhard and Dyer, 1983; Ward, 1987; Kellermanns and Eddleston, 2004). Opening the succession section are Green’s (2002) five factors of survival.

### Succession Planning

A united family, one that successfully deals with conflict, is taught and learned by succeeding generations. The key process uniting all this is education of the young (Gallo, 2002). However, it is important to keep in mind when considering the low successful succession rate of family firms, that families are complex social units with their own histories and conflicts, conflicts that are usually far more intense and long lasting than conflict found in non-family businesses (Kellermanns and Eddleston, 2004). Succession is further complicated by the transfer of daily management of the firm and ownership of the firm. These can be mutually exclusive and take place at different times with different family members setting up potential conflict (Birley 2002).

### A Succession Model

The model presented in the full teaching note is based upon a literature search of over 40 articles and 7 books over the last 30 years regarding family business succession (Breton-Miller et al, 2002). Developing a family business succession model, which Le Breton-Miller et al (2004) detail nicely, is excellent reading for aspiring scholars of entrepreneurship.

### Family Businesses Part 1

Family businesses play a prominent economic role in virtually all economies worldwide and have a significant impact on the North American economies of Canada, Mexico and the U.S. (Kelly et al, 2000). However, literature and research on family owned businesses, and family woman owned businesses in particular, has been dramatically lacking relative to their overall economic impact (Birley, 2001; Kelly et al, 2002). Birley (2002) offers an interesting classification system that should stir class discussion.

### Family Business Part 2

In a continuation of the above, a resource-based view of entrepreneurship and the exclusive characteristics of family-owned firms (Sirmon and Hitt, 2003) is presented.

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## **SUCCESS FACTORS AMONG PHILIPPINE ENTREPRENEURS<sup>1</sup>**

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<sup>1</sup> Original paper submitted to the Annual Conference of the United State Association of Small Business and Entrepreneurship (2005), Indian Wells, California.

## **ABSTRACT**

The challenges that have been brought about by competitive and highly integrated markets, economic downturn, terrorism, and internal political strife in the Philippines pose difficulties and risks to entrepreneurs in the centrally located city of Cebu. Still, amid these threats, the local entrepreneurs have managed to survive. A survey of 113 entrepreneurs from Cebu, Philippines bears out the fact that hard work, the desire for financial independence and willingness to take risks, among others, have contributed to their success. Since the typical Philippine entrepreneur is traditionally unwilling to compromise family ties for business success, the entrepreneurs pursue a strategically thin line that delineates entrepreneurial success and family harmony as an adaptation mechanism to a global environment.

## **INTRODUCTION**

Lack of adequate entrepreneurship is often cited as a serious bottleneck in the development efforts of developing countries. Many developing countries have come to the realization that entrepreneurship is the engine for economic prosperity and started to formulate series of policies to stimulate entrepreneurship development. In an earlier study, McClelland (1961) observed a correlation between desire for achievement and motivation across different cultures. Subsequently, many entrepreneurship-related studies in a developing country context have been devoted to topics such as: who are these entrepreneurs, what motivates them and how business is created, to name just a few.

This paper explores some of the major issues faced by Philippine entrepreneurs. Filipinos are enterprising individuals who have been engaged in business and commerce for many centuries. Americans have taught the Filipinos to ask two critical questions: “does it work?” and “what has he done?” (Andres and Andres, 2001: 13). Jimenez (2002) underscored the importance of innovation and entrepreneurship among Philippine business practitioners. Philippine entrepreneurs who have a steady income stream, continue to explore ways to augment their income. It is not uncommon to see entrepreneurs owning more than two ventures in the Philippines. They are manifesting the Filipino’s quest to improve their standard of living. There are bigger dreams that they want to fulfill and seek to uncover ways to earn more and improve their lot through the establishment of a business (Sanchez, 2000: 15). An increase of status is also desired. Recognition and contribution are two main goals of entrepreneurs. The average Filipino worker would like to be known as a “businessman ” (Damaso, 1982: 103). As of 2000, there were 820,960 registered business establishments in the Philippines (National Statistics Office, 2004). Many entrepreneurs have been drawn by the income and the independence offered by self-employment.

Jimenez (2002) reported an international entrepreneurship research study conducted by Accenture entailing in-depth interviews with 900 board level executives in 22 countries. The 2001 Accenture study noted that characteristics relating to entrepreneurial behavior are rather universal, except for certain differences in cultures and environments prevailing around the world. Though the study included respondents from several international locations, the Philippines was not included. This study seeks to uncover potentially distinct attributes of Philippine entrepreneurs.

As the Philippine business environment becomes more globally integrated, and collaborative engagements with Philippine entrepreneurs loom, an understanding of the entrepreneurial mindsets of individuals in this emerging nation becomes highly relevant. Paje (2002) noted that in developing countries such as the Philippines, there are limited job opportunities in the formal sector of the society, as a result unemployment rates tend to be high in the countryside and migration of people to the urban centers ensue. As absorption of the new entrants is limited, these segment of the society are forced to engage in entrepreneurial activities due to the lack of other options. Morato (2004) pointed out that 91% of the registered enterprises in the Philippines are considered as micro enterprises (informal businesses with very few employees), 8% are described as small (less than 20 employees), while only about 1% are medium (20-99 employees) and large (100 or more employees). This suggests that home-based, family owned ventures abound in this emerging nation of 80 million.

In the context of international entrepreneurship, critical questions need to be asked to better understand this environment. This paper focuses on these questions: What are the attitudes of the Philippine entrepreneurs toward self-employment? What are the reasons for the residents' selection of business over other activities? What is the likelihood of the entrepreneurs' involvement in business in the next two years? What are the Philippine entrepreneurs' attitudes and beliefs regarding business?

### **PHILIPPINE ENTREPRENEURS**

The Philippine entrepreneur's motivation to engage in business is anchored on an aspiration not only for oneself but for the family as well. Value is placed on extended families over that of individuals. Thus, Philippine entrepreneurs want to prosper for the sake of the family. This concept is strengthened by the belief that the only source of emotional, economic, and moral support is the family (Andres, and Andres, 2001: 6).

In a study on entrepreneurship in 23 countries including the Philippines, Benz & Frey (2003) concluded that individuals engaged in self-employment tend to have greater work satisfaction than employees as a result of the freedom and independence they enjoy. Individuals are pulled toward entrepreneurship by the prospect of profit, independence, and a satisfying way of life (Longenecker, Moore and Petty, 1997: 6). Hamilton (2000) pointed out that entrepreneurs are at times willing to earn lower wages as long as they are engaged in self-employment. Since entrepreneurial activities entail a level of risk, in investing resources entrepreneurs directly assume financial risk. In leaving secure jobs, they risk their careers. The stress and time required in starting and running a business may place their families at risk.

There exist entrepreneurial attributes within the Philippine culture. In a cross-cultural study, Hofstede (1991) indicated that the Philippine culture has high power distance, high masculinity, low uncertainty avoidance. These attributes are identified by McGrath et al (1992) as traits typically present among entrepreneurs across international venues. In Hofstede's study, however, Filipinos scored low on individualism. High individualism typically characterizes entrepreneurs (McGrath et al, 1992). This collectivist or group-oriented behavior can temper entrepreneurial tendencies.

Yet, the expectation of achievement attracts the enterprising individual. Achievement is a self-administered reward derived from reaching a challenging goal

(Gibson, Ivancevich, and Donnelly, 1997: 182). Some authors view entrepreneurship as a matter of attitude. The right attitude converts one's quickened heart rate and night sweats into kind of excitement that leads to a successful business (Wolter, 2002: 63).

### **Sampling**

The respondents of this study were 113 randomly selected entrepreneurs in six major business locations in Cebu, Philippines. The entrepreneurs were asked to complete the Entrepreneurial Profile Questionnaire, which was used as a data collection instrument in this study. The Entrepreneurial Profile Questionnaire collected data on the demographic and business profile of the Philippine entrepreneurs. Data regarding the entrepreneurs' attitudes toward business risks incurred in establishing a business, their reasons for engaging in business, their future business plans, the consequences business engagement on their lives, personal beliefs and attitudes toward business, and the problems faced in conjunction with their business ventures.

There was no need for the researcher to translate the questionnaire into the local dialect. English is used as the language of instruction and business communication in the Philippines. For this reason, there was a low possibility of ambiguities or fallacies of intention in the treatment of the data.

Based on the authors' knowledge, this is the first study that delves into the entrepreneurial psyche of the Philippine entrepreneur. The area of study, Cebu is the second largest city in the Philippines, and has posted the largest economic growth in the country (Cebu Investment Promotions Center, 2004). The city has a population in excess of 1.5 million, urbanized, and has over 10,000 enterprises in operation (Department of Trade and Industry-Cebu, 2004).

The study was conducted in coordination with the Cebu Chamber of Commerce Inc. and a local company, Synergy Tech International. One thousand questionnaires were opportunistically distributed in business clusters in the districts of Mandaue, Lapu-lapu, and the Metropolitan Cebu area. Usable completed questionnaires constituted 11.3% of all forms distributed. The sample, comprising 113 entrepreneurs, were engaged in trading, professional services, food service, money lending, and poultry farming.

### **Survey Instrument and Data Collection**

The Entrepreneurial Profile Questionnaire (EPQ) was utilized as a data collection instrument. The EPQ was designed to survey the effect of individual, societal and environmental factors on entrepreneurship by collecting a combination of demographic information and extensive detail related to characteristics and orientations. A five-point Likert scale ranging from "strongly agree" (5) to "strongly disagree" (1) was provided next to each statement. The EPQ was successfully piloted and validated through a series of studies in Romania, Turkey, Russia, Poland, the Czech Republic, Hungary, Lithuania, Estonia, Germany, Venezuela as well as South Africa, Mexico and United States (Gundry & Welsch, 2001). The previous studies suggest that the measured dimensions determine entrepreneurial intensity and are reasonably reliable (Welsch, 1998).

Data on the respondents of the study are presented below.

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Tables 1, 2, 3, 4 about here

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## RESULTS

### Attitudes Toward Business

The Philippine entrepreneurs' attitudes toward business can be traced to their cultural orientation. This orientation governs their lives in both the personal and professional level. An important theme in the life of the typical Filipino is the love for study and hard work in order to meet ordinary material needs without borrowing (Lynch, 1992: 18). Filipinos in rural locations migrate to larger cities in order to attain economic security. Andres (1999: 8) highlights the culture's craving for importance, love, respect, recognition, dignity, and financial security. In addition, Philippine entrepreneurs prefer that they own their business rather than pursue a promising career (Table 5). Filipinos tend to believe that employment limits one's income potential. With entrepreneurship, income opportunity may increase according to the level of effort exerted in order to improve the financial situation. Consequently, there is a belief that there is no limit to the length of time maximum effort is placed to establish their business. Everything is being done in order to succeed in business, and they are willing to make significant personal sacrifices to achieve success. As a result, business becomes the central activity in their lives. Filipinos with entrepreneurial acumen believe that they should be in business for the welfare of the community. Nagai (2004) alludes to the fact that ideology of modernization has been internalized in the Philippines, and led to the transformation of the country's social vision. It is not surprising that Filipino businessmen group themselves into "chambers of commerce" in order to engage in socio-civic activities. This situation is evident among entrepreneurs in Cebu.

Financial independence and achievement are important to the Filipino entrepreneur. In explaining the mechanism of enterprise creation, Camposano (1992: 9) expounded that people generally initiate ventures or create enterprises because of dissatisfaction with the status quo, desire for achievement, independence and autonomy, and the need to augment income. Other reasons are boredom, job lay-offs, individual employment, increase in family need, such as when the children of a moderate-income family need to go to college, or when a parent dies, leaving the spouse with no choice but support the family (Camposano, 1993: 9).

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Table 5 about here

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Some entrepreneurs begin as employees, but work long enough for them to gain specialized knowledge and establish their own business. While employed, they develop new visions, which lead not only to the identification of emerging entrepreneurial opportunities but also to the creation of holistic plan entailing an economic and financial direction geared towards releasing themselves from dependency.



### **Risks and Opportunities**

Going into business independently may incur risks, but these risks are deemed reasonable by the Philippine entrepreneurs, as a wider breadth of opportunities would likely arise (Table 6).

According to Jimenez (2002), while it may be safe to wait out for a more favorable economic climate in the Philippines, individuals and firms that dare take the risk during challenging times are often the ones that manage to survive.

In addition, a combination of non-desirable business responsibilities needs to be performed by entrepreneurs. These tasks contribute to tension since these activities may be unstructured. There is no structured guidance for engaging in one's own independent business enterprise, and encouragement is often given sparingly (Wolter, 2002: 64). For this reason, new entrepreneurs may experience adjustment problems and coping pains.

Other risks such as losing one's position with friends, the prospect of failure, and the ire of the family does not appear to be a major hurdle. The Philippine family is so closely knit that the ideals of family solidarity are frequently upheld. When a Filipino, particularly one from Cebu, is in trouble, he would likely have his family to support him. As a form of security system, the Filipino has developed the extended family system, since he cannot turn to the state for protection (Andres, 1999: 7). His relatives by consanguinity and ceremony forms with him a relationship in which the parties involved take turns in being a benefactor and beneficiary in a value known as reciprocity (Hollnsteiner, 1992: 22). Thus, though the risks attendant to entrepreneurship exist, it is not considered a major obstacle to the Filipino. Instead, opportunities in enterprise development are positively perceived as an opportunity to achieve social and economic improvement, leading to a peaceful coexistence with his family.

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### **Reasons for Engaging in Business**

Among 38 reasons to choose from, the Philippine entrepreneurs cited 19 reasons for engaging in business (Table 7).

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Table 7 about here  
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### **Projected Business Activities**

There were eleven (11) indicators that denoted the Philippine entrepreneurs' ambitions to perform activities for expanding their business interests in the future (Table 8). They aspired to conduct research, add new products or services, acquire new equipment, expand distribution channels and upgrade their computer systems. Expansion of the enterprise was an aspiration, since they aimed to sell to a new market. Thus, they planned to add specialized employees, and projected that they could afford to hire consultants, since professional advice was deemed necessary. The redesign of layout and computerization of current operations were other aspirations indicated.

The Philippine entrepreneurs seek not only to diversify their products and services, but concentrate on a broad range of related products (Poblador, 1998: 32). While this attitude may be largely anchored on culture, the present business environment

also pushes entrepreneurs towards aggressive diversification. For instance, Jimenez (2002) quotes William Torres, President of Mosaic Communications Inc, as stating that the Internet service industry is challenged to offer more value-added services in response to growing competitive pressures from telecom firms expanding into data services.

Talisayon (2002) points to the fact that new business models and business paradigms occurring in the Philippines are testing who among the current entrepreneurs will excel, merely survive, or fall by the sidelines.

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Table 8 about here  
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Many of the entrepreneurs do not have grandiose plans for the future, but believe in taking small but steady steps that will eventually lead to “big rewards”. Gradual, steady, and minor successes with slow but sure activities ensure the growth of the business (Farber, 2003: 48). This attitude highlights the Filipino’s perseverance and sense of sacrifice. Eventually, after the Philippine entrepreneur undertakes concrete measures towards business improvement, a new focus towards an even bigger goal is developed. There exist an inherent desire to build and create something larger than oneself or the business. Particularly in the Philippines where people suffer from poverty and unemployment, entrepreneurs recognize their vital role in keeping the national economic situation viable by providing jobs and creating wealth (Camposano, 1993: 18).

### **Benefits Derived from Entrepreneurship**

Six significant benefits derived from entrepreneurship were cited by the respondents (Table 9). These benefits consisted of the improvement of the standard of living, enjoyment of life, fulfillment of personal goals, creation of jobs, and provision for financial security.

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Table 9 about here  
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Entrepreneurship is a source of residual income in the Philippines (Go, 2002: 28). A high income leads to other benefits that the Filipino yearns for. The benefits are varied for Philippine entrepreneurs, especially in Cebu, a location identified as the melting pot of residents outside the National Capital Region (vicinity of the country’s capital - Manila). Improvement of standard of living, the benefit of a vacation, and the fulfillment of worthwhile goals, such as a good education for children are deemed important. The Filipino’s optimistic fatalism, often referred to as the “come what may ” attitude provides the courage to go into untried fields that appear promising. (Andres, 1999: 5).

Lagua (1999) cites that SME’s in the Philippines contribute to the economy as a result of the following : (1) generation of employment and income growth; (2) stimulation of entrepreneurship and innovation; (3) expansion and diversification of markets; (4) urban-rural dispersion and community stability; (5) increase in savings rate and investment base; (6) alleviation of threats for survival of the poor; and (7) promotion of pluralist society.

### **Difficulties Encountered in the Business Start-Up Stage**

A number of difficulties originating from various factors confronted Philippine entrepreneurs in the business start-up stage (Table 10).

The first two difficulties were financial in nature. One pertained to obtaining a loan as an entry-level financial requirement. Another referred to the cost of securing rental spaces. Because of a law stipulating a ten percent increase in rental yearly, security of tenure might be difficult for entrepreneurs with low start-up capital.

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Financial security is compounded due to the fact that heightened global integration has resulted to the cost of imported goods being cheaper than several local commodities. In the Philippines, liberalization of imports could not lower the prices of local commodities (Hamlin, 2002: 25). Other challenges identified are high construction costs, lack of employees trained in marketing, lack of sources of technical assistance, anti-market attitude and behavior, lack of clear regulations, inherent difficulties in the business start-up process, lack of legal services, lack of international trading information, unreliable suppliers, and lack of market information.

Paje (2002) observed that while the number of entrepreneurial activities abound, failures take place as a result of (1) deficiency in skills and certain management competencies on the part of the entrepreneur, (2) limitations in resources to acquire valuable technology and knowledge, and (3) lack of the proper integration of know-how into the organization.

Additionally, family pressures could increase problems as the demand for the entrepreneur's time from family members gets added into the equation.

Lagua (1999) pointed out that the SME sector serves as a critical link bridging potential incongruous strategies existing between growth and equity. It is therefore important for the government and private sectors to pursue complementary measures in order to further economic progress. Ferreira (2003) suggests that the Philippine government can play a proactive role in the development of entrepreneurs and enterprises through the implementation of three initiatives : (1) create an environment that facilitates opportunity-seeking, (2) establish transparent and egalitarian parameters that simplifies opportunity-screening, and (3) develop open and accessible structures that encourages opportunity-seizing. The government has an important supporting role to play in the creation of entrepreneur-friendly environment.

Despite facing prospects of imbalance and incompatibilities between the society and individuals, Philippine entrepreneurs remain steadfast in their business, perennially on a quest to ride the wave of globalization and staying on course towards small but notable business success.

## **CONCLUSION AND DISCUSSION**

Many entrepreneurs believe that business in the Philippines is largely influenced by culture and the values that the people uphold. Spanish and American influences may have helped shape the Filipinos' attitudes towards entrepreneurship, since the country has been a colony of Spain for over 300 years and that of the US for about 50 years. However, the characteristically Filipino concept that economic and social mobility is an

integral part of life has spurred the entrepreneurial fire of the residents. Furthermore, the traditional Filipino belief that one needs to be able to fully finance their children's education and continually look after the welfare of the family, has been a driving force towards the appreciation of profit and financial stability brought about by entrepreneurship.

This analysis is based on conclusions derived from the respondent survey conducted in 2003. As business and economic environments are in constant flux, it is possible that certain aspects of the society's structure have changed. With regard to the individual structure, it is important to note that though the Philippine entrepreneurs may have shared views and insights, individuals vary in the extent of their beliefs. The combination of entrepreneurial attitudes possessed by an individual does not necessarily reflect that of the culture he or she is associated with.

Nevertheless, it is interesting to note that in the Philippine environment entrepreneurs have learned to manage and nurture positive entrepreneurial beliefs despite an unfavorable business and economic environment. In the course of globalization, entrepreneurs worldwide are faced with several options when responding to emerging opportunities and threats. Philippine entrepreneurs have chosen to move along and capitalize on whatever niche they can find. In facing the daunting challenges that prevail in an emerging environment, they have chosen to continually draw upon a reservoir of self-motivational factors as an inspiration for business success.

Based on the 2001 Accenture international entrepreneurship study, Jimenez (2002) highlights key recommendations for entrepreneurial organizations across borders : (1) Clarify strategy and purpose in the entire organization, (2) Be big, yet small – act within a global paradigm yet remain nimble, flexible, and quick to respond to arising opportunities and challenges, (3) Cultivate entrepreneurial attitude and behavior – through the communication and positive reinforcement that entrepreneurship is valued, (4) Encourage diversity of structure and thinking – by being open and flexible to the changing dynamics of the global economy, and (5) Make the best use of knowledge – by digging deep into organizational structures, technological frameworks, and stakeholder alliances to fully capitalize on intellectual assets.

A globalized environment paves the way for greater cross-cultural business interactions. As international enterprises explore opportunities for expanding their markets or building new competitive advantages in foreign shores, it is relevant to understand the entrepreneurial mindsets of potential business partners, suppliers, customers, and employees. An understanding of entrepreneurial predispositions, opens the gateway to the formulation and implementation of more effective business policies, systems and structures, developmental strategies, alliance models, and modes of organizational development. It opens new doors towards the spreading out and the creation of unified culture on international entrepreneurship. Furthermore, an assessment of the compatibility of entrepreneurial attitudes between the home country and that of a new market, or one market with another, helps in the identification of potential areas of business conflict or synergy creation.

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**Table 1**  
**Classification of Respondents According to Gender**  
(N = 113)

| <b>Gender</b> | <b>F</b> | <b>%</b> |
|---------------|----------|----------|
| Male          | 67       | 59.29    |
| Female        | 46       | 40.71    |
| Total         | 113      | 100.00   |

**Table 2**  
**Classification of Respondents According to Educational Level**  
(N = 113)

| <b>Educational Level</b> | <b>F</b> | <b>%</b> |
|--------------------------|----------|----------|
| Grammar School           | 4        | 3.54     |
| High School              | 8        | 7.08     |
| College                  | 83       | 73.45    |
| Graduate School          | 18       | 15.93    |
| Total                    | 113      | 100.00   |

**Table 3**  
**Classification of Respondents According to Age**  
(N = 113)

| <b>Age Range</b> | <b>F</b> | <b>%</b> |
|------------------|----------|----------|
| Below 25 years   | 49       | 35.40    |
| 26-30 years      | 9        | 7.96     |
| 31-35 years      | 25       | 22.13    |
| 36-40 years      | 26       | 23.01    |
| 41-45 years      | 4        | 3.54     |
| Over 45          | 9        | 7.96     |
| Total            | 113      | 100.00   |

**Table 4**  
**Classification of Respondents According to Type of Business**  
(N = 113)

| <b>Type of Business</b>           | <b>F</b> | <b>%</b> |
|-----------------------------------|----------|----------|
| Service organization              | 4        | 3.54     |
| Retail (including restaurants)    | 59       | 52.21    |
| Finance/Insurance/Real Estate     | 3        | 2.65     |
| Transportation                    | 5        | 4.42     |
| Professional Services             | 1        | 0.88     |
| Distribution/Wholesale            | 15       | 13.27    |
| Manufacturing                     | 11       | 9.74     |
| Construction                      | 6        | 5.32     |
| Others (ie, agriculture, poultry) | 9        | 7.96     |

|                   |     |        |
|-------------------|-----|--------|
| farming, fishing) |     |        |
| Total             | 113 | 100.00 |

**Table 5**  
**Philippine Entrepreneurs' Attitudes Toward Business**

| <b>Attitude Indicators</b>  | <b>Mean</b> |
|---|-------------|
| I would rather own my own business than pursue another promising career.                              | 4.18        |
| There is no limit as to how long I would give a maximum effort to establish my business.              | 4.14        |
| I will do whatever it takes to make my business a success.  | 4.10        |
| I would be willing to make significant personal sacrifices in order to stay in business.              | 4.03        |
| My business is the most important activity in my life.  | 3.80        |
| I would like to make a significant contribution to the community by developing a successful business. | 3.58        |
| I would rather own my own business than a higher salary employed by someone else.                     | 3.53        |
| I would go to work somewhere else only long enough to make another attempt to establish my own firm.  | 3.53        |
| Owning my own business is more important than spending more time with my family.                      | 3.02        |
| My personal philosophy is to do "whatever it takes" to establish my own business.                     | 3.27        |
| I plan to eventually sell my business.  | 1.50        |

**Table 6**  
**Risks Incurred and Opportunities Gained by Philippine Entrepreneurs When Establishing a Business**

| <b>Risk Indicators</b>   | <b>Mean</b> |
|--|-------------|
| Attending to a variety of undesirable responsibilities in a business | 3.94        |
| Quality time with my children  | 2.64        |
| My position in the eyes of my friends                                | 2.61        |
| Willingness to take on additional debt                               | 2.61        |
| Risk of total failure in the business                                | 2.19        |
| Giving up my friends   | 2.03        |
| Sixty hours of work per week   | 1.96        |
| Incurring the wrath of my family                                     | 1.73        |
| Loss of significant recreation time                                  | 1.71        |
| Mortgaging my house  | 1.67        |
| Loss of time in another profession                                   | 1.57        |
| Borrowing my assets  | 1.50        |
| Conflict with the family   | 1.39        |
| Lost time with the family  | 1.38        |



|   |      |
|---|------|
| Use of all my savings                                       | 1.26 |
| Break of my marriage  | 1.03 |
| <b>Opportunity Indicators</b>                               |      |
| Sending my children to a better college/school              | 4.22 |
| Acquiring additional skills at significant personal expense | 3.89 |
| Watching my favorite TV program                             | 3.73 |
| Willing to take on any task in my business                  | 3.41 |
| Attending my favorite sporting event                        | 3.38 |

**Table 7**  
**Philippine Entrepreneurs' Reasons for Engaging in Business**

| <b>Reasons</b>   | <b>Mean</b> |
|--|-------------|
| To be able to develop an idea for a product or a business                                    | 4.26        |
| To fulfill a desire to have high earnings  | 4.24        |
| To keep learning   | 4.17        |
| To take advantage of an opportunity that appeared  | 4.13        |
| To be my own boss; to work for myself  | 4.08        |
| To fulfill the need for more money to survive  | 4.06        |
| To achieve a personal sense of accomplishment  | 4.02        |
| To increase the status and prestige of the family  | 3.99        |
| To make a direct contribution to the success of a family                                     | 3.99        |
| To have considerable freedom to adopt my own approach to work                                | 3.92        |
| To give myself, my spouse and children security  | 3.91        |
| To have fun  | 3.88        |
| To achieve something and get recognition for it  | 3.86        |
| To be challenged by the problems and opportunities of starting a business and making it grow | 3.84        |
| To become part of a network of entrepreneurs   | 3.82        |
| To have greater flexibility in my personal and family life                                   | 3.82        |
| To refrain from working for an unreasonable boss   | 3.78        |
| To achieve a higher position for myself in society   | 3.57        |
| To have influence in my community  | 3.42        |
| To be respected by friends   | 3.38        |
| To be able to work with people I choose  | 3.33        |
| To have the opportunity to lead rather than be led by others                                 | 3.32        |
| To control my own time   | 3.31        |
| To follow the example of a person I admire   | 3.25        |
| To have an element of variety and adventure in my work                                       | 3.12        |
| To make better use of my training or skills  | 3.11        |
| To be innovative and be in the forefront of technological development                        | 3.00        |
| To be able to work with people I like  | 2.87        |
| To make use of a time in my life when business made sense                                    | 2.74        |
| To contribute to the welfare of the community I live in                                      | 2.26        |
| To have access to fringe benefits  | 2.18        |
| To contribute to the welfare of my ethnic group  | 2.11        |
| To contribute to the welfare of my relatives   | 2.03        |

|  |      |
|--|------|
| To work in a desirable location for me and my family | 1.73 |
| To continue a family tradition                       | 1.50 |
| To compensate for my frustration in my previous job  | 1.31 |
| To escape from unsafe working conditions             | 1.25 |
| To perform the only thing I could do                 | 1.17 |

**Table 8**  
**Philippine Entrepreneurs' Projected Business Activities**

| <b>Projected Activities</b>                 | <b>Mean</b> |
|---|-------------|
| Researching on new markets                  | 4.03        |
| Adding a new product or service             | 4.01        |
| Acquiring new equipment                     | 3.99        |
| Expanding distribution channels             | 3.81        |
| Upgrading computer systems                  | 3.80        |
| Selling to a new market                     | 3.78        |
| Adding specialized employees                | 3.67        |
| Seeking professional advice                 | 3.57        |
| Redesigning layout                          | 3.44        |
| Computerizing current operations            | 3.43        |
| Seeking additional financing                | 3.41        |
| Adding operating space                      | 3.30        |
| Redesigning operating methods               | 3.18        |
| Expanding current facilities                | 3.13        |
| Replacing present equipment                 | 3.11        |
| Offsite training for employees              | 3.04        |
| Expanding advertisement and promotion       | 2.54        |
| Expanding the scope of operating activities | 2.38        |

**Table 9**  
**Benefits Derived from Entrepreneurship Identified by Philippine Entrepreneurs**

| <b>Benefits</b>                                    | <b>Mean</b> |
|--|-------------|
| Improvement of standard of living                  | 3.95        |
| Enjoyment of life                                  | 3.88        |
| Fulfillment of personal goals                      | 3.78        |
| Creation of jobs                                   | 3.65        |
| Provision for financial security                   | 3.54        |
| Provision of sufficient income                     | 3.40        |
| Provision for the family of an opportunity to work | 3.15        |
| Reinforcement of the feelings of autonomy, freedom | 3.03        |
| Creation of the means to express myself            | 2.83        |
| Creation of an opportunity to serve the community  | 2.40        |
| Reduction of personal stress                       | 2.36        |

**Table 10**  
**Difficulties Met by Philippine Entrepreneurs in the Start-Up Stage**

| <b>Difficulties</b>   | <b>Mean</b> |
|---|-------------|
| Obtaining a loan  | 4.08        |
| Entry level financial requirements                            | 4.07        |
| Number of competitors   | 4.00        |
| Finding a good location                                       | 3.96        |
| Lack of security  | 3.96        |
| Construction costs  | 3.93        |
| Lack of employees trained in marketing                        | 3.91        |
| Lack of sources of technical assistance                       | 3.87        |
| Anti-market attitudes and behavior                            | 3.83        |
| Lack of clear regulations                                     | 3.81        |
| Beating the entire risk of start-up                           | 3.80        |
| Lack of legal services  | 3.79        |
| Lack of international trading information                     | 3.78        |
| Unreliable suppliers  | 3.77        |
| Fatigue from long hours                                       | 3.75        |
| Being taken seriously by family members                       | 3.74        |
| Lack of market information                                    | 3.73        |
| Bureaucratic red tape   | 3.65        |
| Lack of guidance and counsel                                  | 3.64        |
| Lack of managerial service                                    | 3.61        |
| Scheduling business and family activities                     | 3.56        |
| Lack of distribution channels                                 | 3.48        |
| Lack of access to capital                                     | 3.42        |
| Narrow attitude toward my ethnic groups in business           | 3.41        |
| Lack of entrepreneurial understanding                         | 3.40        |
| Negative attitude toward profit-making                        | 3.38        |
| Extension of credit from suppliers                            | 3.21        |
| Corruption  | 3.17        |
| Lack of employees trained I financial affairs                 | 3.16        |
| Lack of family encouragement                                  | 2.90        |
| Storage / warehouses  | 2.89        |
| Finding enough time to spend with children                    | 2.67        |
| Lack of knowledge of relevant information sources             | 2.50        |
| Government assistance agencies                                | 2.49        |
| Lack of confidence from customers because of my ethnic origin | 2.41        |
| Discriminating practices against my ethnic group              | 1.83        |
| Among women:  |             |
| Narrow attitude toward women in business                      |             |
| Discriminating practices against women                        |             |
| Lack of confidence in women among the customers               |             |

# **STATE-LEVEL ENTREPRENEURSHIP POLICY AND TERTIARY ENTREPRENEURSHIP EDUCATION: A STUDY OF BENCHMARKS AND TRENDS IN NORTH DAKOTA**

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## **ABSTRACT**

Recently the National Governor's Association endorsed policies promoting entrepreneurship as a key vehicle for state-level economic development. One of the policy planks calls for offering entrepreneurship programs at tertiary institutions of higher education. Five years ago, a similar policy was developed and adopted by North Dakota's University System. This study examines the background of these policies and reports entrepreneurship education benchmarks and trends in North Dakota's institutions of higher education.

## **INTRODUCTION**

The Global Entrepreneurship Monitor (1999) attributes almost 70 percent of economic growth to entrepreneurship. Now economic development agencies and government policy makers are embracing entrepreneurship as a key driver of economic growth that must be nurtured.

Some of the endorsement that entrepreneurship has received from policy makers stems from the costs and rising expectations associated with incentive-based economic development schemes. At the state and local level, economic development initiatives often focus on the provision of costly incentives for business relocation and business retention. In addition, it is now expected that states will provide work force training and skills improvement, infrastructure investment, and favorable regulatory and tax environments (National Governor's Association, 2004).

Another set of problems comes with the sorts of businesses attracted by incentives and the industry clusters that develop. Paying incentives to low-wage, low-economic multiplier, and low-skills businesses may create entire industry clusters of such businesses. While jobs are created, the sort of jobs created is unsatisfactory to build future prospects and prosperity (Huenneke, 2004).

With assistance from the Ewing Marion Kauffman Foundation, the National Governor's Association (NGA) recently published *A Governor's Guide to Strengthening State Entrepreneurship Policy* (2004). According to the guide the following five state-level policy initiatives are essential to influence a more positive entrepreneurship environment.

- 1) Integrate Entrepreneurship into State Economic Development Efforts
- 2) States should use the education system to nurture and encourage future entrepreneurs
  - a. Build entrepreneurial readiness through the State's K-12 schools
  - b. Offer entrepreneurship education at public universities
  - c. Support faculty entrepreneurship in the University System
- 3) Incubate Entrepreneurial Companies
- 4) Invest in Diverse Sources of Risk Capital for the State's Entrepreneurs and Growth Companies
- 5) "Get Out of the Way" through Regulatory Reforms and Streamlining

## **PURPOSE**

The purpose of this paper is to inventory (or benchmark) academic entrepreneurship programs in one US state and determine program trends. Thus, the following paper looks at North Dakota and its efforts to nurture entrepreneurship through its tertiary educational system.

First, a profile of the state and its economic performance is built. Second, a review of the North Dakota University System and other colleges and universities is made. Third, a review of the North Dakota Roundtable Report, a policy document that mandates offering entrepreneurship education at public universities, is examined. Fourth, benchmark and trend data for tertiary entrepreneurship education in North Dakota are developed. Fifth, findings and recommendations for future research are offered.

## **North Dakota Population, Economic Health, and Entrepreneurial Standing**

North Dakota is a large state with less than 640,000 people. The state's population is both declining and aging. These two factors will have a significant impact on the state's university system and its future economic growth prospects. In regard to traditional college students entering college upon completion of their high school degrees the picture is bleak. From a recent high of 8,800 annual high school graduates, the number of annual high school graduates will decline to approximately 7,800 over the next decade (North Dakota University System, 2000).

In broad terms the state is struggling economically. Except for Nebraskans, North Dakotans have the highest rate of multiple job holding, 10.3 percent and 9.2 percent respectively. Nationally only 5.3 percent of employees held multiple jobs (North Dakota State Data Center, 2004). North Dakota's 2002 per capita income ranks 37<sup>th</sup> and is just \$26,567 as compared to the 2002 US per capita income of \$30,832 (North Dakota State Data Center, 2003b). Government, services, and retail trade are the biggest income generators for North Dakota and together comprise 48 percent of North Dakota's total 2002 personal income (North Dakota State Data Center, 2003b). North Dakota's 2001 gross state product is \$19.0 billion or just 0.2 percent of the US total (North Dakota State Data Center, 2003a).

According to a study by Goetz and Freshwater (2001), North Dakota soundly lacks an entrepreneurial climate. In relation to the other US states, North Dakota ranks 45<sup>th</sup> in entrepreneurial activity, 46<sup>th</sup> in entrepreneurship, 25<sup>th</sup> in ideas and innovation, 39<sup>th</sup> in human capital, and 47<sup>th</sup> in financial capital.

### **Tertiary Educational Institutions in North Dakota**

Given its small population, North Dakota hosts a large number of colleges and universities. These include the publicly supported North Dakota University System (NDUS) colleges and universities, private universities, and tribal colleges. In total the NDUS is composed of 11 units—two Ph.D. granting institutions, one master's degree granting institution, three bachelor's degree granting institutions, and five associate and trade/technical degree granting institutions. In addition, two private schools, one granting master's degrees, the other granting bachelor degrees compete for students from the general population. Five tribal colleges serve the state's Native American population.

As a unified system, the NDUS came into existence in 1990. The total 2003 enrollment of the NDUS is 41,620. Total enrollment has trended upward--34,293 in 1999, 35,093 in 2000, 37,596 in 2001, and 39,614 in 2002. The following is a brief profile of each NDUS unit as described in the 3<sup>rd</sup> Annual Accountability Measures Report (2003).

Bismarck State College (BSC) is located in Bismarck, ND. Bismarck is the state's second largest city. BSC is a comprehensive community college. Its enrollment is 3,430.

Dickinson State University (DSU) is located in Dickinson, ND. It offers certificates, associate degrees, and bachelor's degrees. Its enrollment is 2,461.

Lake Region State College (LRSC) is a two-year comprehensive community college. LRSC is located at Devil's Lake, ND and has an enrollment of 1,473.

Mayville State University (MaSU) is located in Mayville, ND. It offers certificates, associate degrees, and bachelor degrees. Its enrollment is 817.

Minot State University (MiSU) is a comprehensive mid-sized university offering bachelor's degrees, master's degrees, and education specialist degrees. It is located in Minot, ND, the state's fourth largest city. It has an enrollment of 3,825.

Minot State University-Bottineau Campus (MiSU-B) is located in Bottineau, ND. It offers diploma, certificate, and associate degree programs. Its enrollment is 620.

North Dakota State College of Science (NDSCS) has an enrollment of 2,468. It is located in Wahpeton, ND. It offers diploma, certificate, and associate degree programs.

North Dakota State University (NDSU) is the state's land grant institution and one of the state's two flagship institutions. It offers certificates, bachelors, master's, and doctoral degrees. It is located in Fargo, ND, the state's largest city. Its enrollment is 11,623.

University of North Dakota (UND) is the largest and oldest university in the state and offers certificates, bachelor's, master's, and doctoral degrees. Its enrollment is 13,034. UND is located in Grand Forks, ND, the state's third largest city.

Valley City State University (VSCU) is located in Valley City, ND. Its enrollment is 998 and it offers certificates, and associate and bachelor's degrees.

Williston State College has an enrollment of 871 and is located in extreme northwestern North Dakota in Williston, ND. It offers diploma, certificate, and associate degree programs.

While North Dakota's private and tribal colleges and universities are not governed by the NDUS, they are nonetheless affected by its policies. North Dakota's private higher educational institutions are in direct competition with NDUS schools and imitate successful public institutional ventures. In addition to other aims, the tribal colleges feed students into the NDUS system. Recognizing this role, some North Dakota tribal colleges have attempted to harmonize their systems with those of the NDUS.

### **The Roundtable Report**

In 1999 the North Dakota Legislative Assembly passed a resolution calling for the study of the state's university system. The study would address how the North Dakota University System could meeting the state's needs in the next century, the funding methodology needed to meet these expectations and needs, and an accountability/reporting system (North Dakota University System, 2000).

An interim committee of 61 (21 legislators and 40 business, education, and government representatives) formed the "Roundtable" to assess the state's future and the role of the NDUS in this future. The Roundtable concluded that unless concerted action is taken North Dakota will 1) suffer further population losses, especially among the most productive segment--young adults 2) fall further behind the rest of the country in income and quality of life measures, and 3) be unable compete in the new information-based economy (North Dakota University System, 2000).

The Roundtable Committee made six key recommendations or cornerstones upon which to build a university system. The following are the policy cornerstones as reported in *A North Dakota University System for the 21<sup>st</sup> Century* (2000, p. 7). (Detailed verbiage is included for those cornerstones that directly or peripherally address entrepreneurship in the NDUS setting.)

Cornerstone 1: Economic Development Connection--Direct connection and contributions of the University System to the economic growth and social vitality of North Dakota.

Cornerstone 2: Educational Excellence-High quality education and skill development opportunities which prepare students to be personally and professionally successful, readily able to advance and change careers, be life-long learners, good citizens, leaders, and knowledgeable contributing members of an increasingly global and multi-cultural society.

Cornerstone 3: Flexible and Responsive System-A University System environment, which is responsive to the needs of its various clients and is flexible, empowering, competitive, entrepreneurial, and rewarding.

Cornerstone 4: Accessible System

Cornerstone 5: Funding and Reward-A system of funding, resource allocation, and rewards which assures quality and is linked to the expressed high priority needs and expectations of the University System-assures achievement of the expectations envisioned.

Cornerstone 6: Sustaining the Vision

### **Description of Cornerstone One**

Cornerstone One, the Economic Development Connection, subdivided the responsibilities of the NDUS into three roles—workforce training, encouraging entrepreneurship, and the use of colleges and universities as direct sources of economic development. Workforce training is a well-established university role and fits with pre-conceived notions of economic development. Encouraging entrepreneurship was further subdivided into three parts: 1) Offering college educational programs that will provide “individuals who are so inclined with the knowledge, skills, and experiences necessary for them to become successful entrepreneurs,” 2) Provide assistance and advice to entrepreneurs, 3) Create “Occasions for the entrepreneurial ideas and the financing (venture capital) to come together” (North Dakota University System, 2000, p. 14). The third role, using university and college intellectual capital to spin off and engage in entrepreneurial activities, is identified as one of the more difficult roles to establish and enable. This will require significant changes to NDUS oversight and management routines.

The Roundtable Report (North Dakota University System, 2000) mandates that all units offer educational programs on the topic of entrepreneurship. Two benefits of this policy are stressed. First, it gives North Dakota the ability to grow its own new companies. Second, it exposes and mentors students in entrepreneurship, thus broadening their horizons.

The Roundtable Report then sets out accountability measures. In the case of encouraging entrepreneurship the measure is the “Level and trends in enrollment in entrepreneurship courses and the number of graduates of any future entrepreneurship programs” (North Dakota University System, 2000, p. 67).

In short, the Roundtable Report and the National Governor’s Association stance on policies to promote entrepreneurship are in close coincidence. But, how well have North Dakota’s tertiary educational institutions responded to policy directed entrepreneurship education provision?

## **METHODOLOGY**

The following is a description of the methodology used to benchmark and assess trend data for entrepreneurship education at all tertiary educational institutions in North Dakota.



First, a baseline assessment was done by reviewing the 2001, 2002, and 2003 NDUS Accountability Reports. These annual reports were mandated by the Roundtable. Second, an assay of entrepreneurship programs was collected through Internet searches and catalogs/materials published by North Dakota University System (NDUS), individual NDUS educational units, and non-NDUS educational institutions. Third, a telephone survey of knowledgeable informants (e.g., Deans, Chairs, Directors, etc.) was conducted to determine the veracity of collected materials, future intentions in regard to entrepreneurship education, and drivers of any initiatives/interest in entrepreneurship.

For the purposes of this study North Dakota tertiary educational institutions are classified as four-year public, four-year private, two-year public, and two-year tribal institutions. In addition to entrepreneurship, the search terms included small business and innovation courses and programs.

Total program offerings were assessed. That is, academic programs, academic courses, seminars and institutes, business development outreach, and student development opportunities such as entrepreneurship clubs, competitions, and internship offerings were checked.

## **RESULTS**

In general, the idea to power North Dakota's economic development engine through entrepreneurship education and growing businesses is laudable. The actual results are sobering for their modesty. Moreover, given the mandate that all NDUS units will embrace and offer entrepreneurship education the response is extremely weak.

The publication, A North Dakota University System for the 21<sup>st</sup> Century: The Report of the Roundtable for the North Dakota Legislative Council Interim Committee on Higher Education, (2000) set accountability measures and related data reports and so no actual measures were collected or reported. The 2001 report (Creating a University System for the 21<sup>st</sup> Century: 1<sup>st</sup> Annual Accountability Measures Report) reported only workforce training related measures for Cornerstone 1: Economic Development Connection. No data about entrepreneurship education or university business spin-offs were included. The 2<sup>nd</sup> Annual Accountability Measures Report (2002) reported on the number of businesses using NDUS workforce training services, their level of satisfaction with the training, and the level of research expenditures. Again no data were reported about entrepreneurship programs or courses. The most recent report (2003, p. iii), the 3<sup>rd</sup> Annual Accountability Measures Report stated, "NDUS institutions offered 45 entrepreneurship courses, two entrepreneurship programs and one option within a program. In the past year 862 students enrolled in entrepreneurship courses, and six students graduated from entrepreneurship programs. An additional 425 participants attended three non-credit seminars that had an entrepreneurship focus."

The direct review of Internet, catalog, and published sources undertaken by this study presented an even more modest picture. Our findings indicate that a total of 30 regularly listed entrepreneurship courses are offered by NDUS units. (Perhaps the 45 entrepreneurship courses reported in the 3<sup>rd</sup> Annual Accountability Report include special topics offerings or multiple class sections of regularly listed courses.) Of the eleven NDUS units only two, UND at the

bachelor-degree level and WSC at the associate-degree level, offer a meaningful array and depth of entrepreneurship coursework. Only one unit, UND, offers entrepreneurship options for business and non-business majors. Three NDUS units appear to offer no regularly scheduled entrepreneurship courses at all.

Budding entrepreneurs have few avenues to experience entrepreneurship outside of the classroom. Conferences/seminars with entrepreneurship topics were available at two institutions. One business plan competition was available to MiSU students and one North Dakota-wide business plan competition was available to any tertiary educational institution that was willing to field a team. University-integrated business-help agencies appear to be limited to UND and DSU. The possibility for internships was available at most units. However, clubs for young entrepreneurs were not active at most NDUS units.

Concerning private tertiary institutions, one (University of Mary) offered a regularly scheduled entrepreneurship course and the other (Jamestown College) only offered entrepreneurship as a special topic. Concerning tribal colleges, one (Sitting Bull College) offered both an associate degree and a certificate in Arts/Crafts Entrepreneurship. This certificate and degree were supported by just two entrepreneurship courses—BAD 220 Entrepreneurship and BAD 216 Small Business Management. Another tribal college (Fort Berthold Community College) offers an Entrepreneurship Management Certificate and a Entrepreneurship Marketing Certificate both of which include one entrepreneurship course—BADM 216 Writing a Business Plan. Fort Berthold Community College hosts a chapter of AIBL (American Indian Business Leaders).

Telephone interviews with knowledgeable informants at the various institutions highlighted the role of academic entrepreneurs. Only two higher education units have permanently institutionalized meaningful academic entrepreneurship programs. These are UND and WSC. UND's program includes a BBA in Entrepreneurship. The effort to launch this program was led by an academic champion who rallied others to the cause. In the case of WSC, a grant powered the necessary skills development, course offerings, and ultimately institutionalization. Given that grant production can be considered the output of academic entrepreneurship highlights the importance of academic entrepreneurs.

### **RESPONDING TO “SO WHAT”**

Providing entrepreneurship education at the university level is a critical component to power any state's economic development. In the most recent annual report available only two percent of North Dakota University System students received any entrepreneurship education. Despite a mandate to provide access to entrepreneurship education, too few students are being educated.

Since the mandate to deliver entrepreneurship education is an unfunded mandate, the work of academic entrepreneurs who secure resources, adherents, and build programs is essential. The two comprehensive NDUS entrepreneurship programs are the result of academic entrepreneurship. Certainly creating academic environments that foster academic entrepreneurship is necessary if meaningful entrepreneurship education is to take root.

## CONCLUSIONS AND FUTURE DIRECTION

Can an entrepreneurial climate be built in a state in which entrepreneurship has not yet taken root? Certainly policy decisions that demand tertiary entrepreneurship courses and programs at all NDUS units are a start. Monitoring the output of the NDUS units is a start. However, as an unfunded mandate, meaningful progress depends on two things. The first is internal reallocation of funds and top management support. The second is academic entrepreneurship, that is, academicians who act entrepreneurially to win resources, support, and build programs.

Finally, policy attention needs to be focused on the internal operations of NDUS units. How can the academic units be made friendly for academic entrepreneurs? What disincentives, leadership routines, and organizational impediments retard academic entrepreneurship with the NDUS?

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# **WHAT EXACTLY DO I HAVE IN COMMON WITH AN ENTREPRENEURIAL MANAGER? UNDERGRADUATE PERCEPTIONS OF POTENTIAL BOSSES BASED ON STATEMENTS OF PHILOSOPHY**

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## **Abstract**

Over the years a large body of literature has developed regarding cultural difference using Hofstede's cultural dimensions. In the course of studies regarding this literature attention has been placed on the differences between management and employees from a management perspective, yet little attention has been focused in the opposite direction. This study uses an in-basket laboratory experiment to determine if US students would prefer to work for a boss who shared cultural traits. The literature, methods and findings are followed by a discussion of the results and implications for entrepreneurs.

## **Introduction**

Buntzman and Parker (2004) recently applied the Hofstede value system to an analysis of MBA student perceptions of CEO effectiveness and found evidence in a pilot study that their perceptions of CEO effectiveness might in fact be related to their internationally diverse cultural backgrounds. This study is in some ways a follow-on study. It examines the preferences of undergraduate students to possibly work for individuals whose philosophies reflect various cultural backgrounds typical of the USA and certain European, Latin American and Asian regions.

Currently a wealth of literature exists on the impact of culture on business operations particularly in the area of employer/employee relations. Much of this literature is useful in examining the role that cultural differences plays in the understanding of how business works. Culture though extends farther than just an individual's background; one must also consider the culture of business to which a new graduate will be entering upon completion of a degree program or an experienced worker might enter upon changing jobs. "Corporate culture is comprised of philosophy and mission, manner of internal communications and hiring practices. From the

outside such things as dress code, flexibility of work schedules and level of volunteerism often form a company's public profile" (Pfister 1999).

This attitude is particularly true in American culture. As one U.S. CEO stated: "I think the most important thing you can have is pride in how you dress, in how you act...when you have facilities that are clean and painted, people take pride in that, and you end up with a better safety record, a better environmental record" (Pfister 1999). The philosophy of the CEO was reflected in how the employees reacted to it. One employee indicated that as a result of the CEO's attitude the company had become "extremely image conscious" and failure to adhere to norms would result in co-workers quietly pointing out violations (Pfister 1999).

The American value system as pointed out in a number of studies is not universally accepted. In an application of the Hofstede values (collectivism vs. individualism, high vs. low uncertainty avoidance, high vs. low power distance, masculine vs. feminine and dynamic vs. Confucian) Gouttefarde (1996) observed the interaction between Americans and French working in French companies. The comparison was justified given the cultural differences between the two nations. The French are high on the power distance scale whereas Americans rate low. The French and Americans also are at odds on uncertainty avoidance. Many of the respondents in the Gouttefarde study expressed frustration at their cultural counterparts. The Americans were seen as brash and too individualistic. The French were seen as micromanagers who stifled the creativity of American employees and were mired in bureaucracy. French bosses were seen as aloof from subordinates whereas the feeling was among French subordinates that the American supervisors got too close.

In other international studies (e.g. MacMahon 1996 and Channon & Dakin 1995) the importance of cultural understanding and identity was seen as a key to business success. In terms of hiring practices by small business owners in Ireland one entrepreneur stated: "I think that in a small company you have to be careful in selecting your workforce anyway – you try to make sure that people will fit in with your way of thinking, your way of doing things and the other employees" (MacMahon 1996). In the emerging markets of Central and Eastern Europe after the fall of communism, over 70% of companies surveyed for a study in hiring practices were aiming for "99-100 per cent local staffing in the long term, as most felt local staff would have a better understanding of the local market" (Channon and Dakin 1995).

It must be noted that the individual countries of the European Union (when examined apart from the EU) are considerably more homogeneous than the United States. In a 1998 study Chatman et al, investigated the impact of demographic characteristics on work processes and outcomes. Their findings indicated that the "salience of demographic attributes as social categories was higher in heterogeneous than homogeneous organizations" (Chatman et al 1998) once gender was excluded from the measurements. They also determined that "the salience of organizational attributes was higher in collectivistic than individualistic organizational cultures" (Chatman et al 1998).

But what are companies doing to foster the culture that will best suit their entrepreneurial objectives? Herb Kelleher, former CEO of Southwest Airlines is credited with establishing a culture that carefully "protects and nurtures its employees" (Fryer 2004). Other firms offer

employees access to top executives and perks such as African safaris and other exotic trips. Such actions are significant in that “employee morale and performance improvement are top management concerns” (McMaster 2003). Problems begin to arise when bosses begin to label subordinates as weak performers. According to Jean-Francois Manzoni, a management scholar at a leading French business school: “employee performance tends to adjust up or down according to such expectations” (Mount 2002). The emphasis on cultural understanding was succinctly framed in a recent editorial in the *Dallas Morning News*: “A company is only as good as its employees. That employer-employee relationship is being tested as never before, making it more difficult for companies to get workers to agree with their leaders on the same business goals. Successful businesses will understand the trends that are undermining workplace morale and will respond accordingly” (March 15, 2004).

Given that discussions have been raised on employer responsibilities in cultural awareness as seen above, what can be investigated about the expectations or desires of subordinates coming into a new work situation? Do workers desire to be employed by someone who has a similar background and values to them? In the United States, is cultural similarity a factor in determining whether or not a person would base a decision on job acceptance based upon the perceived opinions and judgments of similarity with the boss?

### **Research Questions**

In order to investigate the whether or not cultural similarities are desirable between employees and employers, we posed the following research questions based on the above:

R1 - Do US undergraduate students prefer a boss whose values are consistent with the US "archetype" that was identified by Hofstede?

R2- Do US business students prefer an entrepreneurial-type boss or one who is more conservative?

R3 - Is the type of business, its size and environment, a factor in determining whether an entrepreneurial or conservative boss would be preferred?

### **Method**

#### **Sample.**

The sample consisted of 100 undergraduate students enrolled in several sections of the authors' required business courses. Participation was voluntary and extra credit was provided.

#### **Instruments.**

We devised an in basket-like laboratory experiment for this study. Written instructions asked respondents to assume the role of a relatively new employee who has been appointed as a member of a 360° style selection committee seeking a replacement for a “very senior management position” for either a large multinational corporation or a small local business in the

service sector. After reading brief statements of philosophy attributed to each candidate in turn, subjects were asked to rate them as good for the organization, whether they would enjoy working for the person, whether the person would be a good role model for them, whether this person should receive priority in being given a personal interview, and the excellence of each candidate's philosophy. Each item was evaluated on a seven point Likert-type scale anchored by "Disagree" (1) and "Agree" (7).

Additionally, we collected data on how the candidates were perceived with respect to the Hofstede dimensions masculinity/femininity, low/high uncertainty avoidance, individualism/collectivism, and high/low power distance on seven point Likert-type scales. The scales asked subjects to rate candidate in terms of: hard driving or easygoing (to represent Hofstede's masculinity/achieving orientation); concern for subordinates, to represent collectivism, or out for himself, to represent individualism; entrepreneurial, representing low uncertainty avoidance, or cautious, representing high uncertainty avoidance; and elitist, representing high power distance, or democratic, representing low power distance.

Four candidates were presented for evaluation. Alex's statement of philosophy was designed to have him perceived as masculine, individualistic, with low power distance (LPD) and low uncertainty avoiding. According to Hofstede (1980) this is a typical value structure in the USA. Bobby was portrayed as masculine, LPD, collectivistic, and high uncertainty avoiding, typical of value systems in Japan and other parts of Asia and Latin America Hofstede (1980).

Charlie's philosophy was intended to present him as feminine, HPD, individualistic, and high uncertainty avoiding. This value system is consistent with Western European countries such as France and some Asian states Hofstede (1980). Finally Del's philosophy was intended to portray his/her value system as masculine, individualistic, HPD, and high uncertainty avoiding, typical of countries such as Belgium and Italy Hofstede (1980).

Independent variables were subject gender, business type (MNC v. Small Business) and type of value system. We used analysis of variance and stepwise multiple regression to analyze our data.

## Results

As stated above, Masculinity/Femininity was measured with the anchors "hard driving" (M) and "easy going" (F); Individualism/Collectivism was measured with the anchors "out for himself" and "concerned for subordinates." Low/High UA was measured with the anchors "entrepreneurial" and "cautious" and High/Low Power distance used the anchors "elitist" and "democratic" (Please see Table 1 below.)

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Table 1 about here

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As is shown in Table 1, Alex is perceived as Masculine (mean <4.0) and significantly more masculine than Bobby. Del is most masculine. Alex is perceived as more individualistic (>4.0), and more so than the collectivist Bobby. He is perceived as a low uncertainty avoider (entrepreneurial) (<4.0) and low PD (democratic) (>4.00). With two exceptions, the "applicants"

were perceived as expected. The exceptions were that Bobby was perceived as Feminine and Charlie was perceived as masculine. Overall, subjects perceived the candidates as would be expected based on their "statements of philosophies."

There were no gender differences in how men and women perceived the candidates. There were no business-type differences in how subjects perceive the candidates suitability for the position. Means for the dependent variables based on type of business tended to be close to the neutral midpoint value of 4 on the seven point Likert – type scales.

The candidates' value systems do appear to have influenced subjects' perceptions and recommendations. We expected that Alex would be rated more favorably because his/her value profile was intended to be similar to that for the USA, and the vast majority of the subjects were also from the US. In performing tests of differences in perceptions, we took the mean value of the rating for the dependent variable for Alex (representing the US value structure) as the test value against whether the others were compared. Results for these comparisons are discussed below.

Would this person be good for the organization? Using t-tests, Charlie (Feminine, High Power Distance, Individualistic, High Uncertainty Avoidance) had a rating of 4.52 (s.d. 1.22) versus 5.09 (s.d. 1.09) for Alex,  $T=-4.65$ ,  $p<.000$ . Thus Charlie was seen as somewhat neutral for the organization compared to Alex.

Would the subject enjoy working for this person? Bobby (B) received the highest rating, 5.12 (s.d. 1.23). This was significantly higher than the ratings for Alex (A). Del (D) had a significantly lower rating and Charlie's (C) low rating approached significance.

Would this person be a good role model? None of the candidates stood out in this regard with mean ratings close to the midpoint of 4.00, but C was significantly lower than A (3.99, s.d. 1.31, vs. 4.28, s.d. 1.48) and  $t=-2.22$ ,  $p<.03$ .

Should preference be given to this person to be offered an interview? No candidate stood out here either. There were no significant differences between A and the other candidates.

Does this applicant have a good overall philosophy? B was rated marginally higher than A,  $T>1.81$ ,  $p<.074$ . C was not significantly different and D was significantly lower ( $t=-2.29$ ,  $p<.024$ ).

Finally, we wondered whether perceptions of an applicant's strengths (would he/she be good for the organization, would enjoy working with others, would be a good role model, has a good overall?) would be predictors of an offer for interviews. We used stepwise multiple regression to explore this issue. For candidates A, B, and C only "excellent philosophy" entered the equation, but for D "a good role model" added explanatory power. Adjusted R-squares ranged from about .26 to about .49

## **Discussion**



We thought that US students would prefer a candidate, one for whom they might actually work according to our scenarios, who matched the value profile of U.S. culture as determined by Hofstede. This was not the case. In fact, using the mean for Alex as the reference point our subjects did not demonstrate a statistically significant preference for any of the candidates be offered an interview before the others.

The regression equations in which the candidates' philosophy was shown to be associated with making an offering all provide food for thought. These are no doubt many factors which bear on an individual's preferences in choosing to join an organization on the one hand, or whom to recruit to it on the other. Our results indicate that consideration of a candidate's philosophy (values) may be a major influence on those decisions. Often the emphasis in making such decisions is placed on using "hard" data such as income or profits or some other measure of achievement. In this experiment, however, we depicted the candidates as equally able and so there was not tangle data on which to base a decision. Another possibility would be to determine preference based on self-interest, but here self-interest concerns such as "would enjoy working with the person," or "would be a good role model," did not enter into the regression equations for three of the four candidates. In fact, for three of the four candidates nothing entered into the regression equation but philosophy. Only in the case of D was "would be a good role model" a predictor with a beta of .37. Perhaps this association is related to the fact that on average our subjects did not think D would be as good a role model as the other candidates.

### **Directions for future research.**

More work needs to be done, with a cross-cultural study and with other types of samples, to determine the impact of senior management characteristics on the preferences of subordinates. In-situ survey research may be most appropriate for such a follow-up study. More research into the impact of organizational philosophies, degree of entrepreneurial culture and the like is warranted.

### **Implications for Practice.**

In the real world, it is the subordinate who is most often the one under consideration to be hired and so is the one to be offered an interview, contrary to the scenario in this study. But the hiring process is a two way street since the subordinate has an opportunity to accept or reject an offer. Organizations that want to attract the best candidates cannot ignore this part of the process and should be aware of the things that make them attractive to potential employees. That is where this study makes a small contribution. "Soft" issues such as leader philosophy, organizational culture and so on should not be ignored if organizations wish to attract the best candidates

### **Limitations of the study.**

As this was a laboratory study with a student population from a limited geographic area it would be unwise to generalize at this time. More research is needed to clarify relationships and to validate the generalizability of the results.

## **Conclusion**

From this study it appears that a “similarity to me” syndrome does not apply to the sample population making these evaluations (assuming that the students sample does itself match the US value archetype). It is striking that a candidate’s overall philosophy is important as a determinant of offers (as indicated by the regression equations). This is a positive sign inasmuch as business schools of late seek to emphasize the importance of values in the workplace. But business schools also have emphasized the importance of an entrepreneurial culture, networking and mentoring and these do not seem to have been influential in preferences since an entrepreneurial orientation, role modeling potential and enjoying working with an individual were, for the most part, inconsequential considerations.

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**Table 1. Perceptions of Candidates**

| <b><i>Lower Vals.</i></b> | <b><i>Alex</i></b> | <b><i>Bobby</i></b> | <b><i>Charlie</i></b> | <b><i>Del</i></b> |
|---------------------------|--------------------|---------------------|-----------------------|-------------------|
| <i>Masc.</i>              | <u>3.67</u>        | <u>4.80*</u>        | <u>3.66</u>           | <u>3.27*</u>      |
| <i>Collec.</i>            | <u>4.27</u>        | <u>3.03*</u>        | <u>4.70*</u>          | <u>5.08*</u>      |
| <i>Low UA</i>             | <u>3.36</u>        | <u>4.99*</u>        | <u>3.88*</u>          | <u>3.91*</u>      |
| <i>High PD</i>            | <u>4.35</u>        | <u>4.84*</u>        | <u>3.77*</u>          | <u>3.78*</u>      |

\* =  $p < .05$

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# **WHAT HAPPENS TO NASCENT ENTREPRENEURS? AN ECONOMETRIC ANALYSIS OF THE PSED**

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## **ABSTRACT**

This paper follows the progress of American nascent entrepreneurs - identified in the initial interview of the Panel Study of Entrepreneurial Dynamics (PSED) - over each of the next two years of the panel. A novel theoretical and econometric model is used to reveal which personal and economic characteristics are associated with venture start-up - and which are associated with remaining a nascent entrepreneur, or giving up entirely. We discuss the implications of our results for lenders, business start-up support agencies, and policy-makers.

## **EXECUTIVE SUMMARY**

At least three groups of stakeholders want to know what happens to nascent entrepreneurs (NEs): policy-makers, lenders, and business start-up support agencies. In this paper, we put ourselves in the position of these stakeholders by predicting what NEs will be doing in one and two years' time – whether continuing as a NE; starting up a new venture; or giving up altogether. Our objective is to advise stakeholders about the factors they should look for when deciding whether and how to offer support to a NE, as well as the effects of such support on NEs' behaviour.

To this end, we estimate a novel model of entrepreneurial choice econometrically using PSED data, and find that:

- Nascent entrepreneurs who go on to start a venture are more likely to be in high-tech, to own their home, receive external finance, and have self-employed parents.
- Nascent entrepreneurs who take longer to launch their ventures are wealthier and provide more self-finance on average, and are more likely to be non-white and to envisage operating a solo home-based or non-high-tech start-up.
- Nascent entrepreneurs who give up altogether are more likely to have attractive “outside” options in the home and in paid employment. Nascent entrepreneurs who have attended business assistance programs are significantly *less* likely to give up in the long run.

We draw several policy implications from these results. First, lenders might consider adding to their loan screening criteria parental self-employment experience, having friends or kin in business, several specific venture characteristics, and NEs' domestic circumstances. Second, our results give some novel support to current US Federal policies of targeting loan assistance

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programs on ethnic minority starts. Third, benefits from business assistance programs only begin to emerge after two years, suggesting that policy-makers should not expect them to yield immediate payoffs.

## EMPIRICAL APPROACH

Consider a set of variables  $Y_i$  which affect the probability that nascent entrepreneur  $i$  chooses one of the following outcomes:

$$Z_i = \begin{cases} 0 & \text{if } i \text{ remains a NE} \\ 1 & \text{if } i \text{ starts the firm} \\ 2 & \text{if } i \text{ gives up / quits} \end{cases} \quad (1)$$

We use a multinomial logit framework to forecast the probability that  $i$  ends up in destination  $Z_i = j$ :

$$\Pr[Z_i = j] = \frac{\exp(Y_i^T \gamma_j)}{\sum_{m=0}^2 \exp(Y_i^T \gamma_m)} \quad j = 0,1,2 \quad (2)$$

In practice, rather than interpreting the coefficients  $\gamma_j$ , it is often easier to interpret the *marginal effects* of the independent variables on the probability of observing a particular destination. These are given by  $\delta_j = \Pr[Z_i = j] \times (\gamma_j - \bar{\gamma})$ , where  $\bar{\gamma}$  is the mean vector computed across all status groups.

We will use (2) to estimate the determinants of NE outcomes  $Z_i$  as described by (1) based on data from each of Waves 1 and 2 of the PSED – where data for the explanatory variables  $Y_i$  are taken from the “Screening interview” (12 months before the Wave 1 interview). Therefore the explanatory variables  $Y_i$  will be truly exogenous to the NE outcomes.

## DATA

The PSED is a representative sample of American adults first interviewed in 1998-99, and then re-interviewed in subsequent 12 monthly intervals. To give some idea about the diversity of NEs’ destinations, and hence the value of being able to predict future destinations based on observable initial characteristics, consider Table 1. This shows the destinations after 1 and 2 years of the PSED’s mixed gender sample of NEs that are used in this article. What is striking is the diversity of destinations among the NEs in the sample, with continuation in NE being the modal category in both years. Our challenge is to explain the factors underlying this diversity.

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Table 1 about here

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## VARIABLES USED IN THE ECONOMETRIC ANALYSIS

We identified several variables from the PSED data set that are likely to affect NEs' choices about whether to continue, launch, or quit. For convenience, they are grouped into the following categories:

- Value of a non-entrepreneurship “outside option”
- Financial circumstances
- Process activities
- Human and social capital
- Control variables

Based on a model which appears in a longer version of this paper, the predicted effects of each variable on NE outcomes are summarised in Table 2.

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Table 2 about here

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In addition, we also included several control variables to capture other manifestations of NE heterogeneity. These relate to the nature of the market, legal and organisational form of the start-up, and family structure. The effects of these variables appear in Table 3.

## RESULTS

Table 3 presents estimates of the determinants of NE destinations, both 12 months and 24 months after the initial interviews. The results indicate reasonably good predictive power, especially for the 24-month case. For brevity and clarity, Table 3 presents estimates of the marginal effects  $\delta_j$  that are statistically significant in at least one destination and time period. Several other variables from the PSED were also included in the econometric analysis, but failed to reach conventional levels of significance. Some of these are listed at the end of Table 3.

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Table 3 about here

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According to Table 3, those NEs who go on to start a venture are significantly more likely to have established credit with suppliers; to own their home; to have received external finance; to be involved in a high-tech start-up; and to have self-employed parents. The first of these three variables - which relate to resources - are important for facilitating start-up within the first year of nascent entrepreneurship. In contrast, the last two variables - which relate to the innate characteristics of the venture and the NE - appear to have a longer-term (2-year) impact on organisational emergence.

NEs who continue to wait before launching do so for a mixture of reasons. Waiting appears to be beneficial for non-white NEs who might have to prepare for entry more thoroughly in the face of discrimination. This might be deemed a negative reason for waiting. Positive reasons for waiting are associated with the luxury of being able to plan start-ups in a more leisurely way, as tends to be the case for retirees; NEs with greater income, wealth, and money invested; and for NEs contemplating a home-based start-up. NEs planning sole start-ups are not under pressure from business partners and so also have the luxury of waiting. Benefits of waiting include greater chances of eventual business success, which rational forward-looking agents should take into account when making their choices. Of course, it is also possible that some of the “waiters” might be lethargic dreamers whose declared intentions of eventually running a business are never really very likely to amount to anything.

Interestingly, the benefits of business assistance programs are more evident in the longer term (2 years after the initial interview) than the shorter term (one year). These programs appear to encourage waiting and deter quits from nascent entrepreneurship. In view of the well-documented evidence of over-optimism among entrepreneurs and high exit rates among new entrants (de Meza and Southey, 1996), these programs might be providing a valuable service, by encouraging greater caution about starting up without deterring NEs from entrepreneurship altogether.

Not surprisingly, individuals who are further into the process of launching the venture, for example having hired workers and established credit with suppliers - are significantly less likely to remain a NE – especially after 2 years – and significantly more likely to start-up. (For similar findings, see Carter *et al*, 1996; Delmar and Shane, 2004; and Kessler and Frank, 2004). Interestingly, although founders who are further into the process are significantly less likely to quit after one year, they are significantly more likely to do so after 2 years. This might be because those who are further into the entrepreneurial process are among the first to encounter insuperable difficulties that lead to quits.

Other factors also affect NEs’ decision to give up. Having attractive options outside entrepreneurship (which are associated with higher levels of education and raising young children) appear to be important, implying a strong voluntary component in quit decisions. In contrast, social capital is associated with lower quit rates. There is also some evidence that NEs who intend to enter markets characterised by strong price competition are less likely to quit, with the opposite being the case for markets characterised by non-price competition. The reasons for this are not entirely clear. A possible explanation is that NEs who intend to introduce a radical innovation (e.g., a novel durable good) for which price competition is unimportant, face greater risks and difficulties, and soon come to realise the limitations of their vision.

### **“SO WHAT?” - POLICY IMPLICATIONS**

These results carry several implications for stakeholders. First, they show that lenders play a key role in facilitating start-ups among nascent entrepreneurs, with receipt of external funds being a significant factor in helping to turn nascent into actual entrepreneurs, and reducing quits from nascent entrepreneurship. This contrasts with the effects of self-finance, which do not tie nascent entrepreneurs into a tight timetable for start-up, and so are associated with delay.

Our findings identify several variables that lenders might usefully incorporate into their loan screening models to improve their lending decisions. As well as relying on “traditional” indicators such as home ownership and education, lenders might also take into account parental self-employment experience; having friends or kin in business; characteristics of the venture (in particular, whether home-based or tech-based); and whether the NE is retired, married, a homemaker, or raises young children. Interestingly, our results suggest that education is associated with *quitting* nascent entrepreneurship, rather than continuing with it. Our theoretical model (outlined in a longer version of this article) can explain this in terms of more attractive outside opportunities in paid employment being available to the better educated.

Second, the evidence that non-whites remain NEs for longer than whites is consistent with the notion that they face different constraints, which necessitates a longer period of waiting before launch. If this reflects discrimination in the capital markets, then current US Federal policy seems justified in targeting assistance to ethnic minorities in the form of special loan guarantee programs. This point is strengthened by our additional finding that non-whites are significantly more likely to eventually start a business (i.e., after 2 years). Clearly, however, more research is needed to dig deeper into the ethnic dimension of NE entry decisions.

Third, our results indicate that existing business assistance programs appear to promote continuation in nascent entrepreneurship, and deter quits. It is notable that these effects are significant after two years, but not after one. This suggests that assistance programs need time to bear fruit. While we uncovered no direct evidence that these programs have significantly increased the number of business starts, that does not imply that the programs are ineffective. Indeed, it is quite possible that greater long-term benefits will accrue by encouraging NEs to delay and improve their business ideas than by urging them to launch precipitately.

We believe the robustness of our findings is enhanced by the exogeneity of the explanatory variables used in our multinomial logit analysis. We deliberately used initial pre-determined variables, rather than current-dated variables, for two reasons. First, only the former are observed by lenders and business advisors when they offer finance or advice. Since we want to offer them practically useful advice we must condition on the kind of data that they can gather themselves. Second, current-dated variables might suffer from the serious drawback of being endogenous, i.e., jointly determined with NEs’ destinations. For example, current wealth, income, and process activities might all be *determined by* NEs’ choices  $Z_i$ , rather than determining these choices. If so, causality is unclear, and one would also be unable to obtain unbiased results from standard statistical procedures (Greene, 2003).

## CONCLUSION

This paper used several waves of the rich PSED longitudinal data set in an attempt to understand what happens to nascent entrepreneurs in America. We first proposed a theoretical model capable of generating testable predictions. We then estimated the model using three waves of PSED data: an initial interview and two subsequent follow-up interviews at twelve-monthly intervals. We identified several key factors which can help predict which nascent entrepreneurs launch their ventures, which remain nascent entrepreneurs, and which give up altogether. We



went on to discuss the implications of our results for three types of stakeholder: lenders, business start-up support agencies, and policy-makers.

We would like to add a final thought for scholars in the nascent entrepreneurship field. Our analysis suggests that future researchers should utilise state-of-the art multinomial logit estimators (rather than the nearly ubiquitous binary logit), and truly exogenous explanatory variables that stakeholders can measure and use. We believe that these are valuable ways of helping stakeholders improve the design of their programs, in order to turn today's nascent entrepreneurs into the active entrepreneurs of the future.

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**Table 1**  
**Destinations of nascent entrepreneurs in the PSED**

|               | <u>12 months after the first<br/>Interview</u> | <u>24 months after the first<br/>Interview</u> |
|---------------|--|--|
| Still nascent | 160<br>(46.8%)                                 | 75<br>(46.3%)                                  |
| Operating     | 112<br>(32.7%)                                 | 40<br>(24.7%)                                  |
| Gave up       | 70<br>(20.5%)                                  | 47<br>(29.0%)                                  |
| <i>Total</i>  | 342<br>(100 %)                                 | 162<br>(100 %)                                 |

Notes:

Numbers of cases appear as the first cell entries, with sample percentages in parentheses underneath.

**Table 2**  
**Predicted effects of explanatory variables on nascent entrepreneurs' outcomes**

|                             | Outcome            |                                 |              |
|-----------------------------|--------------------|---------------------------------|--------------|
|                             | Still nascent: Z=0 | Start up: Z=1                   | Gave up: Z=2 |
| Wealth                      | +                  | –                               | –            |
| Household income            | +                  | –                               | –            |
| Money invested              | +                  | –                               | –            |
| Retired                     | +                  | –                               | –            |
| Home-based venture          | +                  | –                               | –            |
| Household head              | –                  | +                               | +            |
| Children under 6            | –                  | +                               | +            |
| Non-white                   | +                  | [– in short run; + in long run] |              |
| Saving money                | –                  | +                               | –            |
| Received funds              | –                  | +                               | –            |
| Owens own house             | –                  | +                               | –            |
| Hired workers               | –                  | +                               | ?            |
| Credit with suppliers       | –                  | +                               | ?            |
| Post-high school degree     | –                  | –                               | +            |
| College degree              | –                  | –                               | +            |
| Business assistance program | +                  | +                               | –            |
| Self-employed parent        | –                  | +                               | –            |
| Kin own businesses          | –                  | +                               | –            |
| Friends own businesses      | –                  | +                               | –            |

**Table 3**  
**Determinants of destinations of nascent entrepreneurs: significant marginal effects**

| Explanatory variables | 12 months after interview |                      |         | 24 months after interview |                      |         |
|-----------------------|---------------------------|----------------------|---------|---------------------------|----------------------|---------|
|                       | Still nascent             | Start-up             | Gave up | Still nascent             | Start-up             | Gave up |
| Log-likelihood        |                           | -300.974             |         |                           | -110.574             |         |
| $\chi^2(96)$          |                           | 169.049 <sup>a</sup> |         |                           | 154.593 <sup>a</sup> |         |
| Pseudo-R <sup>2</sup> |                           | 0.163                |         |                           | 0.360                |         |
| Actual frequency      | 160                       | 112                  | 70      | 75                        | 40                   | 47      |
| Predicted frequency   | 119                       | 65                   | 32      | 59                        | 27                   | 32      |

(continued on next page)

|                                   |                     |                     |                     |                     |                     |                     |
|-----------------------------------|---------------------|---------------------|---------------------|---------------------|---------------------|---------------------|
| Constant                          | -0.443              | -0.110              | 0.552 <sup>b</sup>  | 0.777               | -0.994 <sup>b</sup> | 0.218               |
| <u>Value of an outside option</u> |                     |                     |                     |                     |                     |                     |
| Wealth (\$)                       | 0.001 <sup>a</sup>  | -0.001 <sup>b</sup> | -0.001              | 0.001               | -0.001              | -0.001              |
| Household income (logs)           | 0.003 <sup>a</sup>  | -0.020 <sup>c</sup> | -0.013              | 0.037 <sup>c</sup>  | 0.025               | 0.013               |
| Money invested                    | 0.059 <sup>a</sup>  | -0.017              | -0.043 <sup>a</sup> |                     |                     |                     |
| Retired                           | 0.383 <sup>b</sup>  | 0.006               | -0.388 <sup>b</sup> | -0.147              | -0.335 <sup>c</sup> | 0.481 <sup>b</sup>  |
| Home-based venture                |                     |                     |                     | 0.281 <sup>b</sup>  | -0.111 <sup>c</sup> | -0.171              |
| Household Head                    | -0.279 <sup>c</sup> | 0.193               | 0.087               |                     |                     |                     |
| No. Children under 6              |                     |                     |                     | -0.139              | -0.059              | 0.198 <sup>b</sup>  |
| Non-white                         | 0.183 <sup>a</sup>  | -0.113              | -0.071              | -0.062              | 0.219 <sup>b</sup>  | -0.157              |
| <u>Financial circumstances</u>    |                     |                     |                     |                     |                     |                     |
| Saving money                      |                     |                     |                     | -0.308 <sup>c</sup> | 0.099               | 0.210               |
| Received funds                    | -0.107              | 0.188 <sup>b</sup>  | -0.081              | 0.153               | 0.099               | -0.252 <sup>c</sup> |
| Owens own house                   | -0.075              | 0.136 <sup>c</sup>  | -0.062              |                     |                     |                     |
| <u>Process</u>                    |                     |                     |                     |                     |                     |                     |
| Hired workers                     | 0.041               | 0.135               | -0.175 <sup>b</sup> | -0.430 <sup>c</sup> | 0.125               | 0.305               |
| Credit with suppliers             | -0.172 <sup>b</sup> | 0.211 <sup>a</sup>  | -0.040              | -0.261 <sup>c</sup> | -0.008              | 0.268 <sup>b</sup>  |
| <u>Human and social capital</u>   |                     |                     |                     |                     |                     |                     |
| Post-HS degree                    |                     |                     |                     | -0.298              | -0.071              | 0.368 <sup>b</sup>  |
| College degree                    |                     |                     |                     | -0.198              | -0.172 <sup>c</sup> | 0.369 <sup>b</sup>  |
| Business assistance program       |                     |                     |                     | 0.336 <sup>c</sup>  | 0.027               | -0.362 <sup>b</sup> |
| Self-employed parent              |                     |                     |                     | -0.016              | 0.142 <sup>b</sup>  | -0.127              |
| Kin own businesses                | -0.131 <sup>c</sup> | 0.098               | 0.033               | 0.135               | -0.249 <sup>b</sup> | 0.115               |
| Friends own businesses            | 0.065               | 0.080               | -0.145 <sup>b</sup> |                     |                     |                     |
| <u>Control variables</u>          |                     |                     |                     |                     |                     |                     |
| Price important                   | 0.158 <sup>b</sup>  | -0.030              | -0.128 <sup>b</sup> |                     |                     |                     |
| Price not important               | -0.173              | -0.045              | 0.218 <sup>b</sup>  | -0.232 <sup>c</sup> | -0.001              | 0.232 <sup>c</sup>  |
| Durable good                      | -0.315              | -0.044              | 0.359 <sup>c</sup>  |                     |                     |                     |
| Competition moderate              | -0.082              | -0.035              | 0.117 <sup>c</sup>  |                     |                     |                     |
| High-tech                         |                     |                     |                     | -0.210              | 0.158 <sup>b</sup>  | 0.052               |
| Sole start-up                     |                     |                     |                     | 0.504 <sup>a</sup>  | -0.182 <sup>c</sup> | -0.323 <sup>c</sup> |
| Partnership start-up              |                     |                     |                     | 0.350               | -0.260 <sup>b</sup> | -0.090              |
| Other owners                      | -0.177              | -0.071              | 0.248 <sup>a</sup>  | -0.350              | -0.040              | 0.389 <sup>c</sup>  |
| Household size                    |                     |                     |                     | 0.120               | 0.055               | -0.174 <sup>c</sup> |
| Married                           | 0.194 <sup>b</sup>  | -0.183 <sup>b</sup> | -0.011              |                     |                     |                     |
| Homemaker                         | 0.097               | 0.022               | -0.118 <sup>b</sup> | -0.181              | -0.016              | 0.196 <sup>c</sup>  |

Notes:

Entries are marginal effects. Missing values denote insignificance in the given specification. Superscripts a, b, and c indicate statistical significance at 1%, 5%, and 10%, respectively, based on robust estimated standard errors. All columns include industry and regional dummies (not reported). Insignificant variables include age, experience, gender, older children, if unemployed.

## LIABILITY ISSUES FROM A CHANGING SMALL FIRM LABOR FORCE

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### *I. Introduction:*

This paper investigates how the changing small-business labor force will create numerous and expensive liability issues for small-business owners in the future.

Many of the laws and regulations governing the U.S. labor market are the product of an earlier era—when workers tended to remain with one employer for longer periods of time.<sup>1 2</sup> Many of these regulations have been modified many times in attempts to make them applicable to 21<sup>st</sup> century employees who will change jobs frequently.

Small employers often do not know how to interpret increasing costly and complex regulations that affect employee health care, pensions and related benefits, workplace safety and security, and to an increasing degree, privacy. The result of this confusion is that one in four privately held companies has been sued by an employee or former employee in the last few years.<sup>3</sup> About a quarter of the lawsuits involved employee benefits.

In an effort to obtain better protection, more small-business owners now rely upon consultants for advice on how to cope with electronic privacy and even terrorism. After health insurance, the “Cost and Availability of Liability Insurance” was the second highest ranked problem by small-business owners in a recent NFIB Research Foundation survey.<sup>4</sup>

Why are additional regulations important? The answer is that small employers need protection from lawsuits that arise from misinterpreting one or more of the newer, more complex labor regulations. One way to obtain this protection is to purchase an increasingly expensive employer liability insurance policy.

As the baby boom generation begins to retire, there will be major demographic shifts in the workforce. The slowdown in the growth of the labor force will result in hiring

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<sup>1</sup> “Job tenure declines among men.” U.S. Bureau of Labor Statistics, *Monthly Labor Review*.” October 6, 1998. Available at [www.bls.gov/opub/ted/1998/oct/wk1/art02.htm](http://www.bls.gov/opub/ted/1998/oct/wk1/art02.htm)

<sup>2</sup> Lynn A. Karoly and Constantijn, W.A. Panis, “The 21<sup>st</sup> Century at Work: Forces Shaping the Future Workforce and Workplace in the United States.” Prepared for the U.S. Department of Labor by the Rand Corporation under contract 0—8330-3492-8, 2004.

<sup>3</sup> “The Chubb 2004 Private Company Risk Survey.” Quoted in *Liability and Insurance Week*, 19 (22), May 31, 2004.

<sup>4</sup> Bruce D. Phillips, *Small Business Problems and Priorities*, (NFIB Research Foundation, Washington, D.C., 2004).

different kinds of workers to prevent labor shortages.<sup>5</sup> These future small-firm employees are likely to be older, more likely to be recent immigrants, and perhaps more likely to be persons with disabilities if labor markets become tight as they did in 1999 and 2000 (part II below).

The changing mix of employees will increase liability insurance costs. Small-firm owners may be more likely to be sued over the unintended interpretations of many labor-related regulations: overtime rules, age discrimination in employment regulations, workers compensation issues, unemployment insurance issues and disagreements over some provision of employee benefits.<sup>6</sup>

A brief overview of the changing composition of employees in small firms is found in section II. Some of the options for small-business owners to avoid potential labor shortages that may also minimize employer liability are discussed in Section III. Employment liability issues based upon federal regulations are discussed in section IV. Liability issues that are more likely to be state-based are summarized in Section V; policy implications and the “so what” issue are found in section VI.

## *II. The New Employees in Small Firms*

Many labor force entrants will consist of both entry-level immigrants and more experienced employees/managers who return to the work force from retirement. It is also unclear whether the skills of recent immigrants—especially Hispanic and Asian workers—will match the skills needed by small-business owners. The current supply of immigrants has been sufficient in most areas to fill semi-skilled jobs in industries like food services and construction; that will probably continue. But problems may arise where better language skills and higher educational attainment are required, especially in office-type occupations, and in health, business, and professional services.<sup>7</sup> The slowdown in labor force growth may push wages higher in particular industries. Rural areas may also be adversely impacted by fewer available workers, especially in manufacturing sectors.

## *III. How Can Small-Business Owners Fill Future Job Vacancies?*

There are a number of steps that small-business owners can take to minimize potential lawsuits associated with older workers, more immigrants, and complex labor regulations. They may or may not minimize potential labor shortages.

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<sup>5</sup> See, for example, Michael W. Horrigan, “Employment Projections to 2012: Concepts and Context.” *Monthly Labor Review*, February, 2004. Available at [www.bls.gov](http://www.bls.gov).

<sup>6</sup> The Chubb Insurance survey indicated that 50 percent of private employers believe a lawsuit filed with the Equal employment Opportunity Commission is likely.

<sup>7</sup> Bruce D. Phillips, “The Future Small Firm Workforce.” *Business Economics*, forthcoming, October, 2004.

The following are ways employers can help resolve labor shortages and their implications for owner liability:

1. Creating incentives to postpone the retirement of *existing* workers through flexible working arrangements - may increase potential liability due to contractual/communications issues and off-site workplaces.
2. Increasing hours of existing workers - may increase potential liability due to misinterpretation of amended overtime (FLSA) rules;
3. Increasing the use of legal immigrant - may increase potential liability due to security, documentation issues;
4. Increasing the employment of persons with disabilities - may increase liability due to employment disability regulations (e.g. ADA).

The following steps may cause declines in potential labor shortages and in potential employer liability problems:

1. Increasing the use of self-employed contractors/consultants, both full-time and part-time - will result in a decline in employer liability since contractors are not employees.
2. Enticing retirees back into the labor force - may decrease potential liability if retirees already have pensions and/or health insurance from previous jobs;
3. Using additional unpaid family members - decrease in potential liability;
4. Leaving vacant jobs open will reduce employer liability.<sup>8</sup>

#### *IV. Employer Liability Issues: Federal Issues*

Little has been written about how hiring older workers, employees with disabilities, and immigrants may increase additional small owner liability. This is more likely if the small employer has no written personnel manual, or listed set of employment practices. The list below, while incomplete, is based upon current Federal laws and regulations that may increase in importance with a more diverse employment mix:

1. *Disability Issues*: if a potentially productive employee is partially disabled, what kinds of additional accommodations are small-business owners willing to make under the Americans With Disabilities Act (ADA) to hire such persons?<sup>9</sup> Are there additional liabilities if persons with disabilities telecommute?
2. *Family and Medical Leave Act (FMLA) Issues*: if an older worker requires extended sick leave, will the employee be retained if the small firm is not subject to FMLA rules?<sup>10</sup> Owners of very small firms might be especially disadvantaged

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<sup>8</sup> William J. Dennis, Jr., ed. "The Changing Search for Employees." NFIB National Small Business Poll. 1 (1), 2001.

<sup>9</sup> An employer may not have to provide "reasonable accommodations" if they can establish "undue hardship" i.e., that it would be unduly expensive, disruptive, or adversely affect the business." For further information see, "Federal Employment Law Handbook," NFIB Legal Foundation, Washington, D.C. , 2004.

<sup>10</sup> A recent NFIB National Small Business Poll on Family Leave suggests that many small owners follow the rules of the FMLA Act, although they are technically not covered by the Act because they have fewer

- if a key worker is disabled for an extended period. How might intermittent absences be accommodated and recorded?
3. *Age Discrimination in Employment (ADEA) Issues:* are age discrimination suits more likely if a small firm increases its proportion of older workers? Will terminating such employees be more problematic?
  4. *General Benefit Issues:* If the typical small firm workforce has a growing proportion of older employees, will an employer feel obligated to offer a 401(k) plan or other pension related benefit to remain competitive? Will there be increased pressure to offer a health plan if a worker - more likely to be female - is less than 65 years old and without health insurance?<sup>11</sup>
  5. *OSHA Issues:* Will older employees be more likely to push for ergonomics rules?<sup>12</sup> Will this vary by industry and/or firm size? Will OSHA compliance change with an aging workforce?
  6. *Immigration Issues:* Due to terrorism, will small-business owners be more subject to government scrutiny if their future usage of immigrants rises? What kinds of additional paperwork costs will be imposed upon these business owners?
  7. *Privacy Issues:* How can small employers guarantee the privacy of all employees, especially the medical records of older workers and new immigrants? What costs may be involved in computerizing new and existing records? Revealing either too much information, or the wrong information may increase the probability of a lawsuit. How much testing (for drugs, violence, background credit checks, etc) will employers be permitted or required to perform in the future?
  8. *Employer Defamation Issues:* How will the dissemination of prior employee job ratings affect liability in the future?

This list is not exhaustive, and it is not mutually exclusive. But it is offered as a partial list of potential employer problems in hiring older workers, immigrants and workers without health insurance.

AARP reports that lawsuits filed against employers over the Age Discrimination in Employment Act (ADEA) have recently begun to increase. As Rix (2004) indicates, it is

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than 50 employees. See NFIB National Small Business Poll, "Family and Medical Leave." (NFIB Research Foundation, Washington, D.C., 4 (2), 2004).

<sup>11</sup> Because a greater proportion of females work part-time, they are less likely to have health insurance. In addition, females move in and out of the labor force more often than males due to child rearing and divorce.

<sup>12</sup> Sara Rix, "Aging and Work--A View From the United States," AARP Public Policy Institute Paper #2004-02, February, 2004, page 15. AARP, "Staying Ahead of the Curve 2003: The AARP Work and Career Study," (Washington, D.C., AARP, 2003).

possible that such lawsuits vary directly with the state of the economy: age-based lawsuits against employers are more likely when labor markets are slack, or the economy is growing below trend.

Lawsuits over age discrimination already occur in small firms. For example, a 72 year-old cab driver was recently fired when his employer learned that its liability insurance carrier would not insure drivers over 70. But the problem was with the insurance company, not the small employer. The fired cab driver sued the cab company.<sup>13</sup> Fortunately, the cab company was able to obtain a waiver from its insurance company, and rehired the driver. It is increasingly likely that small employers will find themselves in such absurd situations in the future. They become the defendant in an age discrimination lawsuit through no fault of their own.

### *Family and Medical Leave/ Employment of Persons With Disabilities*

Most small employers currently accommodate sick leave requests as needed, and most employees are paid for small amounts of time away from the job.<sup>14</sup> But an older workforce with employees who need periodic time off for medical treatments may become problematic when an employee is terminated for cause. Lawsuits due to the lack of formal personnel manuals or miscommunications are always possible and do occur with increasing frequency.<sup>15</sup>

About half the states have either proposed paid leave laws in some form, or made FMLA regulations applicable to employers with fewer than 50 employees in specific circumstances (see section V below). These mandates take the decisions away from small employers who almost always “do the right thing” even when it is not legally required.

About 35 percent of persons with some disability are employed at least part-time, up recently but below the peak participation rates of about 40 percent reached in the early 1990’s.<sup>16</sup> Might employment contracts with “do not sue” clauses be useful in the future? The courts have gone both ways on whether a worker can be made to waive his or her “right to sue” an employer when that employer is making a job offer, whether the worker

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<sup>13</sup> “Insurance Policy Shows Evidence of Age Bias But Not Employer’s Intent, Ninth Circuit Says.” Bureau of National Affairs, Daily Labor Bulletin, June 15, 2004, Page A-5.

<sup>14</sup> William J. Dennis, Jr. ed. “Family and Medical Leave.” NFIB National Small Business Poll, op. cit.

<sup>15</sup> Many analysts and publications stress the need for an employee personnel manual that specifically lists employee and employer obligations under various federal laws. It is part of an overall program to manage risk. See, for example, Karen Breckenridge, “Using Employee Risk Management To Reduce Workers Comp Claims.” North Bay Business Review, June 9, 2004. Available at [www.futurerehab.com](http://www.futurerehab.com). About 20 percent of employer lawsuits that reached the Supreme Court in 2004 were over employment related issues.

<sup>16</sup> “Disability Statistics: Online Source for U.S. Disability Statistics.” Available at [www.ilr.cornell.edu/ped/Disability\\_Statistics/statistics.cfm](http://www.ilr.cornell.edu/ped/Disability_Statistics/statistics.cfm). See also the 2004 Harris National Survey on the Employment of Persons With Disabilities. Available at [www.nod.org/content.cgm?id=1537](http://www.nod.org/content.cgm?id=1537). The trends from the Harris survey and the CPS data do not agree, and neither are readily available by firm size.



is disabled or not.<sup>17</sup>

Additional work is needed before we can make unqualified judgments about the additional assets and liabilities that older workers, immigrants and persons with disabilities bring to smaller employers. The issues above give small employers reasons to think carefully (or seek outside advice) before filling jobs. Decisions should be made carefully based upon the tightness of the labor market in specific industries and in specific places. The wrong decisions may be very costly and significantly increase the probability of a lawsuit.

#### V. *Employer Liability: State Issues*

Many liability issues concern programs jointly administered by federal and state government agencies. These include OSHA issues and environmental regulations. In some cases, it is simply a bureaucratic difference over which level of government administers the program. (Some state employees, for example, act on behalf of the federal OSHA). Other programs, such as Workers' Compensation (WC) and Unemployment Insurance (UI) tend to be state specific and have state based rates.<sup>18</sup> Other issues, such as Family and Medical Leave and tort claims, also tend to be state specific. While some of the liability areas listed below are arguable as "state-specific" issues, they have been included to illustrate the large range of employer liability issues.

1. *Workers Compensation Issues:* Will a larger proportion of older workers influence small employers' workers' compensation issues? Are on-the-job injuries more likely, even in service/retail sectors? Will a larger proportion of older workers cause higher WC premiums?
2. *Unemployment Insurance Issues:* Will older employees be less likely to remain with a single employer? What might happen to an employers' "experience rating" if older employees are terminated for cause more often? Will the qualifications for benefits change to accommodate older workers who are only employed part-time?
3. *State OSHA Issues (Asbestos, Silica Issues, etc.):* If older workers and/or immigrants who have partial disabilities are hired by small employers, how will it be made clear to insurers that the small employer will not have liability for the employees pre-condition? This could be difficult if the older employee

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<sup>17</sup> Vikram David Amar, "A Crucial Contract Issue May Go All the Way to the Supreme Court: Are Agreements to Arbitrate Enforceable, Or Do Parties Still Retain the Right to Sue?" The New York Times, Friday, Feb 21, 2003. Available at <http://writ.news.findlaw.com/amar/2003030221.html> and [www.cgood.org](http://www.cgood.org).

<sup>18</sup> See, for example, NFIB Research Foundation and National Foundation for Unemployment Compensation and Workers Compensation, "Legislative Guide to Workers' Compensation Insurance Reform in the States." NFIB Research Foundation, Washington, D.C., June, 2004.

works in the same industry (e.g. mining or construction) where they had worked before. Will states enact or expand separate ergonomics laws?

4. *Automobile/Accident/Traffic Issues:* Many small employers use automobiles as part of their daily business activities. A recent NFIB National Small Business Poll indicated that traffic accidents are a major concern of small-business owners.<sup>19</sup> With both more older drivers and new (immigrant) drivers, how might these affect the automobile liability insurance premiums of employers? Small employers may well restrict the driving of older workers if necessary.
5. *Environmental Liability Issues:* Will older workers who work for small employers at Superfund sites blame a small employer for any liability if they get sick at either the worksite or at home? State Toxic Release Inventory (TRI) lists and Community Right to Know Laws all have very high paperwork costs and potential high liability costs if a suit is filed.
6. *Personal Injury Law (Non-Vehicle Related):* An NFIB survey indicated that 46 percent of actual lawsuits were related to personal injuries.<sup>20</sup> Will an older workforce increase the likelihood of personal injury lawsuits that occur away from the business owners' premises?
7. *Employee Time-Off Issues:* About half the states have some minor form of unpaid leave in place, and many others are debating similar issues.
8. *Tort Claims (Negligent Hiring, etc.):* Many employers no longer provide employee evaluations for fear of being sued. The result is that good employees suffer because they cannot receive favorable referrals, and poor performers are advantaged.

The summaries below do not lead to any definitive conclusions. Rather, they are presented as a series of examples of issues in which NFIB state positions have met with varying amounts of success. Some have implications for areas such as WC, UI, Family Leave, and Tort Claims that may be impacted by using older workers and a larger proportion of immigrants. But because the examples are not based upon a survey, but rather what is available, no conclusion is possible. Despite the fact that this section looks "where the light is good," it does provide some idea of the likely wide variance in outcomes, based upon the particular politics of each state.

#### *What Are The Likely Actions of State Regulators?*

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<sup>19</sup> William J. Dennis, Jr. ed. "Workplace Safety." NFIB National Small Business Poll, 2 (1), (NFIB Research Foundation, Washington, D.C., April, 2002).

<sup>20</sup> David Stephenson, "Small Business and the Civil Justice System." NFIB Education Foundation, mimeo, 2000.

### *A. Workers' Compensation (WC)*

Studies in Washington, California and Wisconsin have shown that older workers generally have fewer workplace injuries, probably because of maturity and experience. However, when older workers are injured, they do take longer to heal, driving up medical costs and wage losses. The most expensive WC claim can be for permanent disability,<sup>21</sup> although states like Wisconsin are trying to end permanent disability from WC claims by introducing part-time work for disabled workers.<sup>22</sup>

#### *Idaho*

In Idaho, the “no fault” or “exclusive remedy” system of WC has been preserved in which an employee cannot sue an employer when the injured party immediately receives appropriate medical attention. And employers that provide Long Term Care Insurance can deduct it from their business income taxes.<sup>23</sup> These are particularly useful regulations for an older workforce, and may even help attract some older employees.

On the negative side, the “exclusive remedy” doctrine has been recently eroded in many states.<sup>24</sup> Third parties have frequently tried to prove that employers did little to prevent serious injuries through “willful misconduct” or “intentional injury.” Some agreements have been eroded in favor of recoveries for “pain and suffering” awards in WC cases.

### *B. Unemployment Insurance (UI) Issues*

As older workers become more commonplace in smaller firms, what if any, changes might states make to UI eligibility and/or benefit, requirements? For example, could the standard 20 weeks of paid employment needed to be eligible for UI be reduced, or alternately, could the number of hours be reduced?

These issues have already been discussed for part-time workers in many cases, but not for older workers. If requirements to receive benefits are made more liberal for older employees, small firms with higher turnover rates will be at a competitive disadvantage.

In the case of older workers who have had more than one employer, there is some question as to whether the employer who terminated the worker should be liable, or whether several employers should share disproportionately in their accounts being

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<sup>21</sup> Jeff Biddle, Leslie T. Boden and Robert Reville, “Older Workers Face More Serious Consequences From Workplace Injuries.” National Academy of Social Insurance, December 2003.

<sup>22</sup> “Permanent Part-Time Position Reasonable For Disabled Worker, Wisconsin Court Finds.” Bureau of National Affairs, Daily Labor Bulletin, July 8, 2004, Page A-9.

<sup>23</sup> National Federation of Independent Business, “Idaho State Report,” June-July, 2004. Available at [www.nfib.com/ID](http://www.nfib.com/ID).

<sup>24</sup> “Legislative Guide to Workers Compensation Insurance Reform in the States,” op. cit., pages 10-11.

charged. The recent NFIB/UC study suggests that “benefits should be charged in proportion to base period wages.”<sup>25</sup> Therefore, if a worker was employed part of the time for a large firm during the base period, the large firm would also contribute to the employees UI payment, even if that firm was not the last employer of the worker.

### *C. Tort Reform*

The American Tort Reform Association’s (ATRA) “Tort Reform Record” keeps a scorecard on the progress of tort reform in each of the states. During the most recent 2004 legislative session, the most bills were introduced in the areas of “Joint and Several Liability Reform” and “Reform of the Collateral Source Rule.”<sup>26</sup>

If “joint and several liability” is reformed, damages could not be collected from multiple defendants. Thirty-nine states have some modifications of these rules.

Thirty-five percent of medical malpractice claimants receive compensation from other sources—such as WC funds. Twenty-three states have enacted legislation that would disallow collateral source payments in medical malpractice cases, or at least allow the existence of those payments to be introduced as evidence.<sup>27</sup> It is not known how much this will lower settlements, especially in WC based cases, among older workers and immigrants. But this and similar tort reforms in areas such as punitive damages and non-economic damage caps can only help lower the cost of liability insurance.

### *Effects of Higher Employer Liability Premiums*

To protect themselves from lawsuits, small-business owners increasingly purchase a variety of expensive liability insurance policies. These liabilities cover premises liability, employment liability, environmental liability, and professional liability, among other categories. In a 1995 NFIB survey, a theoretical doubling of liability insurance premiums was estimated to have the following effects on small-business owners’ operating policies:

- a) raise selling prices-33 percent;
- b) reduce insurance coverage-16 percent
- c) reduce owner earnings-12 percent;
- d) reduce employment-7percent;
- e) change insurance carriers-6 percent;
- f) freeze employee wages/benefits-3 percent.

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<sup>25</sup> “Legislative Guide to Unemployment Insurance Reform, op cit.

<sup>26</sup> American Tort Reform Association, “Tort Reform Record,” July 13, 2004. Available on the net at [www.atra.org](http://www.atra.org) .

<sup>27</sup> Ibid.

The survey was taken in 1995, a relatively good year for the economy.<sup>28</sup> The mean increase in employer liability premiums between 1995 and 2004 has been significant, but direct premium comparisons are not relevant because liability policies today cover a broader array of areas than policies written a decade ago.<sup>29</sup> With slack economic conditions during 2001-2003, it is likely that the ability to pass on increased insurance costs from employers to customers was severely limited, compared to results reported in 1995.

## VI. *Summary and Conclusion: The “So What” Issue*

This short essay has tried to relate how the changing workforce in small firms may increase owner liability premiums in the future. Much of this is not predictable, but speculative, dependent upon two sets of forces: precisely who will be working in small firms, and the areas that will be further regulated by federal and state governments.

A few things are known. Workers in smaller firms are getting older, just as they are in the general workforce. And owners of small businesses may or may not increase their use of immigrants and disabled workers. Much depends on labor demand and potential labor shortages. The state of the labor market is also likely to determine what additional benefits, if any, small employers offer their employees. Some benefits, like telecommuting, may be relatively costless but increase potential owner liability. Others, like matching 401(k) accounts, or offering health benefits to part-time employees may be much more costly but have few implications for additional employer liability.

Associations like NFIB attempt to use both the federal and state legislative processes to minimize future liability for small-business owners, and hold down and even reduce costs where feasible. There have been both successes and failures. That is not likely to be altered. However, the changing workforce of small firms is likely to make the task of making a profit more difficult in the future.

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<sup>28</sup> NFIB Education Foundation “Small Business—Plaintiff or Defendant.” (Washington, D.C., NFIB Education Foundation, October, 1995). Quoted in David Stephenson’s, “Small Business and the Civil Justice System.” (NFIB Education Foundation, Washington, D.C., 2000).

<sup>29</sup> The issue is complex. Many liability insurers write policies that exclude areas (such as environmental liability) that they did not several years ago. Therefore it is very difficult to compare the cost of a similar policy over time.

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## THE FUTURE SMALL BUSINESS WORKFORCE

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### *I. Introduction:*

During the next decade, there will be major demographic shifts in the workforce as the baby boom generation begins to retire. The rate of growth of the labor force will decline, and the supply of labor for small firm owners will be smaller and more diverse. The labor force will grow about 1.1 percent a year from 2002-2012, compared with rates in excess of 2.0 percent annually during the 1970-1995 period.<sup>1</sup> Future employees are likely to be either under 30 years old or over 50 years old. This is the case because workers 30-44 years old are expected to shrink by over three million by 2010.<sup>2</sup> What does this mean for owners of small firms looking for either entry- level or more experienced workers?

Much has been written about the changing labor force. Many new labor force entrants are also likely to be immigrants or the offspring of recently arrived immigrants, particularly Asian and Hispanic workers.<sup>3</sup> Because the growth of the labor force has slowed, a rapid increase in the demand for labor may mean a return to labor shortages unless there is a significant increase in employed immigrants.<sup>4</sup>

The purpose of this paper is to explore how small firm owners will avoid potential labor shortages during the next decade. How will small firm owners adapt to the changing pool of available workers? Four potential scenarios are explored below:

1. Increases in the labor force participation rate (LFPR) of the baby boom generation will increase labor supply. Increases are being driven by insufficient saving. The lack of retiree health benefits and pensions will cause workers to postpone retirement, but move to small employers because of increased flexibility.
2. Spot shortages will occur in rapidly growing sectors—especially in labor-intensive construction and in manufacturing sub-sectors now dominated by

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<sup>1</sup> Michael W. Horrigan, "Employment Projections to 2012: Concepts and Context," *Monthly Labor Review* February, 2004. Available online at [www.bls.gov](http://www.bls.gov).

<sup>2</sup> Justin A. Heet, "Beyond Workforce 2020: The Coming (and Present) International Market for Labor." Hudson Institute White Paper, October 2003. Available at <http://www.hudson.org>. Fifty-six percent of workers are 40 or over today, compared with 38 percent in 1977.

<sup>3</sup> It is also likely that some of these immigrants will also form small businesses.

<sup>4</sup> There were approximately 7 million legal immigrants in the United States between 1991 and 1998, according to the Census Bureau. Approximately the same level of immigration is assumed for the projection period.

small businesses. It may be especially difficult to find unskilled workers in some industries and in some rural areas.

3. **Future immigration—at about the current rate –will continue during the next ten years. Many of these immigrants will be employed in small firms, but mismatches are likely between the skills required for various jobs, and the education and skills of immigrants.**
4. **Small business owners may use more semi-retired self-employed persons or leased employees to avoid paying additional costly benefits, especially if the older workers are already qualified for Medicare.**

## *II. Potential Labor Shortages Will Vary By Industry*

The Bureau of Labor Statistics (BLS) is projecting overall productivity (output per hour) to increase about 2.1 percent annually from 2002-2012, slower than the 1995-2001 rate of 2.3 percent, but above the 1.5 percent rate of 1990-1995.<sup>5</sup> For small business owners, it means that additional workers may be required to produce the same amount of output in the future.<sup>6</sup>

BLS forecasts that between 2002 and 2012, 96 percent of job growth is expected in service producing sectors. There are four major sectors that are expected to account for about two-thirds of this growth:

**Retail trade: Employment growth of 9.6 percent**

**Professional, scientific, technical and business services: Growth of 22.5 percent**

**Education and health services: Growth of 23.8 percent**

**Leisure and hospitality services: Growth of 9.9 percent<sup>7</sup>**

These four sectors contain a mix of small and large firms, but small businesses dominate many of the sub-industries within the large categories. Most of these sectors are labor intensive.

Small owners are also very important employers in manufacturing sectors. Small business owners contributed over two-thirds of the jobs in specialized manufacturing in 2001,<sup>8</sup> and about half the jobs in metalworking machinery. The jobs in these sectors tend to be more physically demanding, and workers tend to retire earlier from them. Selected manufacturing sectors are areas of potential labor

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<sup>5</sup> “Employment Projections to 2012,” op. cit, charts 1 and 2.

<sup>6</sup> However, productivity is notoriously difficult to predict, and may or may not be a significant determinant of labor demand.

<sup>7</sup> “Employment Projections to 2012,” op. cit.

<sup>8</sup> Specialized manufacturing includes medical and dental equipment, jewelry and silverware, sporting goods, toys and musical instruments, among others. It is new NAICS industry number 339.

shortages.<sup>9</sup> Some of these jobs are likely to remain in or near rural areas from which workers have been leaving.<sup>10</sup>

### *III. Baby Boomers Will Not Retire On Time-The Supply Side*

By 2010, the number of 55-64 year olds will grow by more than 11 million, an increase of 46 percent over their number in 2000. The labor force participation rates (LFPR) of those aged 55 years and over (in 1990) rose about three percentage points between 1990 and 2000, from 56 percent to 59 percent. As shown in Table 1, virtually all of this increase was accounted for by women aged 55+, whose LFPR rose by 7 percentage points.<sup>11</sup>

In table 1, there are large *increases* forecast in LFPR of both men and women 55 years and older. Second, by 2012, almost a third of men (29.1 percent) and almost 20 percent of women 65-74 will be in the labor force. Almost 8 percent of men over 75 years old will also be participating in the labor force by 2012.

Table 1 below tells us nothing about worker supply (e.g. whether workers will be available full-time or part-time). Nor does it tell us how many additional workers will match the needs of small business employers on a part-time vs. full-time basis.<sup>12</sup> While some service jobs can be filled on a part-time basis, this is less likely in traditional manufacturing and in some manufacturing related service sectors like computer or engineering services where close collaboration is needed.

How many additional workers do the increased LFPR in table 1 imply? About 1.94 million additional workers 55 years and over will be available in 2012 by postponing retirement. About two thirds of these will be men. About 200K additional workers will be 75 years and over in 2012. Viewed from another perspective, almost 60 percent of the increase in the labor force between 2002 and 2012 will be comprised of workers 55 years and over who do not retire.<sup>13</sup>

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<sup>9</sup> Many of these manufacturing sectors also require experienced workers, rather than apprentices. About 90 percent of the jobs in manufacturing tend to be full-time, and may not be replaceable by part-time older workers.

<sup>10</sup> See, for example, Mark Drabentstott, "A New Era for Rural Policy." Economic Review, Federal Reserve Bank of Kansas City, 88(4), 2003, pp. 81-95. The author asks whether new entrepreneurs can be drawn to rural America to continue to start new firms.

<sup>11</sup> Ibid, table 6.

<sup>12</sup> We are assuming that the current full-time schedules and part-time schedules of workers in firms reflect employer needs. Whether they will match worker needs/desires in the future is not clear.

<sup>13</sup> Mitra Toosi, "Labor Force Projections to 2012: The Graying of the U.S. Workforce." Monthly Labor Review, February, 2004, Table 5.

**TABLE 1-Current and Projected Labor Force Participation Rates of Workers, 55 Years and Over: 1982-2012**

| <i>Group</i>                    | <i>1982</i> | <i>1992</i> | <i>2002</i> | <i>2012</i> | <i>Change, 2002-2012</i> |
|---------------------------------|-------------|-------------|-------------|-------------|--------------------------|
| <b>All Workers, 55 and Over</b> | 31.9        | 29.7        | 34.5        | 39.7        | 5.2                      |
| 55-64                           | 55.1        | 56.2        | 61.9        | 65.1        | 3.2                      |
| 65-74                           | 16.2        | 16.3        | 20.4        | 23.6        | 3.2                      |
| 75+                             | 4.9         | 4.5         | 5.1         | 5.7         | 0.6                      |
|                                 |             |             |             |             |                          |
| <b>Men, 55 and Over</b>         | 43.8        | 38.4        | 42.0        | 45.8        | 3.8                      |
| 55-64                           | 70.2        | 67.0        | 69.2        | 69.9        | 0.7                      |
| 65-74                           | 22.5        | 21.1        | 25.5        | 29.1        | 3.6                      |
| 75+                             | 8.5         | 7.3         | 7.6         | 8.2         | 0.6                      |
|                                 |             |             |             |             |                          |
| <b>Women, 55 and Over</b>       | 22.7        | 22.8        | 28.5        | 34.5        | 6.0                      |
| 55-64                           | 41.8        | 46.5        | 55.2        | 60.6        | 5.4                      |
| 65-74                           | 11.3        | 12.5        | 16.1        | 18.9        | 2.8                      |
| 75+                             | 2.8         | 2.8         | 3.5         | 4.1         | 0.6                      |
|                                 |             |             |             |             |                          |

Source: Mitra Toossi, “Labor Force Projections to 2012: the Graying of the U.S. Workforce”, Monthly Labor Review, February, 2004, derived from table 3.

These additional workers will partially offset the projected loss of 2.5 million workers aged 35-44 between 2002 and 2012. How do the workers who will be available by postponing retirement compare to the needs of small business owners?

As the February 2004 Monthly Labor Review articles imply, small firm owners can do any of the following to *increase* future labor supply:

1. Create incentives to postpone retirement of *existing* workers; this could include, for example, telecommuting from remote locations.
2. Increase hours or overtime hours of *existing* workers;
3. Shift *existing* older full-time workers to *part-time* status; and/or hire additional part-time workers to fill the vacant hours;
4. Increase the use of legal immigrants;
5. Increase the employment of previously unemployed persons with disabilities;
6. Increase the use of self-employed contractors/consultants, both full-time and part-time as appropriate;
7. Entice retirees back into the labor force.
8. Use additional unpaid family members.

In addition, many small business owners have coped with past labor shortages by simply increasing their own hours of work, or by letting jobs go vacant.<sup>14</sup>

<sup>14</sup> William J. Dennis, Jr., ed. “The Changing Search for Employees.” NFIB National Small Business Poll. (I) 1, 2001.

**The recent recession told us that increasing productivity, increasing overtime hours, hiring temporary workers and letting jobs go vacant were steps to avoid hiring additional workers.<sup>15</sup>**

#### ***Retirement Income Needs of Baby Boomers***

**More workers will need to keep working past retirement for financial reasons, including rising health care costs. The Congressional Budget Office (CBO) recently took a comprehensive look at the preparation of the baby boom generation for retirement..<sup>16</sup> The CBO conclusion, much like that of a 2002 study from the Center For Retirement at Boston College, was that many older workers *considering* retirement have changed their plans. (These new plans are reflected in the higher projected LFPR's of older workers from the Bureau of Labor Statistics.)<sup>17</sup> Based upon additional studies using various datasets from the Census Bureau and the University of Michigan, the CBO study team concluded that additional retirement assets or additional years of work are required for workers over the age of 62."<sup>18</sup>**

#### ***Estimating Business Formation by Baby Boomer Consultants***

**Recent AARP surveys report that 17 percent of baby-boomers expect “to go into business for themselves” (e.g. transition into self-employment) when they retire.<sup>19</sup> It is unknown what percentage will represent self-employed independent contractors, but surveys suggest it is likely to be in the 15-20 percent range.<sup>20</sup> While contractors (or self-employed persons) may be available to small business owners, it is not known whether matches will occur between the hours, places and industries of the self-employed compared to what small business owners will need.<sup>21</sup>**

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<sup>15</sup> Written communications by William Dunkelberg of Temple University and Chief Economist, NFIB. See also the recent issues of NFIB's "Small Business Economic Trends" on the Web at [www.nfibresearch.com](http://www.nfibresearch.com)

<sup>16</sup> "Baby Boomers Retirement Prospects: An Overview.." (Congressional Budget Office, November 2003).

<sup>17</sup> Andrew D. Eschtruth and Jonathan Gemus, "Are Older Workers Responding to the Bear Market?" Center for Retirement Research at Boston College, September, 2002, no. 5.

<sup>18</sup> CBO Retirement Study, op. cit.

<sup>19</sup> "The Policy Book: AARP Public Policies 2003." (American Association of Retired Persons, Chapter 4, Employment, pages 4-28. According to 2002 CPS data, about 16.4 percent of workers aged 50 and over were self-employed. The 17 percent figure approximately represents "transitioners" into self-employment, as well as the long-term self-employed. It is not clear whether these percentages are additive.

<sup>20</sup> See North Carolina study referenced in footnote 18.

<sup>21</sup> Consultants are likely to be of two types: highly educated persons with advanced degrees, and experienced blue collar workers who have worked in the construction, wholesale trade and retail trade sectors.

#### *IV Will Small Firms Hire Larger Numbers of Older Workers?*

Table 2 provides data on the current distribution of workers by firm size and age, as of 2002:

**TABLE 2-Distribution of Workers, 55 Years and Over, By Firm Size: 2002**

| Age of Workers         | Less than 55    | 55-64          | 65-74          | 75+          |
|------------------------|-----------------|----------------|----------------|--------------|
| <b>Firm Size:</b>      |                 |                |                |              |
| <b>Under 10</b>        | <b>83.3</b>     | <b>11.1</b>    | <b>4.4</b>     | <b>1.2</b>   |
| <b>(Number in 000)</b> | <b>(14,628)</b> | <b>(1,945)</b> | <b>(775)</b>   | <b>(218)</b> |
|                        |                 |                |                |              |
| <b>10-24</b>           | <b>86.2</b>     | <b>9.9</b>     | <b>3.1</b>     | <b>0.8</b>   |
|                        | <b>(11,035)</b> | <b>(1,260)</b> | <b>(392)</b>   | <b>(104)</b> |
|                        |                 |                |                |              |
| <b>25-99</b>           | <b>86.1</b>     | <b>10.6</b>    | <b>2.8</b>     | <b>0.5</b>   |
|                        | <b>(15,189)</b> | <b>(1,869)</b> | <b>(495)</b>   | <b>(85)</b>  |
|                        |                 |                |                |              |
| <b>100+</b>            | <b>86.7</b>     | <b>10.9</b>    | <b>2.0</b>     | <b>0.4</b>   |
|                        | <b>(55,526)</b> | <b>(6,967)</b> | <b>(1,301)</b> | <b>(264)</b> |

Source: Current Population Survey (CPS), Bureau of the Census. Source: Prepared for the NFIB Research Foundation by the Employee Benefit Research Institute under contract. Data are from the March, 2003 survey.

From table 2, we observe that there is little variation in the age distribution of employees by firm size. Small business owners with fewer than 10 employees and larger businesses with more than 100 employees employ the largest absolute numbers of workers aged 65 and over.

If future labor force increases will be among men older than 65, and among women 55 years and over, it is useful to know if small firms already employ similar workers.

Table 3 below presents an indirect answer to the question above by examining the percentage of workers employed part-time by major industry in 2002.<sup>22</sup> Two definitions of part-time employment are used: less than 20 hours per week, and less than 35 hours per week. Using the more inclusive definition of less than 35 hours per week, about 20 percent of the non-farm employed worked such a schedule in 2002. However 26-27 percent worked such a schedule in the growing retail trade and service sectors. Clearly younger workers make up the difference. Note that the percentage of part-time employment in manufacturing is also very small.

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<sup>22</sup> The preferred cross tabulation of worker age by industry by firm size is not available.

**TABLE 3-Distribution of Non-farm Full-Time Workers vs. Part-Time Workers By Major Industry: 2002**

| <i>Sector</i>                         | <i>Full-Time</i> | <i>Part-Time<br/>(&lt;35hrs/wk)</i> | <i>Full-Time</i> | <i>Part-Time<br/>(&lt;20hrs/wk)</i> |
|---------------------------------------|------------------|-------------------------------------|------------------|-------------------------------------|
| Ag, Ag Services                       | 82.0             | 18.0                                | 92.8             | 7.2                                 |
| Mining                                | 96.3             | 3.7                                 | 99.3             | 0.7                                 |
| Construction                          | 91.0             | 9.0                                 | 98.2             | 1.8                                 |
| Manufacturing                         | 95.0             | 5.0                                 | 98.9             | 1.1                                 |
| Wholesale,<br>Retail<br>Trade         | 73.8             | 26.2                                | 91.7             | 8.3                                 |
| Transportation,<br>Utilities          | 89.3             | 10.7                                | 97.8             | 2.2                                 |
| Communications                        | 87.3             | 12.7                                | 95.6             | 4.4                                 |
| Finance,<br>Insurance, Real<br>Estate | 87.0             | 13.0                                | 96.7             | 3.3                                 |
| Services                              | 72.4             | 27.6                                | 90.7             | 9.3                                 |
| All Sectors                           | 80.0             | 20.0                                | 93.6             | 6.4                                 |

Source: Tables prepared for the NFIB Research Foundation by the Employee Benefit Research Institute, under contract, from the March, 2003 CPS.

#### *Part-Time Workers By Age Group*

Examining the full-time/part-time distribution of workers by *age group* is another method of analyzing whether the *available* workers will match the *hours required* by *small business owners*. How do the percentages of part-time workers by industry sector compare with the percentages by age group? An answer is in table 4 below.

On a percentage basis, the youngest and oldest age groups comprise the bulk of the part-time workforce. Although about 20 percent of employed women 25-54 work part-time, it is likely that the largest number of future part-time workers needed by small business owners in the retail and service industries are likely to come from two age groups: 16-24 year olds of both genders and females, 55 years and over. On an absolute basis, (not shown in table 4), the actual *number* of part-time workers in the 16-24 age group is about 4 times that in the 55+ group.

**TABLE 4-Percentage of Non-Farm Workers By Age Group Working Part-Time: 2002**

|             | Working <20 Hours per Week |      |        |  | Working 21-35 Hours Per Week |      |        |
|-------------|----------------------------|------|--------|--|------------------------------|------|--------|
|             | Total                      | Male | Female |  | Total                        | Male | Female |
| All Workers | 6.6                        | 4.0  | 9.5    |  | 19.8                         | 12.7 | 27.6   |
| 16-24       | 17.7                       | 14.4 | 21.1   |  | 46.1                         | 40.2 | 52.5   |

|       |      |     |      |  |      |      |      |
|-------|------|-----|------|--|------|------|------|
| 25-44 | 3.6  | 1.1 | 6.5  |  | 13.2 | 5.6  | 21.9 |
| 45-54 | 3.1  | 1.0 | 5.3  |  | 11.7 | 4.7  | 19.3 |
| 55-64 | 5.8  | 3.2 | 8.6  |  | 17.3 | 10.7 | 24.9 |
| 65+   | 21.4 | 1.7 | 27.0 |  | 48.3 | 42.7 | 55.5 |

**Source: Prepared by the Employee Benefit Research Institute for the NFIB Research Foundation, under contract from March, 2003 CPS Data.**

Only the youngest (16-24) and oldest (55+) age groups contribute large numbers working less than 20 hours per week. What is somewhat surprising from table 4 is that a much larger percentage of females 25-54 years old currently work more than 20 hours per week; the proportion of women 55-64 working more than 20 hours per week is almost three times larger than the group working less than 20 hours per week. This probably reflects a combination of business owner requirements (e.g. demand) and worker availability (e.g. supply).

While about five percent of all workers were aged 65 years and over in 2002, about 25-27 percent of employees in trade and services were working part-time (e.g. 21-35 hours per week).<sup>23</sup> While many of these part-time workers are young workers aged 16-24, a growing proportion are also older workers aged 65 years and over, based upon recent increases in LFPR. If potential labor shortages are to be averted, these percentages will have to increase because of the projected slowdown in labor force growth.

If very young workers and older workers are more readily available to small business owners in the future, how likely are owners to hire older workers not yet qualified for Medicare, especially if they cannot afford to pay benefits?<sup>24</sup>

There are also a number of potential conflicts inherent in small firm owners' hiring of older employees and consultants. These include 1) mismatches between available employee hours and those desired by owners, 2) benefit demands by employees versus what employers can afford to pay, 3) location of the business vs. location of employees, and 4) skill mismatches between employees and owner needs.

## ***VI. Will Immigration Eliminate Labor Shortages in Small Firms?***

It is likely that future immigration will partially alleviate labor shortages in small businesses. The main determinants are the level of economic growth (e.g. higher growth implies the need for more workers), new business formation, the possibility of substituting capital for labor, and skill mismatches. The BLS assumes

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<sup>23</sup> Compare Tables 3 and 4 above.

<sup>24</sup> There is some limited evidence that small employers introduced health plans about 13 percent of the time because some employees or their dependents needed the coverage. See, William J. Dennis, Jr. ed. NFIB National Small Business Poll, "Health Insurance." Question 13(f), page 10., 3(4), 2003.



a future level of immigration similar to that of the 1990's, about a million legal immigrants annually, with some variation around that figure.

Small firm owners currently employ immigrants who are U.S. citizens as well as non-citizens. They are already a significant part of the small firm workforce. As shown in Table 5 below, about 17 percent of workers in small firms are immigrants who are citizens and non-citizens—almost 1 out of 5 employees. (In the smallest firms with fewer than 25 employees, about 13 percent of the workforce are also immigrants who are non-citizens).<sup>25</sup>

Small firm owners are more intensive users of immigrants than larger firms. Of the approximate 17.3 million employed immigrants in 2002, about 66 percent worked in the small firm sector (firms with fewer than 500 employees). In raw numbers, about 3.3 million or about 20 percent of employed immigrants worked in firms with fewer than 10 employees.<sup>26</sup>

**TABLE 5-Distribution of Citizens and Non-Citizens By Firm Size, Private Sector: 2002 (Data in 000)**

| Firm Size:<br>(No. Of Employees) | Total<br>(in 000) | Native-Born<br>Citizens | Immigrants-<br>Citizens | Immigrants-<br>Non-Citizens | Pct. Of Size Class |      |      |
|----------------------------------|-------------------|-------------------------|-------------------------|-----------------------------|--------------------|------|------|
|                                  |                   |                         |                         |                             |                    |      |      |
| Total, All<br>Sizes              | 114,756           | 97,410                  | 6,155                   | 11, 191                     | 84.9%              | 5.4% | 9.8% |
| <10                              | 18,180            | 14,795                  | 1,039                   | 2,347                       | 81.4               | 5.7  | 12.9 |
| 10-24                            | 13,263            | 10,963                  | 619                     | 1,681                       | 82.7               | 4.7  | 12.7 |
| 25-99                            | 18,060            | 15,076                  | 909                     | 2,075                       | 83.5               | 5.0  | 11.5 |
| 100-499                          | 17,555            | 14,820                  | 1,022                   | 1,713                       | 84.4               | 5.8  | 9.8  |
| 500+                             | 47,697            | 41,756                  | 2,566                   | 3,375                       | 87.5               | 5.4  | 7.1  |

Note: percentages may not add to totals due to rounding errors.

While small firm owners more intensive use of immigrants is well documented, the more interesting question is whether this utilization will increase in the future. Many immigrants and self-employed persons initially take unskilled or semi-skilled jobs (and then move up fairly quickly); small firm owners will generally increase their utilization of them if the jobs and industries that are predicted to grow match the skill levels of these immigrants.

<sup>25</sup> There is a large body of literature that shows that small firm owners historically provide immigrants, youth and women with their first job opportunities. For a summary see [www.sba.gov/advo/stats](http://www.sba.gov/advo/stats). Click on "Outside Research." See in particular, John Sibley Butler and Patricia Greene. "Don't Call Me Small: The Contribution of Ethnic Enterprises to the Economic and Social Well-Being of America." In Zoltan J. Acs. Ed. *Are Small Firms Important: Their Role and Impact* (Kluwer, Boston, 1999), Chapter 8, pp. 129-147.

<sup>26</sup> By comparison, about 15.2 percent of small firms were minority –owned firms in 1997, the latest Census data available on this subject. They were owned by African-Americans, Hispanics, Asians, American Indians or Alaska Natives/Pacific Islanders. A definitive percentage of the self-employed who are immigrants is not available, but if the sum of Asian and Hispanic business owners are a proxy, it may be close to 10 percent of all business owners as of 1997.

Table 6 below compares the utilization of immigrants in selected labor-intensive occupations during 2000-2002 with the use of immigrants in other occupations that are projected to be rapidly growing from 2002-2012, based upon BLS projections. The second column in Table 6 gives each occupation's percentage of total employment. The third column gives a similar distribution for recently arrived immigrants.<sup>27</sup>

In labor-intensive occupations like construction and food service, there are about twice the proportion of immigrants than of workers in the general labor force. For example, the small business dominated industry of food service and preparation employs about 8.6 percent of the labor force, but about 20.4 percent of recently arrived immigrants. Similar observations are true in construction and production.

**Table 6-Distribution of Recent Immigrants in Selected Labor Intensive Occupations vs. Distribution in Fast-Growing Occupations: 2000-2002**

| Occupation Type:                    | Pct. Of Total Employment | Pct. Total Employment Provided by Recent Immigrants (last 5 years) |
|-------------------------------------|--------------------------|--|
| <i>Labor Intensive Occupations:</i> |                          |  |
| Construction Trades                 | 5.6                      | 10.7   |
| Food Preparation and Serving        | 8.6                      | 20.4   |
| Production Occupations              | 7.8                      | 12.9   |
|                                     |                          |  |
| <i>Fast Growing Occupations:</i>    |                          |  |
| Healthcare Practitioners            | 4.5                      | 2.3  |
| Business and Financial Occupations  | 3.9                      | 1.7  |
| Management Occupations              | 10.6                     | 4.7  |
| Office and Administrative Support   | 14.7                     | 7.1  |
|                                     |                          |  |
| Totals, All listed Occupations      | 55.7                     | 59.8   |

Source: Derived from Michael W. Horrigan, *Employment Projections to 2012: Concepts and Context.* Monthly Labor Review, February, 2004. Table 8.

occupations. In each case, the percentage of immigrants in the occupation is disproportionately high.

Rapidly growing management occupations make up about 10.6 percent of employed persons, but only 4.7 percent of employed immigrants. The totals in both columns 2 and 3 account for about 55 percent-60 percent of total employment, and total employed immigrants, respectively.

Table 6 tells us that based upon this sample of occupations, immigrants make up a small share of employment in occupations that are growing rapidly, and are over-

<sup>27</sup> Immigrants arrived in the U.S. within the last 5 years, according to the BLS.

represented in occupations that are labor intensive. For judging potential labor shortages, are these labor-intensive occupations (top half of table 6) *also* growing very rapidly? That is where potential labor shortages may occur.

The answer is that labor shortages could occur in the food service and hospitality sectors. While many of these are part-time positions, and could also be performed by older workers, it is unclear whether they will take such jobs.<sup>28</sup> Office support positions may be more appealing to older workers, especially if some of the jobs can be done remotely.

## *VII. Summary Observations and Conclusions—The “So What” Issue*

Trying to understand the impact of the aging process upon small business owners involves positive influences, negative influences, and many that are still too difficult and complex to predict.

There will be many positive influences that will mitigate future labor problems for small business owners. The largest is probably the projected increase in labor force participation rates of males 65 years and over, and women, 55-64 years. The forces pushing these groups to remain in the labor force include stagnant pension coverage, insufficient retirement savings and escalating health costs that will occur with a longer life span. It is also possible for these same forces to influence males now 55-64 to remain in the labor force to increase retirement savings.

Assumed levels of immigration that do not vary much from those at present, and two very large sources of labor—(1) older workers and (2) immigrants—will be available. However, there does seem to be some disconnect between the present usage of immigrants, and industries and occupations (as in office employment and in health services) that are growing rapidly. It is unclear whether immigrants will have the skills needed for the more sophisticated full-time manufacturing jobs of the future, nor whether older workers are willing to take some of the less skilled jobs that will become available.

The predictable trends (continuing immigration and rising LFPR of older workers) may help small business owners in labor-intensive sectors. Older workers, some of whom will be employed part-time, will likely be available and desirable in sectors that require more experience and education. And there will also likely be a large pool of self-employed persons that will be composed of both highly educated persons and those with less education but considerable experience. Self-employed persons and outside consultants may also help business owners avoid the benefit problem.

Jobs may have to be restructured—where possible-- to match the available workers, and some compromises will inevitably occur. In the fast growing business services and health services sectors, it is possible that some jobs will be converted to a part-

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<sup>28</sup> Data by age of workers, occupation and firm size is not available.

time basis to avoid paying benefits. In non-retail industries, technology may also allow some jobs to be done outside the workplace.

Geographic mismatches between available workers and available job opportunities may still occur. Small firm owners in rural, non-retirement areas may still face labor shortages, and firms that need highly skilled workers may not find them available at a price that is affordable. On the other hand, there may be a glut of highly educated persons in urban areas that want to work part-time (at attractive salaries) in office environments with good benefits. Such positions may not be available either.

An older workforce also brings with it all kinds of challenging liability issues. Many small employers may find that older workers are the only qualified workers available, but will be well advised to seek counsel on potential lawsuits that may occur with such hires. It is possible that small firm owners will form alliances in the future to create an environment that minimizes the cost of insurance that will be needed to prepare for such eventualities.

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**NO FIRM SIZE IS TOO SMALL,  
BUT FIRM SIZE MATTERS:  
A NEW ANALYSIS OF MITTELSTAEDT, HARBEN, AND WARD**

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**ABSTRACT**

Mittelstaedt, et. al. [2003] wrote an intriguing article that purports to show a firm size of at least twenty employees is a necessary and sufficient condition for export activity. Since smaller percentages of micro firms (less than 20 employees) exported less than the average percentage of all firms in a given industry, the researchers concluded that 20 employees is a necessary condition of export success.

This paper shows that the prior conclusions are flawed in two ways:

1. The Chi-Square test examines whether a grouping of firms (micro, small, medium, large) yields a smaller proportion of exporters than would be expected. This paper shows that the statistically significant results indicate that micro firms do not export as much as the average firm, but the results do not indicate that micro firms do not export at all. Therefore, firm size is not a necessary and sufficient condition for export activity.
2. The conclusion that 20 employees is a necessary and sufficient condition for export activity is flawed because of the arbitrary selection of firm sizes examined. This paper shows that 100 employees or many other arbitrary partitions could have also been shown to be a necessary and sufficient condition for export activity because the chi-square test is a zero sum game and if some firms export more than average, some firms export less than average.

This paper concludes by arguing that policy makers should continue to support very small firms because large firms generally come from small firms. If small firms are not assisted, there may never be any large firms.

**INTRODUCTION:**

Mittelstaedt, Harben, and Ward (2003) argue that small firms with fewer than 20 employees appear to be too small to acquire the knowledge or experience necessary to engage in the



exporting process. Their conclusions contrast with the recent work of Wolff and Pett (2000) who argue that micro firms are capable of exporting. We concur with Wolff and Pett (2000). The purpose of this paper is to provide a response to Mittelstaedt, Harben, and Ward (2003). We challenge the conclusions drawn by them in their article, "How Small is Too Small? Firm Size as a Barrier to Exporting from the United States," published in the *Journal of Small Business Management*. Our conclusions provide much more hope to researchers and public policy officials that are interested in the barriers that may raise the costs of foreign market entry by small firms.

In the next section, we provide a brief review of the literature on exporting by small firms with a particular emphasis on size as a barrier to exporting. Then, we discuss how we evaluated exporting using the same sample of firms previously analyzed by Mittelstaedt, Harben, and Ward (2003) and we explain how our findings and conclusions differ from Mittelstaedt, et. Al. (2003). In the final section, we discuss the implications of this research for researchers and public policy makers as well as directions for future research.

### **LITERATURE REVIEW:**

Research on small firms has emerged as one of the most topical debates in business schools, among business leaders, and by public policy administrators over the past quarter century (Wright, 1993; Autio, Sapienza, Almeida, 2000; Baird, Lyles, and Orris, 1994; Aitken, Hanson, and Harrison, 1997; and Oviatt and McDougall, 1995). Rather than attempt an exhaustive review of past research, this section will emphasize the more dominant research relevant to firm size as a determinant of exporting.

#### **Firm Size**

Research in international business has been dominated by studies of the activities of large firms as they seek to pursue market development strategies in overseas markets. In contrast, the present study focuses on small businesses. As our understanding of international business has grown, researchers have included firm size as an explanatory factor. In general the results of these types of studies has found a positive relationship between firm size and internationalization. Baird, Lyles, and Orris (1994) found that international firms are larger and tend to be industrial firms rather than retail or service firms. A recent study by Dhanaraj and Beamish (2003) confirmed this finding using a resource-base theory of the firm (Penrose, 1959; Barney, 1991) in a sample of Canadian firms.

The most recent research to date also provides some contradictory evidence about the relationship between firm size and export activity. A study published in the *Journal of Small Business Management (JSBM)* by Wolff and Pett (2000) demonstrates that small firms are fully capable of exporting. Wolff and Pett conclude that small firms use a different decision process to export than do large firms. They argue that the resource-based view of the firm may serve as a useful explanation for the success of these small exporters. Very small firms in their study appeared to capitalize on unique resources that were independent of economies of scale or other cost efficiencies.

The work by Wolff and Pett (2000) is in sharp contrast to another JSBM article by Mittelstaedt, Harben, and Ward (2003). Using a sample of manufacturing firms in South Carolina, they found that micro firms, defined as companies with fewer than 20 employees, were far less likely to engage in exporting than small firms with between 20 and 500 employees ((Mittelstaedt, Harben, and Ward, 2003). Their research concluded that these firms simply do not have the resources (time, money, people) to engage in exporting. However, after reviewing their findings, we strongly question how they could have reached their conclusions. We believe that they misinterpreted their results. We believe that the authors did not demonstrate that firms with fewer than 20 employees were incapable of exporting, but merely that small firms were less likely to export than larger firms. In addition, we believe that using 20 employees as a breakpoint is not an absolute value, but rather an artifact of the Chi Square test. We demonstrate this argument in our analysis and discussion.

### **RESEARCH METHODOLOGY:**

Mittelstaedt, et. al., examined firms from the 2000-2001 South Carolina Industrial Directory to see if firm size serves as a necessary and sufficient condition for export success among small manufacturing firms. We use the same data to replicate the study and demonstrate the conclusions from the prior study cannot be supported. More current versions of the South Carolina Industrial Directory are available, but the 2000-2001 version is used to remain consistent with the prior study. Mittelstaedt, et. al sorted the South Carolina firms into three digit SIC codes and then partitioned them into four groups – micro (fewer than 20 employees), small (20-99 employees), medium (100 – 499 employees), and large (500+ employees). The study then counted firms that export and firms that do not export by SIC classification within each size group. Chi-square tests were performed on each SIC classification and 31 of 49 SIC classifications studied had statistically significant results. The meaning of the statistics will be discussed later in this section.

A very helpful example was given on pages 71-72 of the original paper. The example used was SIC code 355 (Special Industry Machinery and Equipment) which has a total of 120 firms and is partitioned into micro, small, medium, and large. The left hand side of Table 1 shows the number of firms that export and firms that do not export in each partition and also shows the calculation of the chi-square test. This example shows that 5.33 fewer micro firms export than would be expected. This example does not show that firms with fewer than 20 employees appear to be too small to export. The example does show that micro firms export, but a smaller percentage of these firms export than would be expected based upon the average of all firms in SIC code 355. This result is consistent with the graphs previously presented.

To further address the assertion that firms with fewer than 20 employees appear to be too small to export, we decided to partition the data in another way to see if there is a minimum firm size to effectively export. We arbitrarily partitioned the data from SIC code 355 into firms with fewer than 100 employees, firms with from 100-200 employees, firms with 200-500 employees, and firms with more than 500 employees. The results are reported on the right hand side of Table 1. This example shows that 4.40 fewer firms with less than 100 employees export than would be expected. The results of the Mittelstaedt, et. al. example on the left hand side of Table 1 and the arbitrary partition on the right hand side of Table 1 occur because of the nature of the

chi-square test and the nature of the data. The expected values in the table are calculated by assuming that the average of firms that export in SIC Code 355 will also be the average of firms that export in each partition. For example, 63.33% [76/120] of firms in this classification export. Therefore the chi-square calculation expects that 63.33% of firms will export in each partition. Thus, 63.33% of the 70 micro firms yields an expectation that 44.33 of these firms will export. Because the expectation is a simple allocation problem, the actual minus the expected values is a zero sum game. That is, the actual number of firms that export (and do not export) and minus the expected number of firms that export (and do not export) sum to zero across the columns and down the rows. Therefore, when firms in some categories export more than average (i.e., large firms), then it follows that firms in some other category have to export less than average (i.e., small firms). The graphs show that small firms export less, therefore any partition of smaller firms will show that smaller firms export less than larger firms. The analysis performed does not show that firms with fewer than 20 employees appear to be too small to export but rather shows that:

Insert Table 1 Here

1. Smaller firms export less AND
2. There is nothing interesting about a partition of 20 employees. Many partitions of employees (20 employees, 100 employee, etc.) yield the result that small firms export less.

These two issues are reinforced when the larger data set is examined [See Table 2]. The left hand side of Table 2 reports the results from Mittelstaedt, et. al. These result show that a smaller percentage of micro firms (less than 20 employees) export than one would expect from the average of all firms in each of the 31 SIC codes reported. The right hand side of Table 2 reports the results when the data is arbitrarily partitioned into firms with fewer than 100 employees, firms with from 100-200 employees, firms with 200-500 employees, and firms with more than 500 employees. The results from the arbitrary apportionment show that a smaller percentage of firms with less than 100 employees export than one would expect from the average of all firms in 27 of the 31 SIC codes reported. Using the same logic as Mittelstaedt, et. al., one could make a strong, but erroneous argument that firms must have at least 100 employees to effectively export.

Insert Table 2 Here

### **SUMMARY:**

This paper examines the results from a study by Mittelstaedt, et. al. (2003) that suggests that a firm size of at least 20 employees is a necessary and sufficient condition for export success among small manufacturing firms. This research shows that the prior research is flawed in two ways:

This paper shows that the prior conclusions are flawed in two ways:

1. The chi-square test examines whether a grouping of firms (micro, small, medium, large) yields a smaller proportion of exporters than would be expected. Our data indicate that micro firms do not export as much as the average firm. The results do not indicate that micro firms do not export at all. Therefore, firm size is not a necessary and sufficient condition for export activity, as concluded by Mittelstaedt and his colleagues.
2. The conclusion that 20 employees is a necessary and sufficient condition for export activity is flawed because of the arbitrary selection of firm sizes examined. This paper shows that 100 employees or many other arbitrary partitions could have also been shown to be a necessary condition for export activity because the chi-square test is a zero sum game and if some firms export more than average, some firms export less than average. Since Graphs 1 & 2 demonstrate that very small firms export less than average, many arbitrary partitions of small firms will show a consistent pattern of less than average exporting. Thus there is no minimum size necessary to engage in the exporting process. In fact, we remind the reader that among the sample firms, 44% of firms with 0 employees exported.

### **RESEARCH IMPLICATIONS:**

The analysis by Mittelstaedt, et. al. (2003) is clearly at odds with our findings. The analysis in this study supports the argument that small firms are fully capable of exporting, such as the recent study by Wolff and Pett (2000). We believe a more fertile ground for future research would be to accept the fact that small firms can and do export (Autio, et. al., 2000). Thus, researchers should try to identify the factors that lead to successful exporting among micro firms, firms with fewer than 20 employees, rather than to continue to pursue correlational studies of the relationship between firm size and export activity. Further research on export propensity is no longer a promising research agenda. Like Olson and Gough (2001), we believe that future studies should begin to pursue more research on the performance implications of exporting by very small firms.

### **POLICY IMPLICATIONS:**

Mittelstaedt, et. al. (2003) also made suggestions to policy makers based upon their conclusions about firm size and export activity. They said that policy makers should focus on fostering domestic growth strategies rather than exporting for micro firms because the micro firms are too small to effectively export. This research shows that this underlying premise is false.

Large firms start as small firms that grow over time. Rather than growing in a consistent and predictable fashion, small firms follow many different strategies toward growth. Export activity is also not neatly described in a simple 1-2-3 fashion. Early research accepted the stages model of internationalization (Johanson and Vahlne, 1977). It was argued that small firms gradually began exporting and escalated their efforts as they grew and gained experience. Bilkey and others essentially argued that exporting is a process of development. However, researchers have recently questioned this perspective. In their ground-breaking work, McDougall, Shane, and Oviatt (1994) and Oviatt and McDougall (1995) argue that some ventures are created with an intent to sell internationally. Autio, Sapienza, and Almeida (2000) call this the “born-global”

trend, whereby new ventures are launched with cross-border business activities in mind. predictable growth strategy described by the stages of internationalization model. Yet, if policymakers were to follow Mittelstaedt, et. al.'s advice, micro small firms would not be assisted with their exporting questions. We believe that if policy makers assist micro small firms with their exporting, these firms may grow to become large firms.

#### **END NOTES:**

1 We realize that other forms of market entry are available to small firms, but exporting remains the most attractive means of foreign market entry.

2

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Others available upon request.

**Table 1**  
**SIC Code 355, Special Industry Machinery and Equipment**

**Initial Partition Into 4 Sizes Of Firms**

| <b>Actual Values</b> | <b>&lt;20</b> | <b>20-99</b> | <b>100-499</b> | <b>500+</b> | <b>Total</b>  |
|----------------------|---------------|--------------|----------------|-------------|---------------|
| Export               | 39.00         | 25.00        | 10.00          | 2.00        | <b>76.00</b>  |
| Don't Expo           | 31.00         | 13.00        | 0.00           | 0.00        | <b>44.00</b>  |
| Total                | 70.00         | 38.00        | 10.00          | 2.00        | <b>120.00</b> |

**Expected Values**

|  |       |       |       | <b>Total</b>  |
|--|-------|-------|-------|---------------|
|  | 44.33 | 24.07 | 6.33  | 1.27          |
|  | 25.67 | 13.93 | 3.67  | 0.73          |
|  | 70.00 | 38.00 | 10.00 | 2.00          |
|  |       |       |       | <b>120.00</b> |

**Actual - Expected Values**

|  |       |       |       | <b>Total</b> |
|--|-------|-------|-------|--------------|
|  | -5.33 | 0.93  | 3.67  | 0.73         |
|  | 5.33  | -0.93 | -3.67 | -0.73        |
|  | 0.00  | 0.00  | 0.00  | 0.00         |
|  |       |       |       | <b>0.00</b>  |

**(A-E)2/E**

|  | <b>&lt;20</b> | <b>20-99</b> | <b>100-499</b> | <b>500+</b> | <b>Sum Sq Errors</b> |
|--|---------------|--------------|----------------|-------------|----------------------|
|  | 0.64          | 0.04         | 2.12           | 0.42        | <b>8.80</b>          |
|  | 1.11          | 0.06         | 3.67           | 0.73        | 3df                  |

p Value  
0.032131

**Another Arbitrary Partition Into 4 Sizes Of Firms**

|  | <b>&lt;100</b> | <b>100-200</b> | <b>200-500</b> | <b>500+</b> | <b>Total</b>  |
|--|----------------|----------------|----------------|-------------|---------------|
|  | 64.00          | 8.00           | 2.00           | 2.00        | <b>76.00</b>  |
|  | 44.00          | 0.00           | 0.00           | 0.00        | <b>44.00</b>  |
|  | 108.00         | 8.00           | 2.00           | 2.00        | <b>120.00</b> |

|  |        |      |      | <b>Total</b>  |
|--|--------|------|------|---------------|
|  | 68.40  | 5.07 | 1.27 | 1.27          |
|  | 39.60  | 2.93 | 0.73 | 0.73          |
|  | 108.00 | 8.00 | 2.00 | 2.00          |
|  |        |      |      | <b>116.00</b> |

|  |       |       |       | <b>Total</b> |
|--|-------|-------|-------|--------------|
|  | -4.40 | 2.93  | 0.73  | 0.73         |
|  | 4.40  | -2.93 | -0.73 | -0.73        |
|  | 0.00  | 0.00  | 0.00  | 0.00         |
|  |       |       |       | <b>0.00</b>  |

|  |      |      |      | <b>Sum Sq Errors</b> |
|--|------|------|------|----------------------|
|  | 0.28 | 1.70 | 0.42 | 0.42                 |
|  | 0.49 | 2.93 | 0.73 | 0.73                 |
|  |      |      |      | 3df                  |

p Value  
0.052184

**Table 2****Actual Number of Firms That Export Minus Expected Number of Firms That Export*****Mittelstaedt, et. al. Partition Into 4 Sizes Of Firms***

|      | (A-E)  | (A-E) | (A-E) | (A-E) |
|------|--------|-------|-------|-------|
| SIC  |        | 20-   | 100-  | 500+  |
| Code | <20    | 99    | 499   |       |
| 201  | -7.33  | -1.33 | 6.33  | 2.33  |
| 209  | -2.76  | 2.61  | 0.16  | 0.00  |
| 228  | -0.38  | 2.92  | -1.77 | -0.77 |
| 233  | -0.25  | -0.42 | -0.25 | 0.92  |
| 243  | -4.42  | 0.65  | 3.76  | 0.00  |
| 249  | -1.65  | -0.16 | 1.81  | 0.00  |
| 251  | -4.09  | -0.42 | 3.13  | 1.38  |
| 254  | -1.25  | -1.00 | 2.25  | 0.00  |
| 265  | -2.83  | 0.50  | 1.61  | 0.72  |
| 275  | -5.81  | 3.36  | 2.50  | -0.05 |
| 281  | -1.67  | -0.51 | 2.65  | -0.47 |
| 282  | -2.12  | -1.15 | 1.51  | 1.76  |
| 286  | -1.00  | -2.60 | 2.80  | 0.80  |
| 287  | -2.64  | 2.86  | -0.23 | 0.00  |
| 301  | -0.55  | -1.64 | -0.09 | 2.27  |
| 308  | -13.68 | 7.17  | 5.16  | 1.34  |
| 332  | -0.91  | -0.73 | 1.64  | 0.00  |
| 334  | -1.50  | 2.00  | -0.50 | 0.00  |
| 336  | -2.77  | 0.62  | 2.15  | 0.00  |
| 342  | -2.29  | -0.14 | 3.00  | -0.57 |
| 344  | -11.39 | -3.65 | 14.29 | 0.75  |
| 349  | -5.50  | 3.00  | 1.50  | 1.00  |
| 352  | -1.88  | 0.75  | 0.75  | 0.38  |
| 353  | -2.86  | 0.45  | 2.41  | 0.00  |
| 354  | -10.49 | 6.46  | 3.48  | 0.55  |
| 355  | -5.33  | 0.93  | 3.67  | 0.73  |
| 359  | -6.43  | -0.09 | 5.72  | 0.79  |
| 362  | -1.43  | -1.68 | 1.71  | 1.39  |
| 363  | -2.00  | 0.50  | 0.50  | 1.00  |
| 364  | -2.09  | 0.41  | 2.27  | -0.59 |
| 366  | -2.00  | 2.00  | 0.00  | 0.00  |

***Another Arbitrary Partition Into 4 Sizes Of Firms***

|  | (A-E)  | (A-E) | (A-E) | (A-E) |
|--|--------|-------|-------|-------|
|  |        | 20-   | 100-  | 500+  |
|  | <20    | 99    | 499   |       |
|  | -8.67  | 4.33  | 2.00  | 2.33  |
|  | -0.16  | 0.26  | -0.11 | 0.00  |
|  | 2.54   | 0.15  | -1.92 | -0.77 |
|  | -0.67  | -0.25 | 0.00  | 0.92  |
|  | -3.76  | 2.23  | 1.54  | 0.00  |
|  | -1.81  | 1.81  | 0.00  | 0.00  |
|  | -4.51  | 1.76  | 1.38  | 1.38  |
|  | -2.25  | 1.50  | 0.75  | 0.00  |
|  | -2.33  | 0.46  | 1.15  | 0.72  |
|  | -2.45  | 1.54  | 0.95  | -0.05 |
|  | -2.18  | 1.59  | 1.06  | -0.47 |
|  | -3.27  | 0.76  | 0.76  | 1.76  |
|  | -3.60  | 1.60  | 1.20  | 0.80  |
|  | 0.23   | -0.23 | 0.00  | 0.00  |
|  | -2.18  | 0.00  | -0.09 | 2.27  |
|  | -6.51  | 2.19  | 2.97  | 1.34  |
|  | -1.64  | 0.00  | 1.64  | 0.00  |
|  | 0.50   | -0.50 | 0.00  | 0.00  |
|  | -2.15  | 2.15  | 0.00  | 0.00  |
|  | -2.43  | 0.86  | 2.14  | -0.57 |
|  | -15.04 | 8.03  | 6.26  | 0.75  |
|  | -2.50  | 0.00  | 1.50  | 1.00  |
|  | -1.13  | 0.75  | 0.00  | 0.38  |
|  | -2.41  | 2.07  | 0.34  | 0.00  |
|  | -4.03  | 0.19  | 3.29  | 0.55  |
|  | -4.40  | 2.93  | 0.73  | 0.73  |
|  | -6.51  | 1.38  | 4.34  | 0.79  |
|  | -3.11  | 0.39  | 1.32  | 1.39  |
|  | -1.50  | 0.00  | 0.50  | 1.00  |
|  | -1.68  | 0.64  | 1.64  | -0.59 |
|  | 0.00   | 0.00  | 0.00  | 0.00  |

# **AN INTEGRATED PROGRAM FOR ENTREPRENEURSHIP CLASSES**

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## **Abstract**

A three -part experiential program consisting of an idea-generating activity-the “bugs”-, a networking activity- “Networking”- and a real-life start-up exercise-the “seed money”- was implemented in an undergraduate class of entrepreneurship during spring 2004. The objective of this program was shifting the “burden” of teaching from a conventional lecturing method to a series of hands-on assignments in which students had to generate business ideas, establish contacts with the local entrepreneurs, and actually start a business. These activities initially appeared as disconnected and unrelated efforts. However, as the class progressed, underlying relatedness of these exercises became more and more apparent.

Major outcomes of this program were: 1- After three rounds of sifting and refining, a long list of business ideas was compiled 2- A large number of local entrepreneurs- among whom many expressed their willingness to be guest speakers- established links with the students and the University. 3-Many students who had never experienced how a small proprietary business operates realized mechanics of starting and managing an enterprise.

## **INTRODUCTION**

The program is based on a simple logic: Adding entertainment to conventional teaching enhances learning. The program critically “engages” students in work and at the same time make them think that they are in a playing field. The theoretical basis of “engagement” (Pine and Gilmore, 1999) simply implies that education is absorption and active participation in an experience, as opposed to absorption and passive participation of the target, in our case, students. The process of “learning by doing” is actually conversion of the explicit knowledge (theory) that is transmittable in formal, systematic language into tacit knowledge (practice) that is personal, and context-specific. As stated by Nonaka and Takeuchi (1995), when experiences are internalized in the form of technical know-how, they become valuable assets.

The following section explains the theoretical background of the three ingredients of the program the bugs, networking, and the seed money.

1- The “Bugs” constitute the first component of the troika. Its purpose is to produce ideas with the potential of becoming new products and services.



The most successful products are response to problems or needs that someone has. Many entrepreneurs get ideas for new products from needs that they have themselves, or they identify when speaking with someone. For instance, Leo Gerstenzang invented the Q-tip in the 1920's. His wife had used a toothpick with cotton stuck on the end to clean their baby's ears, and Leo invented Q-tips to replace her "invention". Or Velcro was invented by George de Mestral-Swiss engineer- in 1948. While hiking, he had noticed that burdock seeds stuck to his clothing extraordinarily well. The seeds had extensions that attached themselves firmly to clothing. Mestral used this same model to develop Velcro.

Inventions do not go all the way from ideas to usage. They go through many phases of refining and filtering, and in a sort of "natural selection". Some ideas may work well in a laboratory experiment but not in the marketplace. Many good ideas and inventions fail to succeed, even after being financed, because companies don't have the well-rounded business knowledge to have all areas of their company on solid ground.

2. The second constituent of the program, networking, is in fact the other side of the invention – finding "bugs". While the latter is the saga of the "hero", the one who is able to solve problems, the former emphasizes on the power of networking. Here, the hero acts within and with the help of a network of friends, associates, and acquaintances. There is more to success than having a good idea and raising money. Marketing, advertising, accounting, taxes, and networking are just some of the other areas of knowledge necessary to maximize success. The advocates of this line of reasoning propose that the "networks" are the "most significant resource of the firm" (Johannisson, 1990, p. 41), and the contacts with the network are often a source of new venture ideas (Christensen and Peterson, 1990). Another research (Hills, et. al, 1997) indicates that network entrepreneurs recognize significantly more opportunities than "solo" entrepreneurs. In fact, in reference to the concept of "bounded rationality" (Simon, 1976), entrepreneurs can use their social networks to expand boundaries of rationality. By taking this approach, our proverbial hero turns into a creature of his environment and networks.

3-The seed money activity initiates from a fact that people have different approaches to learning. Students in a seminar might be all thumbs in a lab or studio; students rich in hands-on experience may not do so well with theory. Students need opportunities to show their talents and learn in ways that work for them. This hands-on activity provides an outlet for practical students and acts as an additional tool of leaning.

## **DESCRIPTION OF THE PROGRAM**

The program of integrated experiential exercises, discussed in this paper, was formed to engage students in learning and turn theories into practices. The three components of this experiment are a brainstorming track -"bugs", a networking track-"networking", and an actual business operations-"seed money".

In developing this program, three ideas merged: The idea of brain storming activity, creatively labeled "bugs" – things that aggravate you came from Marcie Sonneborn (Syracuse University). The networking idea flowed from David Newton (Westmont College, Santa Barbara, California).

Robert Peterson, from University of Portland, presented the third activity in a paper at USASBE 2004 in Dallas, Texas.

The author is not aware of execution of the first two works, but the seed money project had been practiced before. These activities were totally separate and unrelated works developed by different persons. The idea of integration and expansion, however, was developed later.

In this paper particulars of the program are presented so that repeat of the exercise becomes an easy task. It is evident that any reproduction of the experiment has to be modified to echo the local conditions and preferred objectives. For instance, universities have different calendars and the length of terms vary. Some schools, particularly those located in large urban areas, have access to more resources and entrepreneurs, which allows a slightly different approach. In instances, the instructor may desire to invite entrepreneurs as guest speakers to her or his class. Still, the class size may influence the arrangement of groups.

## ACTIVITIES

1- “What does bug you” Report: This is an individual work: For this assignment each student is asked to list 70 or more things that really annoys her/him. In this exercise students must reflect on their own life, their personal needs, activities in which they are involved, things they like to do, relationships that they have, things that they observe in their everyday world, and so forth. As such, they compose a laundry list of particular things that bug them.

This assignment is completed in four phases: In the first phase students are asked to come up with 70 “bugs”. In the second phase students are required to classify their bugs into various categories such as social, personal, environmental, and legal. Here they are told that the purpose is to find a reasonable solution that may lead to creating a certain product or service. In the third phase students need to filter their bugs and select the 10 best promising concepts for future business enterprises. The result of this phase is a table that specifies some key business concepts. The project is completed in the fourth phase and here we have a list of the 10 best bugs that reflects market deficiencies suggesting various business opportunities.

Table one demonstrates a sample of irritating things that students presented as “Bugs”. In the same table, we also note suggested solutions –a potential product- for them.

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Table 1 about here

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As the sample table demonstrates some of the suggested solutions are directed at immediate and local concerns. Others have been proposed to solve universal problems.

2- Networking Report: This is a group work: This assignment requires a group of students to progressively fill up a binder with specific information. The entries include business cards, clipped articles about intriguing entrepreneurs, telephone numbers for great referrals, web URLs or email addresses for related products or services, brochures picked up at trade fairs or exhibits, firm owners cited in various publications in the state and cold call referrals secured during the

semester. Students have to keep adding value to their binders. Which means that in each round, they must submit a progress report to the instructor and the class. They have to add more items to the folder (more business cards, more brochures, etc.), and have to have a follow-up with the business card owners. This implies that during the semester, students will increase their professional contacts, and thereby amplifies their awareness.

There are four rounds of this work: First, students are asked to collect business cards, brochures, newspaper clips, fliers, etc, from the local businesses. They can be from any type of business. In the second phase, in addition to adding more items collected in the previous phase, students are required to interview local entrepreneurs. Since this is a group project, students are expected to conduct at least ten interviews during this phase. In the third phase a table must be completed. Certain information about five of the entrepreneurs who have been interviewed are to be placed in part of this table. At last the previous phase has to be completed and the final project is to be submitted to the instructor for grading.

Despite the clear merits of experiential exercises, a textbook was used during the semester for two reasons: Not all students know or are able to remember business concepts previously learned in other classes. It happened quite a few times that nobody in the class could recall even the simplest business terms. Thus, the textbook could be used as a reference. Additionally, the textbook would exert discipline in the class. The experienced instructor is aware that certain topics and chapters in any textbook are more helpful than others, and those sections must be emphasized.

### **Week-by-week activities: Week One through Week Six**

First two weeks: A general discussion of entrepreneurial characteristics, as well as discussion of identifying opportunities and entry strategies. The assumption is that after covering these subjects, students are ready for completion of the first round of the “bugs” and “network”. In addition, instructors can assign other exercises to their students.

Third week through sixth week: Discussion of business valuation and buying an existing business, management teams, legal forms of organization, and intellectual property. Again, additional homework activities that are related to these topics may be assigned. Here students are prepared for the second round of both experiential exercises. A third exercise, the “seed money” project is to be initiated at this time. In other words, when the seed money project starts, the semester is about six weeks old.

3. Seed Money Project- For this two-month long activity, each student is given \$ 20.00 to start a service or produce a product. They knew that as long as the business was legal and ethical, its type did not matter. When the seed money was distributed the instructor and student- signed a contract. Students were free to form a partnership if their project required more money to start. If a partnership was formed a contract must be signed and kept in the portfolio.

The reason for the rather late start for this project was to pass the course withdrawal period. Also by this time students have become acquainted with the basic concepts of doing business and have had an opportunity to evaluate the pros and cons of selecting the test or seed money options.

The grades given to students are for the quality of the reports only. There is a chance that a certain enterprise loses its initial fund. This itself is an exercise in entrepreneurship and student's responsibility to face the risks of starting a business. The seed money would be collected regardless of the outcomes.

A big bonus can be awarded to each project where the owner(s) were able to entice local entrepreneurs to finance their expansion and growth. Bonus can be extra points or just certificates of appreciation awarded to the individual founders or their enterprises.

Each group has to prepare a collective resume for itself. The instructor forms these groups and they are composed of students with different overall grade averages (GPA). The importance of this collective resume is multi-fold. It enhances group cohesiveness. It reveals to them that no single individual has all the necessary talents and skills. In addition, the seed money project requires having the professional resume of the entrepreneur. Thus, if a partnership has been formed, the said resume would be a collective one. A part of network assignment, too, demands inclusion of a collective resume.

A short report about this project, as was implemented in the class, is presented below:  
Out of 28 students in this class, 22 decided to take the seed money path. The remaining 6 selected to take the tests. Five of these six were graduating seniors. Their final grades were about the same level of some other students who did not take the tests.

Each student received \$20.00. However, some of them formed companies. As the result, we ended up having 11 enterprises. Some students acted alone, but in one case, the "company" had 5 partners. The initial investment of \$440.00 generated net revenue of \$ 826.00. Considering the life span of this exercise (just two months), this return on investment (87.7%) is to be regarded as a huge success by a group of students who had very little or no business experience. Students paid a 10% "tax". Some "donated" extra funds. In total, \$88.90 was collected that was deposited in a special account for our CEO Club.

Types of the businesses that these students founded included: One-person enterprises: A car detailing, a car washing (at your residence), a web designing, a candy making, a jewelry making, a woodcutting, and a decorating business. Businesses that consisted of more than one investor: two T-shirt companies and one massaging enterprise (with one female and two male students). None of these enterprises lost any money. But, the majority of the students lost points due to bad preparation of their reports. In most cases, mistakes were more prominent on balance sheets and income statements.

### **Week-by-week activities: Week Seven through Week Fourteen**

Week seven through week ten: During this phase, the following topics are discussed: Contracts and leases, how to protect business interests, government regulations, and analyzing the market. After these discussions, students should turn in their third round of "bugs" and "network" assignments. They should also demonstrate substantially improved knowledge of market and

how to convert ideas into products. If a seed money project is assigned, its first report is due at this time.

Week eleven through week fourteen: In preparation for the fourth and last reports of the “bugs” and “network” assignments, students will have studied subjects such as pricing, market penetration, developing financial statements, and sources of capital. Since this is about the end of the semester, a final (in fact the second) report of seed money project is also due at this time. Similar to the preceding phases, the instructor may require students to complete other assignments. These homework assignments are the type that will further assist students to acquire knowledge about the complex task of business management.

## **CONCLUSION**

By following the step-by-step activities, the program achieved several objectives: We reviewed the most important subjects of how to manage an enterprise. We made the class an exciting place of learning and playing, and allowing students to actually implement a business concept. And at last, these exercises created opportunities for students to approach a network of experts, supporting group, and potential investors.

Buckingham and Coffman (1999) point out “through Gallup’s studies of great accountants, we have discovered that one of their most important talents is an innate love of precision.” As this experiment progressed, a fact started to reveal itself to both students and the author. We discovered that certain students while completing phases of activities were demonstrating very clear signs of having such entrepreneurial talents as courage, determination, and tolerance for ambiguity, and accepting risks without much anxiety. The three exercises demonstrated to students that when the subject of entrepreneurship is taken seriously, it is not a course for everybody. All participants in the class learned skills necessary to manage an enterprise. They also acquired awareness of rules of the game. One needs a kind of brain wiring to practice a meaningful profession. As we moved on, we discovered the less talented fellows. Some were missing the deadlines. Some were shy in interviewing the local entrepreneurs. Still others couldn’t identify “bugs”, those irritating life experiences, demonstrating their lack of recognizing opportunities. Almost the same individuals were expressing their inability to start a business-seed money activity- and were begging others to accept them as partners.

A direct result of this kind of experiential exercise is “discovering” talents. While it is much easier to teach skills (how-tos) and knowledge (awareness), it is far more crucial and difficult to find hidden talents, conducive to successful future business path. These exercises have the power of digging into the potential pool of human talents and expose the ones that are important in carrying out a business venture.

The author would like to hear from colleagues if they decided to implement this system of experiential exercises in their classes. This work has the potential of further refinement and improvement.

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Table 1. A Sample of Bugs and Suggested Solutions

| What does bug you  | Solution  |
|--|---|
| I frequently lose my keys  | Attaching a beeping device to the key chain to be activated when a button is pressed on the base  |
| I don't like to add liquid detergent any time that I load a washer | Developing an automatic dispenser that will release detergent from a large container inside the machine   |
| It is very hard to level pool tables                               | Developing an electronic device that is attached to a mechanical adjuster on each leg of the pool table. This device would adjust each leg automatically. |

**AN EXPLORATORY STUDY OF RETAIL SERVICE MANAGEMENT IN THE  
PHILIPPINES**

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# **AN EXPLORATORY STUDY OF RETAIL SERVICE MANAGEMENT IN THE PHILIPPINES**

## **ABSTRACT**

The Philippines has become an important source of global middle managers as its population has become more educated and bilingual. Along with China, the Philippines attracts international enterprises seeking to establish a presence in Asia. This exploratory study examines retail small/medium enterprises (SMEs) management and employee perceptions of customer service. The results suggest that managers and employees in the Philippines behave in similar ways to those in western countries, but there are differences, probably related to cultural characteristics. The Philippines is a culturally diverse country, with historical and cultural influences from China, Malaysia, Spain, Japan, and the United States. As the Philippine market becomes more ingrained in a globalized environment, the importance of service quality increases. Global retailers stand to benefit from this study through an enhanced understanding of the mindsets and attributes of managers, employees, and customers in this region of the world. The lessons learned can be valuable in the formulation of training, sales and marketing, business development, human resources management, and strategic planning. Implications for practice are discussed.

## **INTRODUCTION**

The Asian Crisis in 1997 awakened the global community to the fact that Asian economies are closely linked to international markets and that economic and business events that occur in Asia have a direct impact on Western economies. The growing number of emerging economies in the region has also attracted international entrepreneurs to the many business opportunities in this region. This study examines the nature of retail service quality in the Philippines and should help entrepreneurs better understand the Filipino perceptions of this important factor.

With a growing population of around 86 million, a growth rate of 2.36% between 1995-2000, and with close proximity to other Asian markets, the Philippines is strategically appealing (Philippine National Statistics Office, 2002). Purchasing power in the Philippines is generally low, but more than 2 million consumers earn over US\$1,250 per month. Other significant sources of disposable income are derived from an underground economy (30-40% of GDP) and from remittances from overseas Philippine workers amounting to more than US\$ 6 Billion in 2001 (UK Trade Invest, 2004).

Philippine consumers are familiar with many US products, films, music, and mass media advertising. Millions of Filipinos reside in the US and periodically travel back to the Philippines and 94% of Filipinos speak English (Philippine Franchise Association, 2004). Despite this, as the Philippines further industrializes, managers face the challenge of achieving modern results while maintaining their traditional values. Dealing with contrasts is an inherent part of the Philippine culture. As a predominantly coastal region beset with severe seasonal typhoons, Filipinos have developed a fatalistic attitude (known as “bahala na”), leaving their fate to God.



Sison (2003) points out that Filipinos have developed a knack for improvisation and a strong focus on the present.

Cultural dimensions revealed by Geert Hofstede (1991; 2004) also help us to understand Filipinos and their interactions with retailers. Hofstede's cultural values for the Philippines show relative high power distance index (PDI) and low individualism (IDV) measures. In addition, they have a relatively short-term orientation. These values suggest the Filipino culture could influence retailers in the following ways: High PDI – sales people should look for direction from sales managers and other management authorities; Low IDV suggests that sales employees require direction and are less likely to solve problems on their own; a Short Term-Orientation suggests that changes may be able to be instituted rapidly.

## **Retail Environment**

Retail trade in the Philippines has recently blossomed. The Philippine National Statistics Office (2004) counted 437,325 establishments engaged in wholesale and retail trade in 2000, with the industry employing over 1.7 million people. Retail sales in 2002 amounted to 1,692.3 billion pesos (approximately US\$30 billion), an 11.1% increase from 2001 (Euromonitor, 2004). Most retail stores in the Philippines are small, home-based, unregistered, and employ a staff of less than 10 people, with food retail outlets comprising about 65 percent of the total number of outlets. Thirty percent of the country's total retail sales are concentrated in metro Manila.

The Retail Trade Nationalization Act once confined retail trade to Philippine nationals. However, recently the Retail Trade Liberalization Act paved the way for increased retail competition, along with expansion and growth, innovation, introduction of new technologies, professional management, and diversification into new sectors (Patalinghug 2001). Trade liberalization has also increased opportunities for international retailers.

Retailing in the Philippines spans a gamut of venues including sari-sari stores (mom and pop stores), sidewalk vendors, wet and dry markets (produce and dry goods), groceries, supermarkets, hypermarkets, warehouse and discount clubs, large malls, mall stores and shops, and convenience stores (also known as c-stores) (Omana, 2003). However, the lifeblood of Philippine retailing is the huge network of small mom and pop stores known as sari-sari stores. Sari-sari variety stores make up 90% of the retail outlets. Sari-sari stores offer lower-income consumers easy accessibility and credit terms, as well as the opportunity to purchase in smaller portions in line with limited budgets. A modern version of the sari-sari store is the convenience store. It mixes the attributes of a traditional sari-sari store, with that of a supermarket, and offers a wider selection of product lines in a friendly, comfortable, and strategically located venue. Typically open 24 hours a day, 7 days a week, it caters to the fast-paced and changing life-styles of urban professionals. There are over 600 convenience stores in the Philippines (Omana, 2003).

The Philippine retail industry is fragmented, but as large international players enter the country, the industry will likely experience greater consolidation and should be prepared to respond and adapt to incoming paradigm shifts (Lugo, 2002). In fragmented Asian markets like the Philippines, Japan, and Korea, consumers tend to remain loyal to retail stores (Asia

News Network, 2002). In the Philippines, building customer loyalty is a sensible goal for retailers and the ability of a retailer to plan and implement customer retention measures determines future success or failure.

Patalinghug (2001) suggests that while retail saturation continues to grow in the Philippines, the industry continues to offer market opportunities for new entrants and for current players seeking to expand. Franchising is one of the fastest growing sectors in the economy. The growing demand for new products and services attest that there is plenty of room for new players and many opportunities for U.S. companies (U.S. Department of State, 2001).

## **Service Quality**

A number of studies examine retail service quality in the U.S., but we know less about it in developing countries. Previous research, though, generally supports a relationship between culture and service quality (Furrer, Liu & Sudharshan, 2000). Crotts and Erdmann (2000), for example, found that Hofstede's value dimensions relate to travel service satisfaction, suggesting culture relates to perceptions of service quality. In another study, consumers with high uncertainty avoidance values and short-term orientations tended to have higher expectations for service quality (Donthu and Yoo 1998).

Retailers in the Philippines find their market increasingly competitive, with foreign retailers attempting to move into the market in greater numbers (Baetiong and Flores 2002). Competing with global retailers will become increasingly difficult, unless local Filipino retailers can differentiate themselves in ways meaningful to their customers (Jabson 2004). This study takes an initial look at current service quality issues and relates them to various cultural and demographic dimensions.

## **Hypotheses**

We examine the relationships between service quality expectations, perceptions, and fatalism. Since this is an exploratory study with little theory to guide us, we justify our hypotheses with logical explanations. Shopping experience should have an effect on both expectations and perceptions of service quality. Experienced shoppers should be more likely to expect higher service quality and perceive that they get it. Some of this might be due to self-selection. Experienced shoppers know which stores consistently provide good service and are likely to frequent them more often than retailers who provide inconsistent or poor service quality. Our first two hypotheses reflect these assumptions.

H1: The greater the experience in shopping, the greater the expectations for service quality.

H2: The greater the experience in shopping, the greater the perceptions on service quality.

Most Asian cultures tend to be more fatalistic than North Americans and northern Europeans. In addition, religious values may add to the cultural values of fatalism. The Philippines is strongly Roman Catholic, with regional concentrations of Muslims, both groups tend to be fatalistic.

Previous studies showed fatalism inversely affected both expectations and perceptions of service quality (Raven and Welsh 2004), leading to the following hypotheses.

H3: The greater the fatalism, the less service quality expected.

H4: The greater the fatalism, the less perceived service quality.

In traditional societies, genders tend to play traditional public roles (Hofstede, 1991). Since the Philippines is a rapidly developing country, we expect that gender will still play a role in service quality. Raven and Welsh (2004) showed that males had higher expectations of service quality and females lower perceptions of service quality. Since that study occurred in a different culture, we have left the direction open.

H5: There will be a gender difference in expectations of service quality.

H6: There will be a gender difference in perceptions of service quality.

H7: There will be a gender difference in fatalism, with females tending to be more fatalistic than males.

## **METHODOLOGY**

### **The Sample**

Three employees of Synergy Tech International, a Philippine firm, surveyed retail employees in Cebu, under the direction and training of one of the authors. This resulted in a convenience sample of employees, who were first-line salespeople and their managers. There were 124 usable responses. The stores were located mostly in shopping centers (96%), but a few were on the street (.8%), and others were stand-alone stores (3.2%). Of the more than 100 stores sampled, most were small individually owned stores and a few were department stores. A wide variety of products were offered in the stores, including automotive parts, electronics, travel, banks, fashion clothing, sporting goods, food, books, and many other products and services.

**ServQual** The primary measure of interest was service quality, comparing expected service and perceived service outcomes. Validity and reliability of the ServQual scale has been well-supported (Parasuraman, Zeithaml, & Berry, 1986, 1988). The ServQual model measures the expected and perceived levels of service. The level of service is measured on five dimensions:

Tangibles – physical neat appearance of the facilities, personnel, etc.

Reliability – ability to perform service dependably and accurately

Responsiveness – willingness to help customers

Assurance – conveyance of knowledge, trust, and confidence

Empathy – caring, individualized attention

The ServQual instrument was previously used in cross-cultural and cross-industry studies with generally satisfactory results. Lam (1997) used the ServQual instrument in evaluating patient service quality in Hong Kong. A modified version of ServQual determined quality of service in marketing research agencies in the U.K, suggesting the instrument has practical applicability in cross-cultural contexts (Donnelly, Van'T Hull, & Will, 2000).

**Fatalism** Fatalism refers to the level of control people believe they have over outside events. High levels of fatalism suggest people believe they have little control over events affecting their lives. We used a scale developed by Farris and Glenn (1976) to tap this dimension. The questions asked respondents the extent to which they agreed with the following statements:

- Making plans only brings unhappiness because the plans are hard to fulfill.
- It doesn't make much difference if people elect one or another candidate, for nothing will change.
- With the way things are today, an intelligent person ought to think about the present, without worrying about what is going to happen tomorrow.
- The secret of happiness is not expecting too much out of life and being content with what comes your way.

Studies of fatalism have most often been reported in the sociology literature, where it has been linked to attributions of poverty and cross-cultural differences between Lebanese and Portuguese (Abouchedid & Nasser, 2002), among others. Fatalism was used with Hofstede's value dimensions to compare cultural values in Russia, Georgia, Kazakhstan, and Krygystan (Ardichvili, 2001) as well as in Kuwait and Lebanon (Raven & Welsh, 2004).

## **RESULTS AND DISCUSSION**

Due to the abbreviated version of this paper, the data and analyses are not reported, but are available from the contact author. Rather, we discuss the major findings of interest to USASBE members. Our results suggest that shopping experience influences service quality expectations and perceptions in the Philippines. Shoppers with more experience tend to expect higher service quality and perceive that they get it. This has implications for retailers in understanding and communicating what service quality entails and delivering it. Retailers delivering higher service quality than their competition should have more customers that are loyal. It also has implications for retail managers in making sure marketers understand service quality parameters of importance to customers and that training programs emphasize service quality deliverance.

Filipino respondents with lower fatalism scores had higher service quality expectations and perceptions than those with higher scores. The more fatalistic people expected and perceived that they received lower service quality. Fatalism may be an indicator variable for other changes going on slowly within a culture and deserves consideration in global retail strategies.

While the results comparing gender were inconclusive because of large differences in sample sizes – almost 77% of our respondents were females – gender does seem to influence both expectations and perceptions of service quality, with males usually expecting greater service quality and perceiving they got it. In our sample, males were slightly more fatalistic than females, but not significantly so.

Growing competition both domestically and internationally will likely stimulate higher qualities of retail customer service, innovation, technology integration, workforce efficiency, productivity enhancement, research, security control, and cost efficiencies in the Philippines. Performance benchmarks and service measurements need to align with the prevailing business landscape and be continually adjusted to changes in industry and consumer dynamics. A one-size-fits-all global

management approach could be a prelude business disaster. This study provides evidence on the value of training sales people and retail employees in the Philippines. Training can influence the customer orientation of sales people in improving responsiveness, reliability, and empathy, among other service dimensions when coupled with good management techniques.

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# THE IMPACTS OF ADOPTING LEAN PURCHASING AND SUPPLIER MANAGEMENT PRINCIPLES ON SMALL BUSINESSES PARTICIPATION IN FEDERAL PURCHASING

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The views expressed in this thesis are those of the authors and do not reflect the official policy or position of the United States Air Force, Department of Defense, or the U.S. Government.

## Abstract

The Small Business Act requires that small businesses be afforded the maximum practicable opportunity to participate in Federal contracts. Contracts for small businesses have been on the decline for several years. This research seeks to determine whether Lean Aerospace Initiatives (LAI) are acting as entry barriers to small businesses attempting to enter the federal market. Statistical analyses of a decision-making exercise identified specific LAI principles that are acting as market entry barriers for small businesses. This study found that two LAIs did serve to significantly restrict small business participation: target costing and supplier management of inventory.

## INTRODUCTION

Federal procurement agencies are directed by statute and regulation to maximize small business participation in their procurement activities. The same agencies strive to incorporate strategic purchasing initiatives to maximize the efficiency of their procurement processes and the effectiveness of the dollars they spend on behalf of the taxpayers. Unfortunately, small business goals are often in conflict with efforts to incorporate efficiencies and leverage procurement dollars. The research question of this paper is: Are Lean Purchasing and Supplier Management Principles acting as entry barriers to small manufacturing and parts supplier businesses attempting to enter the Federal market?

### Small Business

Federal spending of taxpayer dollars serves a key function – contributing to congressionally established socio-economic goals. One of these socio-economic goals results from the Small Business Act (Public Law 85-536) that provides small business concerns the maximum practicable opportunity to participate in Federal contracts and subcontracts.

In an effort to ensure that small businesses are provided the maximum practical opportunity to compete for federal contracts, the Small Business Administration sets a certain percentage of total contract award dollars to small businesses as target goals for Federal Departments and Agencies. For example in 2001, the Air Force had a goal of awarding 16.2 percent of its contract dollars to small businesses. The Air Force fell short of that goal and awarded only 13.8 percent to small business. From 1995 through 2001, the percentage of dollars being awarded to small businesses declined each year (AFMC/CD Memo, 3 Jul 02).

Miller (2002) identified Lean Purchasing and Supplier Management (Lean PSM) principles as being a common theme in the changing relationship between large business prime contractors and small business subcontractors.

A primary goal of the Lean Aerospace Initiative (LAI) is to add value by eliminating waste and inefficiency while improving quality and reducing costs (Cook and Graser, 2001). Eventually, the LAI became a joint effort between the Air Force, industry and MIT to determine whether or not lean principles could be successfully implemented within the defense aerospace industry.

## **LITERATURE REVIEW**

### **Lean Aerospace Initiative**

LAI's mission statement was "To enable fundamental change within industry and government operations that supports the continuing transformation of the US aerospace enterprise towards providing aerospace systems offering best life-cycle value" (*Proposal*, 1999:3).

In order for a company to truly become "lean", lean principles must be applied to the entire supply or value chain (Cook and Graser, 2001:88). It is estimated that purchased materials and parts make up between 50 to 70 percent of the cost of a typical military aircraft (Cook and Graser, 2001:87). The nine specific Lean PSM practices are: supplier qualification and certification, long-term relationships, communications with suppliers, electronic data interchange (EDI) with suppliers, continuous improvement *kaizen* events at suppliers, target costing, just-in-time (JIT) delivery, supplier management of inventory at customer, and supplier kitting (Cook and Graser, 2001:92-99). Lean PSM principles pertinent to this research follow.

A small business may not have either the monies to finance Lean PSM principles or the human capital necessary for implementation, training, and operations. Depending on the particular industry, small businesses are defined based upon either yearly gross revenues or the number of employees. The gross annual revenue limit can be as high as \$29 million and the maximum number of employees can be as high as 1,500. However, the most common numbers across all industries are a gross revenue limit of \$6 million or having 500 or fewer employees. (SBA Small, 2002) These are human and financial limitations large businesses are not encumbered with.

## **METHODOLOGY**

We selected Department of Defense (DoD) aerospace contracts and contractors to serve as proxies for our research. DoD represents 70% of all Federal contract dollars spent, and



aerospace contracts allow us to investigate the impact of Lean Aerospace Initiatives on small business. Because archival data was not available for this effort, a survey methodology was used.

## Survey Development

The decision making exercise was modeled after Stahl and Zimmerer (1984) and Karakaya and Stahl (1989), and created around a one-half replicate of a full factorial design with six independent variables, each of which had two treatment levels: “High” or “Low” and represented the level of implementation by incumbent subcontractors. The level of PSM factor implementation by the incumbent companies a market entrant is competing against creates the market entry barriers. Figure 1 is an example of the decision making exercise modeled after that of Stahl and Zimmerer (1984) and Karakaya and Stahl (1989). The finalized survey instrument is available from the authors.

During the exercise, please assume you are making the decision to enter or not enter the market as a subcontractor to a large aerospace firm. Each market condition specifies attributes the prime contractor is requiring in making its subcontract award decision. In each condition and decision, consider your company’s current capabilities, financial strength, and any costs necessary for you to implement the required attributes. With the level of the incumbent subcontractors’ implementation for these 6 attributes in mind, please indicate the chance you would decide to enter the market.

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Figure 1 about here

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The research question was studied by testing the following hypotheses:

**H1: EDI is acting as an entry barrier for small businesses attempting to enter the DoD aerospace parts manufacturing/supplier market.**

**H2: Target costing is acting as an entry barrier for small businesses attempting to enter the DoD aerospace parts manufacturing/supplier market.**

**H3: JIT is acting as an entry barrier for small businesses attempting to enter the DoD aerospace parts manufacturing/supplier market.**

**H4: The supplier’s management of inventory at the customer’s facility is acting as an entry barrier for small businesses attempting to enter the DoD aerospace parts manufacturing/supplier market.**

## Sample

The population for this study was all American small businesses that are currently in or considering entering the DoD aerospace manufacturing and parts supplier market. The complexity involved in compiling a comprehensive listing of this population, we utilized the Small Business Administration’s (SBA) Pro-Net Database was used as a sampling frame.

From the Pro-Net sampling frame, a database of small businesses was compiled using searches containing the keywords “aerospace” and “aircraft” within manufacturing and research and development business types.

591 companies received the E-mail surveys and 171 responses were received. The response rate was 28.93 percent. 69 survey responses were found to be unusable because they were incomplete. 102 usable surveys were collected and represent a usable response rate of 17.26 percent.

## **RESULTS AND ANALYSIS**

### **Regression Analysis**

A model consisting of the four main effects and the six possible two-way interactions was analyzed at the individual and group level. The two-way and higher interactions were analyzed to determine if their inclusion in the study was warranted. Using an alpha of .01, five of the two-way interactions, or .81 percent, were significant.

Standardized beta coefficients were computed to allow comparison of the beta coefficients. A negative significant factor would indicate that a high level of implementation by the incumbent subcontractors of the particular PSM factor was causing the decision makers’ probability of entering to decrease and therefore acting as a barrier to entry. The Lean PSM principles of target costing and supplier management of inventory at customer’s facility had significant negative standardized beta coefficients at  $\alpha = .05$  and were therefore acting as market entry deterrents in the sample. The PSM factors of just-in-time and electronic data interchange were not found to be significant predictors among the sample.

Table 1 shows the number of significant effects for each independent variable consistent with the hypotheses and the number of significant effects that were inconsistent with the hypotheses at the individual level.

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Table 1 about here

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The subjects’ judgments relating to TC and SMI were significantly influenced in the hypothesized direction. Out of the 102 subjects, 40 identified TC as a significant factor, and 29 (72.5 percent) subjects viewed a high level of TC implementation by incumbent subcontractors as being a market barrier to entry. A high level of TC implementation by the incumbents had a significant negative effect on the decision makers’ probability of entering the market. Out of the 102 subjects 53 identified SMI as a significant factor, an overwhelming 46 (86.8 percent) viewed a high level of SMI implementation by incumbent subcontractors as being a market barrier to entry. A high level of SMI implementation by the incumbents had a significant negative effect on the decision makers’ probability of entering the market.

The subjects’ judgments relating to EDI and JIT were not significantly influenced in either the hypothesized or other direction. Of the 102 subjects, 50 viewed the level of EDI implementation

by the incumbent subcontractors as being a significant factor. However, 26 (52 percent) viewed a high level of EDI implementation as having a negative effect on the decision makers' probability of entering the market and 24 (48 percent) viewed a high level of EDI implementation by the incumbents as having a positive effect on their probability of entering the market.

It appears that the sample is split into two groups – those that have EDI capabilities and those that do not. Of the 102 subjects, 33 viewed the level of JIT implementation by the incumbent subcontractors as being a significant factor. Of these 33, 19 (57.58 percent) viewed a high level of JIT implementation by the incumbent subcontractors as having a negative effect on the decision makers' probability of entering the market and 14 (42.42 percent) viewed a high level of JIT implementation by the incumbent subcontractors as having a positive effect on their probability of entering the market. Again, the sample appears to be somewhat split between those that have JIT capabilities and those that do not.

### **Repeated Measures ANOVA**

Repeated measures analysis of variance for the combined sample was computed. The marginal means for the treatment levels of each independent variable are shown in Table 2. For each independent variable, the directional impact on the dependent measure was as hypothesized – the Lean PSM factors are acting as entry barriers for market entrants. Thus, an independent variable with a HIGH level of implementation by incumbent subcontractors results in a lower probability of entering the market than do LOW levels of implementation.

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Table 2 about here

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The analysis of variance for the main effects shows that the Lean PSM principles of target costing and supplier management of inventory at customer's facility have a significant difference between their treatment level marginal means. Target costing and supplier management of inventory at the customer's facility have F-statistic values of 6.46968 and 40.44094. The marginal means amounts for TC and SMI are consistent with the hypothesized direction meaning that high levels of implementation of TC and SMI by incumbent subcontractors are acting as significant entry barriers at the overall level. The Lean PSM principles of electronic data interchange and just-in-time delivery do not have significant differences in their marginal mean levels and are therefore not acting as entry barriers.

### **Regression Compared to Repeated Measure ANOVA Results**

The results between the regression and repeated measures analysis of variance are consistent. Both identified a high level of TC and SMI implementation by the incumbent subcontractors as having a significant negative effect on the probability a decision maker would enter the market.

### **Hypotheses 1 Through 4 Test Results**

H1: EDI is acting as an entry barrier for small businesses attempting to enter the DoD aerospace parts manufacturing/supplier market.

**NOT SUPPORTED.** In using the regression and repeated measures analysis of variance, there is insufficient evidence to support the hypothesis that electronic data interchange is acting as a market entry barrier. Implementing an EDI system may require additional capital outlays or investments in a computer network, hardware, software, technical expertise and training.

H2: Target costing is acting as an entry barrier for small businesses attempting to enter the DoD aerospace parts manufacturing/supplier market.

**SUPPORTED.** In using the regression and repeated measures analysis of variance, there is sufficient evidence to support the hypothesis that target costing is acting as a market entry barrier. The data suggest that a high level of target costing implementation by incumbent subcontractors is acting as a market entry barrier. Because target costing requires a high degree of trust, information sharing, and joint problem solving (Monczka et al, 2002:445), incumbents may have a significant advantage in that they have these working relationships already established.

H3: JIT is acting as an entry barrier for small businesses attempting to enter the DoD aerospace parts manufacturing/supplier market.

**NOT SUPPORTED.** In using the regression and repeated measures analysis of variance, there is insufficient evidence to support the hypothesis that just-in-time delivery is acting as a market entry barrier. Implementing JIT may require additional capital outlays or investments in communication/computer equipment, skilled personnel, and training, as well as access to distribution channels.

H4: The supplier's management of inventory at the customer's facility is acting as an entry barrier for small businesses attempting to enter the DoD aerospace parts manufacturing/supplier market.

**SUPPORTED.** In using the regression and repeated measures analysis of variance, there is sufficient evidence to support the hypothesis that the supplier's management of inventory at the customer's facility is acting as a market entry barrier. It makes sense that managing a customer's inventory at their facility is acting as a market entry barrier. Managing a customer's inventory at their facility may involve requiring additional personnel resources, training, and communications systems to name a few. Incumbents may have a significant advantage in that they have these resources available and have already established working relationships with their customers.

## **CONCLUSIONS AND RECOMMENDATIONS**

This research effort yields evidence to support the hypotheses that target costing and supplier management of inventory at the customer's facility are acting as entry barriers for small businesses attempting to enter the DoD aerospace parts supplier/manufacturing market.

This research provides insight that may partially explain why small business participation and awards are on the decline. This understanding may assist SBA in making intelligent and

informed changes to its policy and procedures in order to help achieve its goals and more importantly increase the amount of small business participation. In addition to legislation that promotes small business concerns receiving the maximum practicable opportunity to participate, SBA may need to initiate actions to help new and emerging small businesses break through market entry barriers.

Small businesses within the aerospace industry will benefit from this study. Because specific market entry barriers to the aerospace industry have been identified, SBA should take action to provide training and to assist small businesses in breaking through the barriers and provide the small businesses the maximum practicable opportunities to compete.

Taxpayers also benefit from this study. Market entry barriers “discourage” new entrants into a market, thus providing an advantage to firms already within a market. The resulting lack of competition can result in higher prices that are paid with taxpayer funds out of dwindling Federal budgets. If it is found that market entry barriers do exist within the aerospace market, efforts can be taken to “level the playing field”, increase competition, expand the industrial base, and ultimately make more efficient use of dwindling funds.

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| <u>MARKET CONDITION #1</u>                                 |  |
|--|--|
| <u>Attribute Required by Prime Contractor</u>              | <u>Incumbents' Level of Implementation</u> |
| Electronic Data Interchange.....                           | HIGH                                       |
| Target Costing.....  | LOW  |
| Just-In-Time Delivery.....                                 | LOW  |
| Supplier Management of Inventory at Customer's Facility... | LOW  |

**Example Decision:** Please circle your probability of entering the example market condition.

(No Chance)   0%   10%   20%   30%   40%   50%   60%   70%   80%   90%   100% (Definite)

Figure 1 DoD Aerospace Manufacturing and Parts Supplier Market Entry Decision Making Exercise Example

| <u>Effect</u> | <u>Significant* Effects</u> | <u>Significant* Effects</u> | <u>Total</u> |
|---------------|-----------------------------|-----------------------------|--------------|
|               | <u>Consistent with</u>      | <u>Effects</u>              |              |
|               | <u>Hypotheses</u>           | <u>Inconsistent with</u>    |              |
|               | <u>Hypotheses</u>           | <u>Hypotheses</u>           |              |
| EDI           | 26                          | 24                          | 50           |
| <b>TC</b>     | <b>29</b>                   | 11                          | 40           |
| JIT           | 19                          | 14                          | 33           |
| <b>SMI</b>    | <b>46</b>                   | 7                           | 53           |

\*p<=.05

Table 1 Frequency of Significant Effects Consistent and Inconsistent with Research Hypotheses

|             | <u>Treatment Level</u> |              |
|-------------|------------------------|--------------|
|             | 1                      | 2            |
|             | <u>HIGH</u>            | <u>LOW</u>   |
| EDI         | 59.06                  | 59.13        |
| <b>TC*</b>  | <b>56.55</b>           | <b>60.96</b> |
| JIT         | 58.4                   | 59.11        |
| <b>SMI*</b> | <b>52.73</b>           | <b>64.78</b> |

Table 2 Marginal Means for Treatment Levels of Independent Variables

**HOW DOES A SMALL MEDIUM ENTERPRISE SUCCEED IN AN EMERGING  
ECONOMY?  
THE CASE OF ISKON INTERNET, CROATIA**

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**Abstract**

The country of Croatia has experienced a tremendous amount of social, political and economic change in the past 15 years. Transition from communism to a market economy has brought with it Western management thinking. The purpose of this study was to demonstrate a successful model of small business development in an emerging economy, such as Croatia. The case study method was used to illustrate the story of Iskon Internet, a viable and growing company that evolved and is competing with a government monopoly. Findings indicate education, perseverance as internal variables of success. Conclusions suggest external factors as being essential in the development of small business in a transitional economy.

## **INTRODUCTION**

The country of Croatia has experienced a tremendous amount of social, political and economic change in the past 15 years. Transition from communism to a market economy has brought with it Western management thinking (Revelas, 2003). However, while new systems evolve, old systems and mental models prevail and provide substantial barriers that limit economic growth. The purpose of this case study is to demonstrate a successful model of small business development in an emerging economy such as Croatia.

## **METHODOLOGY**

The case study method is a preferred strategy when attempting to address the 'how' or 'why' question. The focus, in this paper, is to study a phenomenon in a real life context. The essence of a case study, the central tendency of all case studies, is that it attempts to illuminate a decision or set of decisions: why they were implemented, and with what result (Schramm, 1971.) Similarly, case studies also focus on individuals, organizations, processes, programs, neighborhoods, and events (Yin, 2003). The most important component of our case analysis is to explain presumed causal links in real life interventions that are too complex for survey or experimental strategies. In other words, by telling the story, it illustrates the most effective method of reporting our results. For the purpose of this study, we will focus on an organization, Iskon Internet, Croatia, because we believe that this particular business best illustrates our topic and supports our inquiry. It is the belief of the researchers that this particular company illustrates a model of successful evolvement of a small medium enterprise in an emerging economy. Moreover, it addresses the issue of breaking down the perception that a monopoly can be challenged in transitional economies. As part of our inquiry, we used in-depth interviews as the primary method of collecting information. It is our rationale that this was the most effective way of data collection for this investigation. In depth interviews are qualitative in nature, that is, a technique that is not numerical in nature. The purpose of these interviews is to not prove hypotheses, but to probe an understanding of the phenomenon of interest (Trochim, 2001).

## **CROATIA**

Croatia is a mid-sized European state (slightly smaller than West Virginia, with 4.4 million inhabitants (The World Fact Book, 2004)... The country consists of two regions: continental Croatia in central Europe and coastal Croatia is located on the Adriatic Sea in the Mediterranean region. The earliest finding of the Croatian name as Horovathos, which can be traced on the stone inscriptions in Greek, dated from the second century and was found by the Black Sea. A majority of the then Croat tribes moved to the territories of present Croatia in the 7th century (Croatia in Europe, History, 2004). There they were in contact with the Romans and Romanized descendants of Illyrians, Celts and others. The oldest known governmental document was issued back in 852 in Latin script, in which the Croatian name was mentioned (dux Chroatorum). Beginning in 1102, the Croats shared together with the Hungarians a state under common Hungarian and Croatian kings. The kings were crowned twice: with both Hungarian and Croatian crowns (Croatia in Europe, History, 2004). Geographically and politically Croatia was, for centuries, standing on the crossroads of cultures and civilizations (east and west) being the longest barrier to Ottoman Empire penetration into western parts of Europe. Beginning in 1918 through 1929, Croatia was one state in a kingdom shared by Serbs, Croats and Slovenes. In 1929, the region was renamed Yugoslavia and existed as such until 1941. In II World War, the Croats fought the anti-fascists - Germans, Italians and domestic pro nazi regime. Out of that in 1945 a new socialist Yugoslavia (consisted of 6 republics and 2 autonomous provinces), a nonaligned state, evolved. It became increasingly evident that the joint state did not function properly. The



differences in core social values and economic output between republics within common state were major. The struggle for freedom and independence in Croatia began in early 1970s - which culminated in 1990 causing the fall of the communist regime in Croatia, leading to the first multiparty elections, and the proclamation of independence (June 25<sup>th</sup> 1991). In 1991 the Serbian separatists and the Yugoslav Army occupied almost one third of Croatia. After 4 years of UN inefficiency, where some 14,000 troops were deployed, endless negotiations, and further ethnic cleansing, Croatian military forces liberated occupied territories in 1995 by themselves (Croatia in Europe, War in Croatia, 2004). Therefore, Croatia is a land of a long history and tradition but newly independent country and a rapidly emerging Central European market. Since independence, Croatia has been engaged in the process of modifying its laws and practices. Croatia is also currently working toward membership in the European Union (EU) – scheduled to enter in next 3 to 5 years. In preparation for membership Croatia is harmonizing its legislation with the EU. On that path, Croatia faces many economic and social obstacles and changes: structural adjustment, privatization, financial sector reform and growth and competitiveness of domestic industry and exports. Croatia's economic teams developed and implemented a successful stabilization program, which has resulted in the lowest rate of inflation in the region (less than 4 percent), real GDP growth and exchange rate stability. The size of GDP is \$24.79 billion, purchasing power parity and GDP per capita is \$5,700 purchasing power parity (The World Fact Book, 2004).

### **THE CROATIAN MARKETPLACE**

Croatia is progressing through a considerable transformation in its economic and political landscape. The economic structure is moving quickly toward a dynamic, market-based system, and a Western-style infrastructure is being developed. Croatia also has a well-educated and skilled labor force, particularly in technical areas such as engineering. Before the dissolution of Yugoslavia, the Republic of Croatia, after Slovenia, was the most prosperous and industrialized area, with a per capita output one-third above the Yugoslav average (The World Fact Book, 2004). Although the economy is still developing, it has excellent potential with tourism as a main economic driver. However, massive structural unemployment remains a key negative factor, with the 2003 estimate for unemployment rate at 18.9% (The World Fact Book, 2004). In the past 4 years, the government's failure to press the economic reforms needed to spur growth is largely the result of politics and public resistance, particularly from trade unions. Opponents fear reforms would cut jobs, wages, and social benefits. The government has a heavy backlog of civil cases in its legal infrastructure. One of the main deterrents perceived for business development is the government itself - with inefficient and unresponsive public service (bureaucracy at all levels of state agencies and institutions). Even though the government is perceived generally as a barrier, the Croatian market is open to foreign investors. In terms of their rights and obligations, foreign investors are granted "national treatment" - this means that they are treated on an equal basis with domestic companies. Limits on national treatment exist in a few areas, such as arms manufacturing (Country Commercial Guide FY, 2004). Small and medium sized business has evolved as an important driving force in Croatia. As in other economies, it easily adapts to market demands and is less demanding on initial finance and input. Previously, rates of self-employment used to be low and concentrated on the agricultural, crafts, catering and trade sectors, as well as selected professions such as art. Since 1990 the self-employment rate has been rising constantly, often as response to unemployment. Presently, the small business sector is made of approx. 58,000 companies (compared to 35,000 in 1993). The share of total number of companies is 98% but they account for only 44% of the total number of employed persons in Croatia (about 435,000). The small business contribution in GDP is around 55% (Croatian Chamber of Economy, Small Business, 2004).

The number of new business start-ups in the past years well illustrates the existence of an entrepreneurial spirit in Croatia. However, the business environment and support systems (legal, tax, finance, knowledge and skills developments) to those entities was not up to the level where it needed to further new business development. Hence, to increase economic growth in this area, Croatia needs to improve its business infrastructure to assist in prevention of failures and aid growth of small and medium sized companies. Corruption in Croatia is one of the problems that small business can encounter when moving forward for development. The Croatian government has made modest efforts to eliminate corruption, particularly by establishing specialized anti-organized crime and anti-corruption units. However, bribery and corruption are still perceived to be widespread. The Berlin based Transparency International (TI), the international watchdog organization on corruption, has assessed the government's anti-corruption program positively, but still considers Croatia a corrupt country at all levels. TI's rating of public perception for Croatia improved from 74th (mid 90s) on its rank-ordered list of corrupt countries to 51<sup>st</sup> in 2000 and 47<sup>th</sup> out of 91 countries in 2001 (Transparency International, 2001). In terms of human capital, Croatian business people do have confidence in their abilities; however they lack managerial knowledge and skills. Croatia benefited from the previous "self-management" economic system by developing managers familiar with market principles. However, decision-making has tended to be centralized in structure, with the managing director or general manager having all the power. A newer and more innovative managerial class is emerging with extensive Western business knowledge and business behavior. Education (in management, innovation, human capital) and exposure to such principles is improving the overall business environment. Even though most Croatian executives know English and many young managers are fluent, and technology skills among major Croatian companies are extensive, much advancement is needed in education and training.

### **TELECOMMUNICATIONS AND INTERNET**

Croatia's telecom network is quite advanced both in terms of penetration and equipment, including optical cables (some 15,000 kilometers installed), digital equipment and mobile telephones. There are over 1.84 million installed fixed telephone lines and 100% percent of the transmission capacity is digitized (Basic Telecommunication Market Indicators, 2003). Croatian Telecom (HT), 51% owned by Deutsche Telecom (HT General and Financial Data, 2004) is the current and sole telecommunications operator in Croatia. HT had a monopoly in the field of fixed network voice telephony until the end of 2002. Realistically, it still does have the monopoly since there is no other operator to enter the market. The reason being the Telecommunications Act in Croatia allows HT to deny other operators access to its local loop until 2005. Beginning in 2005, HT will be required to allow access to its local loop to other operators under the conditions and modalities defined in EU guidelines. The government invited interested parties to express interest in the concession for the second fixed telecommunications network. Internet development has been slowed by high interconnection costs for Internet Service Providers (ISPs) and no transparent regulations, although some progress was made over the past few years (the entire list of legislation is available on line at [www.telekom.hr](http://www.telekom.hr) or [www.mppv.hr](http://www.mppv.hr)). Thanks to the financial backing of United States, German and Austrian investors, several ISPs (in our case study, Iskon is a brilliant example) managed to become competitive to HT's HTnet (an Internet provider). As of July 2003, there are ten commercial Internet service providers (ISPs) in Croatia. According to industry estimates, at the end of 2003, some one million citizens, or 23 percent (up from 18 percent in 2001) of total population has access to the Internet. However, the number of paying subscribers is much lower: 576,000 citizens and 30,000 businesses (out of which 1,100) access Internet via leased lines (Basic Telecommunication Market Indicators, 2003).

All ISPs in Croatia must use HT's infrastructure for customers to access the Internet. In 2002, ISP's competitive to HT's HTnet, attained or came close to break-even (Interview, CEO Iskon, 2004). ISPs must still rely heavily on their flexibility and innovation, since high HT interconnection costs and unfavorable terms in revenue structure (HT collects revenue for the last mile access to customers), as well as high licensing costs. However, because of Iskon, licensing costs have significantly dropped by their action on the government for better terms and increased fair regulation. Electronic commerce in Croatia is on the rise, with a surging number of Internet transactions registered by travel agencies, bookstores, and IT equipment distributors. Banking is still the leading sector for Internet transactions, as several banks offer online banking services to residential and business entities.

### **THE STORY OF ISKON INTERNET**

The story of Iskon Internet is unique in that its founder, Mr. Damir Sabol, demonstrates persistence in growing a business that was in its infancy. The Internet industry in 1993 was practically non-existent and the vision and dedication of its founder was instrumental in the growth and success of the company. We will discuss the many factors as to why the organization evolved into a viable and successful company.

#### **The Founder**

Mr. Damir Sabol, graduated at the Faculty of Electrical Engineering - University of Zagreb, Croatia in 1996. Simultaneously, he started to explore the Internet, recognizing the opportunity of learning something technologically new. This was a period of time in Croatia's history that was tumultuous, a time when the country was at war, striving for independence. Technologically, the country had not been exposed to the innovation and advantages of technology, in its broadest sense and was eager to move forward socially, politically and economically. In 1995, Mr. Sabol started his career as administrator in Zamir, an NGO, trying to reconnect cities (Zagreb, Belgrade, Sarajevo, etc.) and the entire region in a virtual network. The conflict of war was obvious, communication channels were being disrupted and technology was acting as a bridge to building relationships in the region. The war ended in the latter part of 1995 and Croatia was faced with building and designing its future.

Mr. Sabol's idea of introducing commercial Internet Service Provider (ISP) in Croatia was emerging gradually, as variables in the environment became slowly, but increasingly favorable. The war had concluded, the country was ready for change, something new to assist in building economic stability. In 1997, Mr. Sabol negotiated an agreement to maintain Zamir's technological infrastructure. In addition, the Soros foundation donated the necessary hardware to start and operate a small, single proprietary business. Iskon was conceived! The location of this start up was in the basement of a Zagrebanka business tower, approximately 30 square meters (180 square feet). The company was literally living in the dark, with no ventilation and natural light. The struggle of survival for this start-up would be difficult. Upon this turn of events in 1997, Iskon applied for a government license to operate such an open protocol service. At this particular point in time, the political, legal and business environment were not friendly for such an idea, as it was completely new to the market and also challenged the huge monopoly, HT – Croatian Telecommunication. In 1998, after 12 months of battling the powerful government bureaucracy, a license was issued and Iskon was able to conduct business with a "powerful" and "strong" connection of 5 (five) regular telephone lines for approximately \$12,000. By 1999, 15 leased line business customers were acquired, meaning they had permanent line lease with Iskon. Somehow the business was surviving, even though it was in a completely inadequate space (without natural light and ventilation, where the equipment was malfunctioning). Customers recognized the enthusiasm, dedication and commitment of three Iskon employees, the founder, a technician and the

founder's sister (the founder's sister is presently working on bringing the company in compliance with ISO 9000). In 1999, Iskon negotiated the first investments via foreign venture capital funds, while simultaneously government telecommunication inspectors investigated the company. Inspectors found Iskon was not using only 5 "mighty" lines but 30 and was very near in closing the operation down due to violations of regulation. However, just a few months before inspectors came to check whether Iskon is complying with all the rules and regulations, Mr. Sabol wrote a letter to authorities asking for multiplication and expansion of their capacity. The government agency did not respond. Since the government had not responded to Iskon's letter, inspectors allowed Iskon to operate without interruption. While the tension was building surrounding the government's unresponsiveness (approximately 45 days), investors were losing their patience and almost abandoned the project. Typical of most small business start-ups, Mr. Sabol's roles included, a delivery driver, director of public relations, sales manager, marketing manager, technology chief, and Chief Financial Officer (CFO). This was taking its toll on the founder and was also suppressing business growth. In a then strategic move, Mr. Sabol pondered the future of his company, in an industry that was faltering worldwide and made a critical decision to negotiate for further funding. In 2000, he was successful in a series of negotiations in securing further funding for the company. Initially, the first investor (ANI, Texas, USA) granted a \$300,000 loan (equity convertible) with another \$300,000 in equity to follow. Mr. Sabol used the investment for business development, increasing the number of employees to 60 in a few months. Iskon was now on the fast track and was growing very rapidly. During 2000, another investor approached Iskon and invested \$1.9 million, with third round of investment soon to follow. A total of \$4 million was invested in Iskon and the future looked bright for this fledging company. However, just as the global internet marketplace was on a down trend, retrospective in a surprise move, Dresdner Kleinwort Benson Private Equity entered the Iskon in 2001 with a \$6 million investment, just prior to the internet micro-bubble burst. With the input of new capital, Iskon continued to grow, peaking with 160 employees 80,000 customers in just 1 year. Iskon started to make the transition from a technology company to a service company. However, growth was difficult, as daily tasks became increasingly complex, and four years of double digit workdays, fatigue started to surface for the 31 year old founder. As he mentioned: "... In those days I have learned a lot – about marketing, human resources, sales but above all, I explored my physical and mental limits". In 2001, with a strong customer base, superior customer service and enormous growth rate (another example of running against the trend that was happening globally), Iskon was spending money and operations looked bright. In reality, because of its Iskon's inefficiency (e.g. lack of middle management systems), the company started to decline. Mr. Sabol was losing control of the evolving variables of the business. Moreover, he was losing his aspiration of creativity and his vision of success. Recognizing the decline and challenges that Iskon was facing, he stepped down as CEO of Iskon. Upon this event, a new CFO, Mr. Ratko Pažur (KPMG employee), was brought in to bring fiscal control to the company. An important point to note is a cultural norm in Croatia. Unlike in the United States, failure in Croatian business culture is catastrophic. If a business executive is perceived to have failed, the person is marked as a "loser" or incompetent. Initiating and a progressing to a new career are very difficult. This was an important event, because what has shaped Iskon is that its founder realized that it was time to step down as CEO and open the door to another individual who would elevate the company to the next level. Mr. Sabol moved to Supervisory Board and presently he focuses on strategic business issues in assisting the company in development and growth. As he states: "My wish was not to control the company but to build it." In 2002, Iskon implemented a strategy of consolidation, which consequently evolved the business in showing a profit in 2003. This part of the history of Iskon will be further explained in the next section.

## **The CEO**

Iskon grew dramatically in 2000, with the money flowing (\$5 million from ANI, Texas, USA and another \$6 million from Dresdner Kleinwort Benson Private Equity), from 10 employees to 180 in less than 12 months, sales were increasing, and the customer base was expanding. However, Mr. Sabol (the founder of Iskon) and investors sensed that something was wrong. They realized that company growth was progressing too fast, resulting in deficiencies of quality, hence, threatening sustainable growth. In order to insure the longevity of the company, a leadership change was essential. Externally, the Croatian Government and Deutsche Telecom owned HT (Croatian Telecom) was taking unfair advantage by using its political power to gain favorable business terms (e.g. rates of service, price) and its monopoly of infrastructure. In a major strategic move, Mr. Ratko Pazur, KPMG Croatia senior auditor, joined the company in 1<sup>st</sup> quarter of 2001 as Chief Financial Officer. Within a month of joining Iskon, he was appointed to CEO, being charged with implementing new operational strategy for the company. Mr. Pazur analyzed the company and concluded the following:

- Invoicing deficiency - too many customers were not being invoiced and payment terms were not being managed (e.g. accounts payable)
- An analysis of secondary companies in the business portfolio were analyzed, (portal, PC magazine, web design unit, programming) in some cases sold or consolidated. A strategic move to focus on core business was implemented (Internet Service Provider Solutions-ISP).
- Implementation of middle management systems (e.g. basic supervisory structure and accountability for real outcomes)
- New organizational structure, and compensation structure were essential to bring systematic change to the organization.
- The work force was energetic, loyal and enthusiastic but lacked business experience and skills (e.g. company protocol)
- A analysis of process management and a consolidation of staffing (e.g. termination of 40 employees)
- An analysis of the main monopoly; competitor HT was attempting to increase their hold on the Internet market and strategy was designed.
- Cost control was introduced at all levels of business, price competitiveness was essential to bring financial stability to the company.

The results of these initiatives were very positive, as Iskon now covers 60% of business IP, 35% of IP leased line connections market, 25% of market share with residential internet connection, and 50% of the Croatian online advertising market. With new service processes, such as high quality 24/7-customer support proved to be the right solution for many customers. In 2000, revenues were 919,453.00 EUR and by the end of 2003 it prospered to 7,605,568.00 EUR. Comparing to world marketplace, CEO Pazur found out that there was no real connection with events in Croatia; the ISP industry was suffering through dot.com demise globally, however in Croatia it was growing. He points out: “.... timing was crucial, we learned from the world’s mistakes”. This was a crucial external factor, as the global marketplace struggled with growth in the ISP industry, Croatia was ready for growth. In other words, timing was perfect for the development of this industry and consequently, Iskon Internet. According to Mr. Pazur, both residential and business markets will continue to grow in Croatia. At the moment, Iskon is positioned by strong leadership and market variables that would suggest a very bright future for the company. With a focus on customer satisfaction, quality services, investing in research and development, the imminent deregulation of telecommunications industry and strong company leadership; Iskon is strengthening its position to continue to be a major player in the ISP industry in Croatia.

## **LESSONS LEARNED FROM ISKON**

In conclusion, the Croatian marketplace is advancing rapidly and changes are generally positive in the economy. However, in advancing the economic condition of the country, the state will need to alter its position on new business and small business start-ups. Government regulations are not in favor of small business owners and thus far does not promote prosperity and growth. So far, the success of small businesses in Croatia has been the result of individual entrepreneur's hard work, sacrifice and personal connections.

There is a paradox that is evident: there has to be less government obstacles and less government involvement but only through government action. What we have found and are suggesting is to simplify business infrastructure, increase information awareness of small business programs, and improve educational and legal systems. Croatian entrepreneurship and business in general has been limited, where no significant additional development and growth will be possible without changes in the approach by with governmental agencies implement public policy and promote sound business practices.

In our study, we have mentioned the importance of education to the growth of economic conditions in Croatia. It was clear in Iskon's case that a well educated management team and workforce made a significant impact on the growth and success of the company. Even with 100+ employees, management practices used at Iskon are similar to many large and respected multinational companies. Iskon, while being at the right place at the right time, still had to overcome many barriers to growth. This case illustrates that while global market conditions may inhibit small business to enter the marketplace, many new opportunities exist in emerging economies that have been explored and implemented that can add tremendous value to the country. Hence, there can be greater growth and development in emerging economies. With Croatia joining the European Union, the business environment will bring significant challenges (e.g. tougher competition) but also considerable opportunities (e.g. new markets, new services, product demand and more effective business infrastructure). With emerging boundaries and free flow of goods and services, entrepreneurship in Croatia could evolve into a major economic strategy for business development and growth. Government, business and educational leaders will need to further understand the complexities of this as a potential strategy and work together to enhance small business development in Croatia.

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# ENTREPRENEURSHIP IS A GENERAL EDUCATION COURSE! THE WHY, HOW AND TRANSFERABILITY OF THE CONCEPT

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## Abstract

This paper describes a course entitled Entrepreneurship and Innovation (E&I) that appears to be the first to be given general education status as a social and behavioral science. The paper argues that the core concepts of entrepreneurial thinking are consistent with the goals of general education. Entrepreneurship adds a new dimension to general education by emphasizing integrative learning. This fills a gap defined by leaders who seek to reinvigorate general and education and thereby prepare students for leadership in the 21<sup>st</sup> Century. The discussion concludes with lessons that other colleges can use to incorporate an E&I course into their curriculum.

## **Why Should USASBE be interested in the Entrepreneurship & Innovation Course?**

The authors' university had a blank slate when designing its new entrepreneurship program in 2002. A key component of that new curriculum is an entrepreneurship course that will become part of the university's General Education model. Other universities have programs to link entrepreneurship with the liberal arts, but general education status for entrepreneurial courses is comparatively rare and groundbreaking. In the search for such models, it was found that there were no entrepreneurship courses listed as general education courses. The authors believe that the experience presented in this paper provides a model for faculty from other universities who may use these insights to lead similar efforts on their own campuses.

The authors' university wanted its entrepreneurship program (E-program) to be accessible to budding entrepreneurs within majors and disciplines outside the college of business. The decision to place the initial Entrepreneurship and Innovation Course (hereafter referred to as



E&I) under the university's General Education umbrella was based on a combination of pragmatism, sound pedagogy, and good politics. Career surveys say that the entrepreneurs of the future will include significant numbers of students from non-business disciplines. Self-employment figures now include one geoscientist in eight, thirteen percent of psychology graduates, up to forty percent of music majors, over fifty percent of all artists and related workers (Farr and Shankin, 2004), eleven percent of economists, and over thirty percent of writers and authors (BLS, 2004). The Kauffman Foundation's GEM study reported that individuals with a college degree are more likely to engage in entrepreneurial businesses that create new jobs. The study recommends that entrepreneurship training should be more fully integrated into the collegiate setting so that it is available across departments and to students of diverse disciplines. To this end, the study argues that it is important to educate students in entrepreneurship throughout a broad spectrum of fields and productive endeavors.

The university examined a variety of pedagogical options to develop the course design. The review of undergraduate E-program curricula at a range of institutions confirmed that a common outreach practice in established E-programs is to invite other majors to come *into the business school* to take the entrepreneurship course (E-course) along side business majors. Yet, as Carl J. Schramm notes [President and CEO, Kauffman Foundation], there are considerable barriers to accessibility for non-business majors who find that "the hardest place to take a course is often in the business school" (Flaherty, J., 2004). A related concern was the difficulty that majors outside the College of Business face in trying to fit an E-course into their over-prescribed requirements. Another emerging model is to offer special-purpose courses such as "Small Business and the Arts," taught to non-business majors. This effort, created through start-up grants from the Ewing Marion Kauffman Foundation, seeks to *transplant entrepreneurship courses from the business schools into other disciplines* and departments (Mangan, 2004). The authors' university, however, chose a different path in order to attract a heterogeneous mix of student majors. The result was an introductory course titled "Entrepreneurship and Innovation (E&I)" that was designed to satisfy the rubric of the university's General Education Model, as well as provide an inspirational foundation for business students who pursue a specialization in Entrepreneurship.

Designating an entrepreneurship course as "General Education" would have seemed heretical in the 1990's when the campus was concerned with "Liberalizing Professional Education." Business courses, even interdisciplinary ones, hazard rejection from General Education committees that consider them too applied, too specialized, or narrowly focused on occupational skills and techniques. However, there has been a change in climate as higher education associations, accrediting organizations, and other stakeholders nationwide have called for reform of general education and the liberal arts major. This paper elaborates on the claim that the E&I course belongs in General Education together with traditional arts and science courses. The E&I course design includes content and processes that are compatible with the General Education conceptual framework. The core concepts that comprise entrepreneurial thinking are intrinsically consistent with the purpose of general education. Moreover, the study of entrepreneurship adds an integrative dimension to the learning experience in order to prepare students for leadership in the 21<sup>st</sup> Century.

## What makes this Entrepreneurship and Innovation course distinctive?

In 2004, the College of Business introduced an undergraduate specialization in Entrepreneurship consisting of nine new courses. The launch pad for this specialization was a sophomore level ‘vestibule’ course titled “Entrepreneurship and Innovation (E&I).” The course introduces a new way of thinking – an opportunity and problem solving orientation – to the broadest possible audience. It is different from other business courses in that it avoids business planning and computer games, and instead uses a team-based learning process that models and stimulates entrepreneurial behaviors. The course reframes six traditional concerns of entrepreneurship:

- **Entrepreneurship Domain:** Evolve in small business, high technology - high innovation environments, corporate environments, social enterprises and international enterprises.
- **Entrepreneurial Thinking:** Emphasizes thinking about “Opportunity,” understanding and developing opportunities.
- **Problem Solving:** Offers an overview of strategic and scenario planning that introduces students to means of developing strategy, scenarios, tactics, tools, skills and requisite timing to execute plans.
- **Creativity:** Stresses the importance of creativity by validating the proposition that creativity can be learned and clarifies the underlying logic, specific knowledge, tools and skills for achieving creativity.
- **Opportunity Recognition:** Illustrates the importance of perception, including new ways of seeing and hearing in order to discover and create unique opportunities.
- **Entrepreneurial Careers:** Expands the student’s appreciation for the multiplicity of venues and circumstances to which the entrepreneurial process can be applied.

The student’s *initial encounter* with the discipline reveals the convergence of the generative creative process and the entrepreneur’s innovation response. It does so in the context of the student’s effort to plan his or her life work and future career. Students will be immersed in a learning experience that conveys unmistakably the essential character and multiple forms of entrepreneurial pursuits.

“Entrepreneurship and Innovation” was designed as an exciting and practical introduction to professional business credentials and knowledge, but also as a useful course for any student interested in building an enterprise, regardless of major. Prospective students include majors in Engineering, Health and Exercise Science, Computer Science and others that are planning careers in high technology/innovation organizations. Students who will become corporate “*intrapreneurs*” need exposure to the opportunity focus of such a course and the shift in problem solving strategy that begins with “Why Not?” instead of “Why?” Students in the arts, humanities, social, or political disciplines who aspire to become “social entrepreneurs” and lead non-profit enterprises will benefit. To these ends, the *core entrepreneurial outcomes* are to understand the essentials of entrepreneurship; to learn how to use the motivations, skills, and strategies of successful entrepreneurs; to develop decision-making knowledge and skills; to develop creativity and innovation knowledge and skills; and to learn opportunity recognition for new products, services, and customers.

Designers of the E&I course were clear that conventional didactic pedagogy was not likely to stimulate a wide range of students with dissimilar interests. Rather, the use of original and inventive learning exercises would be central to teaching methodology. Learning activities and resources draw upon authors specializing in creativity such as James Adams (*Conceptual Blockbusting*), Michael Gelb (*How to Think like Leonardo da Vinci*), Roger von Oech (*A Whack on the Side of the Head*) and of course, Edward de Bono (*Lateral Thinking*). This type of pedagogy relies upon changing the way students look at and approach problems. For example, one class will use de Bono's "Brain Sailing" process that aims to improve creative thinking skills through direct effort and change in focus. This technique is juxtaposed as an improvement on brainstorming, which originated in the advertising world. Another de Bono process, "Six Hats Thinking," engages the learner to differentiate among thinking modes and choose the methods that are best adapted to the opportunity at hand. Students can explore various ways to make time for creative thinking. They can discover ways to enlist others in a creative effort, learn how to stop those who are persistently negative and to encourage people to look at the benefits of an idea. The students can also learn how to express their intuition and gut feelings in a meeting.

These approaches lead the student to engage in *integrative thinking and learning*. As described by de Bono and scholars of learning theory, the ideal culmination of a general education is to acquire, through each discipline, a step in the process of making judgments and taking action. Each discipline emphasizes some, but not all of the following: generating data and information; understanding feelings, intuition, and emotion; making critical judgments; promoting optimism or framing the logical benefits of new ideas; stimulating creative effort in oneself and others; and developing process controls that assure the success of the plans. A central aim of the course is to teach not just *one* method of thinking, but to emphasize integrative *thinking* that brings together a variety of models. Students from various fields bring backgrounds that emphasize how professionals perform these entrepreneurial processes. They help one another to appreciate, as Kao, J. (1996) points out, that "Creative ideas spring from the abrasion of divergent inputs."

### **The Emergence of E&I as a General Education Course.**

During the curriculum review process, enthusiasm was expressed by faculty members and administrators for offering the E&I course to students from non-business disciplines. Engineering students were expected to participate as a result of early collaboration with that college's faculty on programs to address professional leadership in high tech / high innovation companies. The course designers also had hoped to draw a heterogeneous audience in order to form of multidisciplinary teams that would benefit from the diversity of inputs and approaches. The authors were pleasantly surprised to discover the campus-wide support to make the course a component within the university's "General Education Model."

As with any curricular innovation, it is crucial to have a congruence of institutional goals, structures, and resource allocation. The E&I course proposal has steadily gained support from the President, Provost, multiple Deans, department chairs, and faculty as a key value-adding element for students across the campus. The interdisciplinary design was chosen for its ability to address a number of internal and external opportunities and problems. The focus on creativity and innovation as generic processes appealed for its intrinsic value. The emphasis on development of critical thinking skills was needed for project-driven disciplines. The

multidisciplinary and collaborative learning approach is consistent with the expectation that students must prepare to work in the ever-changing social environment.

Chief among the extrinsic benefits was responsiveness to continually improve the metrics by which university and individual programs are measured. There is heightened concern about the time it takes to fulfill graduation requirements. Putting an entrepreneurship course in the general education distribution requirements adds flexibility. Another benefit may be an increase student retention and graduation rates across programs. Curricular flexibility would place more attention on satisfaction of persistence-related needs and student competencies. Even one course focusing on the application of entrepreneurial knowledge to liberal studies is a critical strategy to improve job placement rates after graduation, and to prepare students for a more self-directed career path.

### **Why Does The E&I Course Belong In The General Education Model?**

There are at least three secrets to making the case that entrepreneurship belongs in general education. The first is to focus on the universal and generic underpinnings of entrepreneurship and to avoid traditional business school biases toward the for-profit sector. The second key to success is to make an unambiguous case for the goodness of fit between the E&I course content and outcomes and the general education canon. A third factor is the use of the appropriate pedagogy and an appreciation for the learning theory that guides instructional techniques.

First, entrepreneurship can be generalized to a multiplicity of contexts, particularly as the E&I course is configured. The authors broadly defined their response to the question ‘What is Entrepreneurship?’ The course uses Venkataraman’s (2000) thesis that the central issue of Entrepreneurship is “how exactly opportunities are discovered or crystallized or created.” The E&I course adopts Timmons (1990) definition: “Entrepreneurship is creating and building something of value from practically nothing. ... Entrepreneurship is the process of creating or seizing an opportunity and pursuing it regardless of the resources currently controlled.”

Second, there has never been a better time for establishing entrepreneurship as general education. The Association of American Colleges and Universities (AACU), which represents traditional liberal arts institutions, has sponsored or facilitated discussions, research papers and initiatives on the state of general and liberal education. AACU’s meta-analysis of the issues identifies a widespread perception of the need for reform and revitalization of the components of the core curriculum. Higher education associations are mobilizing their memberships to revisit the meaning, relevancy and purpose of a liberal arts base in today’s society. Faculty and students criticize Liberal or General Studies models, taking aim at a number of common issues including:

- Fragmentation of the disciplines that comprise the traditional liberal arts core, each beset by over-specialization;
- Lack of explicit efforts to assure that the student arrives at some degree integration across the disparate disciplines (the ‘functional silos’ problem);
- A bias for teaching in ways that favor abstract and conceptual learning, thus making learning in the liberal arts less accessible for those whose preferred mode of learning is through application of principles and practice; and

- Lack of a shared vision about the benefits of conventional general education subjects among students, their families, the employer community, legislators and educators.

The AACU analyzed methodologies used by education associations, disciplinary associations, accrediting agencies, students, and colleges/universities to define the goals of a college education. Schneider and Shoenberg (undated) reported that there *is* a broad consensus on learning goals among campuses:

- Acquiring intellectual skills or capacities in writing and oral expression, quantitative and moral reasoning, technological literacy, second language, and negotiating difference;
- Understanding and using multiple modes of inquiry and approaches to knowledge;
- Developing societal, civic, and global knowledge;
- Gaining self-knowledge and grounded values; and
- Achieving concentration but also integration of learning between general studies and majors.

Most of these widely embraced goals can be incorporated in the Entrepreneurship and Innovation course through careful articulation of learning objectives, course content, and pedagogy. Among these important objectives, “Achieving concentration but also *integration of learning, including integrative learning, between general studies and majors*” is of special interest because it is the focus of heightened nation-wide attention and a search for new solutions.

“Integrative Learning: Opportunities to Connect” is a collaborative project of the Association of American Colleges and Universities and The Carnegie Foundation for the Advancement of Teaching. Huber and Hutchings (2004) define its aims to identify new ways for students to pull together the threads of knowledge in a way that relates insights and leads to formation of new results. One Carnegie Corporation survey (2000) pointed to promising sources of renewal and transformation. These included several specific tactics such as “Learning by Doing” through techniques, such as research projects, to integrate experience and application with academic work; “Interdisciplinary Approaches” bringing together scholars pursuing interdisciplinary fields of inquiry; and “Integration of the Liberal Arts and Professional Study.” The problems and opportunities defined by higher education authorities are the starting point for aligning an entrepreneurship course with general education. An array of integrative models also is being explored through the Consortium for Liberal Education and Entrepreneurship. This network of colleges and universities is dedicated to encouraging liberal arts and sciences institutions to infuse entrepreneurship into the framework of a liberal education and to facilitate collaborations that connect the arts and sciences with business, engineering, and other professional programs.

A third success factor in building a case for categorizing E&I as general education is a design that draws upon learning theory and data that supports claims that entrepreneurship contributes to learning outcomes. McElroy (2003) argues that it is important to distinguish between *creativity*, the process of generating ideas, and the notion of *innovation*, which is a process of sifting, refining and implementing ideas. Creativity draws upon divergent thinking for idea generation while innovation relies on convergent thinking and putting ideas into action. The higher education critique of general education noted a gap with respect to achieving integration of learning between general studies and majors. General Education courses typically stand as the introductory courses for liberal arts majors. As such they are understandably short on their ability

to assimilate ideas across disciplines and tie together learning that is multidisciplinary. Entrepreneurship and Innovation is inherently multidisciplinary and has the ultimate integration of concepts from divergent sources as its subject focus.

### **What can other campuses learn about incorporating the E&I course into their curriculum?**

Entrepreneurship curriculum has enormous potential to energize and revitalize a general education program. Just one entrepreneurship course emphasizing creativity and innovation can be a tool for integrating learning within general education and pulling together the various styles or modes of thinking learned in a range of subjects. It also can enhance student career prospects by introducing entrepreneurial alternatives. Students are increasingly choosing self-employment, business creation, and entrepreneurial careers within established organizations. This small innovation provides some advantage that may lead to improvements in retention, persistence and graduation rates.

Securing campus support for designating Entrepreneurship a general education course within the social and behavioral sciences bank of the model was not an overnight phenomenon. Several measures that the authors' university employed led to greater success. First, introduction of curriculum was preceded by judicious diplomacy and munificent efforts to create good will and a positive image for entrepreneurial courses and the Center for Innovation and Entrepreneurship. The *Chair of the Center for Innovation and Entrepreneurship* designed a series of initiatives to engage decision-makers in pivotal campus sectors to attract champions outside the College of Business. These initiatives are described in detail below.

A critical first step was to enlist the Provost, and Deans of Engineering, Education and Business to attend USASBE meetings. These individuals provided support at the administrative level to address concerns of colleagues and encourage investment in institutional resources for the entrepreneurship initiatives. Later, these champions were able to spread ideas for integrating entrepreneurship across disciplines to their own academic constituencies within and outside the university. They have become good partners in developing grant proposals and advancing pedagogical papers at national conferences.

Second, the Center for Innovation and Entrepreneurship sponsored an "Entrepreneurship Boot Camp for Liberal Arts Faculty" to address entrepreneurial projects pursued by faculty members. This three-day workshop provided both a graphic and experiential learning opportunity for faculty to familiarize themselves with the curricula. Moreover, it provided each with tools and learning to enhance their own projects and scholarships. Joint ventures with college faculty from other departments led to proposals to seek grant funding to establish programs built upon entrepreneurial goals.

Finally, when curricula were developed, the first proposals were created to provide an open door for all majors. Eliminating the criticism that excessive prerequisites, "majors only" and over use of "leveling requirements" would make it impossible for non-majors to enroll in courses or to complement their major with a minor track. Early establishment of curriculum proposals that remove barriers for non-business majors included a certificate program for engineering majors and a minor for majors in any discipline.

These measures, along with a grounded understanding of general education and liberal arts components, led to an unusual approach to linking entrepreneurship to general education. The quintessential management guru, Drucker (1985), predicted a future in which an Entrepreneurial Society was essential and inescapable in the 21<sup>st</sup> Century. He argued that leaders must remain flexible and self-renewing; pragmatic rather than dogmatic. In Drucker's world, Innovation and Entrepreneurship are essential to address the opportunities and needs emanating from all segments of society. The approach described in this paper is an important step toward sharing that message with the rest of the campus community and brightening the future for many students of various academic backgrounds.

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# **BOARD MEMBER SELECTION IN NEW TECHNOLOGY BUSINESSES:**

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## *Abstract*

*Recent events in the US have focused attention on the fiduciary responsibility of independent board members at a public or private company. This paper examines the process of selecting board members at a high tech start-up where issues of investment in innovation, conflict of interest, firm valuation, non-interference in direct management, exit strategy and accounting practices can be difficult for an entrepreneurial team to handle in a timely manner. Start-ups are in a unique position in that they have the opportunity to initiate a board composition that not only can serve them well in the first few years of business but can set the “tone” or “culture” for the expected levels of ethical behavior in the entrepreneurial team. After reviewing the functions of board members, a typology of candidates and general qualifications, suggestions are made to the start-up’s entrepreneurial team in the form of a checklist for dealing with several of these issues in board governance.*

## **CHANGING ROLE OF THE BOARD OF DIRECTORS**

Recent events in the US have focused attention on the fiduciary responsibility of board members in a company. Questionable tactics in financial reporting at *Enron*, lucrative executive compensation packages at *Tyco* and numerous reports of insider trading and conflict of interest have eroded the confidence in the methodology of board oversight. In the aftermath of recent corporate scandals, the spotlight has shown most brightly on whom shareholders considered the most impartial of board members and who was supposed to best represent their interests – the independent board member. The independence was derived from several attributes: not being part of management or related to any member of management; not having substantial financial investment in the company; not doing business with the company; and not being able to accrue great personal wealth from the company’s performance. Nevertheless, despite the disappointment and due to the urging of institutional investors, companies have moved towards having more and more independent directors. (Colman, 1994) However, there are mixed reviews as to the value of the independent directors on the board in relation to firm performance. (Lin, 1996) (Barnhart and Rosenstein, 1998) (Denis, 2001) The role the board plays in corporate governance is certainly becoming more pronounced and the board’s relationship with the CEO is also changing. (Pound, 1995)

Start-ups have the unique opportunity to begin corporate governance with principles that have become important to shareholders – transparency, communications, standard and widely accepted accounting rules, and the highest ethical standards. Although start-ups



begin their corporate life almost without exception as private companies, many choose to immediately follow SEC and NASDAQ rules about the role independent directors should play in corporate governance. In this way, the corporate governance transition in going from a private company to a public company would be smooth and with no need for major alteration. There are many books and articles outlining the responsibilities of a corporate board member, *The Corporate Director's Guidebook* (1994) being an example. However, few authors have addressed the methodology for the selection of board members, especially in start-ups, let alone high tech start-ups.

Due to the recent adverse stock market conditions and the “witch hunt” now underway in the US to ferret out unethical if not illegal behavior of company management and board members, it is timely for the entrepreneurial team (“ET”) to place more importance on board selection than ever before. Further, the selection process may become more laborious than before due to the disinterest being generated in potential board members as they see board membership as more “risky” than in the past. Director and Officer (“D&O”) insurance policies, once relatively common in public but rare in private companies, may become a requirement for a prospective board member of any stature, wealth and reputation to join a company board. Few public companies have braved not having D&O insurance in the past and fewer will dare continue not having such protection.

Another reason for developing a corporate governance plan at a start-up centers on its high risk of business failure in the early years. A strong board can assist in detecting and attending to signs of business ailments (Scherrer, 2003). Assembling the right board can also assist the high tech start-up in maintaining its focus on innovation and commercialization processes. (Perel, 2002) High tech start-ups have the added business hurdle to overcome of introducing a new technology to the market and achieving its acceptance within a window of opportunity dictated primarily by the level of investment and low competition.

## **FUNCTIONS OF A BOARD MEMBER**

The Sarbanes-Oxley Act of 2002 imposes requirements on board governance as an attempt to make more uniform board oversight of companies. Basic duties and responsibilities were initially outlined in the Model Business Corporation Act of 1978. (Model Act) However, over time five types of relationships have developed between the board and the company: (a) Legalistic; (b) Agency; (c) Strategy and policy; (d) Advisory; (e) Contributory. Four of these types are described in Ong and Lee (2000) as “theories” that researchers have used linearly and individually to describe the functioning of the board relative to the company. Little research has been done to model board influence on company performance using even two of the relationships at the same time let alone all five.

The five relationships or functions ascribed to board behavior in this paper are listed below in similar form to that of Table 1 in Ong and Lee (2000). We will briefly discuss the attributes of each relationship and the impact they may have in assembling a board for a high tech start-up.

**Legal.** The company board has powers and responsibilities endowed by its articles of incorporation, corporate bylaws, federal and state statutes, or regulations passed down from the SEC or stock exchanges.

**Agency.** The role of agency dates back to the expectation that owners and managers can have a divergence of interests. (Berle and Means, 1932) In this light the primary job of the board directors is to provide impartial and diligent oversight of a company's operation and management *in the interest of all shareholders*.

**Strategy and Policy.** As a result of performing its legal and oversight duties, the board exercises judgment in evaluating business plans, investment opportunities and organizational priorities. The process of evaluating and approving such major strategic options of the company empowers the board in establishing strategy for the company. (Zahra, 1990) Research has shown a positive correlation between board involvement in corporate strategy and firm performance. (Pearce and Zahra, 1991)

**Advisory.** Board members are expected to perform in an advisory role to company management. Large investors in a technology company, such as venture capitalists ("VC's"), at times insist on playing a major advisory role as board members, especially with youthful and inexperienced management teams. VC's can overplay this role to their detriment if they fail to gain the trust of the entrepreneurial team early in their association. (Besenitz, Moesel, Fiet and Barney, 1997)

**Contributory.** Board members do volunteer their services operationally in many ways with or without additional compensation under the conditions that the time to complete the service is not burdensome and that the service does not compromise their career or current position. This relationship is attributed to a "stewardship" function of a board member. (Davis, Schoorman and Donaldson, 1996)

## **TYPOLGY OF BOARD MEMBERS**

**Investor.** Anyone who has made a significant investment in the start-up frequently asks for a board seat principally for the sake of "protecting" their investment. Venture capitalists commonly ask for a restructuring of the board as they make an investment, assuring themselves of enough board seats to reflect the size of investment being made in the company. Depending on the limited partnership agreement governing the venture capital firm, it is often the case that the VC partner him/herself has to sit on the board associated with his/her "deal."

**Employee/Manager.** It is common for managers or other employees, especially founders, to request a board seat, frequently using the argument that they own considerable stock and they have a significant stake in board decisions. Entrepreneurs can find that the CEO's membership is adequate for representing the interests of the managers and other employees. Employees are obvious "insiders" who are biased in that they tend to protect their jobs with the company.

**Relevant Stakeholder.** Other stakeholders found on boards include customers, suppliers, legal counsel, spouses of the CEO or other board members and family members. Entrepreneurs are advised to avoid encouraging such candidates to join the board, principally for avoiding conflict of interest.

**The Independent Board Member.** Extensive research has been conducted analyzing company performance relative to board structure parameters such as number of insiders, number of independent members, board compensation, etc. The motivation for such research is obvious. It attempts to answer the question: “What kind of board is associated with acceptable company performance? The consensus from this research, despite a weak association, is to advocate for more independent board members (Barnhart and Rosenstein, 1998) (Denis, 2001).

### **GENERAL QUALIFICATIONS FOR INDEPENDENT BOARD MEMBERS**

More variables that are ascribed to a board member on an individual basis that certainly can influence company performance include (a) communications; (b) motivation; (c) operations experience; (d) teamwork; (e) time. These attributes are especially important for an entrepreneur to assess in a candidate for a board position.

**Communications.** One attribute that may portray the prospective board member’s true temperament is that board member’s ability to communicate. Witnessing the would-be board member’s oral presentations, especially in group meetings, and a review of some his/her writings on business subjects can give insight into the individual’s mode of thinking, reasoning and judgment.

**Motivation for Being an Independent Board Member.** What motivates a person to join a board as an independent director? Compensation in the form of bonuses and stock options can be a significant incentive. (Gutierrez, 2003) One model of human behavior poses three classes of variables in determining human behavior (Jain and Triandis, 1990). Social factors such as roles, norms, self concept and interpersonal agreements form one class of variables. Act satisfaction associated with pleasurable activities is another class. Finally, perceived consequences of performing the act is the third class.

**Operations Experience.** Just as it has been reported in the literature (Farris, 1982) that basic knowledge of the underlying technology area has been found to be useful in the success of a manager of knowledge workers in a technology area (resulting in more innovation), so it is likely that a board member can exercise his/her fiduciary responsibility in an improved manner if he/she is knowledgeable in the technology area of the start-up. There is certainly merit to having independent board members who have different backgrounds, such as legal, financial, technical, managerial and ethnicity.

**Teamwork.** It is imperative that the prospective board member demonstrate the ability to handle group dynamics in a professional manner. A tendency to dominate meetings, be vociferous or cantankerous can torpedo a board meeting.

**Time Requirements.** Serving on a board can consume considerable time so entrepreneurs should be aware of the contribution of possibly the most important asset a professional has – his/her time. Frequently, independent directors have a full time job at another company or organization and simply cannot afford more than that amount of time per month.

## **BEST PRACTICES IN BOARD GOVERNANCE**

Several best practices that are pertinent to high tech start-ups are the following. Several of these practices are listed in Sherwin (2003):

1. Majority of directors are independent.
2. The Chair and CEO are separated.
3. Audit committee is composed entirely of independent directors, whose backgrounds indicate a high degree of financial competence.
4. Board conducts annual performance review of management team.
5. Board has a CEO succession plan in place.
6. All committees chaired by independent directors.
7. Board membership exhibits diversity in experience, skills, backgrounds, gender and ethnicity.
8. Trust, communications and teamwork are nurtured in board activities.
9. Review of strategic plan and annual financial plan happens at every board meeting.
10. Board meetings are planned with published agenda one week in advance with targeted start and end times.

## **CHECKLIST FOR BOARD SELECTION AND CONCLUSIONS**

As a result of the prior discussion the following ten assessment steps in Table 1 form a guide for entrepreneurial teams in dealing with board member selection. The first seven steps assess the board member candidate's suitability for general board membership while Steps 8-10 specifically deal with the issue of the start-up's technology focus. There is much activity, perhaps even turmoil, in the initial period of starting up a company. Entrepreneurial teams are often eager to start the product or service development process once funding is secured. It is easy to put off board member selection or relegate it to the lead investor in the company. However, the ET may never be in such an advantageous position again to help select the best available group of people who will perform oversight of the company's management and make other valuable contributions.

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Table 1

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Usage of Table 1 by an ET in assessing a board member candidate can also be modified by assigning a "weight" to each attribute. For example, the absence of a board member on the current board that exhibits strength in Step 4 may lead the ET to assign a higher weight to Step 4 than to others. However, it is important that ET's understand that no

attribute can be ignored. Indeed, board candidates who rate poorly in Steps 3, 5 and 7 can cause trouble far in excess of their potential positive contributions.

In summary, the selection of board members for new technology businesses is an important step in laying the groundwork for a company's success. The process of selection should be seen by ET's as a rare opportunity to strengthen the people assets of the company. Choosing board members can very well rival the importance of choosing key operational team members.

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**Table 1**  
**Assessment Steps for Selecting an Independent Board Member**  
**in a High Tech Start-up**

| Step No. | Attribute                                     | Areas   | Comment   |
|----------|---|---|---|
| 1        | Business Experience                           | Marketing, Sales, Strategy  | These areas are probably most useful to a start-up  |
| 2        | Communication Skills                          | Active Listening and Succinct Verbalization                           | Individual must be able to “listen” to the E-team’s issues and not “overtalk.”            |
| 3        | Ethics & Background                           | Impeccable ethical background   | Avoid selection of anyone with questionable reputation.                                   |
| 4        | Ability to “Open Doors”                       | Relationship with Potential customers, suppliers, potential investors | This is valuable initial “capital” for the start-up.                                      |
| 5        | No Conflict of Interest                       | No significant interest in ownership or financial association         | Too much potential conflict will necessitate excusing the board member from deliberations |
| 6        | Time Availability                             | No more than 2 other board memberships                                | Regardless of other virtues, absences from deliberations does disservice to company       |
| 7        | Chemistry with Founders                       | More so than age difference, interpersonal skill is important         | Difficulty in relating to founding team is a “no-no.”                                     |
| 8        | Gen. Knowledge of Technology                  | Career in technology  | A degree in technology helps  |
| 9        | Specific Knowledge of Company’s Technology    | User, Developer, Researcher   | User is most needed for a start-up  |
| 10       | Operational Knowledge of Technology Companies | Executive of functional area  | Sales and Marketing of Technology products or services most helpful                       |

# **RESOURCE CONFIGURATION IN FAMILY FIRMS: LINKING RESOURCES, STRATEGIC PLANNING AND ENVIRONMENTAL DYNAMISM TO PERFORMANCE**

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## **ABSTRACT**

We apply the resource-based view (RBV) to the study of family firms by investigating how family specific (altruism) and firm specific (technology) resources contribute to performance. We then examine how the impact of these resources is moderated by strategic planning and environmental dynamism. Our findings suggest that family firms can benefit from emphasizing the positive aspects of kinship and from developing technological assets. In addition, we found a heightened importance of altruism in dynamic environments, and that strategic planning increased in importance for those family firms that lack technological resources.

## **INTRODUCTION**

Resource management is critical to managing a family firm and gaining a competitive advantage (Chrisman, Chua & Zahra, 2003). In particular, a family firm's culture can act as an important strategic resource that can lead to a distinct advantage (Zahra, Hayton & Salvato, 2004). While family firms are often criticized for failing to seek new ventures (Cabrera-Suarez, Saa-Perez & Almeida, 2001), being conservative and resisting change (Morris, 1998), those family firms that are innovative and possess technological resources may increase their distinctiveness. In addition, while many family firms are plagued by conflict that can devastate their performance, other family firms possess harmonious cultures that increase cooperation and commitment (Zahra et al., 2004). Indeed, effective relationships within a family firm can be a unique resource (Kellermanns & Eddleston, 2004). Therefore, due to the interaction between the family and the business, a family firm's competitive advantage may come from resources derived from the business's technological capabilities or resources derived from effective family relationships.

However, possessing resources may not be enough to achieve a competitive advantage. Strategic planning and the environment may affect the degree to which resources are able to contribute to performance. Family firms must manage their resources and plan for the future in order to succeed in today's competitive landscape (Sirmon & Hitt, 2003). Leveraging resources requires managers to participate in strategic planning aimed at creating a distinct advantage (McGrath & MacMillan, 2000). Furthermore, while resources are the essential building blocks of gaining a competitive advantage, they must be leveraged to effectively pursue environmental opportunities (Chrisma, et al., 2003). Certain resources may be essential in a dynamic environment if a firm is to perform well and protect its competitive advantage (Sirmon & Hitt, 2003). Family firms operating in dynamic environments need to manage their resources so as to exploit opportunities present in uncertain markets (Shane & Venkataraman, 2002). As such, in line with recent research on RBV, strategic planning and the environment must be considered in order to fully understand how a family firm's resources contribute to its performance (Sirmon & Hitt, 2003).

Our paper examines the affect of two distinct and potentially important resources on family firm performance. First, because it has been suggested that innovation may be an important resource that distinguishes family firms and contributes to their competitive advantage (Zahra et al., 2004)



we examine how technological resources impact a family firm's performance. Second, given that positive and effective family relationships have been argued to be an important source of competitive advantage that is unique to family firms (Kellermanns & Eddleston, 2004), we investigate how altruism contributes to family firm performance. In line with recent research on RBV (i.e. Cabrera-Suarez et al., 2001; Chrisman et al., 2003; Sirmon & Hitt, 2003), we also consider the role that strategic planning and environmental dynamism play in shaping how these distinct resources affect a family firm's performance.

### **THE RESOURCE-BASED VIEW OF THE FIRM**

According to RBV, firms can develop unique characteristics that allow them to gain a sustainable competitive advantage, thus positively affecting their performance. These firm-specific assets can be both tangible and intangible, but the key is that they are not available to all firms in the industry. Barney (1991) described four characteristics of these firm-specific assets: that they need to be valuable, rare, not easy to imitate, and non-substitutable. A further element of RBV is that resources alone do not confer a competitive advantage. Firms must also allocate these resources for strategic activities, deploy them effectively to obtain a sustainable competitive advantage and accomplish strategic objectives. Therefore, in order to succeed, firms must develop resources that cannot be easily imitated and are firm-specific, embedded in the organization and non-transferable. (Makadok, 2001).

#### **Technology as a Firm-Specific Resource**

Family firms are often criticized for failing to invest in new ventures (Cabrera-Suarez et al., 2001), avoiding risk and resisting change (Morris, 1998). Many family firms do not plan for the future or invest in technological capabilities. They become fixated on maintaining the status quo and fail to invest in technology thereby limiting their growth. In contrast, it has been argued that family firms need to innovate and pursue entrepreneurial activities in order to increase their distinctiveness and enhance their profitability (Zahra et al., 2004). By developing technology and continuously renewing that technology, a firm can create an important strategic resource that can lead to a sustainable competitive advantage, thereby enhancing its growth and profitability.

**Hypothesis 1:** Technological resources are positively related to family firm performance.

#### **The Family as a Resource**

While most research focuses on how family relationships can negatively impact firm performance (Kellermanns & Eddleston, 2004), recently it has been argued that "familiness" can be a source of competitive advantage for family firms (Sirmon & Hitt, 2003). In particular, altruism may explain why in some family firms members are able to successfully work together and run a business while in others, family members are laden with animosity that deteriorates performance (Kellermanns & Eddleston, 2004). As such, high levels of altruism within a family firm may constitute as an important source of competitive advantage. Altruistic family firm members can be seen as stewards rather than as agents of the firm. In line with stewardship theory (Davis, Schoorman & Donaldson, 1997), altruistic families are characterized as possessing collectivistic orientations that encourage family members to exercise self-restraint and to consider the effect of their actions on the firm (Kellermanns & Eddleston, 2004). Indeed, research suggests that the agency costs of family firms tend to be lower than the agency costs of non-family firms (Chrisman et al., 2004; Sirmon & Hitt, 2003).

**Hypothesis 2:** Altruism is positively related to family firm performance.

### **The Need for Strategic Planning**

While resources are important to a firm's performance, according to RBV, whether an organization gains a competitive advantage and the associated returns depends on the strategic planning used to leverage those resources (Chrisman et al., 2003; McGrath & MacMillan, 2000). Therefore, a family firm's level of strategic planning may impact the degree to which altruism and technological resources affect performance. Specifically, strategic planning may heighten the positive effects of technological resources on family firm performance because the long-term nature of family firms allows them to strategically plan the dedication of resources required for innovation and risk taking (Zahra et al., 2004). In addition, research suggests that for family firms to prosper from their innovative capacity they must invest in formal strategic processes (McCann, Leon-Guerrero & Haley, 2001).

Concerning altruism, to create a sustainable competitive advantage, "familiness" must be properly assessed and managed in a family business (Cabrera-Suarez, et al., 2001). When family firms place noneconomic goals, like avoiding family conflict or creating jobs for family members, ahead of economic considerations, performance can be compromised (Chrisman, et al., 2003). In addition, because family employees often work for a firm not because of their qualifications, but because of their family status (Schulze, Lubatikin & Dino, 2003), the discussion of each family member's abilities and how they can be efficiently and effectively deployed is of the utmost importance (Kellermanns & Eddleston, 2004). Employees of family businesses need to be motivated to participate in strategic planning and implement strategies if the firm is to benefit from its resources (Sirmon & Hitt, 2003). As such, greater strategic planning may amplify the positive effects of altruism on family firm performance.

**Hypothesis 3:** Strategic planning moderates the relationship between (a) technological resources and (b) altruism and family firm performance. Specifically, higher levels of strategic planning enhance the positive relationship between (a) technological resources and (b) altruism.

### **Environmental Dynamism: The Impact of a Turbulent Environment**

Environmental dynamism may affect the extent to which resources contribute to a firm's performance. Specifically, family firms operating in dynamic environments may need greater resources in order to exploit opportunities present in uncertain markets (Shane & Venkataraman, 2002). Concerning technological resources, venturing activities and innovation may be particularly important to surviving in a highly dynamic environment (Sirmon & Hitt, 2003). A turbulent environment, with fast-changing unpredictable markets, is complex, threatening and risky. There is less time to react, resource needs can change quickly, and technologies underlying products can become suddenly obsolete. Entrepreneurial behavior may fit well within such dynamic environments, particularly in technology intensive industries (Zahra & Bogner, 1999).

Furthermore, in uncertain, dynamic environments, a stewardship philosophy toward management, which encourages a collectivistic, trustworthy and pro-organizational culture, is argued to be most effective (Davis et al., 1997). Family firms that encourage cooperation and collaboration may be best able to respond to environmental changes (Zahra, et al., 2004). This is because in order to prosper in an uncertain and turbulent environment, trust and shared responsibility is essential (Davis et al., 1997). This leads to the following hypothesis:

**Hypothesis 4:** Environmental dynamism moderates the relationship between (a) technological resources and (b) altruism and family firm performance. Specifically, higher degrees of environmental dynamism enhance the positive relationship between (a) technological resources and (b) altruism.

## METHOD

**Sample.** Data for the study were collected using a questionnaire survey. A mailing list of 232 family businesses was obtained from the family business centers at two universities. We sought multiple respondents from each family firm because consensus among several stakeholders in the family firm would aid in the representativeness of our results to family businesses. There were 126 questionnaires returned, resulting in 74 family firms and a 32% response rate. The employment size for non-family employees of these firms ranged from 2 to 545 with an average size of 97 and a median of 44.

**Measures.** All constructs were measured on a 7-point Likert scale anchored by “strongly disagree” to “strongly agree”, unless otherwise noted in the subsequent section. Alphas ranged from .83 to .90. We measured altruism among family members by adapting four items from a scale developed by Becker and Vance (1993). In order to assess the level of technological resources within a family firm, we used three items modified from scales developed by Miller & Barbosa (1983) and Zahra (1996). We measured strategic planning in family firms by modifying three items from a scale by Gould (1979). Environmental dynamism was captured by utilizing four scale items used by Zahra (1996). Performance was assessed with eight questions regarding growth, returns and profitability. In addition, we controlled for firm size.

## RESULTS

The hypotheses proposed in the research model were tested using multiple regression analysis. Results are presented in Table 1. In model one, the control for size was entered, however, it was not significantly related to performance. To test Hypotheses 1 and 2, we entered both independent variables in the second model. A significant change in  $R^2$  was observed ( $\Delta R^2 = .20$ ,  $p < .001$ ) and technological resources ( $\beta = 0.25$ ,  $p < .05$ ) and altruism ( $\beta = 0.34$ ,  $p < .01$ ) were found to have a significant positive impact on performance, supporting Hypotheses 1 and 2.

In order to test the suggested moderation effects, we first entered the moderators independently in Model 3 and then entered the four interaction terms in Model 4. A significant change in  $R^2$  was produced ( $\Delta R^2 = .12$ ,  $p < .05$ ). Hypothesis 3 was partly supported; whereas strategic planning did not affect the relationship between altruism and performance, a significant interaction was observed between strategic planning and technological resources ( $\beta = 0.45$ ,  $p < .01$ ). Hypothesis 4 was also partly supported; whereas environmental dynamism did not moderate the relationship between technological resources and performance, a significant interaction was observed between environmental dynamism and altruism ( $\beta = 0.22$ ,  $p < .05$ ). To facilitate interpretation, the two significant interactions were plotted in Figure 2 and Figure 3. The interaction between strategic planning and technological resources in Figure 2 shows that when there is little strategic planning, technological resources become increasingly important to family firm performance. However, when there is much strategic planning, the level of technological resources has no significant impact on family firm performance. The second significant interaction effect between environmental dynamism and altruism is displayed in Figure 3. The interaction shows that in

stable environments, altruism has little effect on performance. However, when the environment is dynamic, a higher level of altruism is associated with stronger family firm performance.

## **DISCUSSION AND IMPLICATIONS FOR FUTURE RESEARCH**

Our study contributes to the family firm literature in many ways. Kellermanns and Eddleston (2004) argued an indirect positive performance effect of altruism in family firms, however other research portrayed altruism as detrimental to family firms (Schulze, et al., 2003). Our study is the first empirical investigation that begins to resolve these opposing arguments. Whereas altruism might lead to non-zero agency costs in family firms (Schulze et al., 2003), our study suggests that these costs are still lower than in non-family firms. This notion is further supported by our results that showed the enhanced importance of altruism in dynamic environments. In these environments high agency costs seem even more detrimental than in stable environments. Thus, our study shows that if altruism is present and fostered in family firms, it can be a powerful resource, which can lead to a competitive advantage that is not replicable in other firms.

We further demonstrated the importance of technological resources and strategic planning in family firms. Whereas superior strategic planning can offset the negative performance consequences of impoverished technological firms, our study supports the importance of strong technological resources for all family firms. These findings are significant given that family firms are often criticized for failing to seek new ventures or to be innovative (Cabrera-Suarez et al., 2001). Our study demonstrates that family firms that invest in technological resources will have a stronger performance. However, we also see that for those firms with little technological resources, strategic planning may be able to compensate and help these firms to succeed. Given these findings, future researchers should further investigate how family firms can improve their technological resources and also, how family firms that may not have technological capabilities may use strategic planning to compensate and contribute to their performance.

Another avenue for future studies should be aimed at unraveling our complex findings regarding environmental dynamism. While altruism was found to be a positive resource in dynamic environments, technological resources did not have a significant effect. Perhaps technological resources were not significant because in highly dynamic environments, competitive advantages are short-lived, and even new competencies produce only temporary advantages. It appears that higher levels of technological resources in neither dynamic nor stable environments ensure a long-term advantage. In contrast, today's competitive landscape requires the integration of specialized knowledge. Altruism may foster knowledge exchange and learning within a family firm which may help them succeed in dynamic environments.

Importantly, this study showed that the performance of family firms cannot be fully understood without taking into account the psychodynamic effects of family relationships. Thus, our study shows a specific family resource, altruism, that helps family firms to succeed. As such, this study demonstrates that family relationships and interactions are significantly tied to a family firm's performance. This suggests that the family can be a source of competitive advantage for a family firm. Our findings also suggest from the resource-based perspective that the inclusion of other "familiness" variables may provide fruitful avenues for future studies that are aimed at helping family firms understand the unique resource that effective family relationships can provide.

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**Table 1: Hierarchical Regression Analysis<sup>a</sup>**  
**Dependent Variable: Organizational Performance**

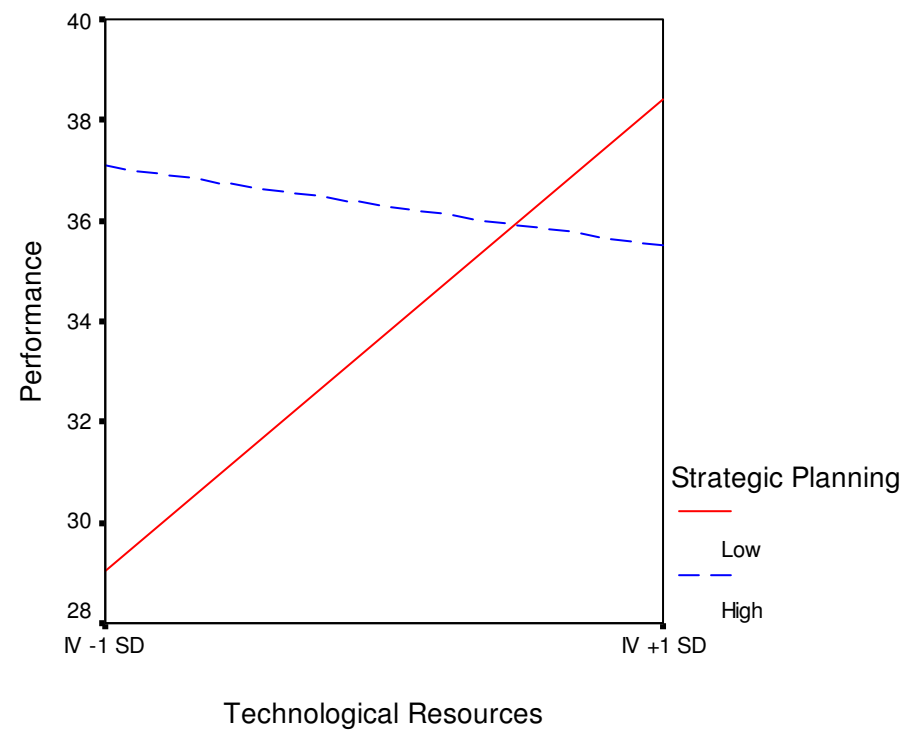
|  | Model 1 | Model 2 | Model 3          | Model 4          |
|--|---------|---------|------------------|------------------|
| <b>Step 1: Controls</b>                      |         |         |                  |                  |
| Firm Size (Employees) <sup>1</sup>           | -.04    | -.06    | -.05             | -.01             |
| <b>Step 2: Main Effects</b>                  |         |         |                  |                  |
| Altruism                                     |         | .34**   | .27*             | .15              |
| Technological Resources                      |         | .25*    | .25*             | .30**            |
| <b>Step 3: Moderators</b>                    |         |         |                  |                  |
| Strategic Planning                           |         |         | .21 <sup>†</sup> | .20 <sup>†</sup> |
| Environmental Dynamism                       |         |         | .02              | -.08             |
| <b>Step 4: Interaction Effects</b>           |         |         |                  |                  |
| Strategic Planning * Altruism                |         |         |                  | .09              |
| Strategic Planning * Technological Resources |         |         |                  | -.45**           |
| Environmental Dynamism * Altruism            |         |         |                  | .22*             |
| Environmental Dynamism * Tech Resources      |         |         |                  | .20              |
| Change in R <sup>2</sup>                     | .00     | .20***  | .04              | .12*             |
| R <sup>2</sup>                               | .00     | .20     | .25              | .36              |
| Adjusted R <sup>2</sup>                      | -.01    | .17     | .19              | .28              |
| F  | .11     | 5.96*** | 4.42**           | 4.07***          |

<sup>a</sup> Regression coefficients are reported as betas.

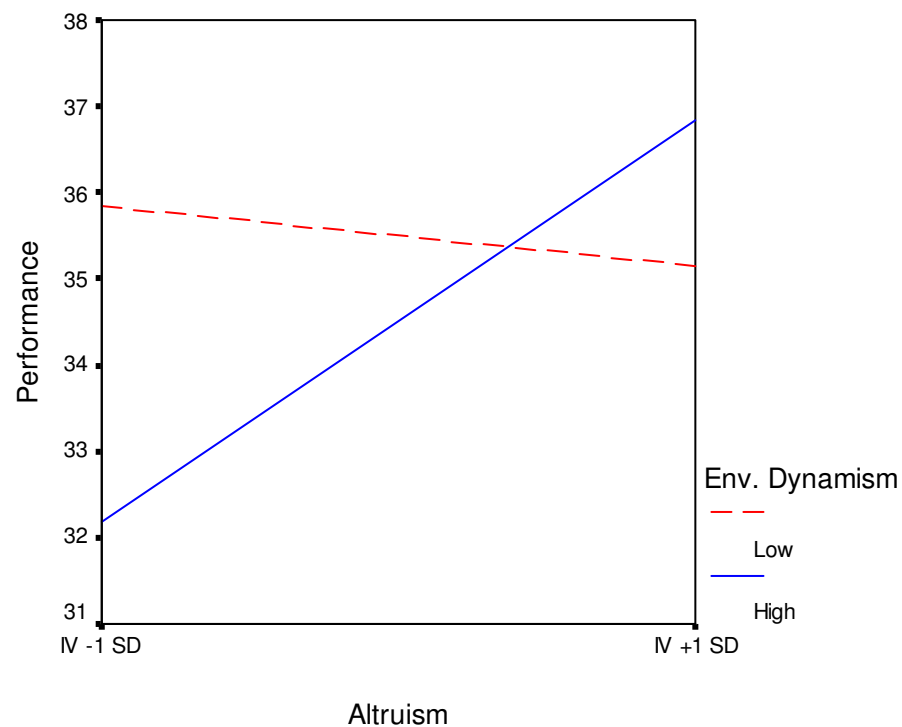
<sup>1</sup> logarithmized

N = 74, <sup>†</sup> p <.10; \* p <.05; \*\* p <.01; \*\*\* p <.001.

**Figure 2: Interaction: Strategic Planning and Technological Resources**



**Figure 3: Interaction: Environmental Dynamism and Altruism**



## **SMALL BUSINESS AND COMMUNITY BANKS**

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### **Abstract**

Using survey data from a sample of U.S. small businesses collected in 1987, 1995 and 2001, this paper addresses the question of whether small firms obtain better banking outcomes from community banks. Over the entire period, we find that small firms using community banks experience higher quality service are less likely to have experienced increases in the number of services with fees or fees per unit of service, and experienced improved credit availability. The results for loan terms were mixed, with no differences detected for rates charged or compensating balances required, but a significantly higher incidence of collateral requirements and lower incidence of loan fees. These results also suggest that small firms with limited operating histories or those with limited financial data that is used in typical credit scoring models have a better chance of success for a loan approval at a community bank.



## **SMALL BUSINESS AND COMMUNITY BANKS**

### **INTRODUCTION**

Do community financial institutions (“CFIs”) provide small firms with better banking outcomes, such as service quality, credit availability and loan terms?<sup>1</sup> This question is important to small businesses because of their heavy reliance on banks for their external financing (Berger and Udell, 1998) as well as important for macroeconomic policy given the importance of small business in the job generation process. Community banks, with their flatter organization structures are better suited to produce soft information such as information about the owner’s character, relationship with suppliers or ability to manage through a business cycle (Berger and Udell, 2002, Stein, 2002). This information should benefit small, small, information-opaque firms that may not have a track record of hard information required of many large banks that rely on financial ratios or credit scoring to make lending decisions. Indeed, the preponderance of the empirical evidence shows that community banks enhance credit availability for small firms (e.g., Berger et al, 2004). Yet, there is scant evidence regarding whether community banks provide improved loan terms or improved service.

In this paper we use survey responses from a representative set of U.S. small businesses in 1987, 1995 and 2001 to determine whether small firm owners have a better banking experience at community banks. These data provide detailed firm-level information on owner assessments of service quality that include accessibility of the loan officer, quality of service, capability of staff, staff turnover, and the overall ease of doing business. The survey provides information on the outcome of the most recent loan attempt and an assessment of any unmet borrowing needs in the past few years. If owners were successful on the most recent attempt, they reported both the rate and non-rate terms of the loan. Using the size of their current bank as the key independent variable, we are able to investigate the association between choice of bank size and measures of service quality, credit availability, and loan terms.

This paper adds to the literature on understanding of how locally-owned banks can benefit small firms compared to large banks. Other papers have examined the effect of bank size on small firm credit availability and attributes of a banking relationship that are important to small firms (e.g., Berger et al, 2004, Cole et al, 2004, and Scott, 2004). While these papers provide important results, they do not address the association between bank size and service quality or bank size and loan terms. Perhaps more importantly, none of the extant empirical work examines whether smaller banks have been able to consistently deliver these benefits to small firms over a period (1987-2001) when dramatic consolidation took place in the U.S. banking system.

### **DATA DESCRIPTION AND ANALYSIS**

The data in this study come from the Credit, Banks and Small Business (CBSB) survey conducted by the National Federation of Independent Business through surveys of

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<sup>1</sup> Gramm-Leach-Bliley (CFI, 12 USC 1422(13)) defines community banks by asset size. This definition is a legal, not an economic one, and CFIs could be defined by market size, deposit base, or customer base. However, defining CFI by asset size is most frequently used for research and policy purposes.

random samples of its 600,000 members in 1987, 1995, and 2001. The response rates have varied over time: 26 percent in 1987, 20 percent in 1995, and 18 percent in 2001.<sup>2</sup> Although self-reported, there is no reason to believe that there is any systematic self-reporting bias in the reports in the banking outcomes. The data are similar to that gathered by the Board of Governors of the Federal Reserve System in their Survey of Small Business Finance through a telephone survey of small firms drawn from the Dun and Bradstreet files.

Table I about here

Key demographic statistics are presented in Table I for each survey. The definition of the variables used in the analysis and key summary statistics are shown in Table II for all firms that reported a commercial bank as their primary institutions. A CFI, or community financial institution, is defined as a bank with assets under \$1,000 million and LFIs (large financial institutions) are banks with assets over \$1,000 million. The number of observations in Table II is restricted to those owners that reported the size of their bank or the name of the bank, permitting an assignment of the asset size of the bank.

Table II about here

A comparison of the small firm characteristics and their banking outcomes between CFIs and LFIs is shown in Table III. Service quality is assessed by ratings four characteristics: accessibility of the account manager, overall quality of service, capability of staff and staff turnover. These ratings are based on the owner's assessment of the change in the characteristic at their principal bank in the last three years and are coded as a '1' if better, '0' if no change, and '-1' if worse. With the exception of overall service quality in 1987 small firms rated CFI performance significantly higher than LFIs. The ratings on accessibility of account manager and staff capability have shown little change since 1987, but the quality of service and staff turnover have shown a marked decline between 1995 and 2001. An overall CFI service quality index, based on the sum of the four service characteristic ratings, is also higher for CFIs, but the mean value of the index declined significantly between 1987 and 2001.

Owners doing business at CFIs are significantly less likely to be denied in their last loan application in all of the surveys and for those approved, their loan size received is significantly lower – which may be due to smaller firms self-selecting smaller banks. However, there are no significant differences between CFIs and LFIs for those owners reporting unmet borrowing needs over the past three years.

The average loan rate for all loans is systematically higher at CFIs, but the difference from large bank rates is not significant. The evidence on non-rate terms is mixed, with a significantly higher incidence of collateral requirements only in 2001, but a significantly lower incidence of required business checking accounts as a condition of their most recent loan in 1995 and 2001. Loan size is also significantly lower, either because of the

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<sup>2</sup> A similar decline in the response rate has been experienced with the Board of Governor's Survey of Small Business Finance.

smaller size of firms using community banks or binding lending limitations because of less capital (e.g., loan-to-one borrower limits).

Table III about here

Table III also suggests that owners at CFIs have a different demographic profile than those at LFIs. Owners currently doing business at CFIs are younger and smaller (in terms of employment and sales), which suggests a more risky profile that may be reflected in the higher average loan rates. Owners at CFIs also tend to be organized more frequently as proprietorships and less likely as corporations, an outcome that is likely correlated with size. Owners banking at CFIs are significantly less likely to be located in urban areas (Metropolitan Statistical Areas or “MSA”), in markets with greater employment and higher deposit concentration ratios.

### **MULTIVARIATE RESULTS**

Multivariate analysis was used to confirm the relationships identified in Table III for both non-loan term (service quality index, change in fees and credit availability) and loan-term (rate, collateral, loan size, and compensating balances). The key feature of the multivariate analysis is the use of instrumental variables for bank size to avoid complications arising from the possibility that improved outcomes at CFIs are attributable to the characteristics of the small firm that cause it to choose the CFI, not the bank size itself. These instruments include population, region, MSA, and deposit concentration.

In addition, a simultaneous equation model is used to estimate the loan term equations because these terms are jointly determined by the bank. A full set of control variables is included in the analysis such as firm size, years in business, form of business, and industry classification. Additional control variables are included in the loan term equations to control for the yield curve, the overall level of rates, default risk premiums, maturity and loan type.

The multivariate results (not reported here but available from the authors) confirm most of the results in Table III. Owners banking at community banks consistently report higher service quality, a lower incidence of services with new fees or higher fees on existing services, and a lower chance of being turned down on their most recent loan request. Loan terms were not affected by the choice of a CFI with the exception of a consistently higher incidence of collateral at CFIs.

### **CONCLUSIONS**

Do small banks provide better banking outcomes for small firms? After controlling for the endogeneity between firm size and the selection of the bank, the results in this paper confirm the Berger et al (2004) results that credit availability improves for small firms at CFIs. In addition, owners at CFIs experience better service and lower incidence of fee increases, with mixed results for loan terms. Despite the consolidation of the banking industry and the concomitant reduction in the number of community banks, these results suggest that owners of small firms receive better banking outcomes at CFIs – an

advantage that has persisted over 14 years from 1987 through 2001. These results also suggest that owners who lack the hard operating numbers that are used in credit scoring models used by many large banks are likely to have a better chance of success in obtaining a loan at a community bank.

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**TABLE I. Distribution of NFIB survey respondent demographic characteristics**

The frequency distributions for selected firm characteristics from the 1987, 1995, and 2001 National Federation of Independent Business (NFIB) Credit, Banks and Small Business Survey.

| <b><u>Form of Business</u></b>        | <b><u>1987</u></b> | <b><u>1995</u></b> | <b><u>2001</u></b> |
|---------------------------------------|--------------------|--------------------|--------------------|
| Proprietorship                        | 35                 | 31                 | 26                 |
| Partnership                           | 8                  | 6                  | 8                  |
| Corporation                           | 57                 | 42                 | 40                 |
| S-Corporation                         |                    | 21                 | 24                 |
| No answer                             | 1                  | 1                  | 2                  |
|                                       | 100                | 100                | 100                |
| <b>Full Time Equivalent Employees</b> |                    |                    |                    |
| One                                   | 8                  | 6                  | 7                  |
| 2-4                                   | 24                 | 23                 | 29                 |
| 5-9                                   | 30                 | 30                 | 25                 |
| 10-19                                 | 19                 | 20                 | 17                 |
| 20-49                                 | 13                 | 14                 | 12                 |
| 50-99                                 | 4                  | 4                  | 4                  |
| 100-499                               | 2                  | 3                  | 2                  |
| No answer                             |                    | 1                  | 5                  |
|                                       | 100                | 100                | 100                |
| <b>Years in Business</b>              |                    |                    |                    |
| 0-4                                   | 24                 | 15                 | 11                 |
| 5-9                                   | 20                 | 21                 | 14                 |
| 10-14                                 | 17                 | 19                 | 16                 |
| 15-19                                 | 10                 | 14                 | 14                 |
| 20-24                                 | 9                  | 11                 | 13                 |
| 25 or more                            | 18                 | 19                 | 28                 |
| No answer                             | 2                  | 1                  | 5                  |
|                                       | 100                | 100                | 100                |
| <b>Industry</b>                       |                    |                    |                    |
| Construction/mining                   | 12                 | 13                 | 15                 |
| Manufacturing                         | 12                 | 12                 | 11                 |
| Transportation                        | 3                  | 3                  | 4                  |
| Wholesale                             | 9                  | 6                  | 10                 |
| Retail                                | 24                 | 21                 | 20                 |
| FIRE                                  | 8                  | 7                  | 6                  |
| Business services                     | 21                 | 21                 | 17                 |
| Professional services                 | 8                  | 5                  | 8                  |
| Agriculture                           | 4                  | 8                  | 5                  |
| No answer                             |                    | 4                  | 4                  |
|                                       | 100                | 100                | 100                |
| <b>Sales Growth (past 3 years)</b>    |                    |                    |                    |
| Decline                               | 14                 | 14                 | 15                 |
| No change (-5 to 5%)                  | 25                 | 30                 | 29                 |
| Grew 6-10%                            | 40                 | 26                 | 28                 |
| Grew 11-20%                           |                    | 12                 | 12                 |
| Grew > 20%                            | 13                 | 11                 | 9                  |
| Too new to tell                       | 5                  | 4                  | 2                  |
| No answer                             | 2                  | 2                  | 6                  |
|                                       | 100                | 100                | 100                |

**Table II. Variable definitions and descriptive statistics**

Means and standard deviations are presented for all firms that reported a commercial bank as their primary financial institution. No answer responses are excluded from the computation of the summary statistics. The summary statistics are also presented for all firms that report a commercial bank with assets below \$1,000 million (CFI) and those with assets above \$1,000 million (LFI) as of June 2001, 1995, and 1987. The sum of the CFI and LFI observations do not equal the total because of cases where the bank size could not be determined from the information provided on the survey. All data are taken from the 1987, 1995, and 2001 National Federation of Independent Business Credit, Banks and Small Business Surveys.

| Variable Name  | Definition  | 1987  |           |             | 1995   |           |             | 2001   |           |             |
|--|---|-------|-----------|-------------|--------|-----------|-------------|--------|-----------|-------------|
|  |   | Mean  | Std. Dev. | No. of Obs. | Mean   | Std. Dev. | No. of Obs. | Mean   | Std. Dev. | No. of Obs. |
| <i>Change in characteristics at principal bank in last 3 years</i> |   |       |           |             |        |           |             |        |           |             |
| Accessibility  | 1 if better; 0 if no change; and -1 if worse  | 0.05  | 0.53      | 1286        | 0.04   | 0.54      | 3122        | 0.00   | 0.54      | 1871        |
| Quality of service   | 1 if better; 0 if no change; and -1 if worse  | 0.10  | 0.59      | 1244        | 0.08   | 0.58      | 3206        | -0.03  | 0.60      | 1892        |
| Capability of staff  | 1 if better; 0 if no change; and -1 if worse  | 0.02  | 0.57      | 1301        | 0.01   | 0.54      | 3187        | -0.02  | 0.56      | 1865        |
| Staff turnover   | 1 if better; 0 if no change; and -1 if worse  | -0.05 | 0.53      | 1263        | -0.06  | 0.54      | 3072        | -0.26  | 0.56      | 1855        |
| Ease of doing business   | 1 if better; 0 if no change; and -1 if worse  | NA    | NA        | NA          | NA     | NA        | NA          | 0.02   | 0.63      | 1859        |
| Service Quality Index  | Accessibility+Quality of service + Capability of staff + Staff turnover   | 0.13  | 1.67      | 1176        | 0.09   | 1.77      | 2704        | -0.30  | 1.76      | 1823        |
| <i>Higher fees incurred in past 12 months</i>                      |   |       |           |             |        |           |             |        |           |             |
| Number of fees   | Number of services with fees (2 = 'substantially higher'; 1 = 'higher'; 0 = 'no change'; -1 = 'lower'; and -2 = 'much lower') | 0.45  | 0.82      | 1374        | 0.52   | 0.80      | 2966        | 0.53   | 0.78      | 1705        |
| Fees per unit of service   | Fees per unit of service (2 = 'substantially higher'; 1 = 'higher'; 0 = 'no change'; -1 = 'lower'; and -2 = 'much lower')     | 0.57  | 0.75      | 1250        | 0.60   | 0.74      | 2858        | 0.54   | 0.73      | 1718        |
| <i>Credit availability</i>   |   |       |           |             |        |           |             |        |           |             |
| Turned down  | =1 if turned down in last loan attempt  | 0.21  | 0.40      | 1231        | 0.16   | 0.36      | 2863        | 0.10   | 0.30      | 1544        |
| Borrowing needs met  | =1 if borrowing needs were met all or most of the time during the last three years  | NA    | NA        | NA          | 0.26   | 0.44      | 2221        | 0.10   | 0.30      | 1501        |
| <i>Loan terms</i>  |   |       |           |             |        |           |             |        |           |             |
| Loan size (\$000)  | Size of most recently reported loan   | \$ 98 | \$ 233    | 996         | \$ 178 | \$ 578    | 2297        | \$ 229 | \$ 650    | 1175        |
| Interest rate  | Nominal interest rate reported on most recent loan (all loans)  | 11.22 | 2.26      | 903         | 9.45   | 2.14      | 2297        | 8.48   | 2.71      | 650         |
| Collateral required  | 1 if collateral was required as a condition of the loan   | 0.68  | 0.47      | 1009        | 0.66   | 0.48      | 2334        | 0.65   | 0.48      | 1239        |
| Checking balances required   | 1 if business checking accounts were required as a condition of the loan  | NA    | NA        | NA          | 0.28   | 0.45      | 2322        | 0.37   | 0.48      | 1284        |

**Table III: Comparison of CFI and LFI owner and banking outcomes <sup>a</sup>**

| <b>Banking Outcomes</b>                   | <b>1987</b> |            | <b>1995</b> |            | <b>2001</b> |            |
|---|-------------|------------|-------------|------------|-------------|------------|
|   | <u>CFI</u>  | <u>LFI</u> | <u>CFI</u>  | <u>LFI</u> | <u>CFI</u>  | <u>LFI</u> |
| Service Index                             |             |            |             |            |             |            |
| (Accessibility+Quality+Capability+Staff)  | 0.22        | -0.05 *    | 0.20        | -0.06 *    | 0.03        | -0.53 *    |
| Accessibility                             | 0.07        | 0.01 *     | 0.07        | 0.00 *     | 0.06        | -0.05 *    |
| Quality of service                        | 0.10        | 0.09       | 0.10        | 0.06 *     | 0.05        | -0.10 *    |
| Capability of staff                       | 0.06        | -0.06 *    | 0.03        | -0.02 *    | 0.06        | -0.07 *    |
| Staff turnover                            | -0.02       | -0.11 *    | -0.01       | -0.12 *    | -0.16       | -0.32 *    |
| Ease of doing business                    | NA          | NA         | NA          | NA         | 0.08        | -0.03 *    |
| Increased number of services with fees    | 0.43        | 0.49       | 0.49        | 0.55 *     | 0.41        | 0.52 *     |
| Increased fees per unit of service        | 0.53        | 0.63 *     | 0.56        | 0.65 *     | 0.44        | 0.64 *     |
| Turned down on last loan request          | 0.19        | 0.24 *     | 0.14        | 0.19 *     | 0.08        | 0.12 *     |
| Borrowing needs not met over last 3 years | NA          | NA         | 0.24        | 0.28       | 0.09        | 0.11       |
| Loan size (\$000)                         | \$ 84.2     | \$ 129.2 * | \$ 130.2    | \$ 245.5 * | \$ 193.8    | \$ 259.5 * |
| Interest rate: all loans                  | 11.32       | 10.99 *    | 9.50        | 9.37       | 8.52        | 8.45       |
| Collateral required                       | 0.67        | 0.70       | 0.66        | 0.65       | 0.69        | 0.62 *     |
| Compensated balances required             | NA          | NA         | 0.25        | 0.31 *     | 0.34        | 0.40 *     |
| Loan fee required                         | NA          | NA         | NA          | NA         | 0.31        | 0.34       |
| <b>Firm Characteristics</b>               |             |            |             |            |             |            |
| Years in business                         | 14.1        | 15.0       | 15.7        | 16.6       | 18.1        | 19.9 *     |
| FTE                                       | 13.7        | 18.2 *     | 11.8        | 21.1       | 13.7        | 19.6 *     |
| Sales (\$000)                             | NA          | NA         | \$2,047     | \$2,856 *  | \$2,116     | \$3,007 *  |
| Form of business                          |             |            |             |            |             |            |
| Proprietorship                            | 0.37        | 0.29 *     | 0.33        | 0.25 *     | 0.29        | 0.22 *     |
| Partnership                               | 0.09        | 0.07       | 0.06        | 0.05       | 0.08        | 0.08       |
| Corporation                               | 0.33        | 0.64 *     | 0.40        | 0.47 *     | 0.37        | 0.44 *     |
| S-Corporation                             | NA          | NA         | 0.20        | 0.23       | 0.24        | 0.25       |
| Industry                                  |             |            |             |            |             |            |
| Agriculture                               | 0.04        | 0.03       | 0.09        | 0.05 *     | 0.08        | 0.06       |
| Manufacture                               | 0.12        | 0.14       | 0.13        | 0.13       | 0.12        | 0.12       |
| Construction                              | 0.12        | 0.10       | 0.13        | 0.13       | 0.15        | 0.15       |
| Transportation                            | 0.03        | 0.03       | 0.04        | 0.02       | 0.04        | 0.04       |
| Wholesale                                 | 0.09        | 0.11       | 0.05        | 0.07 *     | 0.09        | 0.12 *     |
| Retail                                    | 0.26        | 0.19 *     | 0.24        | 0.19 *     | 0.20        | 0.20       |
| Finance                                   | 0.07        | 0.08       | 0.07        | 0.07       | 0.07        | 0.06       |
| Services                                  | 0.18        | 0.24 *     | 0.18        | 0.22 *     | 0.15        | 0.15       |
| Professional                              | 0.09        | 0.07       | 0.04        | 0.05       | 0.06        | 0.07       |
| <b>Market Structure</b>                   |             |            |             |            |             |            |
| Urban location                            | 0.20        | 0.42 *     | 0.55        | 0.78 *     | 0.49        | 0.76 *     |
| Deposit concentration (HHI)               | NA          | NA         | 2397        | 2185 *     | 2161        | 1943 *     |
| Employment (000)                          | NA          | NA         | 365         | 585 *      | 465         | 640 *      |

<sup>a</sup> \* indicate a significant difference between the CFI and LFI mean values at the .01 level

# ENVIRONMENTAL PSYCHOLOGY AS A COMPLEMENT TO RESTAURANT REVENUE MANAGEMENT: EFFECTS ON MEAL DURATION AND TABLE TURNS

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## ABSTRACT

Environmental psychology complements restaurant revenue management. This paper reviews the literature on restaurant revenue management and environmental psychology. Hypotheses are derived and tested on the effects of environmental cues on meal duration and table turns. The results of a survey of 153 restaurants show that environmental cues such as music, lighting, and color significantly affect meal duration and table turns. Implications of environmental psychology for small business owners/managers are discussed.

## INTRODUCTION

Revenue management developed in the airlines as yield management (Cross, 1997). It involves the management of demand in order to maximize sales revenues from existing capacity (Cross, 1997). It has spread to other industries and is widely used in the communication, hotel, and shipping industries (McGill and Van Ryzin, 1999). Revenue management also can be applied in small business. Kimes et al. (1998) developed a framework for applying revenue management in restaurants. It involves methods which present customers with cues that affect their meal duration i.e., the time that they spend seated at a table in a restaurant. The net effect of these methods is to reduce and make meal duration more predictable and to increase the number of table turns. This allows a restaurant to seat more customers in a given period of time and thus to increase revenue generation.

Environmental psychology complements restaurant revenue management as a tool that owners/managers of restaurants can use to affect meal duration and table turns. Environmental psychology is based on a stimulus-organism-response (SOR) framework and examines how stimuli elicit behavioral responses. It has been applied in retail stores to study the effects of the physical context of a business acting as a cue that affects customers' behavior. There is no large sample empirical evidence on the effects of environmental psychology on meal duration and table turns in restaurants.

The purpose of this study is to examine whether environmental psychology in the form of cues such as lighting, colors, and music would have significant effects on meal duration and table turns in restaurants. This paper reviews the literatures on restaurant revenue management and



environmental psychology to derive hypotheses. Next, the results of a survey that tests the hypotheses are presented. Lastly, the implications of these results for small businesses are discussed.

## **LITERATURE REVIEW**

Revenue management manages demand in order to maximize sales revenues from a business's existing capacity (Kimes and Chase, 1998; Cross, 1997). There are several conditions that facilitate the practice of revenue management in a business. First, a business's outputs should be perishable (Weigand, 1999). For example, the airlines have a perishable product (i.e., a flight on a given date and time to a given destination flies only once). Second, a business should have primarily fixed capacity (Weaterford and Bodily, 1992). For example, the airlines have fixed capacity in their investment in their fleet of airplanes. Given fixed capacity, one means that small businesses might use to improve profitability is to increase the amount of revenue generated from fixed capacity.

A framework for applying revenue management in restaurants has been developed (Kimes et al., 1998). Restaurants have perishable outputs, i.e., the time that a seat can be filled by a customer, and they have fixed capacity that is difficult to expand, i.e., the number of seats (Kimes et al., 1998). The framework proposes methods restaurants can use to manage their demand and pricing in order to maximize revenues. One method for managing demand is to manage meal duration (Kimes, Barrash, and Alexander, 1999). Meal duration is the length of time that a customer occupies a seat in a restaurant. A restaurant can establish standard operating procedures that, among other things, present customers with cues in an effort to control the time that customers spend at a table. For example, during busy periods, waiters may clear a customer's table as soon as the customer finishes his or her entree and present the customer with the check. This standard operating procedure functions as a cue to discourage customers from lingering at their tables (Kimes et al., 1998). Predictable meal duration facilitates decision making with respect to reservations and seating. A smaller variance in meal duration facilitates the ability of the restaurant's owner/manager to predict actual meal duration. Information about meal duration is useful in deciding which reservations to accept and at what times to accept them. Further, meal duration information supports better seating decisions (e.g., which parties to seat and when they should be seated). Meal duration information can be used to take actions to minimize the time that seats in a restaurant sit empty. These actions will function to increase the revenue that a restaurant generates from its fixed capacity. Further, decreasing meal duration allows a restaurant to serve more customers in a given period of time, which in turn increases revenue generation.

The rate of revenue generation from fixed capacity in restaurant can be measured by revenue per available seat hour (Kimes, 1999; Kimes et al., 1998). Revenue per available seat hour is equal to the revenue generated over a given period of time divided by the number of seat hours available during that same time period (Kimes, 1999). This measure provides an indicator of the rate at which revenue is being generated from existing capacity. As table turns increase and meal duration decreases, revenue per available seat hour increases (Kimes, 1999).

Another method that may affect table turns and meal duration and thus function as a complement to restaurant revenue management is the application of environmental psychology to restaurants. Environmental psychology applied to business has been labeled as atmospherics (Turley and

Milliman, 2000). As such it has been defined as the intentional control and structuring of environmental cues (Kotler, 1973). Atmospheric addresses the role of environmental cues (i.e., the physical context) of a service setting in which consumption takes place such a retail store. The environmental cues of a business can be classified into external variables (e.g., size, color of building, entrances, signs), interior variables (e.g., color schemes, lighting, music, cleanliness), layout and design variables (e.g., space design and allocation, waiting areas, traffic flow), and point -of-purchase variables (e.g., displays, signs) (Turley and Milliman, 2000).

Environmental psychology is based on a stimulus-organism-response (SOR) perspective (Mehrabian and Russell, 1974). Stimuli from the environment give rise to primary emotional responses in people. These primary emotional responses then give rise to behavioral responses. Behavioral responses are classified as either approach or avoidance. In a retail context, approach behavioral responses are behaviors such as desire to stay, explore the environment, and communicate with others (Bitner, 1992; Donovan and Rossiter, 1982). Avoidance responses are behaviors such as desire to leave, remain inactive in an environment, and avoid interaction with others (Bitner, 1992; Donovan and Rossiter, 1982). These behavioral responses in a retail setting may influence the amount of time and money customers spend in a store (Donovan and Rossiter, 1982).

Empirical research has provided evidence on the affects of the environmental cues of retail businesses on customers' behavioral responses. Interior and layout and design variables affect customers' behaviors. Up beat music resulted in significantly faster shopping traffic flow times in a supermarket than slower tempo music (Milliman, 1982). Background music significantly affected the time and money customers spent in a wine store located within a restaurant (Areni and Kim, 1993).

The interior variable of lighting affects customers' behavior. Brighter lighting was associated with significantly higher levels of handling and examining merchandise in a wine store than with softer lighting (Areni and Kim, 1993). Colors also provide a stimulus that affects customers' behavior. In general, warm colors (e.g., red, yellow) stimulate higher levels of arousal than cool colors (e.g., green, blue). A blue colored store had a higher simulated purchase rate than a red store (Bellizzi and Hite, 1992).

Environmental psychology can be applied to complement revenue management to affect table turns and meal duration and hence revenue per available seat hour. Variables related to the physical context of a restaurant can be used as cues to influence customers' behaviors. For example, a restaurant with a layout and design such as a kitchen that is open to the view of customers provides a stimulus that can contribute to higher levels of primary emotional response in customers (Roboson, 1999). A primary emotional response may result in either approach or avoidance behaviors that may influence the time that customers take to complete their meal. Similarly, interior variables in a restaurant such as lighting, music, and colors may elicit approach or avoidance behaviors (Roboson, 1999). These relationships between cues and behavioral responses may be different in most restaurant settings than in retail settings because dining is different than shopping. For instance, bright lights elicit an approach behavior in retailing but would be assumed to elicit an avoidance behavior in restaurants.

In a field study located in a single restaurant, Milliman (1986) found that customers spent significantly more time at their tables and more money on bar drinks while listening to slow music than while listening to fast music. Thus, from a restaurant revenue management perspective, both meal duration and number of table turns will be affected.

For purposes of this research, high levels of environmental cues were defined as bright lights, bright colors, loud music, fast music, open kitchen design, and a noisy setting.

Hypothesis One: Higher levels of environmental cues will be negatively associated with meal duration.

Hypothesis Two: Higher levels of environmental cues will be negatively associated with the range of meal duration.

Hypothesis Three: Higher levels of environmental cues will be positively associated with the number of table turns.

## **METHODS**

The sample used in this survey research was generated from a list of 949 full service restaurants provided by a New England state chapter of the National Restaurant Association. Each restaurant was given a number and a sample of 589 restaurants was then drawn through the use of a table of random numbers. The data were collected by the use of a semi-structured questionnaire. The questionnaire mailing methods are based on Dillman (2000) Total Design Method procedures with four timed, hand-signed mailings. Five hundred and eighty-nine questionnaires were mailed. A total of 254 replies were received for an overall response rate of 43%. Of the 254 responses, 153 were usable responses from full service restaurants. No evidence was found that there were any significant differences between early and late responders.

### **Measures**

The full service status of a restaurant was measured through a question that asked respondents if their restaurant was a full service restaurant. The question used the definition of a full service restaurant from the 1997 U.S. Economic Census (U.S. Census Bureau).

Questionnaire items for environmental cues were generated from literature in environmental psychology and used seven point response scales. The stem used for these questionnaire items was "Please indicate for each of the following which best describes your main dining area". The item responses were factor analyzed (Principal Components with Oblimin rotation) and a two-factor solution explained 62% of the variance. The scale for the variable Interior Layout (Eigenvalue = 2.3, Cronbach's alpha = .60) included four items: Lighting (anchors "Bright room lighting" & "Intimate table lighting"), Colors (anchors "Bright colors" & "Subdued colors"), Kitchen open (anchors "Open kitchen" & "Hidden kitchen"), and Noise (anchors "Noisy" & "Quiet"). The scale for the variable Music (Eigenvalue = 1.4, Cronbach's alpha = .82) included two items: Level (anchors "Soft music" & "Loud music") and Pace (anchors "Slow music" & "Fast music").

Respondents provided the information for the dependent variables the number of table turns and meal duration in open-ended questions. Respondents were asked the number of table turns that their restaurant had in a typical weekend dinner period. Respondents were asked the length of meal duration they considered to be typical short, average, and long meal durations in their restaurants. The variable Range of Meal Duration was computed by subtracting short meal duration from long meal duration. The range of meal duration was used as a surrogate measure for the variance of a restaurant's meal duration time.

## RESULTS

Sixty-seven percent of the sample was male and 33% was female. The average age of the restaurants was 3.3 years with average sales in 2002 in the \$600,000 to \$799,000 range. The average number of seats in the sample of restaurants was 124, serving an average of 182 dinners with an average of 4.7 paid employees. Descriptive statistics for the dependent and independent variables are shown in Table 1.

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Table one about here

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The hypotheses were tested using simple regression. Hypothesis one, higher levels of environmental cues will be negatively associated with meal duration, was partially supported. The variable Interior Layout was not significantly associated with average meal duration (3.10,  $p = .09$ ), see table 1 panel A. Music was significantly and negatively associated with average meal duration (7.54,  $p = .00$ ) with an adjusted  $R^2$  of .06, see table 2 panel A.

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Table two about here

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Hypothesis two, higher levels of environmental cues will be negatively associated with the range of meal duration, was partially supported. The variable Interior Layout was significantly and negatively associated with the range of meal duration (4.00,  $p = .05$ ) with an adjusted  $R^2$  of .11, see table 2 panel B. Music was not significantly associated with meal duration, see table 2 panel B.

Hypothesis three, higher levels of environmental cues will be positively associated with the number of table turns, was partially supported. The variable Interior Layout was significantly and positively associated with the number of table turns (6.62,  $p = .01$ ) with an adjusted  $R^2$  of .13, see table 2 panel C. Music was not significantly associated with table turns, see table 2 panel C.

## DISCUSSION AND CONCLUSIONS

There has been no prior large sample empirical evidence on the effects of environmental psychology in a restaurant setting. This study provides evidence that environmental cues are

complementary to restaurant revenue management strategies. Specifically, environmental cues can be employed to help reduce the variation in and length of meal duration and to increase table turns.

All of the hypotheses in this study were supported by the findings; however, the detailed results provide insight regarding specific cues that affect the revenue management variables of meal duration and table turns. Brighter lights and colors, an open kitchen, and a noisier setting (i.e., Interior Layout) did not appear to affect average meal duration but they did serve to decrease the range of meal duration and they increased the number of table turns. A decrease in the range or variance in meal duration facilitates restaurant owners predicting the value of actual meal duration. This information increases the accuracy of predictions of table availability for reservation decisions. A higher frequency of table turns means that more customers can be served given the fixed capacity of a finite number of tables in a restaurant.

Increases in the volume and tempo of music (i.e., Music) appeared to have different effects from those of Interior Layout. While louder and faster paced music decreased average meal duration, it did not seem to affect the variance in mealtime (i.e., range) or the number of table turns. With respect to meal duration, however, the effect of Music was smaller in magnitude than the effect of Interior Layout on the other dependent variables, range of meal duration and table turns, suggesting that Interior Layout may be a more important factor in restaurants. Future studies should examine the interior layout cues and musical cues to explore possible relationships with other factors such as type of restaurant, etc.

### **Implications for Practice (“so what?”)**

In practice, this study confirms that owners and managers of a restaurant should examine the fit between their goals for table turns and meal duration and the environmental cues present in their restaurant. They may be able to change certain aspects of their business such as the color, lighting, and music to better fit their goals. At the margin, they may be able to reduce meal duration and increase table turns to increase their sales revenue while not decreasing their customers' level of satisfaction.

In fact, environmental psychology presents small business owners and managers of any type small business with an opportunity to improve their revenue management practices. The owner/manager should walk up to the front door of his or her business, and step inside while observing how the environmental cues of his/her business may stimulate customers. Do the physical surroundings present customers with cues that stimulate them to come in, stay, and explore the services and merchandise, and spend money? Do these cues and the business's goals for customer service times match, i.e., are cues signaling customers to leave when the business wants them to linger (e.g., a bookstore)? Adopting the perspective of a customer and continually seeking input from customers and front line associates regarding the effectiveness of various levels of environmental cues are critical activities for the small business owner.

Small business owners/managers should use a checklist consisting of external items (e.g., size, color of building, entrances, signs), interior items (e.g., color schemes, lighting, music, cleanliness), layout and design items (e.g., space design and allocation, waiting areas, traffic

flow), and point -of-purchase items (e.g., displays, signs). They should then assess the match between business goals for customer service times (e.g., desire customers to linger, such as in a bookstore, or to pass through quickly, such as in a convenience store) and the use of environmental cues (e.g., lighting, music, colors). In this way, the physical context and environmental cues provided by a business setting become more than just upkeep but a means of attracting customers and an opportunity to improve the business.

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**Table 1**  
**Descriptive Statistics for the Dependent and Independent Variables**

| Variable               | Theoretical Range | Actual Range   | Mean  | Median | Standard Deviation |
|------------------------|-------------------|----------------|-------|--------|--------------------|
| Average Meal Duration  | NA                | 15.00 - 150.00 | 64.01 | 60.00  | 28.83              |
| Number of Table Turns  | NA                | 0.50 - 19.00   | 3.10  | 3.00   | 3.00               |
| Range of Meal Duration | NA                | 20.00 - 190.00 | 58.67 | 50.00  | 31.39              |
| Interior Layout        | 1.00-7.00         | 1.00 - 7.00    | 2.88  | 2.75   | 1.31               |
| Music                  | 1.00-7.00         | 1.00 - 7.00    | 3.20  | 3.25   | 1.44               |

**Table 2**  
**Simple Regression Analysis**

**Panel A: Dependent Variable - Average Meal Duration**

| Independent Variables | Regression Coefficient | t for coefficient    | F for Equation      | Adj R <sup>2</sup> |
|-----------------------|------------------------|----------------------|---------------------|--------------------|
| Interior Design       | -.28                   | -1.76 <sup>*</sup>   | 3.10 <sup>*</sup>   | .05                |
| Music                 | -.25                   | -2.75 <sup>***</sup> | 7.54 <sup>***</sup> | .06                |

**Panel B: Dependent Variable - Range of Meal Duration**

| Independent Variables | Regression Coefficient | t for coefficient   | F for equation     | Adj R <sup>2</sup> |
|-----------------------|------------------------|---------------------|--------------------|--------------------|
| Interior Design       | -.32                   | -1.99 <sup>**</sup> | 4.00 <sup>**</sup> | .11                |
| Music                 | -.02                   | -0.20               | 0.41               | .00                |

**Panel C: Dependent Variable - Number of Table Turns**

| Independent Variable | Regression Coefficient | t for Variable      | F for Equation      | Adj R <sup>2</sup> |
|----------------------|------------------------|---------------------|---------------------|--------------------|
| Interior Design      | .39                    | 2.57 <sup>***</sup> | 6.62 <sup>***</sup> | .13                |
| Music                | .15                    | 1.62                | 2.61                | .02                |

Level of significance \*\*\* =  $\leq .01$ ; \*\* =  $\leq .05$ ; and \* =  $\leq .10$



# WOMEN ANGEL INVESTORS: THE ABCs (ACTIVITIES, BARRIERS and CONCLUSIONS)

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## ABSTRACT

Women have become a growing financial power within the United States and are becoming active in the equity financing of entrepreneurial ventures. To gain a better understanding of the emerging women angel market, research was conducted at the women angel organizational level. Fifty-eight percent of the women angel organizations in the US participated in the study, representing 300 women angel investors in 2003. Based on an analysis of the results several implications emerge. It appears that women angel groups provide a much needed venue for women entrepreneurs to pitch their business concept, with a third of the businesses being women owned or operated, three times larger than in the general angel population. In capital commitments the women angel groups in the survey had fewer investments than the general angel groups, but the percent of investments that were allocated to women led ventures were double the national average. When controlled by gender, the yield rate for women-led ventures lagged behind the general yield rates for women angel organizations. In general, women angels are active, they invest in a wide range of industries, and they provided a much needed venue for women entrepreneurs seeking equity capital. However, significant barriers exist, including investment inexperience, professional business inexperience and the inherent consequences for angel investing since the majority of the wealth is inherited. This research points to some significant market needs, including additional research on the investment process of women angels, developing educational forums for women angel investing and facilitating the development of women angel networks.

## **INTRODUCTION**

There is a limited amount of research on the business angel market, yet it is well known that angels provide the majority of seed and start-up equity capital to high growth entrepreneurial ventures in the United States. This lack of understanding of the early stage equity financing of high growth ventures exacerbates the inefficiencies in the angel market and contributes to the capital gap. More importantly, there is a paucity of research on the role of women as angel investors, even though women are developing an increasing presence in the angel market.

Women have become a significant and growing financial power within the United States over the past twenty years. Women comprise 47% of all individuals with assets over \$500,000 (U.S. Labor Department, 1997). From 1996 to 1998 the number of wealthy women, defined as having investable assets of \$500,000 or more, grew by 68% while the number of wealthy men grew by only 36% (Merrill Lynch & Cap Gemini Ernst and Young, 2002). Women now control over 51% of the private wealth in the United States (Federal Reserve) and among top wealth holders in 1995, the average net worth for women was \$1.38 million, slightly higher than for male wealth holders, and the women carried less debt (IRS, 2001). These statistics indicate that women have attained significant financial power, and therefore have the wealth required to become major players within the realm of equity financing of entrepreneurial ventures. But are women considering membership in private equity organizations as an investment option? Of the over 200 angel organizations operating within the U.S., only 19 organizations are significantly affiliated with women. How are the women that are involved as angel investors participating? What are the underlying incentives and disincentives for women to become involved as angel investors?

Some of these underlying issues can be identified by analyzing the formation, structure and investment experiences of women affiliated angel organizations that do exist. How and why have these organizations formed? How are they administered and how active are they? What industries do they invest in and how is the investment decision made? The following research answers these questions and addresses the underlying implications of the findings on the future role of women as angels.

## **METHODOLOGY**

Data was gathered using a combination of postal questionnaires and phone interviews. Organizations were targeted based on historical information indicating a membership of at least 25% women, or organizations which had at least 25% of entrepreneur presentations made by ventures with a female member on the management team. For this latter category, if at least 25% of the firms making presentations in a year were women led, then the corresponding angel organization was a potential respondent. The historical data used to identify these organizations was gathered from previous research conducted by the Center for Venture Research (Sohl, 2003). A primary contact (the executive director, board chair or president) at each organization was identified and this individual completed both the postal questionnaire and the phone interview. Questions for both the postal questionnaire and phone survey were developed with the goal of gathering information about the organization's structure and membership, as well as quantitative data related to historical investments. Phone survey questions and open ended questions on the postal survey were designed to capture the values, attitudes and beliefs of the respondents on the subject of women angels. Results were compiled and analyzed by the Center for Venture Research.

A comprehensive postal and phone survey was distributed to 25 organizations that appeared to meet the inclusion criteria for the study. Of these 25, a total of six were found to not be angel groups. Of these 19 organizations, 11 participated in the study, representing a response rate of 58%. The angel organizations surveyed represented 236 women investors in 2002, and 292 women angel investors in 2003. It should be noted that this research represents the first study of women angel investors and as such is exploratory in nature. The statistics reported are descriptive and based solely on the 11 respondents. It is important to note that this study is limited to investments made by angels that are members of organizations and does not include individual angels. These individual angels represent a larger proportion of the angel market. Thus, given the small sample size and the restriction to angel groups, the ability to generalize the results to the population of women angels is restricted. However, the high response rate (58%) and the number of women investors (292) represented by the organizations both lend support to the potential value of the descriptive statistics.

### **ORGANIZATION STRUCTURE AND FORMATION**

Seventy three percent of the organizations that responded were formed as entirely new entities, while the remaining groups formed as new entities derived from another organization. Half of the groups are comprised of 100% women. Of these, all stated that one of the reasons that the organization formed was to encourage more women to become involved as investors. A majority of the groups indicated that the reason for forming was to provide support to women entrepreneurs.

The majority of the responding angel organizations have chosen to organize as non-profit entities and to have affiliations with external private equity organizations. These external relationships are a common practice for angel organizations, which often partner with venture capitalists or other angel groups for both increased deal flow and potential sources of additional funding. In describing their modus operandi, the responding women angel organizations are split between those who meet regularly to review investment opportunities and ones that facilitate the angel investment process by organizing meetings or events that include angel investors and entrepreneurs. These types of organizational structures are also prevalent in the more general angel population. All of the organizations had a net worth requirement for membership, most common being that their members are accredited investors. Many organizations include an additional layer of membership requirement, such as past investment experience, the ability to pay membership fees or industry specific expertise.

It is interesting to note that the responding women angel groups differ with respect to the source of investment capital. The majority of the groups obtain investment funds on an individual basis, while the rest have a pooled fund from which investments are drawn. Most of the organizations conduct educational seminars for angel investors, while some conduct seminars for entrepreneurs. Of the respondent contacts interviewed, half felt that women face a barrier as angel investors due to their lack of experience and knowledge as investors in general. It appears that women angel organizations are trying to develop their members by offering educational opportunities. However this practice only addresses the women who have already joined the organization and not potential women angel investors outside of the groups.

## INVESTMENT ACTIVITY

The majority of the organizations surveyed note that their primary method for identifying investment opportunities is networking. This indicates that women use social contacts to learn about potential future investments. This preference for personal connections when considering potential investments is in line with the characteristics of most angel groups, angel investors in general prefer to rely on personal or social connections for deal flow. The notion of social capital, or the value associated with a given person's network, is relevant on both sides of the angel investment relationship. However gender may have an impact on this notion to the degree that women typically have different social networks than men do. The results on this social dimension are mixed, with 30% of the contacts interviewed indicating that they feel women face a barrier as angel investors because they are on the outside of traditional social networks, and others believing that women are at an advantage because they have better access to women entrepreneurs and women-led deals. While women may interact within different networks, leading to the possibility of losing deals with entrepreneurs who move in traditionally male dominated social circles, women in angel groups may have better access to deals where the business is led by a woman or a woman is a member of the management team.

On average, each women angel organization had 32 firms present their business concept to their membership over the course of 2002, of which 33% were women owned or operated. In 2003, on average about 28 firms presented and 32% of these firms were women owned or operated. In comparison to all angel groups, these figures indicate that women angel groups

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Figure 1 about here  
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appear to be attracting more women owned and operated firms than angel groups overall. However, the degree to which women angel groups miss opportunities or deals due to their lack of a presence within traditional networks can not be measured.

Of the women organizations that actively considered investments in 2002, 86% made an investment, resulting in an overall average of 4.1 investments per organization for 2002. Of these investments, 10.5% were in women owned or operated firms. In 2003, of the organizations that actively considered investments, all did so and made an average of 2.8 investments, per organization, for the year. Of these investments, 13.3% were in women owned or operated firms. These investment patterns are similar to those of all angel groups during the 2002-03 time period. The one notable exception is that in 2003, while the women angel groups in the survey had fewer investments per group than the general angel groups, the percent of investments that were allocated to women led ventures by the respondents were double the national average.

The yield (acceptance) rate is defined as the percentage of investment opportunities that are brought to the attention of investors (by the angel organization) that resulted in an investment. For the overall angel market, based on data collected in previous research by the Center for Venture Research (Sohl, 2003), market yield rates were 7.1% in 2002, and yield rates for women-led ventures were 5.2% for the same time period. For the women angel organizations of this study, yield rates for all investment opportunities, regardless of gender, were 9.9% in 2002 and 8.2% in 2003, similar to the general angel population. However, for women-led ventures presenting to women angels, the yield rates were 6.2% in 2002 and 5.6% in 2003. It appears that in both years yield rates for women-led ventures lagged behind the

general yield rates for women angel organizations, although this gap is less pronounced in 2003. Since the percentage of women presenting to women angel groups is three times as large as the number presenting to all angel groups, this lag in yield rates is even more prominent.

For the investments made, 65% were made in seed and start-up ventures in 2002 and 56% were in seed and start-ups for 2003. This is a key point because in general angel groups have decreased investments at the seed and start-up stages in order to allocate dollars to later stage investments as follow-on financing. For the general angel population seed and start-up investing accounted for 50% of total investments in 2002 and 52% in 2003.

The findings for the women groups in this study indicate that women may be filling a critical gap in the development of new firms by choosing to invest at earlier stages. The United States has a critical need for seed and start-up capital and if women are inclined to invest at this stage, they will both be meeting an economic need and exploiting a potential for high returns by electing a riskier investment position. However, the results of the study could be explained by the fact that 90% of the women's angel organizations are within the first four years of their life and may not have had an opportunity to provide follow-on rounds of financing to existing portfolio companies.

In terms of the industries or sectors in which women angel organizations invested, there was a fairly diversified representation and even dispersion. This indicates that women angel investors are not concentrating their efforts into one sector and are diversifying their investments appropriately. The results indicated that the majority of investments were in the high tech sector with manufacturing and software receiving the largest percentage of investments. One notable point is that the investment in the retail segment is significantly higher for women than for all angel groups overall. Research conducted by the Center for Venture Research (Sohl, 2003) identifies, for 2002, that for all angel groups, retail investments comprised only 5.5% of all investments, while the women angel groups invested 12.5% in retail.

When asked why they believe women angel investors do not make more angel investments than currently reported, the survey respondents stated that the primary reason was that women angels lack the early-stage investment experience. Respondents also stated that they believe women lack experience in pricing and structuring the investment deal, and that women have a lack of experience in conducting due diligence and monitoring the investment. Some respondents indicated that women angels lack the funds needed to make more investments. Three out of the top four reasons given indicate that a lack of experience or knowledge of early stage equity investing is the most significant barrier preventing women angels from investing more actively. This response is consistent with the findings of the telephone survey, where half of the respondents stated that a significant barrier for women angels is a lack of investment experience or knowledge. In the general workplace women are still struggling to attain professional parity with men in the fields of finance, accounting and investments. Consider that 75% of the workforce in the banking industry is comprised of women, but only 25% of these women hold executive level positions within the industry (Sraeel, 2003). Gender differences and biases in professional fields may have resulted in a current female population that is less skilled as investors, which in turn may require women angels to spend more time on education and development than their male counterparts

Angels often indicate that there are non-financial incentives for making investments in entrepreneurial ventures. In terms of the non-financial aspects of the investment, women respondents indicated the biggest non-financial motivator for women angels was the desire to assist women entrepreneurs. This response was followed by the feeling of social responsibility, the desire to assist entrepreneurs in general and the opportunity to increase the access to capital for women entrepreneurs. These findings indicate that women angels are motivated by the chance to help other women to succeed in their ventures, given that the potential investment meets their financial criteria.

## **BARRIERS AND ADVANTAGES FOR WOMEN ANGELS**

The differences between men and women as investors are significant. A Simmons Market Research Bureau study released in 2000 revealed that women investors are both fewer in numbers and tend to be more conservative in their investment choices (Whelan, 2001). How are women angels at an advantage or disadvantage as investors? To address these issues phone interviews were conducted with the individual respondents. A third of these individual respondents interviewed felt that women are at a disadvantage as angel investors because their sources of wealth are more often inherited than earned. Women angels who have inherited their wealth may not have the professional experience or credibility of investors who have created their own wealth. Additionally, individual respondents felt that women are at a disadvantage as angel investors because they tend to be more risk averse by nature, leading to missed investment opportunities in riskier deals.

However, respondents feel that women angels also possess significant advantages as investors. Nearly half of the individual respondents stated that they see women as being better at research and more willing to ask questions and seek information when considering an investment. Also, many believe that women are more inclusive and approachable, willing to look at deals that might have been overlooked by other investors. A number of respondents also felt that women are more patient than men, which translates positively to deals that have long exit horizons, which are quite common for angel investments. Women are not expecting immediate results and are willing to nurture the investment over its life. Finally, half of the respondents felt that women are less ego driven and can work more collaboratively as investors. One respondent illustrated this difference when describing two meetings, one of male angels and one of female angels. In the male angel meeting, members frequently interrupted each other and competed for time to prove their ideas. Also, several of the men seemed to dominate the discussion. In the meeting of women angels, the members shared the speaking time, did not interrupt each other, and no one person dominated the speaking time. Personality differences in men and women seem to have an effect on the way angels interact as investors. It appears that the ability to work collaboratively and in a supportive way would have a positive effect in the area of angel investing, where much of the skill involves working with and supporting entrepreneurs.

## **FUTURE OUTLOOK FOR WOMEN AS ANGEL INVESTORS**

It appears that women face significant barriers as they consider the option to become involved as angel investors within angel groups. It is clear that a significant number of women have the wealth required to become involved, but the fact that women are still to a large extent on the outside of traditional networks, networks which often serve to spread awareness to potential angel investors, indicates that women may not even be aware of the opportunity to become involved as angel investors. Fortunately, the lack of awareness can be

addressed by educational movements. Nearly half of the survey respondents suggested that well publicized success stories of women angel investors would be the best way to assist the future growth and development of the women's angel market. A third of the respondents also suggested that the best way for women to overcome barriers as angel investors is to form special forums or organizations to help women learn the skills they need and to learn how to become involved. Some women angels suggested that promoting the concept of angel investing through social networks would raise awareness. Strategic communications initiatives are both possible and essential in order to increase the number of women who are involved as angel investors. Continuing and targeted education programs will help to ensure that any increase is sustainable over the long term.

Women may also face a bias if their wealth has been inherited versus earned, or if they do not have enough relevant professional and investment experience to be considered valuable to general angel organizations. Fortunately women are making great strides in attaining higher education, professional positions and roles as business owners and community leaders. Over half of women today are earning college degrees, one third more than men. Fifty percent of law graduates today are women and 40% of MBA graduates are women (Barletta, 2003). According to the U.S. Economic Census, the number of women-owned businesses has increased by 16% and the revenues from those businesses have increased by 33 % since 1992 (Brush, 2001). In comparison, the number of all U.S. firms grew at a rate of 6% with a 24% increase in revenue (Brush, 2001).

## CONCLUSION

The research findings indicate that the women angel organizations that do exist are active and invest in a wide range of industries and sectors. Women angel groups are motivated by the desire to attain financial returns, but also have a desire to assist women entrepreneurs in growing their ventures. It was also found that women angel organizations have invested primarily in seed and start-up ventures which indicates that women angels are filling a critical gap in the financing of entrepreneurial ventures.

Women still face barriers in the private equity community, related to their investment inexperience, professional inexperience and inherited wealth. As women continue to make progress professionally and socially some of these barriers may be overcome. As women continue to advance themselves, it will be essential to provide ways to educate and promote the concept of angel investing to women. The subject is largely uncovered territory for women and there is no established network for communicating the opportunities that exist for women angels. Facilitating the development of women networks, both formal and informal, the development of educational forums, and an improved understanding of the investment process of women angels will help in accelerating the development of a sustainable women angel market. For the number of women angels to grow in the future, targeted research, and educational programs must be employed in order to raise awareness and promote understanding.

**Acknowledgements:** The authors would like to thank all the survey participants who generously gave their time to respond to our survey and to participate in the personal interview portion of this research. We would also like to especially thank Becca Nealis for her valuable assistance in data collection and her work on the initial draft of the paper. This research was funded through grant # 20032172 from the Ewing Marion Kauffman Foundation.

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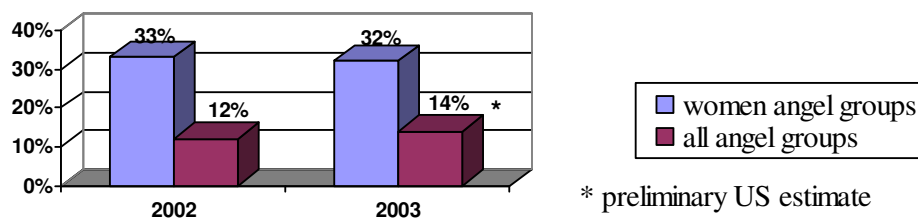
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Figure 1: Percent Women Entrepreneurs Seeking Capital





The Effectiveness of Information Provided by SCORE's Email Counseling  
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Entrepreneurial Counseling

The Effectiveness of Information Provided by SCORE's Email Counseling  
To Nascent and Small Business Owner-Managers\*

**ABSTRACT**

The literature on external sources of assistance to small business has not devoted much of its empirical discussion to examining the role of the SCORE, an organization of volunteer retired executives, who are frequently important advisors to small businesses. The literature is absent in regard to examining whether SCORE counseling, especially online through their web counseling program is effective based on the feedback received from online clients. Based on a sample of almost 2000 online clients who responded to an online survey in 2004, data were analyzed to determine what differences, if any, existed among client perception of the effectiveness of the information provided. Specifically, did the information help them in deciding to start a business, expand their existing business, or deal with problems in their existing business?

**LITERATURE REVIEW**

**Introduction**

Individuals, whether they are considering going into business (i.e., nascent), or they already are small business owner-managers, need information, capital, skills, and labor to start business activities. They seek advice on a variety of topics, including advertising, marketing, promotion, human resources, personnel matters, legal questions, accounting, bookkeeping, taxes, management practices or business strategy, industry-specific technical matters, computers, software, websites, telecommunications, loans, financial analysis or cash management, evaluation of prospective purchases or business investments, a government rule or requirement not including taxes, and business layout or design (Dennis, 2002).

These individuals, nascent or existing small business owner-managers, who generally seek advice or use professional advisors, have a greater chance of either starting a business or sustaining their own business than those individuals who do not seek and use informal advisors and informal sources of advice. Because there is no generally accepted set of reasons why businesses fail or succeed, advice from counselors has significant value (Lussier, 1995). In addition, research by Fann and Smeltzer (1989) indicates that the frequency with which small business managers use information sources is positively related to the firm's sustainability.

How do individuals go through the process of seeking and using advisors and sources of advice? The willingness to accept one's limitations, seeking advice and the use of advisors' and implementing the advice solicited will be discussed in turn.

Willingness to accept one's limitations. Solomon and Fernald's (2000, 1999) research examined issues surrounding the entrepreneur's

\* The authors wish to thank the National Office of the SCORE Association for access to the data

willingness to accept their limitations and their perception of the need for and usefulness of external sources of assistance, as well as its impact on the observable behavior of the entrepreneur in actively seeking assistance rather than passively accepting assistance offered by others. Their research indicated that regardless of growth status of the business, the issue is whether the entrepreneur will actively seek external assistance or passively wait until there is a crisis demanding their attention.

Seeking advice and use of advisors. Solomon, Dennis and Fernald (2004) research indicated that small business owner-managers solicit advice from a wide variety of sources outside the business. Unpaid advice often comes from bankers; paid advice often comes from accountants and lawyers, as well as consultants and engineers (Phillips, 2002). Owner-managers are able to call on the experience and objectivity of the professionals. Accountants are able to offer general advice to matters that need consideration in providing for management continuity (Dimsdale, 1974).

For an established small business the most valuable asset an outside advisor brings is objectivity. They may be able to devise a plan for the firm that is not affected by internal politics and conflicts, giving the firm a more viable chance at success. Professional management consultants can bring advice beyond that obtainable from any single individual and can devote their full attention to one specific problem, as well as assist in implementing the plan (Dimsdale, 1974). Small business owner-managers tend to use informal sources more frequently than formal sources except after the business is established (Fann & Smeltzer, 1989).

#### Implementing the advice solicited.

Soliciting advice does not necessarily mean that the advice is adopted or implemented. Suggestions and/or recommendations can be rejected for many reasons, legitimate and not. There are different ways to look at rejection of solicited advice. One is that when owners-managers solicit more sources of advice, they are more receptive to advice generally. If they are more receptive, they are more likely to implement the advice that they receive. An opposing perspective can be put in the following terms: because those who are consulted first are presumed to be most able to help, the more widely a family business owner-manager seeks advice the more likely it is that the advice increasingly will be ill-fitting or inappropriate (Solomon and Fernald, 2000, 1999). Thus proportionately, they are more likely to reject it. Two sources of small business advice not previously mentioned are the SCORE and SBDC programs.

#### SCORE and SBDC

Many new start-ups and nascent entrepreneurs turn to professional advisors and counseling programs for assistance and guidance (Barnes, 1988). Two programs of the US Small Business Administration (SBA) in particular – Senior Corps of Retired Executives (SCORE) and the Small Business Development Centers (SBDCs) offer counseling services, with their various sub-centers and chapters in many locations throughout the United States, and are willing to visit the client's workplace when necessary (Chrisman, Gatewood, & Donlevy, 2002). Chrisman and Katrishen (1995) found that the clients of the Small Business Development Center (SBDC)

program increased sales and employment significantly more than they would have if no assistance had been received. Nahavandi and Chesteen (1988) also reported that business managers were highly satisfied with the services received from a particular SBDC and that consulting had a positive impact on their businesses.

### The Internet as a Knowledge Sharing Medium

As Internet connectivity has expanded globally to even very remote places, virtual communities are gaining prominence. First, they bring together people in a cost-effective manner. Instead of organizing expensive face-to-face consulting engagements, conferences, workshops, and courses, an organization, private or public, can achieve many of the same goals by linking participants electronically to each other and to a wealth of online resources. An example of this is “The World Links for Development” (World) program, which provides Internet connectivity and training for teachers and students in developing countries.

SCORE’s attempt to use the Internet to provide real-time counseling to assist small business owner-managers is one of many new innovative approaches SCORE is piloting in cooperation with the US Small Business Administration (SBA) in order to expand and assist SCORE’s outreach to the small business community, nascent start-up and early business ventures. The idea of creating a platform to allow small business owners to 24/7 access and to share knowledge is a key component of knowledge management. A website providing online counseling is both the process and outcome of a virtual community. It can be dynamic and promote knowledge sharing between and among members. Above all, a community website, such as SCORE’s, reflects and incorporates the growing knowledge base of that community and the learning that is taking place.

One person or a group of persons, SCORE’s email counselors within a knowledge community, must play the role of coordinator/facilitator/moderator. These individuals are responsible for addressing inquiries, encouraging participation, animating discussion, exercising leadership if needed, and so forth. These tasks can be labor-intensive but, without an effective, energetic, and diplomatic facilitator, it is very unlikely a virtual community can succeed. SCORE and its cadre of email counselors took the role of developing the site and playing the role of facilitator.

Based on the literature and the absence of any empirical studies linking online knowledge transfer vis-à-vis counseling to the small business community, the national SCORE Association sought to survey its clients to ascertain their view on the usefulness and effectiveness of their email counselors. The authors obtained the results of the survey to examine more closely whether or not particular subsets of the total sample viewed the usefulness and effectiveness of the service received differently. As such, six hypotheses were developed.

### Hypotheses

H1: Those seeking advice on starting a business will perceive SCORE email counseling as more useful than will those seeking advice on operating problems of an existing business or expansion of an existing business.

- H2: Those seeking advice on starting a business will perceive SCORE email counseling as having greater capacity to assist them than will those seeking advice on operating problems of an existing business or expansion of an existing business.
- H3: Those seeking advice on starting a business will perceive SCORE email counseling as easier to work with than will those seeking advice on operating problems of an existing business or expansion of an existing business.
- H4: Those seeking advice on starting a business will perceive SCORE email counseling as more current on today's business environment than will those seeking advice on operating problems of an existing business or expansion of an existing business.
- H5: Those seeking advice on starting a business will perceive SCORE email counseling as being more knowledgeable than will those seeking advice on operating problems of an existing business or expansion of an existing business.
- H6: Those seeking advice on starting a business will perceive SCORE email counseling as meeting their needs better than will those seeking advice on operating problems of an existing business or expansion of an existing business.

## **METHODOLOGY**

Community Research, Inc. (CRI) was engaged by the National SCORE Office (NSO) to conduct research among its clients that had recently received email services from their SCORE counselors. SCORE had developed and provided to CRI its survey for posting online. The survey was then formatted for the online system to enable SCORE clients to take the survey from any location nationally that has a connection to the Internet.

SCORE clients were requested to take the anonymous survey via an email link sent to them by their counselors. Taking the survey was voluntary. No incentives were offered to the respondents in order to receive their opinions. During the fourth quarter of 2003, 2,000 responses were received, thereby producing a low statistical margin of error of just 2.2% +/- . What the margin of error percentage means statistically is that the chances are 95 out of 100 that if every respondent in the selected population had taken the survey, the results would not differ more than the indicated margin of error percentage.

## **FINDINGS**

Each of the six hypotheses were analyzed using SPSS PC+ analysis of variance (ANOVA) as we were examining mean differences among the three client types – those seeking advice in: a) starting a business, solving operational problems in their business and expanding their business in relation to the perception to a group of six attitudinal interval data sets using a 5-point Likert scale with 1=Highly Effective, 2= Effective, 3= Neutral, 4= Ineffective and 5= Highly Ineffective.

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Insert Table 1 here

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The mean for the client group seeking assistance on deciding whether or not to go into business had a lower mean (2.04), indicating a higher perceived level of effectiveness regarding the usefulness of SCORE's email counseling than those seeking advice on operating problems in an existing business (2.22) or expansion of an existing business (2.44). [Descriptive statistics are available from the first author.] The data showed that the differences between and within the three groups were significant at the .01 level. Further analysis using ANOVA's post hoc function indicated that indeed the client group seeking assistance on deciding whether or not to go into business mean was statistically significant than those seeking advice on operating problems of an existing business (-.16 at the .05 level ) or expansion of an existing business (-.39 at the .01 level). Therefore, we accept H1.

The mean for the client group seeking assistance on deciding whether or not to go into business had a lower mean (2.06), indicating a higher perceived level of effectiveness regarding SCORE's email counseling capacity to assist than those seeking advice on operating problems of an existing business (2.21) or expansion of an existing business (2.45). The data showed that the differences between and within the three groups were significant at the .01 level for Hypothesis 2. Further analysis using ANOVA's post hoc function indicated that indeed the client group seeking assistance on deciding whether or not to go into business mean was statistically significant than those seeking advice on operating problems of an existing business (-.15 at the .05 level) or expansion of an existing business (-.38 at the .01 level). Therefore we accept H2.

The mean for the client group seeking assistance on deciding whether or not to go into business had a lower mean (1.94) indicating a higher perceived level of effectiveness regarding SCORE's email counseling capacity to assist than those seeking advice on operating problems in an existing business (2.04) or expansion of an existing business (2.31). The data revealed that the differences between and within the three groups were significant at the .01 level for Hypothesis 3. Further analysis using ANOVA's post hoc function indicated that indeed the client group seeking assistance on deciding whether or not to go into business mean was not statistically significant than those seeking advice on operating problems of an existing business (-.10 at the .122 level, but was statistically significant for the client group whose sought assistance with expansion of an existing business (-.39 at the .01 level). Therefore the mixed results do not allow us to accept or reject H3.

The mean for the client group seeking assistance on deciding whether or not to go into business had a lower mean (2.03) indicating a higher perceived level of effectiveness regarding SCORE's email counseling current knowledge of today's business environment than those seeking advice on operating problems in an existing business (2.15) or expansion of an existing business (2.43). Table 1 shows that the differences between and within the three groups were significant at the .01 level for Hypothesis 4. Further analysis using ANOVA's post hoc function indicated that indeed the client group seeking assistance on deciding whether or not to go into business mean was not statistically significant than those seeking advice on operating problems of an existing business (-.12 at the .057 level), but was statistically significant for the client group whose

sought assistance with expansion of an existing business (-.40 at the .01 level). Therefore, as in the previous hypothesis, the mixed results do not allow us to accept or reject H4.

The mean for the client group seeking assistance on deciding whether or not to go into business had a lower mean (1.96) indicating a higher perceived level of effectiveness regarding SCORE's email counseling being knowledgeable than those seeking advice on operating problems in an existing business (2.08) or expansion of an existing business (2.28). The data revealed that the differences between and within the three groups were significant at the .01 level for Hypothesis 5. Further analysis using ANOVA's post hoc function indicated that indeed the client group seeking assistance on deciding whether or not to go into business mean was not statistically significant than those seeking advice on operating problems of an existing business (-.12 at the .061 level), but was statistically significant for the client group who sought assistance with expansion of an existing business (-.43 at the .01 level). Therefore, again we are unable to accept or reject H5.

The mean for the client group seeking assistance on deciding whether or not to go into business had a lower mean (2.16) indicating a higher perceived level of effectiveness regarding SCORE's email counseling ability to meet the clients needs than those seeking advice on operating problems of an existing business (2.36) or expansion of an existing business (2.59). The data revealed that the differences between and within the three groups were significant at the .01 level for Hypothesis 2. Further analysis using ANOVA's post hoc function indicated that indeed the client group seeking assistance on deciding whether or not to go into business mean was statistically significant than those seeking advice on operating problems of an existing business (-.20 at the .01 level) or expansion of an existing business (-.43 at the .01 level). Therefore we accept H6.

## **CONCLUSIONS**

As the nascent population in the United States continues to expand and maintain its level of intense activity, the need for 24/7 knowledge portals become more critical. SCORE, a federally funded program directed by the US Small Business Administration, developed a strategy to meet this need by creating an email-counseling program on their web site [[www.SCORE.org](http://www.SCORE.org)]. The purpose of this paper was to report the results of one portion of an extensive national survey measuring how individual small business owner-managers perceived the effectiveness of the program services.

Based on the data analyses, Hypotheses 1, 2 and 6 were accepted. Those hypotheses dealt with looking at the cause and effect of client's perceived needs for using email counseling –deciding whether to start a business, handling operational problems in their businesses or handling issues dealing with expanding their businesses to how they rated the effectiveness or the usefulness of the email counseling, the capacity of the counselors to assist them and the meeting of their needs by the email counseling program. The ratings of the owner-managers deciding to start a business were higher, more statistically significant [higher rating] than were the ratings of the other two groups. All three groups, however, rated the overall effectiveness around 2.3 on a five point scale with 1= highly effective.

The other three hypotheses, 3, 4 and 5, were neither accepted nor rejected in that the client groups showed no marked difference in their perception of the effectiveness of the counselor ease of working with clients, possessing current marketing information and general management knowledge. As such, SCORE needs to examine its approach to email counseling, but should be encouraged by the results.

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**Table 1**  
**ANOVA**  
**Multiple Comparisons**

| Dependent Variable   | (I) Primary Reason for contacting SCORE                       | (J) Primary Reason for contacting SCORE                       | Mean Difference (I-J) | Std. Error | Sig. |
|--|---|---|-----------------------|------------|------|
| <b>Effectiveness of information you received from the SCORE Counselor relative to the Usefulness of the Advice</b>                                     | Assistance in deciding whether or not to start a new business | Assistance with problems about existing business              | -.16                  | .068       | **   |
|  |   | Assistance with the expansion to an existing business         | -.39                  | .080       | *    |
| <b>Effectiveness of information you received from the SCORE Counselor relative to the Counselor's ability to assist you</b>                            | Assistance in deciding whether or not to start a new business | Assistance with problems about existing business              | -.15                  | .067       | **   |
|  |   | Assistance with the expansion to an existing business         | -.38                  | .079       | *    |
| <b>Effectiveness of information you received from the SCORE Counselor relative to the Counselor's being easy to work with</b>                          | Assistance in deciding whether or not to start a new business | Assistance with problems about existing business              | -.10                  | .065       | .122 |
|  |   | Assistance with the expansion to an existing business         | -.39                  | .076       | *    |
| <b>Effectiveness of information you received from the SCORE Counselor relative to the Counselor's being current about today's business environment</b> | Assistance in deciding whether or not to start a new business | Assistance with problems about existing business              | -.12                  | .064       | .057 |
|  |   | Assistance with the expansion to an existing business         | -.40                  | .076       | *    |
| <b>Effectiveness of information you received from the SCORE Counselor relative to the Counselor's being knowledgeable</b>                              | Assistance in deciding whether or not to start a new business | Assistance with problems about existing business              | -.12                  | .066       | .061 |
|  |   | Assistance with the expansion to an existing business         | -.31                  | .077       | *    |
|  |   | Assistance in deciding whether or not to start a new business | .43                   | .085       | *    |
| <b>Effectiveness of information you received from the SCORE Counselor relative to the Assistance meeting your needs</b>                                | Assistance in deciding whether or not to start a new business | Assistance with problems about existing business              | -.20                  | .071       | *    |
|  |   | Assistance with the expansion to an existing business         | -.43                  | .085       | *    |

- \*= The mean difference is significant at the .01 level.
- \*\*= The mean difference is significant at the .05 level.

# DEFINING “MINORITY BUSINESS” IN THE UNITED STATES AND IN EUROPE

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## ABSTRACT

This paper discusses the concept of minority business and related definitional issues, and then examines a recent major change in the definition of such businesses made by the National Minority Supplier Development Council, the principal link between large US corporations and the minority business community. Under this NMSDC policy change, and in contrast to long-established federal guidelines, certain companies with as little as 30% minority ownership can still be certified as “minority controlled” and thus be eligible for corporate minority-targeted purchasing programs. The discussion is then extended to the European context – the rise of immigration and the related increase in ethnic minority business enterprises, the current nature of public policy toward such enterprises in terms of programs and legislation, and the implications of the US experience for Europe. Finally, future issues with regard to European ethnic minority enterprise are raised, along with areas for future research focus.

## INTRODUCTION

Defining the concept of a “minority business” is a complex task. On the surface, it would seem that a business owned solely, or at least primarily, by members of a ‘minority’ group would constitute a “minority business.” Yet various arguments have been made that build upon or modify this seemingly simple definition, and even the basic terminology is open to debate. In the United States “minority businessperson” and “minority business” are the generally-used terms, while in Europe variations of “ethnic entrepreneur” and “ethnic enterprise” are more commonly used (Gunaratnum, 2003). (In this paper, these terms will be used interchangeably.)

While most of the literature relies on the minority or ethnic *grouping* of the business owners to identify a minority or ethnic business, some researchers argue that the minority or ethnic grouping of the business owners is less meaningful than the minority or ethnic community context of the business and/or the involvement of the business owners in that community, and that it is important to differentiate between minority business owners who are heavily involved

with the minority community and those who are less involved or not at all involved (Chaganti & Greene, 2002; Gunaratnum, 2003).

Recent analyses add further complexity to this issue, developing a “mixed embeddedness” perspective. This conceptualization considers a variety of contextual factors, including business sector, geographic locality, labor markets and institutional situation, to define a minority or ethnic business (Ram & Smallbone, 2003a).

## **THE AMERICAN DEFINITION**

The need for a definition of a “minority business” in the United States derives from the economic and social policy assumption that such businesses are both an important component of the U.S. economy and strengthen the social fabric of the country, and that the development of such businesses is therefore a desirable policy objective. And in order to assist and develop minority businesses, it is necessary to know what they are and who they are.

The development and support of minority businesses has been an objective of both the public and private sectors in the United States since the late 1960s, with the federal government taking the lead in this effort to develop such programs, primarily within the Office of Minority Business Enterprise (now the Minority Business Development Agency) and the U.S. Small Business Administration (Whistler & Wichmann, 1979; Sonfield, 1997; <http://www.mbda.gov>; <http://www.sba.gov>).

In response to economic, ethical and political pressures, many large U.S. corporations in the 1970s and 1980s initiated efforts to increase the number of minority and women-owned companies as suppliers of the goods and services they purchase. These corporations established their own programs within their procurement departments and joined with other big businesses to form minority procurement coordinating groups to act as clearinghouses between small minority firms and large corporations (Gupta, 1992; Fitzgerald, 1995; Morgan, 1995; Klimley, 1996; Sonfield, 1997).

In the 1990s, these public and private programs received both praise and criticism (Bates, 1997, 2001; Cavalluzzo & Cavalluzzo, 1998; Freeman, 1994; Theodore, 1995; Waldinger & Bailey, 1991). During this period, US Supreme Court rulings set tough new legal standards for federal, state and local government minority assistance and set-aside programs, and both President Clinton and many state and local politicians issued executive orders to constrain or halt these programs. These new legal standards require a minority business seeking affirmative action assistance to document that it faces discrimination or other concrete barriers and furthermore that the business is fully able and willing to compete with current non-minority business suppliers (LaNoue, 1994). On the other hand, most *corporate* programs were not impacted and remained strong (Holmes, 1995, 1996; ‘Many Minority,’ 1995; Kirk, Franklin & Robinson 1996; Sonfield, 1997).

Currently, in order to insure that these U.S. governmental and private programs are successful in assisting minority and women-owned businesses, most utilize formal definitions of such ownership. Central to the federal definition, and virtually all other public and private sector

definitions as well, is that at least 51% of the firm be directly and unconditionally owned by one or more members of a minority group. Often the term “minority” is now replaced by “socially disadvantaged,” but the listing of such groups clearly involves minority status: African-Americans, Hispanic Americans, Native Americans (American Indian, Alaska Native), and Asian Pacific Americans (<http://www.sba.gov>).

This listing of groups includes most, but not all, recognized minority groups, and thus enables both governmental and private sector programs to target and assist eligible existing and potential minority businesses. Each of the above groups (except Native Americans) includes both U.S.-born and first-generation immigrant business owners (for example immigrants from Latin America, the Caribbean, and Asia). U.S. policy does not differentiate between native-born and foreign-born minority individuals, as it assumes that both face barriers not faced by non-minorities and that assistance programs should benefit both groups.

Certainly these various public and private programs have proven effective. In the early years of federal and state programs aimed primarily at African-American-owned businesses, such businesses grew at a rate greater than that of the total economy (Sonfield, 1979). In more recent years, with “minority business” referring to *all* of the above-named groups, U.S. government data indicate that minority-owned businesses in general are one of the fastest growing segments of the U.S. economy (<http://www.mbda.gov>). As discussed above, this minority business growth includes businesses owned by both new immigrants and by U.S.-born businesspeople. The assumption underlying programs assisting all of these individuals and their companies is that they all face the same barriers, regardless of whether or not they recently arrived from another country, perhaps with some business experience, and that the development and growth of all of these companies is desirable social policy .

## **MINORITY BUSINESS IN THE U.S. ECONOMY**

The importance and value of minority business in the U.S. economy is well documented. The most recent federal economic census data (1997) place the number of minority businesses in the United States at a record high of 3,039,000 enterprises, and that number is growing at double the rate of all companies. These firms generate sales of almost \$600 billion, thus contributing significantly to the economy (<http://www.mbda.gov>). Various research studies over many years have further indicated that a healthy minority business sector is desirable for the nation, providing a variety of economic and social benefits, including minority employment, economic integration with the majority economy and community, community economic development, and role models for minorities and especially minority entrepreneurs (Green & Faux, 1969; Sonfield, 1986; Dadzie & Cho, 1989; Thompson & Hood, 1993; Light & Rosenstein, 1995; Edmondson & Carroll, 1999). Thus the fostering of both new minority businesses and the growth of existing minority businesses is a desirable component of U.S. social and economic policy.

### **Re-Defining ‘Minority Business’ in the United States**

Although the 51% minority ownership U.S. guidelines may seem logical, in the 1990s certain problems with this definition of ‘minority business’ arose. Many minority owners of larger businesses complained that the 51% rule limited their ability to grow their companies. If a company was currently at or slightly above the 51% point of minority ownership, then further

funding could only come from an expansion of debt or from additional minority ownership. Similarly, even firms with 100% minority ownership were limited in the amount of new non-minority equity funding they could obtain. Most minority companies wanted to grow for the same reasons as any firm does; but an additional impetus arose for minority-owned suppliers as many large U.S. corporations in the 1990s chose, for efficiency purposes, to reduce the number of their suppliers to a group of fewer and larger firms.

In response to both the complaints from large minority firms looking for new equity financing and from major corporations looking for larger minority suppliers, a major minority-oriented organization shook up the minority business community by changing its definition of “minority business.” The National Minority Supplier Development Council (NMSDC) is a private organization which provides a link between large U.S. corporations and minority-owned businesses. Chartered in 1972, it is supported by 3500 corporate members, including most *Fortune 500* companies, which rely on the NMSDC’s evaluation process by which it certifies the ‘minority’ status of firms wishing to become eligible as suppliers to these large corporations. About 15,000 U.S. minority-owned businesses have been NMSDC-certified and in 2002 its corporate members reported \$72 billion in contracts with minority suppliers (<http://www.nmsdc.org>).

In 1999, the NMSDC proposed a change in its definition of a “minority business,” entitled the “Equity Capital Initiative.” (More recently the title has been changed to the “Growth Initiative.”) Basically, the NMSDC proposed to allow currently-certified minority-owned firms to sell equity to venture capital firms and reduce minority ownership to as low as 30% and still maintain NMSDC-certification as “minority-controlled.” The objective was to provide equity-funding opportunities to those minority firms that desired to grow in this manner.

However, this proposal proved to be much more controversial than the NMSDC expected, with many minority organizations voicing strong opposition to the proposal, arguing that it would erode the concept of affirmative action and not benefit most minority businesses. On the other hand, many large corporations supported the proposal, arguing that it would allow minority companies to grow and compete with larger white-owned firms. This, in turn, would also allow big corporations to satisfy their concurrent needs for larger and fewer suppliers *and* for minority-owned suppliers.

After a prolonged effort to ease concerns and opposition by emphasizing the safeguards built into this new definition of a minority business, the NMSDC approved and implemented this new policy in February 2000 with the following provisions: only currently-certified minority companies would be considered, and consideration would be on a case-by-case basis. Furthermore, minority interests would still have to maintain 51% of the *voting* stock, control of day-to-day operations, and have a majority of seats on the company’s board of directors (Schwab, 2000; Wynter & Thomas, 2000).

## **THE FIRST FIVE YEARS**

The NMSDC had high expectations for this significant change in policy. Minority firms with growth potential would be free to obtain the equity financing needed for such growth, without

jeopardizing their minority certification status and their eligibility to compete for minority-targeted supplier opportunities. It was expected that a good number of businesses previously certified by the NMSDC under the 51% definition of “minority business” would soon seek new equity financing and concurrently seek this new certification.

However, a number of economic and other business factors have worked against this happening. After the NMSDC’s Equity Capital Initiative implementation in 2000, the U.S. economy became much weaker than most experts had expected, with the slump in technology-based industries being especially strong. Thus, sources of venture capital financing largely dried up. Furthermore, with a weak economy, many minority companies that in 2000 envisioned significant growth potential for themselves in the next decade reduced their expectations considerably (Dingle, 2003, Long, 2003, 2004).

Rather than a surge in venture capital funding activity, the past five years have seen a significant number of mergers and acquisitions, including the acquisition and absorption of some of the largest minority-owned companies by much larger *Fortune 1000* corporations. This trend has resulted in some of the strongest minority-owned businesses losing their independence and minority status, a situation very different from the NMSDC’s vision of the Equity Capital Initiative as the appropriate mechanism for the support and growth of these strongest minority-owned companies, and the maintenance of their minority-controlled status.

Similarly, during these past several years, some large U.S. mainstream companies have taken an equity position in some minority-owned firms, often in the same industry. These equity positions have usually been less than 50%, thus allowing the smaller firm to keep its independence and minority status. While such corporate investments have created effective and profitable partnerships and joint ventures, few of these minority-owned companies have grown significantly as a result of the injected equity financing (Long, 2004).

In fact, as of mid-2004, only one company has been certified by the NMSDC under its Equity Capital Initiative. This company, En Pointe Technologies, Inc., headquartered in El Segundo, California, is a leading national provider of business-to-business information technology products and services, with fiscal year 2003 revenues of \$290 million and net profits of \$383,000.

In discussions with NMSDC and En Pointe officers, it is clear that the company’s top management had high expectations for their re-certification by the NMSDC. However, the company has found the benefits of this re-certification to be mixed. While the corporate members of the NMSDC understand that a potential supplier can be “minority-controlled” and yet have less than 51% minority ownership, most other potential customers of En Pointe, in both the private and public sectors, do not understand or do not recognize this change in ‘minority business’ definition and continue to use the more established definition of a “minority business” – a business that has at least 51% minority ownership. Thus, other than for NMSDC corporate members, En Pointe has had major difficulties in securing minority-targeted sales contracts from most large potential customers. Federal, state and local government agencies and offices are generally required to continue to use a 51% minority ownership guideline when awarding contracts under minority-targeted programs, and non-NMSDC member businesses in the private

sector simply do not understand the concept of “minority-controlled” as opposed to “minority-owned” and continue to use the 51% guidelines out of habit rather than requirement. En Point’s salespeople find themselves often having to try to educate potential customers about their “minority-controlled” status rather than simply sell the quality of their company and its products and services (Turner, 2003).

## **LESSONS AND IMPLICATIONS FOR THE UNITED STATES**

Clearly, U.S. minority-owned businesses that desire to grow, yet maintain their “minority” status, have some difficult choices facing them. Assuming that the U.S. economy is now improving and therefore provides future opportunities for growth, such businesses must consider alternative methods of financing growth, and the advantages and disadvantages of each alternative. To maintain traditional “minority business” status, the company must maintain at least 51% minority ownership, and therefore finance growth via debt and/or equity investment from current owners, other minority investors, or main-stream companies that will be satisfied with a less-than-50% equity position in the company. Yet, as recognized by the NMSDC (and thus the purpose of its Equity Capital Initiative), *major* growth usually requires greater additional funds than can be provided by these methods.

However, significant amounts of venture capital funding and subsequent re-certification by the NMSDC as a “minority-controlled” company (rather than “minority-owned”) will forfeit or jeopardize most opportunities for minority-targeted sales contracts from government agencies or business purchasers that are not NMSDC members. So such a company contemplating the financing of further growth must choose between two less-than-ideal alternatives. Only if the company’s top management believe that significant growth is possible without participating in governmental and non-NMSDC corporate minority-targeted purchasing programs should they consider Equity Capital Initiative re-certification.

If a company does opt for such re-certification, there is one way to maintain some federal government set-aside contract business - through the U.S. Small Business Administration’s “Mentor-Protégé” Program. Under this program, any mid- or large-sized company, including a “minority-controlled” company with less than 51% minority ownership, can serve as a “mentor company” in partnership with a smaller minority-owned “protégé company” and be eligible to bid for minority-targeted federal sales contracts (<http://www.sba.gov>). En Pointe, in fact, has pursued this route to government contracts following its re-certification. But opportunities under this program for companies such as En Pointe are much more limited than under programs for “minority-owned” companies.

Consultants and other advisors to U.S. minority-owned businesses should be aware of the NMSDC’s programs for both “minority-owned” and “minority-controlled” businesses. In the United States, most minority business owner/managers have at best a limited understanding of minority-targeted governmental and corporate purchasing programs, including the NMSDC’s, and most are totally ignorant of the NMSDC’s “minority-controlled” certification. Thus, consultants will need to educate their minority clients about these various programs and the advantages and disadvantages of each of them. And for minority clients that have strong growth potential, consultants should familiarize themselves with the NMSDC’s Equity Capital Initiative

so that they will be able to guide such clients through the complex decision of whether to pursue this new certification.

Implications also exist for future U.S. research in the field of minority business. If and when more U.S. businesses are re-certified as “minority-controlled” by the NMSDC, it will be appropriate to investigate the experiences of these companies. Is the Equity Capital Initiative a potentially beneficial program that will offer otherwise unavailable growth opportunities to minority-owned businesses, or do the disadvantages of the program outweigh the advantages?

## **LESSONS AND IMPLICATIONS FOR EUROPE**

The issues of ethnic business and its definition are especially timely in Europe as well. A significant rise in ethnic and immigrant business ownership has been seen in recent years throughout much of Europe, and a policy-related focus on such businesses has become especially important (Ram & Smallbone, 2003a). Recent studies have argued that past analyses of ethnic enterprises in Europe have been too narrow, focusing largely on class, ethnicity and ethnic resources, and that broader macro-economic and regulatory issues should also be studied (Kloosterman & Rath, 2003). Furthermore, other studies have concluded that various European policies and programs aimed at small enterprises in general may not be of value to, or may even have a negative impact upon, ethnic minority enterprises (Kontos, 2003).

In Europe, the existence and details of both governmental and corporate minority procurement programs and other assistance programs for minority-owned businesses vary considerably. While in the United States, the terms “minority business” or “minority-owned business” as well as the current eligibility listing of specific minority groups seem appropriate, in various European countries an assortment of different terms and listings are used.

For example, in the U.K., terms such as “ethnic business,” “black and minority ethnic business” (BME), and “ethnic minority business” (EMB) are all used, and the five largest groups of “historically ethnic minority entrepreneurs” are African-Caribbean, Indian, Pakistani, Bangladeshi and Chinese (Centre for Enterprise and Economic Development Research, 2001). In other European countries, the terms used and the ethnic groups listed may be different, but most minority groups are ethnic immigrant groups and therefore issues of “ethnic minority business” are usually considered a component of the larger general issue of immigration. Furthermore, EMBs have been the subject of growing interest in recent years, and the reasons for this are both economic and social. As such businesses constitute an increasing component of many national economies, they are thus important to economic growth. Also, as immigration in Europe has increased, strong and growing EMBs can contribute to reducing social exclusion and to raising living standards among disadvantaged minority immigrant groups (<http://europa.eu.int>).

Still, throughout Europe, there is limited *specific* targeting of EMBs within small business assistance programs run by governmental and other agencies (Ram & Smallbone, 2003b). In a study by DG Enterprise for the European Commission (2000), it was found that only 15% of 288 business support agencies surveyed had a specific program, department, group or individual dealing with ethnic minority entrepreneurs. Rather than having public and private-sector



programs specifically targeted toward minorities as in the United States, the European response to the issue of minority business development is more often one of non-discrimination policies for small business assistance and public procurement. For example, all public sector procurement contracts within the European Community are covered by EC treaty, no matter what their value, and this treaty includes a number of non-discriminatory principles (<http://www.sbs.gov.uk>).

Furthermore, most ethnic minority businesses in Europe are owned solely by minorities. Thus the need for a “definition” involving the *percentage* of minority versus non-minority ownership is rarely an issue of concern (<http://europa.eu.int>). This definitional issue exists in the United States because some minority-owned businesses have grown fairly large and have brought in non-minority owners, and also because of a need to identify “minority-front” companies that are not truly minority-owned and therefore illegally receiving minority-targeted procurement contracts. Until EC countries implement legislation or other programs specifically aimed at minority enterprises (equivalent to U.S. “affirmative action”), the issue of “minority-front” companies is not relevant in Europe.

Yet it appears that a greater focus on the *definition* of minority business would be of value in Europe. With clearer and more concrete definitions, more specifically minority-targeted assistance and procurement programs can be developed in those countries where appropriate, and the companies eligible for such programs can be better identified. This will be especially important as many minority businesses in Europe grow and eventually bring in non-minority ownership. And in the current situation, with relatively few specifically minority-targeted programs in existence, those minority companies in need of existing non-discriminatory protection can also be identified. Furthermore, perhaps private-sector corporate procurement programs for minority businesses, similar to the NMSDC’s programs in the United States, might be of value in certain European countries. For all of these reasons, the U.S. issue of minority business *definition*, and the NMSDC’s established procurement programs for “minority-owned” companies and its experience with its new “Equity Capital Initiative” for “minority-controlled” businesses in the United States, should be of interest and provide lessons for any nation’s existing or future social policies relating to the development of ethnic minority businesses.

## CONCLUSIONS

This paper has focused on policy-related issues of ethnic minority business and ownership. Much recent research in the U.S. has been policy-oriented, and future research with regard to ethnic minority business in Europe should include this focus too. What is the role of the EU and of individual countries in protecting, supporting and fostering ethnic minority enterprises? Is current non-discriminatory legislation sufficient to achieve these goals, or is there a greater need for proactive programs and legislation that specifically identify and target ethnic minority enterprises and their owners? As European policy toward ethnic minority enterprise continues to develop, these and other questions must be answered.

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A listing of the 42 references is available from the author.

# **ECONOMIC DEVELOPMENT, TECHNOLOGICAL INNOVATION AND OPPORTUNITY CREATION**

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## **ABSTRACT**

Opportunity recognition by entrepreneurs has become a central focus of much recent research literature in entrepreneurship. Opportunity recognition is linked to wealth creation by entrepreneurs but does not address entrepreneurship's important link to wealth distribution. This paper argues that Schumpeter's creative destruction, when combined with the current literature on management of technology, shows the wealth creation role of entrepreneurship is primarily achieved by opportunity creation rather than simple recognition. Specifically we argue that disruptive technologies match Schumpeter's description of creative destruction and that such technologies are resisted by existing markets. Thus, we conclude that no market opportunity exists for disruptive technologies and entrepreneurs must create demand by developing new markets for the technology.

## **INTRODUCTION**

Interest in entrepreneurship today arises from the recognition that it contributes to economic growth. However, emphasis on growth overlooks entrepreneurship's vital role in wealth distribution. Economists recognize that economic and social progress must incorporate not only growth but also equitable distribution of wealth. Moreover, the broad use of the entrepreneurship concept leads to problems when researching the subject. It is difficult to create definitions of entrepreneurship that capture the divergent usages in today's research literature. Many definitions only deal with specific issues.

Much research makes no distinction between innovation in small new and existing large firms. Additionally, empirical inquiry becomes fragmented; it is difficult to compare studies based on different concepts of entrepreneurship.

The purpose of this paper is to explain how entrepreneurship theorists have misinterpreted the role of technology entrepreneurs in capitalist economies and to emphasize both the reality of and importance of entrepreneurs to wealth distribution. To this we add technology management's theoretical affirmation of Schumpeter's belief that entrepreneurs create opportunities. Following this, we provide an overview of contemporary definitions of entrepreneurship. We conclude that the most important function of entrepreneurs is to create opportunities for their technologies in otherwise resistant markets thereby assuring a continuing process of wealth creation and redistribution; in other words, creative destruction.

We begin with a review of Schumpeter's theory of creative destruction with emphasis on wealth distribution. Next we examine the general equilibrium model to show that it omits

entrepreneurs and does not address wealth creation. Then we examine Kirzner's theory of the entrepreneurs' vital role in establishing equilibrium in neo-classical economics, which underlies current focus on opportunity recognition. Fourth, we venture into the management of technology literature to find the reinforcement for Schumpeter's view that entrepreneurs vigorously push their technology upon resistant markets. This is followed by an overview of contemporary views of entrepreneurship. We conclude by arguing that entrepreneurs provide a very important but rarely recognized service to capitalism.

### **SCHUMPETER'S WEALTH DISTRIBUTION**

According to Schumpeter (1942), entrepreneurs provide a fundamental role in the capitalist system that fulfills a necessary condition for its existence. Schumpeter argues that without creative destruction, wealth would become increasingly concentrated in the hands of a few large firms and this would destabilize society. Entrepreneurship, by his definition is innovation by new firms. Entrepreneurs 'discipline' incumbent firms through the fear that new firms may enter their markets and destroy the existing market structure. When entrepreneurs do so, a process of creative destruction and redistribution of wealth occurs (Schumpeter, 1942, p. 132-134).

In creative destruction, wealth distribution occurs as new firms use innovations to acquire a major market share in a market dominated by existing large firms. The innovations also create new demand for better or unique new products. As market shares transfer from existing to new firms, new firms' wealth grows and the existing firms' wealth declines. This wealth transfer process extends to the employees, suppliers and shareholders of the new firms who gain income and wealth while employees, suppliers and shareholders of the incumbent firms lose wealth. In this way, new wealth is created and new and old wealth is redistributed.

Unfortunately, Schumpeter goes on by prophesizing that large firms would become more efficient innovators through organized R&D departments, reducing the number of entrepreneurs. Wealth would become more concentrated, requiring emergence of a socialistic system to equitably redistribute wealth. His assumption about the decline of entrepreneurship has been rejected by empirical evidence showing that small firms are major innovators (Futures Group, 1984). Furthermore, small firms are important for job creation and economic growth as shown by Birch (1987) and Kirchoff (1994). Even if Schumpeter's prognosis on capitalism has turned out to be wrong, his logic on the importance of new independent firms is still valid.

Wealth creation and distribution may occur as established firms destroy established competitors by means of innovation. However, this will only change wealth distribution among the existing, wealthy firms and this leads to increased concentration of wealth rather than redistribution of wealth to other parts of society. It is important for researchers and policy makers to make a distinction between the two in order to better understand the nature of the redistribution mechanism and to ensure that it is still at work. This is difficult using the definitions of entrepreneurship provided by Shane and Venkataraman (2000) and Wennekers and Thurik (1999) for two reasons. First, there is no distinction made between entrepreneurship in new firms and established firms. Second, Shane and Venkataraman only focus on opportunity recognition. Limiting entrepreneurship to opportunity recognition implies that entrepreneurs are only responsive to changes in market equilibrium. Neo-classical economics hypothesizes market equilibrium but relegates, according to Schumpeter (1934), wealth creation to exogenous effects. It also by definition leaves out the entrepreneur.

### **GENERAL EQUILIBRIUM ECONOMICS**

The gain in social well being within nations is often referred to in a dual statement: "economic growth and development", referring to the two main measures of economic welfare –

growth in wealth and distribution of wealth. In today's social melee, there is so much focus on growth in wealth that we often forget the importance of wealth distribution. One of Marshall's (1890) motives for developing "neo-classical theory" 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 argued that markets 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 organizing of effort; and so forth.

Today, Marshall's neo-classical theory is widely known and underlies the area of "general equilibrium theory." But general equilibrium theory has significant weaknesses that are important in this context. First, it does not provide a mechanism for wealth creation. Second, it provides no explanation for economic growth but only for the process of equilibrating markets. Third, the theory assumes that generation of new technology is external to the economic system. Finally, there is no room for entrepreneurs as all suppliers offer undifferentiated products, have access to perfect information about market activities, and follow a specific pattern of decision making towards the single objective of profit maximization.

Recent developments in general equilibrium theory, most notably within a field termed 'new growth theory' (see Scherer, 1999 for a review) have tried to amend these weaknesses but still there is no role for the entrepreneur in the theory (Walsh, 1970). As Kirzner (1997) persuasively notes, although most economists today agree that markets work, general equilibrium theory does not explain how they work (p. 9). He proposes a theory where the entrepreneur is a central actor.

#### **KIRZNER'S ALERTNESS TO OPPORTUNITY**

Kirzner's (1997) theory assumes that temporary disequilibria will occur in perfect markets. Such disequilibria reduce the efficiency of the market process. But, such disequilibria represent opportunities for someone to make a profit by finding a way to enter the market and reset the market equilibrium. Given perfect information, all suppliers know about the disequilibrium but an alert entrepreneur can identify such disequilibrium and act quickly to equilibrate the market while making a profit. Thus, the entrepreneur actually facilitates the equilibration of a market that is in disequilibrium. Kirzner gives the entrepreneur an important and vital role in maintaining equilibrium in the perfect market.

Kirzner (1979) further concludes that the most important capability the entrepreneur requires is an alertness to discover existing disequilibria and the innovativeness to equilibrate them. Entrepreneurial alertness is the key to success. Since information about the disequilibrium is available to everyone, alertness is necessary to be first to recognize an opportunity (market disequilibrium) and to profit from it. However, Kirzner, attempting to reconcile mainstream and Austrian economics, has formulated his theory in the context of the neo-classical market equilibrium model. This focus on entrepreneurs operating in the neo-classical model definitely does not fit markets dominated by technological innovation. The entire meaning of technological innovation is introducing new, differentiated products that behave differently and are priced differently than existing products. Differentiation is the motive for introducing new technology. This is one reason the neo-classical model is rejected by Schumpeter (1934).

#### **DISRUPTIVE TECHNOLOGY AND INNOVATION**

Schumpeter focuses his discussion of innovation on two factors, invention and commercialization. Innovation is the commercialization of invention. An invention is the new idea but a new idea is of no value to society until it is introduced in the market. Schumpeter

(1934, p. 46-47) defined technological innovation as the introduction of new combinations of methods for supplying commodities in the economy. Combinations, or inventions, could consist of: “(1) a new good, (2) a new method of production, (3) a new market, (4) a new source of supply of raw material or half-manufactured goods, or (5) a new organization of any industry (p. 66).” Schumpeter’s view of the importance of innovation is widely accepted by many economic researchers within new growth theory. New growth theorists believe innovations are the most important contribution to economic growth and development. More recently, technological innovations have begun to be recognized as a major source of innovation in industrialized societies (see Scherer, 1999).

Schumpeter (1934) provides a relatively detailed guide to the commercialization of inventions that are the basis for creative destruction. He describes the entrepreneur’s attack on existing market structures and success therein in spite of resistance by both the potential buyers and sellers in the market. This resistance to commercialization of new inventions is also a description of commercialization of inventions based upon disruptive technologies.

### **DISRUPTIVE TECHNOLOGY, INNOVATION AND CREATIVE DESTRUCTION**

Unlike Marshall’s (1890) model, Schumpeter (1942) theorizes that competition is not from 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” (p. 84). In the process the entrepreneur gains a temporary monopoly situation, which transfers market shares (and wealth) from existing, declining firms to the entrepreneur).

Along with the literature on the economics of innovation there has emerged a discipline interested in the management of technology and innovation. One focus of this research is understanding the difference between innovations that change market structures, and those that do not. However, the technology management literature has not consolidated into a consistent use of terminology let alone a well formulated theory. Thus, it is necessary to examine the literature and use it to define terminology that can provide a basis for our further discussion.

Bower and Christensen (1995), Bitindo and Frohman (1981) and others identify two classes of technology: (1) disruptive, radical, emergent or step-function technologies; or alternatively (2) evolutionary, sustaining, incremental technologies. We will use the term disruptive technologies and focus solely on this since incremental technologies are not likely to underlie creative destruction. Bower and Christensen (1995) offer a definition: “... disruptive technologies disrupt the current capability set required by a given market. Disruptive technologies are those that do not support current firm based manufacturing practice.” They note that disruptive technologies may not be “... radically new from a technological point of view but have superior performance trajectories along critical dimensions that customers value.” Thus they adopt Schumpeter’s perceptions that inventions can be new combinations of existing technologies.

Commercialization of disruptive technological inventions have a unique characteristic. Abernathy and Utterback (1988) 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. Bower and Christensen (1995) reinforce this buyer behavioral characteristic by stating that a technology is considered disruptive when “... its utility generates products with different performance attributes that may not be valued by existing customers.” There is a clear understanding that a category of innovations exist that are radically different and create entirely new market structures.

It is the impact of these innovations on society that returns us to our discussion of economic development. Schumpeter (1934) describes capitalism as an economic system that finds its competitive strength in innovation. The product innovative activity he 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 resistance to adopting disruptive technologies is the commercialization process that Schumpeter (1942) ascribes solely to entrepreneurs. The entrepreneur must demonstrate that the technologies embodied in a new product or service provide significant cost reductions and/or performance improvements. Since there may be no existing markets and new markets are opaque to potential customers (Abernathy & Utterback, 1988) the entrepreneur must create a commercialization opportunity by pushing the technology upon customers. In this way, customers are eventually found who are willing to take the risks of newness (Mansfield, 1968). A truly disruptive technology eventually finds its uses in many product innovations and in different markets.

Disruptive technologies and discontinuous innovations logically embody Schumpeter's concept of creative destruction. Many, but not all, of these disruptive technologies emerge from newly formed firms as Schumpeter believed they would. One advantage new firms have is that they do not have an established customer base to satisfy. Instead, they are free to invent and commercialize for a whole new set of customers. They therefore play a vital role in creating new economic opportunities that can be exploited.

Just as current views on technological innovation are richer and more inclusive than Schumpeter's so has the concept of the entrepreneur and entrepreneurship become broader.

### **CONTRASTING CONTEMPORARY VIEWS OF ENTREPRENEURSHIP**

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). Kirchoff (1994) 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/services sales so as to achieve firm survival and growth." (p. 62). Up to this time, the formation of a new organization is clearly a component of entrepreneurship.

However, a number of researchers within the field have emphasized entrepreneurial and innovative behavior of managers that is not limited to new organization formation. Stevenson (1997) defines entrepreneurship as the "pursuit of opportunity without regard to resources currently controlled." And Shane and Venkataraman (2000) 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" (p. 218). Shane and Eckhardt's (2003) definition goes even further by broadening the number and topics covered by entrepreneurship; "... entrepreneurial opportunities as situations in which new goods, services, raw materials, markets and organizing methods can be introduced through the formation of new means, ends, or means ends relationships." Note there is no mention of new organization

formation. The definitions above view entrepreneurship as the act of innovation rather than the function of the entrepreneur derived from the creation of new firms.

Hébert and Link (1989) and Casson (1982) both propose definitions of entrepreneurship based upon the role of entrepreneurs as decision makers. They see the entrepreneur as an individual that is specialized in decision making concerning the reallocation of resources. On the other hand, Wennekers and Thurik (1999) propose a definition based on the interaction between entrepreneurship and economic growth. They define entrepreneurship as the “the manifest ability and willingness of individuals, on their own, in teams, within and outside existing organizations,” to “perceive and create new economic opportunities (new products, new production methods, new organizational schemes and new product-market combinations) and to introduce their ideas in the market, in the face of uncertainty and other obstacles, by making decisions on location, form and the use of resources and institutions” (p. 46-47). In similar fashion Baumol (1993) defines the entrepreneur as an individual that locates new ideas and puts them into effects without certainty about the results. This includes all “non-routine activities by those who direct the economic activities of larger or smaller groups or organizations.” (p. 8). To summarize, the entrepreneur is therefore involved in creating changes in the economic system as well as identifying existing opportunities and responding to them in a range of different organizational contexts, facing uncertainty. Baumol’s definition combines the three basic economic perspectives and suggests that they are not incommensurable. He states that the entrepreneur is “incapable of leaving matters where they are.” (Baumol, 1993, p. 11) Baumol adds that entrepreneurs face uncertainty, thereby combining Schumpeter’s view on the creative powers of the entrepreneur, Kirzner’s view of the alert entrepreneur, and Knights view on the entrepreneur as an economic actor dealing with uncertainty.

Baumol’s synthesis of the three different schools of entrepreneurship can be interpreted to include 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 potential effects of this broader definition of entrepreneurial innovation on wealth distribution. We cannot specifically investigate, understand or promote entrepreneurship as a mechanism of wealth distribution using this definition as it does not distinguish between the innovations that can redistribute wealth and those that may concentrate wealth. Successful innovation by existing firms may change the wealth distribution but such changes are more likely to increase concentration of wealth rather than redistributing it. Socially beneficial wealth redistribution is only possible through new, independent firms. In other words, innovation is necessary but not sufficient for social welfare unless the innovating is done by new, independent firms.

## **CONCLUSIONS**

The purpose of this paper has been to show that the concept of entrepreneurship should include the concept of opportunity creation and that special attention should be given to entrepreneurs in new and small firms who pursue the role of opportunity creators. If the field of entrepreneurship is to contribute to the understanding of the link between innovation and the redistribution of wealth, research focused solely on opportunity identification is inadequate .

We began our argument by acknowledging the growing interest in entrepreneurs’ opportunity recognition capabilities. This concept is frequently referenced back to Kirzner’s (1997) theoretical model of entrepreneurship’s role in general equilibrium theory. He sought to develop a theory that put entrepreneurs back into the dominant neo-classical economic theory. He

succeeds but his addition to theory does not alter the fact that general equilibrium model is plagued by many other weaknesses that have not been resolved. We then argued that the appropriate starting point is the work of Schumpeter who stressed the opportunity creation aspect of entrepreneurship in the first part of the 20th century. Schumpeter (1934; 1939; 1942) saw the entrepreneur as introducing new combinations of methods for supplying new commodities and other innovations to the economy that lead to creative destruction and the growth and redistribution of wealth.

Next we showed that the technology management literature supports Schumpeter's theory. Abernathy and Utterback (1988) and others have shown that "disruptive technologies" that yield "discontinuous" innovations that are disproportionately introduced by new entrants. This suggests that creative destruction and Schumpeterian entrepreneurs are alive and well in the major capitalist countries. Our analysis of the disruptive technology literature shows that entrepreneurial alertness to opportunity is inadequate to explain commercialization of disruptive technologies. Instead, we argue that commercialization of disruptive technologies requires entrepreneurs to create opportunities in markets that resist entrepreneurs' efforts to achieve success. Reliance upon opportunity alertness will not identify nor commercialize a disruptive technology. And, as noted above, successful commercialization of disruptive technologies by entrepreneurs in new firms are the core of Schumpeter's creative destruction that creates new wealth — and redistributes old.

Later work has studied the technology innovation process in much more detail and painted a more complex picture than Schumpeter did. There are important differences in the technologies that provide the basis for innovation. Disruptive technologies introduced by independent new firms organized and driven by entrepreneurs destroy market structures and create and redistribute wealth. But, imitators may enter these developing new markets relying on evolutionary technologies derived from the disruptive technologies. Such evolutionary technologies (Foster, 1986; Bower & Christensen, 1995) are used to modify and improve the existing innovations within the emerging new market structure. In this way, these entrepreneurs create new wealth.. Such entrepreneurs may well possess opportunity alertness rather than creation but, to the extent they are new independent firms, they may also redistribute wealth as they contribute to the destruction of existing market structures.

We argue that current definitions of entrepreneurship are incomplete for two reasons. First, it is important to pay special attention to new, independent firms. Wealth redistribution is unlikely to happen through existing firms, or through new firms owned as components of existing firms. This does not mean that innovation from within existing firms is not important. We stress only the specific economic role of wealth redistribution by new, independent ventures. Second, both opportunity creation and opportunity recognition have to be included in the concept of entrepreneurship. By including both opportunity recognition and opportunity creation in the concept of entrepreneurship, and paying special attention to the establishment and growth of new, independent firms, it becomes clear how the subject of entrepreneurship relates to wealth redistribution, at least through technological innovation. We believe the same principles can be applied to non-technical innovations but leave that for future research.

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FROM MINORITY BUSINESS TO MULTICULTURAL ENTERPRISE:  
Changing Descriptions, Demographics and Dimensions of Cultural Diversity

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INTRODUCTION

The language that is used in the United States to describe and analyze businesses started, owned and operated by persons of color is quite diverse: “minority business,” “minority and women-owned business enterprise (MWBE),” “ethnic enterprise,” “diversity business,” and “multicultural enterprise.” These are five of the most widely used terms. Of course this list omits specific racial/ethnic references to describe group-designated types of business such as Black, Hispanic, Asian and Native American. There are also designations for immigrant businesses that usually are considered as yet another and seemingly unrelated demographic and cultural category. The listed terms have overlapping meanings and some of them are used interchangeably. They generally have distinct meanings and uses with respect to administrative and policy purposes in the public and private sectors of the economy. There are also substantive analytical differences in how they are used to study this area of business and management. Their meanings also have changed with time and different periods of political and cultural expression.

This paper provides a review of the enterprise classification terms included under the USASBE’s Minority and Women Entrepreneurship Division. Attention is focused on the ones that are most widely used in the business and management literature. My three main objectives are to: (1) compile illustrative definitions and uses of the terms; (2) compare and contrast uses with substantive program and policy applications; and (3) provide illustrations and interpretations of the increasing importance of a multicultural perspective in business and management along with the challenges that are presented in the academic, practitioner and policymaking communities.

But the paper is about much more than semantics. This sector of U.S. business is quite substantial and growing rapidly. According to the 1997 Survey of Minority Business, there were 3.04 million firms that generated \$591.3 billion in gross receipts and provided employment to 4.5 million individuals. Their combined payroll was \$96 billion. (U.S. Department of Commerce, 2001) While this is a small percent of the national business economy, the entry and growth rates as well as the relative importance of these firms as sources of wealth building in their respective communities is noteworthy. Individuals in these groups have a business start-up rate that exceeds that of the White population.

Yet these businesses have long faced barriers that inhibited growth and participation in the economy. Indeed, until the 1960s and the emergence of the Civil Rights movement this issue was largely neglected in both the public and private sectors of the economy. Efforts since then to remove the barrier that have inhibited the growth and success of this sector of the economy have had uneven support and results.

Some level of support for the continuation of investments in this sector can be seen at all levels of government. In states where political opposition has placed restrictions on the use of minority business programs, the private sector has generally maintained interest and support in recognition of the value of diversity in business.

Further, there is the growing demographic trend that places the populations most directly served by and associated with these businesses as being visible and important in terms of spending power in the economy. This has increased the potential and importance of multicultural perspectives in business.

## MULTICULTURAL ENTERPRISE CLASSIFICATION DESCRIPTIONS

The classification descriptions discussed in this paper are presented in Exhibit 1. This provides an overview of how the language has changed over time. Some additional contextual background is also provided in this section of the paper.

### Minority Business

The term “minority business” has been used since at least the 1960s. One significant date in this regard is that on March 5, 1969 President Nixon issued an executive order establishing the Office of Minority Business Enterprise (OMBE). (U.S. Department of Commerce 1973, p. 146) In June of that year the U.S. Bureau of the Budget published a study on minority entrepreneurship. Besides having the longest period of general usage, it is the most familiar term. It is also likely to be the most enduring. Because of its brevity, longevity and popularity, it is widely institutionalized in various forms. At the federal level, there is still a Minority Business Development Agency as a successor to the Office of Minority Business Enterprise. Every five years (with endings of 7 and 2), a survey of minority-owned business enterprises is conducted by the U.S. Department of Commerce.

In the private sector there are innumerable minority business development councils. Examples include: National Minority Supplier Development Council (NMSDC); Southern California Minority Business Council (SCMBC) [one of 40 affiliated regional councils]; the National Minority Business Council (NMBC) [an advocacy and professional service group with headquarters in New York City and founded in 1972]; and the Minority Business Enterprise Legal Defense & Education Fund (MBELDEF), an organization that has pursued litigation, completed training, consulting and conducted disparity studies in relation to minority business enterprise). Minority business opportunity days and related business development and networking events are other ways in which the term has been institutionalized. There is a Minorities in Business magazine as well as other group and organizational names that illustrate the terms’ widespread use. Many studies and reports on this business sector use minority business in their title. Even when multicultural is used in a program designation such as “Multicultural Supplier Development” the detailed program description is likely to have “minority business enterprise” prominently in the text of the document

# Exhibit 1

## Description of Terms Related to the Emergence of Multicultural Enterprise

| TERM AND USAGE   | DEFINITION  | COMMENTS  |
|--|---|---|
| <b>Minority Business:</b><br>Historical, general and demographic description based on population under-representation in the economy and society.  | Businesses owned by persons of color that include Blacks, Hispanics (Spanish-surnamed groups), Asian and Pacific Islanders, and Native Americans. [This is contemporary language rather than the terms used in the 1960s.]                                    | Defined officially in the Survey of Minority-Owned Business, 1969.  |
| <b>Minority and Women-Owned Business Enterprise: (MWBE)</b> Extensively used in federal, state and local government as well as private-sector programs designed to provide contracting and business opportunities for this sector. | Small business that is at least 51% owned by one or more minority-group members or women. For a corporation at least 51% of the stock must be owned by and management and daily business operations controlled by one of more of such individuals             | Developed mainly since the 1970s and generally includes a certification process to ensure legitimate participation in MWBE programs.                          |
| <b>Ethnic Enterprise:</b><br>Generally used more in scholarly or academic writing than in administrative programs.   | Business ownership among groups of color defined with respect to their socio-cultural, linguistic characteristics and national origin. Often combined with the term “minority-ethnic” to identify overlapping distinctions of race and ethnicity in business. | Emerged from the 1970s and the scholarly work of Ivan Light in <u>Ethnic Enterprise in America</u> . (1972) and others.                                       |
| <b>Diversity Business:</b><br>Used to emphasize the diversity goals and purposes of programs aimed at increasing business opportunities and employment for under-utilized groups and firms in the economy.                         | Businesses owned by women, Blacks, Hispanics, Asians, Native Indian and other racial/ethnic groups. “Disadvantaged business” should be included here as well as in programs associated with minority and women-owned business enterprise.                     | Emerged in the 1990s as an alternative to minority and related terms that were considered more political and controversial. (See DiversityBusiness.com)       |
| <b>Multicultural Enterprise:</b><br>Used to emphasize the changing orientation from an ethnocentric or one-culture focus to the inclusion of acculturation and cultural diversity in shaping business policies and practices.      | Reflects businesses owned by racial/ethnic groups of color as well as business practices in the market environment in which people of color live, work and compete in the enterprise economy.   | Emerged in the 1990s as a recognition of the changing demographics of the nation as well as increasing cultural influences on business policies and practice. |

An important addition to some of the descriptions are identified ethnic groups that can be sorted out from “Other.” One example is “Asian-Indian American” which identifies persons whose heritage or origin is from India, Pakistan, or Bangladesh. The point here is that business or enterprise classification descriptions need to be broader and more inclusive now than in the past because of the changing demographics and varied cultural influences that need to be understood and responded to.

#### Minority and Women-Owned Business Enterprise (MWBE)

This category of enterprise carries with it specific ownership rules as well as documentation or certification that the business qualifies for agency contracting and business opportunities. The criteria used in the definition involve controversy. For example, the 51% rule is criticized as placing limitations on business and investment relationships that are detrimental to some of the businesses. It is argued, for example, that access to some sources of capital is constrained by the rule. Proposals have been made to attempt to reduce the 51% rule without opening the firm up to criticism as a front that provides cover for ostensibly White or non-minority ownership. As reported by Sonfield (2004), the National Minority Supplier Development Council (NMSDC) has proposed that the ownership rule be reduced to as low as 30% in order to increase access to equity capital. As a result of the strong and vocal political opposition from other minority organizations, the reluctance of corporate firms to become embroiled in controversy, the percent reduction in minority ownership has not gained much ground. As Sonfield (2004, p. 166) reported, after three years only one firm had been certified under the new rule by NMSDC.

An even more protracted and volatile controversy has surrounded the program and policy uses of the definition. Contracting opportunities and efforts to ensure wider participation of these businesses in purchasing and contracting by public agencies, in particular, has led to a movement to quash MWBE programs. Ironically, most of the cases to invalidate such programs have pertained to minority rather than women-owned businesses. This is partly due to the greater volatility of race-based issues of contracting when compared with gender-based disparities. Also, gender-based coverage includes White women. This apparently removes claims of reverse discrimination based on race. Litigation has gone all the way to the U.S. Supreme Court. Restrictions have been placed on alleged uses of so-called race preferences or set-asides in public contracting. Nevertheless, the programs have generally not been eliminated. They have been changed to remove perceived or actual preferences for minority or women-owned firms. Even in California and Washington where statewide referendums have been approved to ban the use of race and ethnicity in public sector decisions regarding employment, contracting and school admissions, some version of MWBE programs remain in effect. However, as a result of the sustained controversy and attacks since at least the 1980s, such programs have been substantially weakened as a policy tool for advancing minority and women-owned business.

#### Ethnic Enterprise

The term “ethnic enterprise” carries with it considerable academic and analytical cache. It does so because racial/ethnic background and affiliation really matter in business education and management practice. It matters in term of history and the experiences of individuals and entire groups based on social customs, attitudes and economic practices. Various processes are in place to limit the viability and growth of ethnic enterprise. Denial or restricted access to

labor markets, for some groups can be widespread. Denial of access to capital markets is well known. Considerations of patterns of discrimination in housing, education and other areas of economic and social life add further constraints on ethnic enterprise development.

However, the term ethnic enterprise explicitly omits race. Thus, its usage in practical and policy terms is likely to remain somewhat limited. However, it provides a bridge between immigrant and minority business. That makes it attractive for academic and some policymaking purposes.

#### Diversity Business

This term has come into usage as a neutral or less politically-charged description of business pertaining to people of color. Diversity is seen as a desirable goal in bringing differences and sensitivity to broadening the participation of people in business. However, it lacks specific associated meanings and explicit recognition of groups of people. For example, it seems awkward to me to say that a business is “diversity-owned.” In one case where the term was used it was followed in parenthesis by women, Blacks, Hispanics, Asians and Native Indian and other minority groups. So what has been gained in communication by using the term diversity? The term may communicate to some people in business when the term “diversity suppliers” is used. This is likely to suggest that a firm or agency is seeking to broaden the participation of suppliers from different groups, sources of business and the like. So it seems that it would be best to say that it is unclear how the usage of this term will fare in the coming years. However, because of its implied goal-oriented neutrality, its usage is likely to increase. Generally, there will still need to be an accompanying explanation of who is included, how they are contributing to the goals of inclusion, correcting under-representation or otherwise supporting the achievement of cultural diversity.

#### Multicultural Enterprise

The notion of U.S. society becoming more multicultural has helped in the acceptance of the term multicultural enterprise. At least in academic circles the ideas of multicultural education, multicultural communication and other fields as well make it seem appropriate that the term multicultural also applies to business enterprise. Moreover multiculturalism has come to business through advertising and marketing in a big way. Corporations now have senior managers who are responsible for multicultural products and markets. As noted below there is growing acceptance of multicultural influences in business.

### CHANGING DEMOGRAPHICS AND MULTICULTURAL INFLUENCES

#### Changing Demographics

In the decade of the 1990s the general population of people of color grew from three-to-eleven times as fast as the Anglo-American population increase of 4.4%. Asians increased by 49.6%, African Americans by 39% and Hispanics by 14.3% (Aspirations of Minority Business, 2000). These groups now represent 28% of the U.S. population with expected growth to one-third by 2010 and to about 50% at mid-century. Already the phrase “majority-minority” is a demographic reality in some areas. When combined with spending power estimated in excess of \$1.1 trillion, their status in emerging markets is attracting more and more attention in the larger economy.

The racial/ethnic composition of these groups is as follows: Hispanics (35.3 million people) 40.6%; African Americans (34.6 million) 39.0%; Asian/Pacific Islanders (10.6

million) 12.3% and Native Americans (2.5 million) 2.9%. (Minorities in Business, 2001). The numbers translate into sizable measures of economic activity.

Comparative business ownership among the groups follows a noticeably different pattern: Hispanics 39.5%; Asians 30.0%; Blacks 27.1% and American Indians 6.5%.

Changes are occurring in other aspects of minority business. Strong networks of business alliances and relationships are in place. Efforts are being made to change perceptions, capabilities and the delivery of goods and services. Firms in the sector are becoming more competitive.

### Multicultural Influences

Cultural diversity is now widely recognized and generally supported as a desirable quality in organizational, community and national life. This stems from recognizing that our world is about as diverse as it is vast. Through commerce, communication and advances in technology, differences are brought to us just about wherever we are. Understanding cultural differences has been an essential part of doing business abroad for a very long time. Increasingly the demographic and cultural diversity from within are resulting in more and more recognition of the multicultural influences at home.

Its scope is very broad and includes differences in language, life styles and cultural traditions. Aspects of institutional life are also embraced through education, churches and church life, newspapers and in other ways that reflect various dimensions of community and culture.

Indeed diversity is big business. One of the prime influences in the corporate sector that affects minority business is "minority supplier development." This includes programs that are designed to diversify their supplier networks. This support is strongest in the U.S. automobile industry. The big three companies (Ford, Daimler-Chrysler and General Motors) spent \$3.5 billion, \$2.7 billion and \$2.3 billion, respectively, for a total of \$8.5 billion. According to Hannon (2001) these firms lead in diversity supplier spending.

Another and even larger influence is the evolving multicultural orientation in the U.S. business environment. This is represented by a complex diversity infrastructure that includes many different policies, programs, procedures and institutions.

## EDUCATIONAL, PROGRAM AND POLICY IMPLICATIONS OF A MULTICULTURAL FOCUS

### Educational Implications

The changes reviewed in this paper are evident in many aspects of business education. Many business schools are responding in a variety of ways. Attention to diversity in admissions is one way. Curriculum changes with course development is another. Learning experiences that include group projects with minority business and student consulting are common adaptations to reflect diversity in the business school environment.

Some, like University of Arizona – West, have acknowledged the importance of faculty diversity. (Maimon and Garcia 1997) These faculty members emphasize such benefits of cultural diversity as providing different perspectives and voices in learning, learning how to think critically and adapt to different people and situations. They go on to say: "The business community has already realized that a diverse workforce will lead to a successful

enterprise...bringing with it diversification as in portfolio diversification.[and generally]... leading organizational members to reach their full potential.”

Similarly, encouraging the development of minority and women-owned businesses adds to the diversity of opportunity in business and carries with it as well the strengths associated with diversification. In addition it recognizes the strengths and contributions of extending cultural understanding and opportunity to historically-denied groups. It helps us understand better the structure of barriers associated with racial, ethnic and gender discrimination.

#### Minority Business Development Program and Policy Implications

The wide range of MWBE programs from school districts and port authorities to city and county government, states and federal levels suggest that the infrastructure of minority business support is essentially a permanent part of the policy framework of the nation. Despite efforts to curtail or close such programs, they are still present just about everywhere.

An even bigger support system exists in the private sector. According to the National Business Supplier Development Councils total private sector spending in 2002 was \$72 billion. This compares with the federal government investment in the Small Business Administration of less than \$6 billion (Lum, Spratlen and Verchot 2004). While the total for all government procurement would obviously be much higher, even that represents between two and three percent of procurement among the Departments of Defense and Transportation as the two largest spending federal agencies in support of minority business.

### CONCLUSIONS

Multicultural enterprise has evolved from minority enterprise over the past several decades. Although the term minority business may be demographically inaccurate to describe this sector, it is still in widespread use. And is likely to remain so. Yet the focus, content and orientation in the contemporary business environment are decidedly multicultural. Academics, practitioners, policy makers and the general public will need to learn to live with the continued use of diverse terms and phrases as applied to the multicultural enterprise sector of the economy. But after all that is merely a reflection of complexity and diversity in the business world of the contemporary Information Age.

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## Age Characteristics and Personality Traits of Current and Prospective Women Small Business Owners

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### ABSTRACT

The Center for Women's Business Research (formerly National Foundation of Women Business Owners--NFWBO) estimated that between 1997 and 2002 the number of women-owned firms increased by 14 per cent nationwide – twice the rate of all firms. Employment increased by 30 per cent--1.5 times the U.S. rate, and sales grew by 40 per cent--the same rate as all firms in the U.S, and \$1.15 trillion in sales was generated by 2002. (Center for Women's Business Research, 2002)

This paper looks at possible age characteristics of Women Small Business Owners (WSBOs) as well as some personality traits. It is based upon previous studies, literature review and a pilot study recently tested (June 2004.) This paper is also setting the stage for a larger research project that will go to a wider population than the limited respondents used in the pilot study. The researchers hope to find what relationships have remained the same through the years since 1980, as to the average age of the women starting their own business, as well as what changes are taking place. This will include whether there has been influence of other family (parents, grandparents, siblings) who have already taken the entrepreneurship route, or if these women are making their own pathway. By identifying trends, educators may be more able to provide the support needed by these women in their entrepreneurial journey.

Until the late 1980s research on women entrepreneurs had been a neglected area of academic study. Increasingly, research is focusing on women small business owners as an identifiable group separate from their male counterparts.

### LITERATURE REVIEW

For many women business owners, the management of the combined responsibility for work and family is an issue of significant concern and leads to a search for flexibility to manage these dual responsibilities and have a more balanced life. (Olson and Currie, 1992; Fierman, 1990; Taylor, 1995; Zelner, 1994). Many women see small business ownership as a way to achieve this balance. Family security has been identified an important value by all respondents to a 1992 study of women business owners in the construction industry. This characteristic might also impact studies done of women starting businesses during their child bearing/child rearing years. These years may range from teen years through to the mid-forties.

In the mid-1980s, women small business owners frequently identified frustration and boredom in their previous jobs as key reasons for starting their businesses (Hisrich and Brush, 1985). Other reasons were interest in the business and personal autonomy. Women small business owners (WSBOs) usually had liberal arts backgrounds and, typically, had work experience in areas such as services, teaching, middle management or secretarial positions. Most American female owner/managers had worked in a business similar to their current one. However, these same women lacked experience with finance, marketing, and routine business operations. The 1980s female entrepreneur was most likely to be the first-born child from a middle-or upper-middle-class family. Her father was probably self-employed. Over half of these

women were married; and, on average, they had two children. Nearly 70 per cent had a college education, majoring in mostly non-business fields.

In the early 1980s in Japan, WSBOs were heavily involved in small retail businesses in a single commercial neighborhood, while their husbands worked as salaried employees elsewhere. Some of these shops were inherited. However, most women were involved in family businesses run jointly by husband and wife, often with each spouse running a branch store in different neighborhoods (Daiichi Kangyo Bank, 1989).

A decade later, the 1990s women who were or became small business owners were more likely to have management experience in a private-sector for profit business according to the National Association of Women Business Owners (1998a.) Fifty-six percent of these women owned businesses totally unrelated to previous careers and 14 per cent had turned a personal interest into a business pursuit.

The 1990s “modern” female entrepreneur usually arrived at business ownership in one of three ways: (1) by developing an entrepreneurial career early in life – the “intentional entrepreneur”; (2) by becoming entrepreneurs after a substantial [“incubator”] period in a corporation or other organization—the “organizational entrepreneur”; or, (3) by following a “career without boundaries,” going back and forth between corporate experience and business ownership (*Moore, 2000*).

### **Age, marital, and maternal status:**

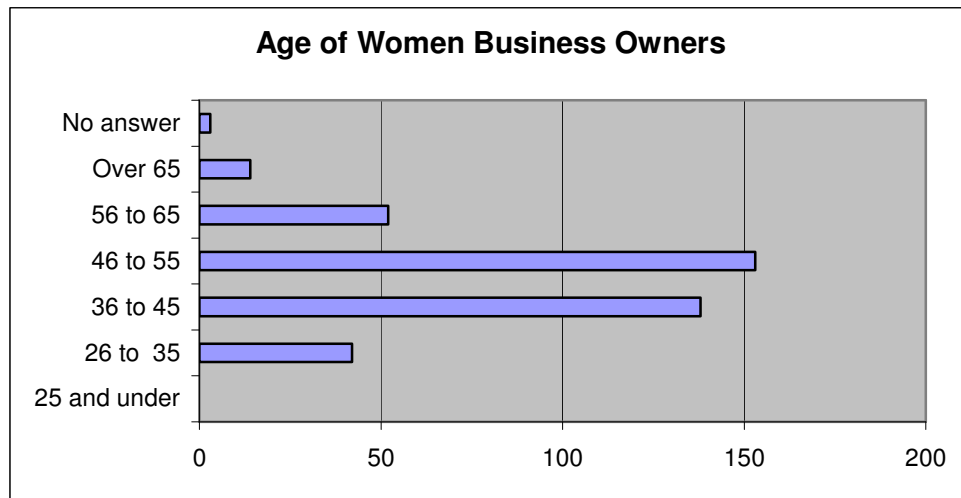
A majority of women small business owners are in their 30s and 40s. This seems to be the case internationally. In a study of female business owners in Poland, the majority were between 35 and 50 years old (median age 45) (Zapalska, 1997). Canadian women business owners (Lee-Gosselin and Grise, 1990) were found to be between 31 and 45 years old, married with an average of 2.4 children (Deng, Hassan, and Jivan, 1995). A majority of women business owners in Asia were in their 30s and early 40s.

A study in the USA compared women corporate managers and women small business owners and found that the managers were in their 30s, most likely to be married and had few or no children. The business owners were somewhat older (41-60+ years) than the managerial group, and somewhat more likely to be married and have children (Brodsky, 1993). In central Ohio (USA), female owner/managers were mostly under 51 and married with few children (Burdette, 1990).

In the Taylor (1995) study of the Dallas/Fort Worth (U.S.A.) geographic area, approximately seven out of ten of the 402 respondents were between the ages of 36 and 55. (See Figure 1) This is similar to the Poland and Canadian studies. The respondents in the Taylor study were all women who owned their own businesses and the majority had been doing so for at least five years. Marital status of this group indicated that 68 per cent were married at the time they started their business, 15 per cent were single and another 15 per cent were divorced. Only 35 per cent of the total number of respondents had dependent children still living at home, and of those, the majority only had two children.

Authors examining age cohorts in the USA have predicted that individuals born between 1960 and 1980, sometimes referred to as Generation Xers (or Gen X) as a group have strong entrepreneurial characteristics (Zemke, Raines, and Filipczak, 2000; Strauss and Howe, 1991). Potential entrepreneurs, ages 11 years and older, are the targets of a book, Girls and Young Women Entrepreneurs. Aimed at the next generation of female small business owners, the book includes first person success stories and provides instructions on how to be an entrepreneur.

Figure 1



Ages of respondents in U.S. study. (Taylor, 1995)

A group of low-income women in a rural area of a Midwestern (USA) state opted for sole business ownership as a strategy for becoming economically self-sufficient (Egan, 1997). These women averaged 35.7 years and had one to four children. All had received welfare for 2.5 years to 12 years after divorcing husbands or leaving partners. Subsequent to starting their own businesses, all had completed self-employment training programs.

The decision to become self-employed often fulfills a lifelong dream. Two-thirds of the women reported having empowering families, including decisive women and entrepreneurial role models during childhood and youth. The family's reinforcement of a woman setting her own goals and achieving success in self-initiated efforts was coupled with the women's familiarity with people who were entrepreneurs and embodied these familial messages. The other third, having no such early experiences, reported that self-employment was related to negative employment experiences [in low-paying jobs] and the presence of a mentor. These women described how the experience of being an employee failed to match their sense of autonomy and capability and helped them learn how differently they would behave as bosses.

It is these areas that the new study will attempt to research. Indications in the limited pilot study imply that more women may be thinking of starting their own business long before becoming entrenched in a career track. It may also be more of a choice for personal preference of being their own boss and have little to do with family security, very similar to why men make the same choice.

Self-assurance and strong personality are two more tendencies that are being examined in the new study. Is the tendency of continuing towards masculine attitudes (as far as business leadership style) gaining momentum among the newer female entrepreneurs? In a USA study comparing female managers and female entrepreneurs, neither group self-identified with the stereotypically feminine sex role (Brodscky, 1993). Two thirds of the total sample held culturally masculine attitudes. One third of

the entrepreneurs and one fourth of the managers adopted an androgynous self-perception. The managers perceived themselves as bright, analytical, strong, articulate, politically aware, linear thinkers, who are determined, self-assured and work long hours. Like their managerial counterparts, the entrepreneurs saw themselves as bright, determined, verbally skilled, analytic and strong. The entrepreneurs' personalities, however, tended to be less warm, very dominant, expedient, bold, suspicious, shrewd, self-assured, somewhat conservative, self-sufficient, and tough minded. By self-report their pace appeared to be faster, they worked longer hours. They also were seen as more aggressive and less bound by convention.

Personality traits such as self-discipline, perseverance, and an intense desire to succeed have an impact on the success of the female-owned business. Other success factors related to managerial practices include: the inclination and ability to plan, willingness to seek professional assistance, attendance at business courses, and realistic profit expectations (Taylor, 1995). Planning is critical since it helps in setting goals, meeting deadlines, predicting future growth, and obtaining future financing, and should be done continuously in the course of business operations.

Women may seek outcomes other than business growth as a measure of their success (Larwood and Gattiker, 1989). For example, women tend to have a stronger preference for jobs that offer opportunities for professional growth and challenge, while men preferred jobs that offered higher income (Bigoneess, 1988; Brennen and Tomkiewicz, 1979). Moore and Buttner, 1997 suggest internal standards mattered more than external measures and that an "ethic of care" figured more predominantly for women than men small business owners. Women entrepreneurs focused on the process in their work and enjoyed it more than on the outcomes.

Female managers believed they could obtain personal and career support by working inside the system and valued the resources and team effort found in corporations. In contrast, female entrepreneurs relied on individualistic drive and energy and were not as concerned about the opinions of others. They looked for support in strong external networks.

## **EXPLORATION OF THE SPECIFIC ISSUES INVOLVED IN THE NEW STUDY**

The new study has recently (June 2004) been tested in a group of women (and 1 man) enrolled in an entrepreneurship class. Far from an objective group of respondents, this was an upper level elective class for all students and open to people regardless of major at a public university. Age ranges in the class were broken down to "younger than 25" (37.5% of respondents), "25 to 35" (37.5%), and "older than 35" (25%). Twenty-four people out of 29 responded to the survey. Seventy-five percent were scheduled to graduate within one year. Twenty-nine percent of the respondents had already owned their own business, or were currently business owners. When asked how many of the respondents had a family member who was an entrepreneur, 63% replied affirmatively. An expected fault in the questionnaire for this group of respondents' (since they had elected to take the class) occurred with the question "How likely do you think you are to be an entrepreneur at some time in the future". A solid 62.5% replied "very likely" while 25% replied "somewhat likely" and only 3 respondents were "undecided." None of the students chose one of the two negative responses available.

At this point, a statistical analysis has not been completed on the respondents' answers to the questions concerning organization, assumed risk, and perceived challenges for an entrepreneur. This is currently in process and will be completed on the pilot study by mid-October of 2004.

## Implications for future study

An expanding role for women's involvement in small businesses ownership is an international fact. Age does not appear to be a limiting factor in describing female entrepreneurs. In fact, women of child-bearing age continue to start businesses at a record setting pace. This study will be given in several venues this coming year. An attempt will be made to include current business owners (chosen at random and from different localities) as well as university students in other types of classes. Community members not currently involved with owning their own business will also be surveyed. Gender personality differences as well as age differences and the impact on entrepreneurial choices will be closely examined.

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# **BOARDS OF DIRECTORS FOR SMALL BUSINESSES AND SMALL PRIVATE CORPORATIONS: THE CHANGING ROLE, DUTIES AND EXPECTATIONS – PART III**

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## **ABSTRACT**

*Today the governance and management structure of business organizations, particularly publicly traded corporations utilizes a board of directors. Organization use of boards of directors is considered an openly accepted and utilized structure to provide leadership and management direction in business organization. Because large public companies recognize the value to the corporation and because of the increased regulatory requirements placed on publicly traded companies, the use of boards of directors are strongly endorsed. For small businesses and privately held companies, however, a board of directors is not always viewed as a useful part of the corporate structure.*

*A survey of 180 small, often family owned, non-public corporations was conducted in one Midwestern state to review the status of board usage and value. This paper reports PART III data of a study which focused on the board functions and operations of small privately held corporations. The study corroborated the expanding body of literature suggesting the lack of formality in board functions for small privately held companies. The study identified the most important factors influencing board function, activities and performance as: needs of the company, skills and specialized expertise of the directors, sophistication of ownership and management, as*

*well as life cycle stage, family ownership and trading status of the corporation's stock.*

## **INTRODUCTION**

Solid corporate governance has been a long held positive perspective as an indicator of the quality of a company. This follows in start-ups where establishing corporate governance early in an organization's life cycle sets the tone for building and growing a solid foundation (Comtex, 2002). The involvement of a board of directors is considered to be an integral part of the governance and management structure of most publicly traded corporations, particularly large organizations (Cain, 2002). However, board decisions are not accepted on faith. Today investors, governments, communities and employees are all reviewing board performance and are not afraid to challenge board decisions (Conger, Lawler and Finegold, 2002).

Caution and sometimes apprehension about the future has resulted from the expansion of the 90's, the tech burst, September 11th, and the accounting scandals which have left the business community hurting. A rapidly changing business world encompasses multiple themes, two of the most important are that regulation matters and that "boards count" (Business Week, 2002).

Principles of Corporate Governance are being actively addressed by such recognized authorities as "The Business Roundtable." The roundtable is an association of CEOs of leading

corporations representing over 10 million employees in the US with \$3.5 trillion in revenues (The Business Roundtable, 2002). The Business Roundtable endorses the following guiding principles for boards of directors for public corporations:

- Selection of and oversight of a CEO.
- Effective/ethical operations which produce value for stockholders.
- Financial statements which present the accurate financial condition
- Use of an independent accounting firm to audit the financial statements.
- The independent accounting firm must insure that it is independent, without conflicts of interest.
- The corporation has a responsibility to deal with its employees in a fair and equitable manner (Business Roundtable, (2002)

Principles of guidance are intended to provide boards directors and management leadership with best practices and serve as milestones on ever improving standards. In keeping with the attention given to board governance, Business Week magazine has ranked the best and worst boards since 1996. Their research involves polling of top experts, reviews of dozens of boards, and considers factors of credentials, stock ownership and even attendance. Starting in October 2002 they added new categories of Most Improved Boards, Boards That Need Work, and a Hall of Shame. All of this attention is insuring that board members are taking their responsibilities more seriously. Jeffrey Sonnenfield, Associate Dean of the Yale School of Management perhaps best sums it up, "Boards of directors will be rolling up their sleeves and becoming much more closely involved with management decision-making" (BusinessWeek, 2002).

More and more boards are utilizing guidelines, policies and working instruments in their corporate governance role. Siebens in his Journal of Business Ethics article "Concepts and

Working Instruments for Corporate Governance," indicates that a qualitatively better direction can be achieved through:

- Complete openness
- Spreading of knowledge in the board's composition
- Frequent meetings
- Splitting-up of special functions
- Thorough preparation and recording of all meetings
- Replacement of weak or regularly absent directors
- Sufficient time to discuss (Siebens, 2002)

All of the attention to corporate governance has impacted all types of organizations. When comparing the governance of large public to smaller organizations, one finds that in privately held companies and small businesses a board is not always seen as an integral part of the corporate structure. Reasons include fewer regulatory governance requirements or perhaps the closer relationship between managers and owners. In addition there is the sometimes inaccurate perception that boards, even where legally required, add little value to the corporation (Narva, 2001). Perhaps the most significant legislation since the U.S. Securities and Exchange laws of the 30's, the Sarbanes-Oxley Act has redesigned corporate governance and reporting obligations, expands and strengthens accountability standards for directors and officers, and identifies specific securities violations to be crimes. The message in Sarbanes-Oxley is that for private businesses a new aspect to decision making will be critical. The act may have been directed at public companies, but it impacts privates also (PricewaterhouseCoopers, 2003). Small firms are not exempt from Sarbanes-Oxley but may well have difficulties meeting the more rigorous regulations under the act (Hansard, 2002).

This paper reports PART III – Informal Function findings of a study which focused on the functions and operations in the small

privately held corporate environment. The interest in this topic evolved from the involvement of the authors on boards of directors, advisory committees, and planning task force activities for small corporations, small businesses and non-profit organizations. The intent was to provide a link from the extensive literature sources, materials, training, and development programs available for boards of large organizations to smaller organizations.

The authors were encouraged to pursue their work in this area during a statewide SCORE (Service Corps of Retired Executives) conference. In addition, SBDC (Small Business Development Center) and SBA-BIC (US Small Business Administration - Business Information Center) and T-BIC (Tribal -Business Information Center) affiliates supported the concept. This paper is a component of a multi part series which centers on small privately held corporations and non-profit organizations affiliated with small business and entrepreneurship. Given the changes in corporate governance, ethical issues, and challenges facing board members of all organizations today (Carver, 2002), interest in organizational governance will continue to expand. The Small Firms Association's launch of a publication "Corporate Governance: Guidelines for Small Business," is an example of a number of resources now available (Delaney, 2001).

## **BACKGROUND**

An extensive body of material exists concerning the roles, functions and duties of boards of directors, however, there is no one work that clearly describes board requirements (Cain, 2002). Despite the growing emphasis on corporate governance one must adapt the approach to have a structure useful for small privately held companies, small businesses and non-profit organizations. Selected works examine the unique aspects of small company

boards and assess the challenges required to recruit effective directors (Thurman, 2000).

Past work on small private firms where CEO's have significant power to effect board composition and level of CEO involvement has been accomplished. Results affirmed that CEO's with greater ownership and family stakes tend to have small boards with less representation by outside directors and greater representation by dependent directors, primarily family directors (Fiegener, Brown, Dreux, and Dennis, 2000).

Much of the work related to corporate governance discusses the need to seek board members with skills and experiences to match the needs of the organization. For example the publication entitled, "Trends in Corporate Governance Series: Changing Roles for Boards of Directors in Entrepreneurial Companies, Modern Corporate Governance Practices," by the accounting firm Grant Thornton LLP was reviewed in the PART I – SBIDA paper (Teksten, Moser, Elbert, 2003) delineating the functions on which a board must focus. Two particularly critical functions are...

- Periodic evaluation of its own performance.
- Performance evaluation of individual directors (Grant Thornton, 2001).

The focus on family business planning has received more attention of late. Lussier and Sonfield for example, provide a unique perspective with their focus on family business planning, management activities, styles and characteristics (Lussier, Sonfield, 2004). Narva provides credible reasons for utilization of an independent board with experienced directors for a family controlled enterprise.

They include...

- Credibility with non-family managers.
- Credibility with Financial Institutions.
- Disaster Management.
- Coordination with Non-Management Owners (Narva, 2001).

Each organization needs to review a variety of factors including their unique critical needs, abilities of personnel, stage in organization life cycle and a variety of other factors. Because of the multitude of needs, requirements and individual aspects of private corporations, one could easily surmise that there are no definitive answers for board organization, orientation, education, utilization or administration. The contribution of directors in small and medium enterprises was examined. Results showed that non-executive directors foster formality and discipline but also face challenges related to the perception of adding value to the boardroom (Mileham, 1996). The **PART III – Informal Function** results being presented here were designed to explore areas of board emphasis for small incorporated businesses. In addition, the study reviewed the roles that boards play at various points in the firm's life cycle and the impact of the percentage of family ownership on board organization and usage. **PART I - Primary Function** and **PART II – Formal Function** data was presented at the 2003 and 2004 SBIDA conferences (Teksten, Moser, & Elbert, 2003; Teksten, Moser, & Elbert, 2004).

## **METHODOLOGY**

As part of the project, a mail questionnaire survey of 180 businesses was conducted as part of this project. Businesses were selected from a database maintained by the North Dakota Department of Commerce. Participants of the survey were board members of incorporated firms with a minimum of twenty employees. Of the 180 surveys mailed, 53 were returned. Eighteen were deemed unusable because they were completed incorrectly, were not really corporations or were subsidiaries owned by out of state parent entities that had no local boards of directors. As a result only 35 surveys were considered usable. While this is short of the 50 typically expected, it does

represent the best effort of the researchers to elicit responses. The response rate was 19.4% (35/180). Personal interviews were conducted to further explore initial findings derived from the questionnaire. A significant amount of information was compiled as a result of the survey and personal interviews. It is the intent of the authors to present the findings of the study as part of a multi-part series.

## **RESULTS**

The study validated much of the literature noting the **lack of formality** in board functions for small privately held companies. Critical factors influencing board function and action included needs of the company, abilities of the directors, sophistication of ownership and management, as well as life cycle stage, percent of family ownership and whether or not a corporation's stocks are traded. The responses to survey questions related to board functions and operations were summarized under various classifications. The classifications and relative numbers for each category were as follows: All Responses (35) - further delineated as, Life Cycle (Mature - 27, Early and Rapid Growth Life - 8). Secondly, Ownership further delineated as (100% Family Owned - 16, 51 - 100% Family Owned - 9, Less than 51% Family Owned - 9, Failed Response - 1), Traded (3). Respondents were also asked to provide their opinions regarding whether board functions or objectives were carried out in an informal or formal manner. Survey completion instructions indicated that...

**“Formal would mean that the objective or function is documented as such in a board manual, is included in the training of old and new board members, is in the minutes, is included on a written agenda, etc.”**

**“Informal would mean that such formal attention is not brought to bear but the objective or function is still considered as a primary function to all board members as evidenced by periodic (at least annual) board discussions or actions on the topic.”**

Data presented at the 2003 and 2004 SBIDA conferences centered on the **PART I – Primary Functions** of Service – providing counsel and advice to CEO and Management, Fulfill Legal Requirements, Long Term Strategy and Policy Formulation and Approve Major Investments, Acquisitions and Sale of Assets and **PART II – Formal Functions** which included functions noted in Part I plus the functions of Selecting and compensating directors and Selecting and compensating the CEO/Top Management. Table 1 – Boards of Directors of Small Private Companies: **Informal Functions** further details the responses based on state of Life Cycle and % of Family Ownership. As noted in the table the four functions rated highest across all classifications include...

- Service – providing counsel and advice to CEO and management (60%)
- Networking (Access to capital, markets, agencies, people, expertise) (46%)
- Innovation (new venture / product development/expansion) (49%)
- Provide energy and outside perspective to the organization. Select & compensate directors (49%)

Many of the Primary Functions - Informal received high responses across all classifications as shown in Table 1.

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Insert Table 1 about here

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The data compiled in the study were too extensive to completely include in this paper, however the complete study is available from

the authors upon request. Expanded details and emphases within categories regarding top ranked functions and a recap of the project will be provided as part of the next component of the series.

## ***DISCUSSION***

The results of the study of board primary function, formal function and informal function assessment reveals high consistency with the listing developed by Grant Thornton (2001) and other training, educational development firms including NACD (National Association of Corporate Directors) and consulting firms to include PricewaterhouseCoopers. Further, the primary, formal and informal functions that were not rated as being as board critical provides further understanding of the wide range of expectations and needs of small business boards.

## ***IMPLICATIONS***

This study examined board functions and operations as reflected in the literature to ascertain implications and potential applications for small non-public corporations. The intent was to review the changing role of board responsibilities as a result of unique world and corporate events. Primary Functions, Formal Functions and Informal Functions of board operations were, for the most part, verified. The study verified some interesting perspectives with regard to how boards of small organizations viewed their purpose. The intent of presenting a practical overview of recommended practices for boards of small private companies as well as providing a glimpse into how smaller companies may be approaching corporate governance was accomplished in part. Further verified by the research and the ever increasing attention in the literature is the realization that there are many further opportunities to study the changing roles of board members for organizations of all size and structure.

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|  | Table 1  |               |          |          |                       |             |                    |              |  | Traded |
|--|----------|---------------|----------|----------|-----------------------|-------------|--------------------|--------------|--|--------|
|  | ALL      | Life Cycle    |          |          | % of Family Ownership |             |                    |              |  |        |
|  |          |               |          |          |                       |             |                    |              |  |        |
|  |          | # Respondents | 35       | Mature   | Early & Rapid Growth  | 100% Family | 51% to 100% Family | < 51% Family |  |        |
|  | 35       | 27            | 8        | 16       | 9                     | 9           | 3                  |              |  |        |
|  | Informal | Informal      | Informal | Informal | Informal              | Informal    | Informal           |              |  |        |
| Service - providing counsel and advice to CEO and management         | 60%      | 56%           | 75%      | 63%      | 67%                   | 56%         | 0%                 |              |  |        |
| Resource Acquisition – aid in acquiring resources for the company    | 37%      | 37%           | 75%      | 44%      | 33%                   | 33%         | 33%                |              |  |        |
| Control - monitoring function  | 40%      | 30%           | 75%      | 31%      | 44%                   | 56%         | 0%                 |              |  |        |
| Fulfill Legal Requirements   | 34%      | 33%           | 38%      | 38%      | 44%                   | 22%         | 0%                 |              |  |        |
| Window Dressing  | 6%       | 7%            | 0%       | 6%       | 11%                   | 0%          | 0%                 |              |  |        |
| Stockholder/Stakeholder Improvement                                  | 43%      | 41%           | 50%      | 38%      | 44%                   | 56%         | 0%                 |              |  |        |
| Networking (Access to capital, markets, agencies, people, expertise) | 46%      | 44%           | 50%      | 31%      | 56%                   | 67%         | 67%                |              |  |        |
| Long Term Strategy & Policy Formulation                              | 37%      | 37%           | 38%      | 25%      | 67%                   | 33%         | 33%                |              |  |        |
| Independent Assessment/Review/Audit of management                    | 20%      | 15%           | 38%      | 19%      | 22%                   | 22%         | 0%                 |              |  |        |
| Management continuity and succession planning especially of CEO      | 43%      | 44%           | 38%      | 31%      | 44%                   | 67%         | 67%                |              |  |        |
| Specialized expertise (financial / international / technical)        | 29%      | 19%           | 63%      | 13%      | 44%                   | 44%         | 33%                |              |  |        |
| Innovation (new venture / product development / expansion)           | 49%      | 44%           | 63%      | 44%      | 67%                   | 44%         | 67%                |              |  |        |
| Arbitration (owner and non owner family members / multiple owners)   | 3%       | 4%            | 0%       | 6%       | 0%                    | 0%          | 0%                 |              |  |        |
| Crisis Management  | 29%      | 26%           | 38%      | 31%      | 22%                   | 33%         | 0%                 |              |  |        |
| Legal and ethical conduct oversight                                  | 26%      | 26%           | 25%      | 25%      | 22%                   | 33%         | 33%                |              |  |        |
| Evaluate board processes and performance                             | 20%      | 19%           | 25%      | 25%      | 22%                   | 11%         | 0%                 |              |  |        |
| Select and compensate directors                                      | 20%      | 19%           | 25%      | 19%      | 33%                   | 11%         | 0%                 |              |  |        |
| Select and compensate CEO/Top Management                             | 23%      | 19%           | 38%      | 6%       | 44%                   | 33%         | 33%                |              |  |        |
| Assist in mentoring or training of CEO and top management            | 34%      | 30%           | 50%      | 25%      | 33%                   | 44%         | 67%                |              |  |        |
| Assist in mentoring or training of new board members                 | 23%      | 22%           | 25%      | 19%      | 22%                   | 33%         | 33%                |              |  |        |
| Approve major investments, acquisitions, and the sale of assets      | 26%      | 26%           | 25%      | 25%      | 44%                   | 11%         | 0%                 |              |  |        |
| Provide Credibility with non family managers                         | 20%      | 22%           | 13%      | 25%      | 33%                   | 0%          | 33%                |              |  |        |
| Provide Credibility with financial Institutions                      | 26%      | 30%           | 13%      | 19%      | 44%                   | 22%         | 0%                 |              |  |        |
| Coordination with non-management owners                              | 17%      | 7%            | 50%      | 13%      | 22%                   | 22%         | 0%                 |              |  |        |
| Provide energy and outside perspective to the organization           | 49%      | 41%           | 75%      | 44%      | 44%                   | 56%         | 67%                |              |  |        |

# DO FAMILY MEETINGS REALLY MATTER? THEIR RELATIONSHIP TO PLANNING AND PERFORMANCE OUTCOMES

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## ABSTRACT

This empirical research focused on examining the relationship of family meetings and the characteristics of those family meetings (who attends, issues discussed and issues decided) to planning processes (succession planning, estate planning, family mission and business mission) and performance outcomes (revenues and number of generations survived). Of the 926 surveys sent to family businesses in a midwestern state, 241 were returned with useable data. Multivariate analyses of variance were used in drawing out the relationships. Significant differences were found in the planning processes between businesses that hold family meeting and those that don't. These differences, however, were not found significantly related to the performance outcomes. Significant relationships between family meetings and both planning processes and performance outcomes were found when comparing family businesses based on who participated in the family meetings. The results of the research are then discussed with respect to other family business research, and finally several practical implications are identified.

## INTRODUCTION

Family meetings are "...periodic gatherings (that) bring the family together to share goals and decisions, discuss common problems, learn about the business, and preserve family identity, values and traditions" (Aronoff and Ward, 1992, p.3). In their 1992 monograph entitled Family Meetings: How to Build a Stronger Family and a Stronger Business, Craig Aronoff and John Ward emphatically stated that these family gatherings can help build both a stronger family and a stronger business, and that they believed "...family meetings are one of the two most important steps a business owner can take to ensure the continuity of the family business (p.3)."

These thoughts followed John Ward's 1987 discussion of his study of successful family businesses in which he identified three principles that appeared to guide such companies. The three principles were a commitment to the future, the existence of a system of extensive communication and conscientious planning (Ward, 1987, p.9). The family meeting was viewed as the key vehicle for implementing these principles.

Given the strong reputations of Aronoff and Ward in the family business arena, it is not surprising to then find that since the late 1980's numerous books and articles written regarding how to manage family businesses have discussed the significance of family meetings (or their more formal form, the family council) in creating healthy, successful family businesses. Rarely do educational programs on building family businesses not mention family meetings as a key to success. In fact, family business forums and centers offer specific programs on how to establish successful family meetings. While there is logic to claiming that family meetings are a key to family business success, there has been little empirical research that demonstrates the value of family business meetings or that identifies under what conditions they are valuable.

Only one of the three most comprehensive empirical data gathering surveys (Arthur Anderson & Co., 1995, Arthur Anderson/Mass Mutual, 1997; and Mass Mutual Financial Group/Raymond Institute, 2003) in the series entitled the “American Family Business Survey” even had any questions regarding family business meetings. That study, the one in 1995, found 32% of family businesses held formal family meetings. Of those that held such meetings, 91.4% reported discussing business, 52% ownership, and 49% non-business topics. Those were the limited findings. Outcomes related to having a meeting, or from the issues discussed, were not examined in the study.

A more limited study by Joseph Astrachan and Thomas Korendo (1994) found 51% of their family businesses surveyed hold regularly scheduled family meetings limited to family members in the business. Further, the research found that those firms with governance practices that included strategic plans, boards of directors, and family meetings were “...correlated with business longevity over multiple generations” (p.119), and to a lesser degree with firm revenues. Family meetings were not broken out as a separate item in the correlations so it is not possible to determine if one of these practices or some combination are related to longevity.

In a more focused study on the way family meetings impact family business, Timothy Habbershon and Joseph Astrachan (1997) built a model to show how family meetings develop family unity through the creation of perceived shared beliefs regarding goals that may be an important stimulant of collective family activity focused on actions to achieve those goals. The study keyed on the theoretical model and on the ability of instruments to measure perceived agreement and not on empirical measurements of relating family meetings to outcomes.

Empirical studies prior to 1997 did not demonstrate a relationship between family meetings and family business success. Since 1997, empirical research relating to family meetings doesn’t appear to exist. Despite the lack of empirical findings, advisors continue to discuss the merits of family meetings. Thus, in moving family business research forward, there is a significant need for empirical research focused on the impact of family meeting outcomes. The results of that research could then be used in providing a firmer foundation for advocating that families to engage in such meetings, and depending on how the research is structured, possibly provide advice on how to structure the meetings.

The research discussed in this paper is intended to help fill the gap of a lack of focused research on family meeting impact noted above. Two performance and four planning outcomes were identified for consideration in the study. The two performance outcomes are level of revenues and number of generations of the family managing the business. Both are measurable, obtainable and are generally considered to be measures of success in family businesses over time. In getting at the performance and planning outcomes, the research also includes gathering information relating to who participates in the meetings and topics discussed in the meetings.

Recognizing the importance of planning to the successful completion of engaging in directed activities to accomplish goals, completed key family business planning documents were also looked at as possible positive outcomes related to family meetings. The specific planning outcomes examined are the existence of business mission statements, succession plans, estate plans and family mission statements.

In structuring the study, the focus was on the following three questions:

1. Are family meetings related to specific performance and planning outcomes?
2. Are characteristics of family meetings (who attends, issues discussed, and issues decided) related to performance and planning outcomes?
3. Can family meetings be grouped in a meaningful way based on who attends the meetings?

The first question focuses on the fundamental issue underlying the project, which is identifying the relationship between family meetings and specific outcomes. If there is an affirmative answer to that question, then questions two and three are intended to assist family businesses in structuring family meetings to increase their impact. The inclusion of information regarding who attends meetings and what items are typically discussed are intended to look at possible mitigating variables.

## METHOD

926 family businesses in a Midwestern state were sent a survey concerning family business governance, of those, 244 returned surveys. Respondents were asked if the business was a family business, and if not, they were dropped from the sample. Only three such businesses were identified; thus reducing the sample to 241 for a response rate of 26%.

The survey was a single page with 22 questions. The first set of questions was about general characteristics of the business that could be viewed as outcome measures, including the generation currently in control of the business and revenues of the business (see Footnotes to Table 1 for coding). The second set focused on planning with questions asking if the organization had a mission statement, if the family had a mission statement, if there was a succession plan and if there was an estate plan. Finally, governance of the family business was assessed by asking if the family held family meetings, who attended those meetings and what issues were decided at those meeting. Table 1 summarizes the descriptive statistics for all of these variables. The final variable *Decision* is the number of topics decided in the family meeting for each family that held formal family meetings.

As seen in Table 1, the average company is in its second generation, most have estate plans and business missions, but many fewer have succession plans and family mission statements. Of the family businesses, 35% hold family meetings with those in attendance typically being family members employed in the business. Items most frequently decided were role and responsibilities of members in the business, stock ownership, succession, and community involvement.

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Table 1 about here

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The first analysis was to determine if holding family meetings was related to the existence of planning and/or outcomes. The second analysis was to determine if the comprehensiveness of family meetings (number of issues decided in family meetings) was related to planning and outcomes. The third analysis was performed to determine if it was possible to cluster family organizations in a meaningful way based on who was allowed to attend family meetings. If the clustering process resulted in identifiable groups, the final step was to determine if these groups differed on issues discussed, existence of an active planning process (succession plan, estate plan, family mission, business mission) and performance measures (revenue and number of generations the organization has survived).

## RESULTS

In order to determine whether holding family meetings was related to a planning process and outcome measures, two multivariate analyses of variance were conducted comparing family businesses that held family meetings and those that did not. Results from the analysis using the four planning variables indicated that the overall multivariate F was significant [ $F(4,214) = 167.87, p < .001$ ]. The univariate F ratios for existence of a family mission [ $F(1,217) = 9.74, p < .003$ ] and existence of a succession plan [ $F(1,217) = 6.07, p < .02$ ] were significant. The other two variables had F ratios with a probability of  $p < .06$ . Not surprisingly, family businesses that held formal family meetings were more likely to have a family mission statement (21% versus 7%) and more likely to have a succession plan (44% versus 28%) than those that did not. For the other two variables, the pattern was the same but less pronounced. Results for the outcome measures indicated no significant differences between family businesses that held family meetings and those that did not.

Correlations were calculated between *Decisions* and the planning and outcome variables. Results showed that there were no significant relationships between comprehensiveness of family meetings (number of types of decisions made in a family meeting) and these variables. Apparently just having family meetings, regardless of their extensiveness, is all that is needed to increase likelihood of more formal planning.

To determine if there were types of family meetings based on who participated in them, a cluster analysis was performed using just those organizations that held family meetings ( $n = 77$ ). Results of this analysis indicated a three group solution. (The four group solution resulted in two groups of four (4). These cell sizes were too small for subsequent analyses.) Table 2 presents a summary of the three groups that held family meetings plus those family businesses that did not hold meetings. A Multivariate Analysis of Variance was performed to determine which of the family meeting participant variables differentiated among the three groups of businesses that held family meetings. The results indicated that three variables differentiated between the groups, with children attending generating a significant F ratio (Metchild ( $F(2,74) = 5.91, p < .005$ )). The other two differentiating variables (those not employed in the business and in-laws) did not produce an F ratio because the within group variance was zero. See Table 2 for a summary of differences between the groups. The first group is labeled *Inclusive* (everyone is at the meeting), the second group is labeled *Adult* (only blood relatives 18 years and older attend), and the third group is labeled *Employed* (only those employed in the business attend). In effect, the *Inclusive* group is most inclusive and the *Employed* group the least.

These three groups with family meetings were then compared on the kinds of decisions made. A MANOVA was performed using the three types of family meeting participants as the independent variable and issues decided at these meetings as the dependent variable. The multivariate F ratio was not significant. There was only one univariate ratio that was significant and that was for stock ownership ( $F(2, 70)=3.97, p < .03$ ). As Table 2 shows, the more inclusive the group, the more likely they are to made decisions about stock ownership.

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Table 2 about here

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Two other MANOVA's were conducted using the groups of family meetings types plus the group that held no family meetings as the independent variable and planning activities as dependent variables in one analysis and performance outcomes as dependent variables in the other. The multivariate F ratio for planning was significant ( $F(12,609)=2.95, p < .001$ ) as were the univariate effects for three of the four planning variables estate plan ( $F(3,204) = 3.74, p < .02$ ), family mission ( $F(3,204) = 3.66, p < .02$ ) and business mission ( $F(3,204) = 3.28, p < .03$ ). As Table 2 shows the *Inclusive* group had the lowest percentage of family businesses with an estate plan. This group in contrast has the highest percentage with a business mission and the *Adult* group has the highest percentage with a family mission statement.

The performance outcome measures resulted in a significant multivariate F ratio ( $6, 428$ ) = 3.004,  $p < .01$ ) with univariate F ratio for *Revenue* [ $F(3,214) = 4.05, p < .01$ ] being significant but that for *Generation* did not quite reach the .05 level [ $F(3,214) = 2.60, p < .06$ ]. Given the exploratory nature of this study, the results for *Generation* are included with the caveat that they did not reach the present significance level. Overall, the results indicate that *Inclusive* companies have had more generations of ownership and generate more revenue with the *No Meeting* companies having the second largest number of generations but were third in generating revenue. While there were no significant effects when just comparing family businesses that had family meetings with those that did not, there were significant effects when comparing family businesses based on who participated in family meetings.

## DISCUSSION

The analysis was unable to find significant differences for outcome variables between family businesses utilizing family meetings and those that do not utilize family meetings. No relationship was found between the comprehensiveness of the decisions made in the family meetings and any of the outcome variables (*Revenue, Generation*) in the study. Significant differences were found in the planning processes between family businesses that hold family meetings and those that don't. However, these differences were not significantly related to the performance measures used in the study. This seems to run counter to the prevailing thought in family business literature. Previous research (Astrachan & Kolenko, 1995) found a relationship between a combination of governance practices including family meetings and generations and revenues. While not conclusive, this suggests that if a relationship exists, it is a more complex relationship, than has been previously examined. The complexity of the relationship became

more evident when we examined family meetings more closely on the basis of who attends the meetings. When grouping the family firms on the basis of who attends the family meetings, we found significant relationships between the different groups and the firm performance measures. Overall, the results indicate that the *Inclusive* group companies, those that include the largest percentage of family members, regardless of age, in-laws and others, have survived for more generations and generate the most revenue. However, this group of firms had the lowest percentage of firms reporting a formal estate plan. Possibly the distribution of stock ownership, given that this decision is discussed most prevalently in this group, has reduced the need for estate plans.

The group of family businesses excluding family members under 18 years-of-age and in-laws had the lowest levels of revenues and had been in existence for the fewest number of generations. These values were even lower than the values for family businesses without family meetings. However, this group does have the highest percentage of firms with estate plans and a family mission statement.

This is interesting because it suggests that just having family meetings doesn't necessarily lead to a higher level of performance. To add greater value to the family businesses, it appears that family firms need to focus on the composition of the family meeting, not just on having them. The data seems to tell us that the more inclusive the family meeting membership is, the greater will be the positive effect on the firm. What is discussed and decided upon is not as important as who participates in the process. This makes sense if we think about how the inclusion of all family perspectives and interests has the potential to have a positive effect on the quality of decisions made in the firm. The improved quality and quantity of communication, the inclusion of more perspectives and skill sets in making decisions, and the increased probability of having all of the key stakeholders in the business agreeing on the goals and direction for the business, are all potential positive outcomes of inclusive family meetings. When all of these elements are combined, they lead to better decisions which can lead to better performance of the firm. In addition, if younger family members are included, it may help to encourage them to become a part of the business when they grow up. This could be an important factor in providing future family involvement in the business assuring the continuity of the family business.

The results also imply that just creating a mission statement and having an estate plan doesn't guarantee better performance for the family business. The group with the highest percentage of firms with these plans performed at the lowest level. These plans must be communicated and implemented to have a positive impact on the business. This is more likely to occur in businesses where all family members are included in the family meetings.

Future research could be conducted with samples from other geographic regions to improve the generalizability of the research. Research should include other measures of financial performance if possible. It should also look at the value of the family meetings to family itself. Perhaps these meetings assist the family in providing family management and leadership for successive generations in the business thereby increasing the probability of successful transition from generation to generation. This would provide a valuable contribution to our understanding of family businesses.

**Table 1**

Descriptive Statistics and Variable Names for All Variables Used in Analyses

| <b>Variable Definition</b>                       | <b>Name</b> | <b>Mean</b> | <b>Std.<br/>Deviation</b> | <b>Valid<br/>N</b> |
|--|-------------|-------------|---------------------------|--------------------|
| <b>Outcomes</b>                                  |             |             |                           |                    |
| Generation controlling the business <sup>1</sup> | Generat     | 2.15        | 0.907                     | 222                |
| Revenue <sup>2</sup>                             | Revenue     | 3.50        | 1.759                     | 219                |
| <b>Planning</b>                                  |             |             |                           |                    |
| Have a written succession plan <sup>3</sup>      | Sucplan     | 0.33        | 0.472                     | 217                |
| Have a written estate plan                       | Estplan     | 0.66        | 0.474                     | 216                |
| Have written family mission statement            | Fammisn     | 0.12        | 0.325                     | 218                |
| Have a formal business mission statement         | Busmisn     | 0.61        | 0.489                     | 222                |
| <b>Family Meetings</b>                           |             |             |                           |                    |
| Hold formal family meetings                      | Fammeet     | 0.35        | 0.477                     | 223                |
| <b>Who Attends</b>                               |             |             |                           |                    |
| Family members employed in business              | Metfamin    | 0.95        | 0.223                     | 77                 |
| Adult family members not employed in bus         | Metfamot    | 0.53        | 0.502                     | 77                 |
| Family members under 18                          | Metchild    | 0.06        | 0.248                     | 77                 |
| In-laws  | Metinlaw    | 0.22        | 0.417                     | 77                 |
| Others   | Metothr     | 0.08        | 0.270                     | 77                 |
| <b>What Issues Decided</b>                       |             |             |                           |                    |
| Business roles and responsibilities of family    | Dcroles     | 0.72        | 0.454                     | 74                 |
| Which family members can be employed             | Dcemploy    | 0.34        | 0.476                     | 74                 |
| Qualifications of family to be managers          | Dcmgmt      | 0.31        | 0.466                     | 74                 |
| Compensation policies for family members         | Dccomp      | 0.46        | 0.502                     | 74                 |
| Stock ownership                                  | Dcstock     | 0.61        | 0.492                     | 74                 |
| Voting stock control                             | Dccontrl    | 0.35        | 0.481                     | 74                 |
| Dividend policy                                  | Dcdivid     | 0.32        | 0.471                     | 74                 |
| Succession                                       | Dcsucc      | 0.64        | 0.485                     | 74                 |
| Code of conduct family/business relationship     | Dccode      | 0.49        | 0.503                     | 74                 |
| Community involvement                            | Dccommu     | 0.54        | 0.502                     | 74                 |
| Methods of family conflict management            | Dcconmg     | 0.24        | 0.432                     | 74                 |
| Other decision topics                            | Dcothr      | 0.10        | 0.296                     | 73                 |
| <b>How Many Different Issues Decided</b>         |             |             |                           |                    |
| Number of decision topics chosen                 | Decisions   | 11.00       | 5.11                      | 74                 |

<sup>1</sup> Actual generation, first = 1, second = 2, etc.

<sup>2</sup> Coded 1=\$0-\$999,999, 2=\$1Mil - \$4Mil, 3=\$5Mil - \$9Mil, 4=\$10Mil - \$24Mil, 5=\$25Mil - \$49Mil, 6=\$50Mil - \$99Mil, 7=\$100Mil - \$199Mil, 8 = \$200Mil or more

<sup>3</sup> For remainder of questions a "1" indicates response was a yes, "0" it was a no.



**Table 2**Company Profiles based on Who Attends Family Meetings

| <b>Group</b>                  | <b>Family Members Attending</b>   | <b>Decisions Made</b> | <b>Planning Process Elements</b>                              | <b>Generations Revenue</b>      |
|-------------------------------|---|-----------------------|---|---------------------------------|
| 0<br>n=151                    | No Meeting  | No Meeting            | 60% estate plan<br>7% family mission<br>55% business mission  | 2.21 Generation<br>3.39 Revenue |
| 1<br>n=17<br><b>Inclusive</b> | 100% Employed<br>100% Not employed<br>24% Under 18<br>100% In-laws<br>18% Other | 87% stock ownership   | 50% estate plan<br>19% family mission<br>94% business mission | 2.47 Generation<br>4.88 Revenue |
| 2<br>n=24<br><b>Adults</b>    | 87% Employed<br>100% Not employed<br>00% Under 18<br>00% In-laws<br>04% Other   | 61% stock ownership   | 86% estate plan<br>27% family mission<br>68% business mission | 1.76 Generation<br>3.19 Revenue |
| 3<br>n=36<br><b>Employed</b>  | 97% Employed<br>00% Not employed<br>03% Under 18<br>00% In-laws<br>06% Other    | 47% stock ownership   | 79% estate plan<br>18% family mission<br>59% business mission | 1.99 Generation<br>3.51 Revenue |

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**SESSION**  
**TECHNOLOGY, INNOVATION AND BUSINESS DEVELOPMENT:**  
**THEORETICAL PERSPECTIVES**

by

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**ABSTRACT**

The concept of innovation is usually restricted to the technology or technical field. Until the 1990s, scarcely anybody talked about social innovation except, in certain cases, to refer to the likely effect of society on the emergence of technical innovation. The analysis stopped there. Thus, this article aims to broaden the analysis of innovation by examining not only its technological dimension, but also its social and territorial dimension, a notion that has recently come into use in the theories of “new economic sociology” and “socio-economic geography”. The paper is divided into three parts. Part One will review the bases laid by Schumpeter and Veblen’s founding analyses in reference to technology, innovation and entrepreneurship. Part Two will address innovation from the perspective of evolutionary economists. We will reconstruct an explanation of social innovation as a cognitive process confronted with localized social resistance, thus posing the problem of social and territorial diffusion of innovation. Part Three concludes by emphasizing the strong link between sociality, territoriality and market.

**INTRODUCTION**

The concept of innovation is usually restricted to the technology or technical field. Until the 1990s, scarcely anybody talked about social innovation except, in certain cases, to refer to the likely effect of society on the emergence of technical innovation. The analysis stopped there. Thus, this article aims to broaden the analysis of innovation by examining not only its technological dimension, but also its social and territorial dimension, a notion that has recently come into use in the theories of “new economic sociology” (Levesque et al. 2001) and “socio-economic geography” (Benko and Lipietz, 2000).

From our perspective, innovation is not considered to be the simple mechanical insertion of technical novelty into production. This perspective extends beyond the idea that there is, downstream of the invention, a social usage that is ready or naturally disposed to integrate a

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technique, a process or a particular type of organization of social relations. We argue that the continuous presence of society must be taken into account throughout the “process of innovation production,” starting with the inventor’s instinct, the different mechanisms leading to its institutionalization, the necessary efforts to construct the social usage of the invention, and ending up with its diffusion.

This perspective does not deny the role of the market in the production of innovation, but argues that the latter is embedded in society. It is essential to examine this link in order to understand the different dynamics of development which take place in territories which, while certainly specific, are related to global processes. In this paper, our analysis of the role of society in innovation processes consists of an overview, indeed a summary, of the different perspectives developed to study the innovation process. We suggest an approach that will allow us to revisit some of the different stages marking the evolution of the concept of innovation.

The article is divided into three parts. Part One will review the bases laid by Schumpeter and Veblen’s founding analyses. Part Two will address innovation from the perspective of evolutionary economists. Part Three will conclude by emphasizing the strong link between sociality, territoriality and market. In this perspective, we consider that innovation and innovative business development constitute a social and territorial construction, whose production and effects depend on local and global socio-economic contexts that are conflict ridden and hierarchical. From this perspective, the territory mediatizes and structures arrangements of production actors, organizations and decision makers, thus allowing for the emergence of specific innovation cultures but that are not isolated from nor independent of more global contexts.

### **INNOVATION AND SOCIETY: FOUNDING ANALYSES**

It must first be specified that the works by classical analysts of society and its evolution did not focus much on the notion of innovation. This lack of interest is explained, in our view, by the deterministic and unilinear conception of social change held by these authors. This conception, against which Braudel (1985) rebelled, was held by important authors such as Durkheim, Weber, Spencer and Marx. It was only towards the end of the 19th century that the concept of innovation entered into the language of sociology in a veiled way. This occurred when the notion of “imitation” was used by Tarde (1890) who explained that societies evolve through the daily accumulation of inventions -- “innovations”-- which gradually alter the lot of human behaviour. According to Tarde, the distinctive feature of human beings is to imitate fellow human beings and therefore when a new behaviour appears, it entails an “epidemiological” reaction whereby “the innovation” is imitated as soon as conditions permit. However, Tarde did not dwell on the conditions of this imitation and this vision remained marginal. It was not until the analyses by two trail-blazing authors, namely Schumpeter and Veblen, that a more comprehensive conceptualization of innovative processes emerged.

### Schumpeter's entrepreneur-innovator

Schumpeter's main contribution to the analysis of innovation is the entrepreneur-innovator. He borrows his vision of the entrepreneur or business leader from the notion of *Führerschaft* which refers to the fact that in all fields of social activity, the leader has a special role. The abilities of this leader essentially amount to initiative and will. By transposing this notion into the field of economics, Schumpeter derives from it the notion of business and entrepreneur. Business is the act of achieving and the entrepreneur is the agent who carries out new combinations of production factors (Tremblay, 1989).

For Schumpeter, the entrepreneur is not the inventor of a discovery but the one who introduces this discovery into the firm, the industry, the economy, that is, strictly speaking, the person responsible for its diffusion. In his view, economic society is run by human decisions, those of entrepreneurs, and not by ideologies or abstract social classes. This is what basically distinguishes Schumpeter's theory from the deterministic and macro-social perspectives mentioned above. Thus, change stems from the concrete exercise of a function and not from the function per se, which means that when somebody is an "entrepreneur," it is because he implements new combinations; he creates a context through which the framework of social intervention broadens and is transformed. Only this act of entrepreneurship corresponds to the role and function of an entrepreneur. Schumpeter constructs his analysis in the economic environment and sees an actor-transformer in anybody who can implement a new combination of arrangements in a firm, an organization with an economic vocation. (Tremblay, 1989)

From this perspective, the function of the entrepreneur consists in overcoming a series of obstacles. According to Schumpeter, innovation is a creative response to these obstacles. Three major types of resistance to innovation can be identified. First, the entrepreneur-innovator acts in a context of uncertainty, that is, given the information that he has, he is not sure that his project will be successful. He may use retrospective data, but these bring little certainty since nobody is using them the way he suggests. The second type of obstacle appears to be fairly obvious and was described by Schumpeter in 1935 as follows: "It is objectively more difficult to innovate than to use what is usual and proven." (translation) Lastly, the third type of obstacle -- in our view, the most important-- involves the reaction of the social milieu to the innovation, or "to anybody who wants to innovate" (Schumpeter, 1935) (translation). Thus, Schumpeter said: "It is not enough to produce satisfactory soap, it was also necessary to induce people to wash."<sup>4</sup> This metaphor still applies to the present day since it raises the issue of the social construction of usage of the invention, which is the specific feature of innovation. (Tremblay, 1989)

Although Schumpeter's works have made it possible to isolate the role of the entrepreneur as a key agent of change in economic organizations, he did not broaden the role of the entrepreneur to other types of actors in the social, political and cultural spheres. To grasp

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4. This is an excerpt of *Business Cycles* (pp. 243-244) taken up again in Marty (1955: 92).

the full complexity of the recognition of usage, the link must be made between Schumpeter and Veblen's works.

### **Veblen and the role of technology**

Veblen makes an important contribution to the economic analysis of innovation, but especially to the global and interdisciplinary examination of this subject. For Veblen, just as for Schumpeter, technology or, in his words, "the state of the industrial arts," is the key and determining economic factor in social evolution. What Veblen meant by "technology" can be summed up in two series of elements: on the one hand, a system of tools, instruments and machines, and on the other, what we consider to be the most important aspect – know-how. Veblen also used the terms "intangible assets," "collective assets" and "immaterial wealth" while referring to this technical know-how that he deemed to be more important than the tools and instruments which make up physical capital. Veblen viewed technology as an "indivisible possession of the community at large, whereas the instruments created by this technology can become man's individual property" (Corbo, 1973; Tremblay, 1989, 1992).

For Veblen, technology will only be effective if it finds the appropriate material conditions, if the required material forces are available, and if it is located in an appropriate diffusion or "propagation environment." To a certain extent, Veblen's theory is thus imbued with a degree of "technological determinism." However, Veblen brings other forces into play which will help to tone down this determinism that tends to be emphasized. Among these other forces is "culture." Indeed, Veblen views technology not as a static reality but a dynamic reality "that continuously evolves and whose effectiveness depends on a number of specific conditions." "Although it is true that technology influences culture, it is also true that culture can facilitate as well as inhibit the effectiveness and progress of technology" (Corbo, 1973, p. 295) (translation). Once again, we are getting closer to a global rather than a solely economic vision of technology.

Thus, to sum up, for Schumpeter, innovation lies in the process that leads to the generalization, even the creation of the social usage of invention. Although the entrepreneur is in charge of constructing the usage, he does so by creating on his own something that the inventor did not have, which in itself also constitutes an invention. In this respect, Veblen completes and even goes beyond Schumpeter's analysis by bringing out the effects of reciprocity between technique/technology and the social environment. For him, not only do technologies have an effect on the cultural and institutional environment, but this institutional environment itself exerts an effect on the technologies. Thus, a form of reciprocity of effects exists between the social context and the technologies (or innovation, a term that we prefer but Veblen hardly uses).

### **THE EVOLUTIONARY APPROACH: FROM CYCLICAL TO SPATIAL EFFECT**

As we have just seen, Schumpeter and Veblen's works constitute important background for the development of an analysis which embeds innovation in society. However, it was the "evolutionary" economists who completed their work by proposing a global vision of

innovation. For this movement, innovation is a *process* (Freeman et al., 1982), a “process which transmits and receives impulses, connects new technical ideas to the markets” (Le Bas, 1995) (translation), a process of problem solving, a learning process which brings into play knowledge, skills, competencies, know-how, capacities and abilities (Winter, 1987).

### **Cyclical effect of innovation**

According to evolutionary economists, the innovation process occurs in an organization or a firm; thus, their vision is closer to that of Schumpeter (Dosi, 1988). For Schumpeter, at first small or medium-sized firms were the initial sites of innovation, whereas the concentration of capital over the years has given rise to the domination of large firms and their research and development departments. However, for the evolutionary economists, these two places (SMEs and large enterprises) do not necessarily succeed one another in time but can, on the contrary, co-exist.

This seems to correspond better to today's reality in which, depending on the sectors and the degree of maturity of the sector involved, it is in some cases SMEs and in other cases large enterprises which dominate the innovation process. Moreover, these two innovation regimes can be explained by the phase a given industry is going through (Dosi, 1988). As observed by Dosi, when an industry is in an emerging phase (for example, multimedia, biotechnology, optronics, etc.), innovation tends to proceed by trial and error.

Entrepreneurs take risks and new technologies appear, leading to the creation of new enterprises. On the contrary, during the maturity phase --for example, the steel and automobile sectors where markets are quite saturated and generally oligopolistic -- technological changes and innovation in general constitute one of the, if not the main, weapons of competition.

The revitalizing potential of an innovation thus does not last forever. It runs out, which explains technological revolutions as well as the appearance of new technological cycles and the obsolescence of former technologies. As explained by Vernon (1976), whose analysis is similar to those by Dosi (1988), the revitalizing potential of an innovation is closely related to the life cycle of a product. Vernon's works show that there are five phases to a product initiated through innovation: novelty, growth, maturity, standardization and decline.

The revitalizing effect of innovation is felt during the first phases when the manufacturing of the new product creates new market opportunities, attracts capital and thus generates new enterprises, including small ones, where new usages and types of the product are developed. The creation is subsequently replaced by mass production with stricter and more intensified standards, and the revitalizing potential of the innovation diminishes. Based on his analysis of the United States, Vernon put forward an explanation of the effect of innovation on economic development. According to this explanation, development is linked to the capacity of a country, or a regional or local milieu, to specialize in the manufacturing of products which are still in their first phases and then to withdraw from it as the cycle advances in order to redirect its economic specialization towards other emerging products.

It thus paves the way for a new development strategy centred on the capacity to innovate, where growth depends on the specialization in the first phases of goods production.

### **The spatial effect of innovation**

As highlighted by the evolutionary perspective, innovations have an effect on temporal dynamics. However, they also have a major effect on the territory. This spatial effect is due to the fact that an innovation stems from the combination of the technical discovery or invention with a community's organizational and economic capacity to develop it. Yet, this combination is a specific phenomenon. As Perroux (1986) asserts, innovation does not appear everywhere nor at the same time. It appears in specific places where it brings about changes in the methods of production and therefore of consumption, where it changes production standards and from where it is diffused.

Perroux puts the diffusion of innovation in the context of a process which brings into conflict production and consumption practices induced by innovation on the one hand with, on the other hand, a community's potential to adapt to them. But to adapt to innovation does not simply mean to imitate it, as suggested by Rostow (1960) in his study on the stages of economic growth. It also and especially refers to the voluntary actions taken jointly by entrepreneurs and organizations to appropriate the innovative process, develop it, extend it, and generate a recurrent dynamic capacity. This obviously implies various types of innovation (Perrin, 1985).

Thus, a question arises: How can a milieu adapt so as to create productive groups capable of taking advantage of the effect of innovations? To pose this problem means to turn the question around. Thus, we must examine how communities react to the diffusion of the innovation. Rather than considering what effect the innovation has, we must consider how to move over to the new production practices induced by the innovation, either by specializing in the types of production that have a revitalizing potential, or by putting forward social conditions that allow the community to innovate.

Based on the evolutionary analysis, innovation is thus viewed as a social process that is linked with technologies or technical systems, as well as with the goods market and the labour market (Le Bas, 1995). This process is therefore uncertain, although not entirely so. The firm acts as an interface between these elements, mediating and making choices within the context of this set of social facts of which it is part. According to this vision, the diffusion of new production practices induced by innovation occurs through changes in production standards – changes that are passed on from firm to firm, and thus from place to place, through their productive interrelations. This diffusion is carried out within the boundaries of the firms which contribute to the innovation-induced production and is then generalized across the industries which include combinations of firms and actors.

### **The systemic territorialized effect of innovation**

The diffusion of change is accompanied by or confronted with social changes which are related to the social structure and the cultural characteristics of the different milieux. These

changes have to do with the communities' ability to adapt to the technological change induced by the different types of innovation and to appropriate them, thus in turn generating a recurrent capacity to develop innovations and produce growth. The combination of social changes which include the organizational and social structure of a community as well as the capacity to get in step with the innovations diffused throughout the industries, are conditions for the emergence of production systems characterized by innovation in specific regions and milieux (Lundvall, 1988; Wolfe, 2002; Braczyk, Cooke, Heidenreich, 2003).

Several studies have addressed the relationships between innovation and territory in this type of place by using the notions of "innovative milieux" (Aydalot, 1986; Maillat, 1992), industrial district (Becattini, 1991; Piore and Sabel, 1984) and technopole (Benko, 1991). In all cases, despite the different approaches, these notions have been used to designate the methods of arranging a community's technology, territory and organizations (Storper, 1997). The result is communities where production and society are interlinked by configuring territorial production systems. Territorial proximity allows the territorial system of firms to practically rely on economies of scale linked with the entire production process while not losing their flexibility and adaptability to the vagaries of the market owing to the segmentation of this process (Klein, Tremblay, Fontan, 2003).

The agglomeration effect of these territorial systems encourages the establishment of local forms of co-operation so as to collectively take charge of a series of individual production problems and thus ensure local governance. Therein lies the synergy induced by this type of system. This synergy is made possible by the fact that firms are part of comparable production processes and the goal of the established collective learning processes is to solve common difficulties. The implementation of these solutions means new infrastructures and is expressed through the will to strengthen the partnerships between the large enterprises, SMEs, institutions of higher learning (universities, research institutes), local authorities (municipalities, local organizations) and government institutions.

The analysis of the relationships between innovation and territory highlights the system effect created by the strengthened links between the economic, social, political and cultural actors sharing the same geographical space within a context of reticular interrelations constructed at the global level. The place is more than a localization, it is a system. There is a "place effect" which directs the action of actors. This effect is economic, political, social, cultural and ideological. It is the effect of place which leads to the hierarchical structuring of local systems, as a result of the territorial arrangements of stages and actors of a globalized network (De Bresson and Amesse, 1991; Holbrook and Wolfe, 2002).

#### **INNOVATION EMBEDDED IN THE LOCAL, THE GLOBAL, THE INDIVIDUAL AND THE COLLECTIVE**

To study innovation is to explain a process with dimensions that become determining factors and eclipse others, depending on what is being innovated. Though certainly technical and economic, the innovation process is just as social as it is political and obviously has a cultural impact. To study an innovation is to shed light on the social,



technical, economic, political and cultural characteristics that are put forward by individual and collective actors. This set of factors is significant in that it occurs in a specific place and time. Therefore, it is important to take into consideration both the territory and the temporal dimension.

We hypothesize that innovation is conditioned by a social context. Therefore, for us, the dynamic of social innovation brings into play actors who hold positions within a set of institutional arrangements. Since these groups, as demonstrated by Hollingsworth and Boyer (1996), are geographically structured on the basis of different but complementary regulatory modes of social systems, social innovation operates on the basis of these regulatory levels. Therefore, reference can be made to the existence of a set of social innovation systems that belong to geographical spaces ranging from the global space to the local space, transiting through the intermediary spaces (continental, national and regional). We are thus faced with a spatialized map linking a combination of innovation systems, some of which are moreover cross-border. Thus, innovation cannot escape from the cultural determinism of the world and the social system which embeds it, but this cultural determinism is itself organized into a hierarchy around the reality of the global economy.

Our vision of innovation emphasizes the social construction of innovation and the processes and interrelations which come into play at all levels. Our main intention was to put forward an overall perspective which views actors as well as territories as interrelated elements that are sometimes under tension. From this perspective, innovation does not in itself have a positive function linked to social progress. Social usage becomes positive or negative for a community, depending on what the social actors will do with it. Socially innovative action pertains to the field of strategy since it works on the action system of an organization or a community. Socially innovative action implies a greater structuring of the social milieu (1) prior to the innovation, through a redefinition of cultural orientations; (2) during its implementation, through the new methods of managing social relations, consultation and partnership for example; and (3) following its implementation, through pressures exerted in order to change individual and collective consumption habits. This is how 'milieux' are constructed where invention and novelty can emerge more easily and where the cycle leading to the recognition of its social usage and institutionalization speeds up, thus establishing innovation systems.

This brief overview of the different approaches to the role of society in innovation processes and business development leads us to conclude that innovation results from acts that are certainly individual, in the sense of a leadership exerted by an individual, but that are reticulated, framed and made possible by a favourable or unfavourable cultural and social context, by a fairly conciliatory economic context and by negotiations taking place between actors who are more or less in agreement with the definition of a new social usage. Therefore, social innovation encompasses both the fact of innovating, that is, a culturally-oriented inventive act, a product of the imagination or chance, and the institutional process of social recognition of its usage, that is, as it becomes established.

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## **OFFSHORE OUTSOURCING: THE IMPACT ON BUSINESSES**

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### **ABSTRACT**

The concept of outsourcing is a business practice that has gained momentum. However, many view this trend as a plague that is deteriorating American professional jobs. At the same time, many companies have incorporated outsourcing as a critical strategy in business planning. However, political opposition across the nation to outsourcing American jobs is strong. Legislatures without a doubt are going to introduce new bills or laws to prevent or at least limit offshore outsourcing. This paper investigates the advantages and disadvantages of outsourcing, the global market, and the political ramifications of outsourcing information technology, especially offshore.

## **INTRODUCTION**

The popularity of outsourcing continues to gain momentum in both the private and public sectors. In the mid-1990's, outsourcing was viewed as a viable solution to achieving cost control and production efficiency. Many companies began to incorporate outsourcing as a critical strategy in business planning. Today, because of historical successes, corporations are turning to outsourcing for a wide range of functions from logistics to human resources to customer relations. The reasons include cost, quality, performance, supplier pressure, access to special technical and application skills, and other factors. (Applegate, 2003)

The government sector also is increasing its use of outsourcing. At one time, government outsourcing was primarily applied to contracts in areas such as maintenance, security, and food services. However, the government is finding it necessary to follow the commercial trend to outsourcing a wide range of functions, including information technology functions. (Office of Information Technology, 1998)

Outsourcing is critical to U.S. organizations as they endeavor to become or remain competitive in the global economy. It is for this reason that this paper investigates the advantages and disadvantages of outsourcing, the global market, and the political ramifications of outsourcing information technology, especially offshore.

## **IT OUTSOURCING**

Outsourcing is typically defined as when a buyer transfers ownership of a process to a supplier. Manufacturing, for example, has been using offshore arrangements for decades as a way to drive down costs and boost production. The IT industry is following a similar path. Before 1990 the major drivers for outsourcing were primarily: cost-effective access to computing power or system development skill, avoidance of building IT in house, access to IT skills, and access to special functional capabilities (Applegate, 2003). In the 1990s the production of IT hardware moved offshore, resulting in price reductions of 10% to 30%. Thus, if moving jobs offshore means lower costs, then a company can sell its products at a lower price, and everyone gains. When computer hardware began to be made abroad, prices plummeted. Therefore, if software prices decline, then small- and medium-size companies will be able to afford to adopt more technology solutions. (Mann, 2003; Haydik, 2004)

Two factors have affected the growth of IT outsourcing:

1. Acceptance of strategic alliances - The value of strategic alliances is widely recognized and interrelated forces motivate their creation.
2. Changes in the technological environment - IT integration of internal systems with those of customers and suppliers and the process of changing organizational structure to compete efficiently in the global marketplace.

According to a study by IDC, spending by US customers on offshore IT services will continue to concentrate heavily on applications, with most activity in the areas of custom application development, application management and systems integration. Global investment in offshore

IT services will grow from nearly \$7 billion in 2003 to \$17 billion by 2008, new research has predicted. It is predicted that the countries poised to win from this growth in outsourcing will be India, the Philippines and China, joined by central and eastern Europe. The procurement of IT services is not only growing as a share of the total IT services market, but is expanding from traditional IT services, such as application development and maintenance. (Intetics, 2003).

## **GLOBAL MARKET**

Businesses are beginning to look outside of established outsource providers for a variety of reasons: cost, risk mitigation, specialized technology and language skills and proximity to the U.S. But the infrastructure to support IT services varies from region to region. India, China and Russia (among others) are churning out vast numbers of very bright and capable technology workers. These countries have discovered that the initial investment in a technology infrastructure is far lower than the initial investment in a traditional asset-intensive industry, i.e. manufacturing automobiles. With a sense of vigor and vision these nations have burst onto the tech scene in a very short time. Currently, India leads the pack as the prime location for offshore IT operations such as code maintenance, help desk and desktop maintenance. As the worker base becomes more skilled and as demand increases for India services, wages are increasing. Some economists feel that India's wages could rise so fast that they could push much of the offshore labor market from India to China and Southeast Asia in the next decade (where wages remain lower). Outsourcing service providers in African countries are at a more basic stage of growth than those in the Philippines. Although South Africa is already home to a handful of international services providers and homegrown providers, other countries on the continent are just beginning to build industrial parks to capture a share of the offshore outsourcing market. U.S. companies, however, might not need to look very far abroad for outsourcing services, especially if cost is not the major issue, and language is a consideration. Canada has a telecom infrastructure virtually identical to the U.S. Mexico, however, offers some cost advantages and is particularly appropriate when Spanish services are required. (Swoyer, 2004)

## **ADVANTAGES TO IT OUTSOURCING**

The drivers of outsourcing include general managers' concerns about costs and quality, breakdowns in IT performance, intense vendor pressure, simplified general management, financial factors, corporate culture, eliminating an internal irritant, and other factors (Applegate, 2003). It appears that organizations that outsource for long term, strategic reasons often are more satisfied with the outsourcing results than those that outsource for short term, tactical reasons. U.S. companies cut or at times eliminate unwanted costs when jobs are outsourced to international suppliers. By doing so, these companies now have the freedom to be more flexible when making IT business decisions for their companies. Outsourcing is a means by which revenue is generated, production is improved, and the U.S. economy is increased. More resources are also made available which in turn provides quicker products to the marketplace.

Moving certain business functions to other offshore companies allows a company to have no overhead costs. For instance, offshore companies provide their own facilities to do the work. There is no need to recruit, hire, or train new employees at all for the company. Also, other expenses related to employees such as insurance, worker's compensation, social security, and

company benefits are all gone. Offshore companies "pick-up" the tab where in the meantime U.S. companies are again cutting costs and increasing profits to boost the American economy. In deciding which company to choose, U.S. businesses can tap into an international pool of highly talented, experienced workers who can do the same skilled job at a lower price. With this in mind, any project that is handed over to a potential vendor will be placed under highly qualified proven individuals who work together effectively. U.S. companies are then able to vary their involvement however they wish. Having well documented processes in place for service jobs, corporations can trust that it will be completed on time, within project budget, and meets the specified criteria as given to the offshore vendor. It can be argued that outsourcing projects to offshore companies improves a company's main focus on the job at hand and not on unneeded tasks. (Kalakota, 2004)

Coupling innovative approaches with offshore outsourcing can payoff for everyone. Consider the case of Net Scalar Inc., a Silicon Valley maker of network switches that speed online applications such as Google searches. It had to cut its 100-person staff to 55 in 2002 after the September 11 attacks dried up sales. To survive, it launched an operation in Bangalore. Round-the-clock work in the U.S. and India helped it pack leading-edge data compression and security features into its latest product. Now, with sales jumping more than tenfold, to well above \$10 million last year, it has boosted its U.S. staff to 105, even larger than before. (Hof, 2004)

### **DISADVANTAGES TO IT OUTSOURCING**

As with all new initiatives that are implemented into a company's business strategy, there are some drawbacks to outsourcing. They include but are not limited to language and cultural differences, displaced American IT professionals, loss of intellectual property or trade secrets, foreign political infrastructure, hidden costs, unfamiliarity and lack of experience with offshore providers and their capabilities. All of the aforementioned weaknesses are important and significant for a company that is considering outsourcing. Language and cultural differences are the critical weaknesses that are causing some corporations to reevaluate which IT functions should be outsourced. One big name company that has decided to return certain offshore work to the U.S. is Dell Corporation. Dell brought back a technical support center after corporate clients complained about communication and service. Fundamental language and cultural differences derail the cost savings that are suppose to be achieved with outsourcing.

The losses of intellectual property or trade secrets are threats to corporations because offshore workers come in contact with specific operations during the course of normal work. As part of learning operations, offshore workers can gain knowledge that can be applied to other projects down the road. This is a positive thing if these projects are done on the company's behalf. On the other hand, the company's accumulated knowledge may be applied to solutions for other customers at a later date. Since most offshore workers are employed as contractors, there is the distinct possibility that this knowledge will be applied to competitors' solutions.

Various studies show that 20% to 35% of IT outsourcing contracts are not revived after the y expire. Most customers in these cases are not satisfied with the quality and/or price of the services. (Intetics, 2003; Swoyer, 2004)

## **POLITICAL RAMIFICATIONS**

Losing jobs to offshore outsourcing has created a hot political issue in the United States. As long as the economy continues to struggle, the pressure to keep IT jobs in the U.S. will be strong. Today, state and federal legislatures are trying to discourage offshore outsourcing of IT jobs to foreign countries. In May 2004, Tennessee was the first state to pass legislation aimed at preventing offshore outsourcing of its IT services. The new law states that contractors that keep data entry, call center and other IT support jobs in the U.S. will receive significant preferential treatment during the bidding process on future new contracts. This is not surprising because many other states are considering similar actions too. Legislatures are being pressured to introduce new bills or laws to prevent or at least limit offshore outsourcing.

Political opposition across the nation to outsourcing American jobs is strong. An amendment known as the Dodd Amendment, which was introduced in February, 2004 and passed in March by the Senate, is another step to stopping the needless exporting of American jobs. It prohibits offshore outsourcing of federal, state, and local government contracts where federal dollars are involved. However, the Dodd Amendment includes a provision that the Secretary of Commerce must certify that these anti-offshore outsourcing measures will not harm the U.S. economy. So far, the House of Representatives has yet to consider the Amendment as law yet and it is unclear what will happen in the future. Nonetheless, the issue is not going away.

## **SUMMARY**

Outsourcing will continue to grow to be an accepted way of doing business as companies focus more directly on customer service and cost/budget reductions. As the concept becomes more accepted and outsourcing opportunities expand, the process will be more clearly outlined. Companies will accept outsourcing as another tool to improve services and reduce costs. Properly used, along with modular contracting, past performance initiatives, outsourcing will provide firms with the means to achieve excellence. Finally, firms will become comfortable with the entire process. They will approach outsourcing as a management tool that solves long term, strategic problems rather than short term, tactical problems. In doing so, companies will work with their alliances to realize successful outsourcing efforts.

IT outsourcing will continue to be a critical strategy to efficient and effective business operations. There are obvious benefits that offset the disadvantages. However, the political ramifications are certain to drive the decision-making regarding the market exchange process.

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## **LIVING WAGE ORDINANCES AND SMALL BUSINESS**

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### **ABSTRACT**

During the last decade over 100 governmental units (primarily cities) have implemented living wage ordinances. These regulations require employers who receive public funds through subsidies and contracts to pay their workforces a wage based on a definition of “need” rather than “skills.” Such ordinances feature a minimum wage floor that is higher—and often much higher—than the traditional minimum wages set by state and federal legislation. This paper provides a history of the living wage movement and presents challenges small business owners must address in their decision-making regarding this highly controversial and politicized issue.

### **INTRODUCTION**

Two key efforts in the United States wage movement attempt to assist low-income families in freeing themselves from poverty by increasing their incomes. The first involved the enactment of a minimum wage. At the outset of the 20<sup>th</sup> century individuals and pro labor organizations lobbied for a minimum wage and this quest for wage reform turned to a fight for a legislated minimum wage and, ultimately, to the passage of the national Fair Labor Standards Act in the 1930s (Glickman, 1997). Numerous states have at times imposed a higher minimum wage than today’s \$5.15 per hour.

The second effort in the wage movement involved the development of a living wage at local levels and is a more recent innovation. Recently a number of books have addressed issues of the working poor and how laws at (chiefly) the city and county levels can be designed to assist these individuals not only in terms of a higher minimum wage, but also with respect to medical coverage (Shipler, 1998). Collectively, these local wage campaigns have emerged under the rubric of “living wage” statutes. A living wage involves local legislation that requires employers to pay a certain wage above the federal or state minimum wage level under predetermined conditions to a specific set of employees. In general, beneficiaries include employees of contractors or subcontractors with city service contracts or those businesses that have received economic development subsidies or financial assistance from cities or other governmental entities (Varricchione, 2001). Living wage mandates differ from a traditional minimum wage in that the living wage is, at least theoretically, tied to meeting some standard of living and only applies to employers who receive some benefit from the government. The goal of living wages, like that of minimum wages, is to raise incomes of low-wage workers in order to reduce poverty.

### **A HISTORY OF LIVING WAGE**

In 1994, Baltimore, Maryland was the first major United States city to pass a living wage ordinance, followed a year later by ones in Milwaukee, Wisconsin, and by Santa Clara County,



California. By mid 2004, according to the Association of Community Organizations for Reform Now's (ACORN) Living Wage Resource Center (ACORN, n.d.a), there were 120 entities (cities, counties, school boards, colleges, and universities) with living wage policies.

Such ordinances require wages to be paid based on some definition of need; that is, a wage that is commensurate with workers' needs as consumers (Glickman, 1997). A needs-based or consumerist understanding marks a departure from a more traditional one that asserts workers may expect wages corresponding to the value of the product(s) or service(s) they produce (Glickman, 1997). Living wage opponents object to the idea of paying workers above that which they currently draw in the labor market, thus interfering with the workings of the free market.

Living wage ordinances have been selectively applied to private sector employees who receive public funds from city or county contracts or economic development subsidies to pay at least enough to keep a family of four out of poverty (Reynolds & ACORN, 2003). Supporters of living wages argue that requiring a set-level of wages in government contracts is nothing new and that, for example, the Davis-Bacon Act was enacted by Congress in 1931 and required that union-level wages (higher than non-union wages) be paid to all workers on federal construction projects. This concept was incorporated into many state laws and local ordinances which are commonly referred to as "prevailing wage" laws, a mandate still in force throughout the U.S., and one commonly accepted by both the buying and selling communities (Matthews, 2002).

The "living wage" label communicates that the higher wage levels are closer to the pay that full-time workers need to support themselves and their families at a subsistence level (Matthews, 2002). By restricting the beneficiaries of ordinances to a select group of full-time workers, advocates of living wages highlight the inherent moral worth of *earning* rather than *receiving* a living income and thereby negating the "...danger of the 'undeserving' poor receiving 'something for nothing'" (Nadeem, 2004).

The living wage movement in the United States has gained momentum and has become a significant local public policy trend as evidenced by those having implemented living wage laws over the last decade or so (Elmore, 2003). A number of trends in national and global economies may have contributed to these living wage campaigns and resulting ordinances. Some factors may be attributable to the growing gap between rich and poor, growth of the temporary workforce, mounting large scale lay-offs, declining real wages, the loss of union membership, the failure of the federal government's minimum wage to keep pace with inflation, and loss of various governmental supports for the working poor (Buckley, 2003).

Even though living wage policies seem to be gaining popular support across the country, not all responses have been favorable. Opponents, such as Michigan State Senator David Jaye (R), have gone so far as to introduce legislation to outlaw the living wage ordinances which were passed by five communities in southeastern Michigan. Senator Jaye stated, "These bleeding heart liberal advocates of paying people an artificial high minimum wage are actually destroying the jobs of welfare recipients, minorities and young people" (Ellis, 2004). Other states and lesser legislative governmental units have not taken such an adversarial approach and have basically acquiesced to the concept by doing nothing to prohibit it. With such an emotionally charged issue, legislative authorities and small business people must be prepared to address the concept.

## CURRENT IMPLEMENTATION

While living wage campaigns vary in scope, they generally are founded on two basic beliefs: 1) public tax dollars should not be used to subsidize employers who pay poverty-level wages and 2) workers who have full-time jobs should not be trapped in poverty. The Economic Policy Institute estimates that most living wage ordinances cover less than 1% of the local workforce (Economic Policy Institute, 2004). Even supporters understand the campaigns to be merely necessary first steps in poverty alleviation (Spain & Wiley, 1998). Pollin and Luce (1998) argued that “among other things, successful living wage campaigns create political momentum that can be used to build support for more ambitious measures to eliminate low-wage poverty in the United States” (p. 3). Thus, living wage campaigns appear to aim for short-term victories and then seek to extend those gains on a larger scale through a process of “imitation and diffusion” (Martin, 2001) so that more and more political entities adopt living wages. Narrowing the coverage of ordinances to employees of contractors and sometimes of city or county governments enhances the passage of such ordinances. “The ultimate potential of a living wage campaign is not just changes in government policy, but the opportunity to take concrete steps toward building an economic democracy movement” (Reynolds & ACORN, 2003).

Living wage regulations vary considerably in coverage and scope (see Table 1) and are often explicitly pegged to the wage level needed for a family with one full-time, year-round worker to reach the federal poverty level. The rates specified by living wage ordinances range from a low of \$6.25 in Milwaukee, Wisconsin to a high of \$14.75 in Fairfax, California (*Living Wage Facts*, n.d.). Some ordinances incorporate yearly adjustments based on the annual update of the federal poverty index. Some calculate adjustments according to an inflationary index. Still others mandate that both of the above adjustment methods be computed and that the one producing the highest living wage be implemented.

Many ordinances include requirements for health benefits. For example, the Hartford Municipal Code provides that if health benefits are not given, compensation must be made based on the average cost of comprehensive health insurance in Connecticut. Most ordinances clearly state that no employer shall respond to its provisions by reducing health insurance benefits. Some living wage laws exempt certain categories of city contractors, such as non-profit agencies. Many apply the requirements only to service contracts or business subsidy awards above a specific size, or to firms with a certain minimum number of employees. Most laws require employers to pay the higher wages and benefits only during the time that employees actually perform publicly funded work. Under some laws, the city or county may grant exemptions to individual firms that demonstrate that they cannot reasonably afford to pay their employees a living wage due to budgetary or other constraints (Elmore, 2003).

Posting, record keeping, and reporting requirements, as well as penalties for violations, are often included in living wage ordinances. Actual compliance with living wage laws is generally left to the employer, subject to audit and verification by a political entity. If an employer is discovered to have violated the specific provision by not paying a living wage, the statutes generally impose some form of penalty, though there is no uniformity of penalties among the existing statutes. For example, a Somerville, MA ordinance not only suspends contract payments to employers if they

fail to comply with its living wage law, but also imposes a \$500 a week penalty for each employee found to have been paid incorrectly (City of Somerville Ordinance, 2004).

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Insert Table 1 about here  
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There are three prominent features of living wage laws nationwide (Neumark & Adams, 2003a). First, all living wage ordinances feature a minimum wage floor that is higher than the traditional minimum wages set by state and federal legislation. Many ordinances are directly tied to guidelines establishing the federal poverty level, therefore automatically establishing a new wage level needed for a family each year, which is above this level.

A second feature of living wage ordinances is static family size, even though poverty levels vary dramatically depending on number of children and adults in a household. Generally, ordinances do not consider the income of other family members. For example, if two adults of the same family work for a covered contractor both would receive the living wage, placing their combined family income well above the poverty level. These situations suggest that living wage laws may not target genuine family needs, a criticism also leveled at minimum wages (Neumark & Adams, 2003b). However, living wage laws may affect a substantially different set of workers than do minimum wages, implying that the effects of living wages on poverty require separate study.

Finally, coverage by living wage ordinances is far from universal. The most common coverage—and also the most narrow—is restricted to companies under contract with a given city or public entity and the percentage of workers covered is typically, as indicated earlier, in the 1% range. Some living wage laws are applied to companies receiving business assistance from the city (ACORN, 2004). The least living wage coverage is that imposed on cities themselves in covering their own employees. Regardless, narrow coverage contrasts with minimum wage laws which apply to nearly all workers. Thus, living wage laws impose high wage floors, have an antipoverty objective that is often reflected in the choice of the wage floor, and often apply to what may constitute a relatively limited group of workers.

## **LIVING WAGE CONSIDERATIONS FOR SMALL BUSINESS**

Small firms have had a significant positive impact on the United States economy (Megginson, Byrd, & Megginson, 2003). One way that they do this is by providing jobs and training to low-skilled workers. Card and Krueger (1995) conducted an important systematic inquiry into the characteristics of employers who hire minimum-wage employees. Among their main findings were that almost 60% of all minimum-wage workers are employed at establishments with less than 25 workers. Firms in retail trade and service industries were found to employ over 80 percent of minimum-wage workers, with more than half of all such workers being employed in the retail industry alone. Card and Krueger (1995) additionally found that small businesses were more likely to pay the minimum wage than large businesses. These findings are consistent with the work of Brown and Medoff (1989) who determined that smaller employers pay lower wages than larger ones. This is especially true for adult low-skilled workers, for whom small businesses provide a disproportionate

number of jobs. Similarly, Loeff and her colleagues (Loeff, Berger, Black, Scott, & Allen, 1999) found that of all minimum-wage workers, about 54% work in firms with less than 100 employees, while 46% work in firms with 100 or more employees, and about 40% of all minimum-wage workers are employed in firms with less than 25 employees. Smaller firms, then, tended to have a greater share of minimum-wage workers than did larger firms.

Loeff and her research associates (Loeff et al, 1999) also examined the effects of raising the minimum wage by firm size. This analysis of wage growth in small and large firms turned up no major surprises. In general, while the effects were small, raises in the minimum wage appeared to have adverse effects on workers in terms of job loss in both small and large businesses. However, as indicated above, small firms employ a greater share of minimum-wage workers than do large firms. Therefore, it is important to take into account the effects of minimum wage changes on small businesses when contemplating a change in the minimum wage because they and their workers are likely to disproportionately bear any adverse effects resulting from the change.

Following this rationale, if living wages essentially require a higher mandated minimum wage for covered businesses and these organizations are smaller firms tending to have a greater share of minimum-wage workers than larger ones, then it could be expected that such small firms will be impacted to a greater degree by living wage ordinances than other organizations. Consequently, it would benefit owners of small firms considering city/county contracts to make sure that they are fully aware of the ramifications of living wage laws for their organization.

With this in mind, small business vendors may elect to review the following questions so as to prepare themselves for dealing with living wage legislation that is increasingly being passed in local jurisdictions across the nation. Not all questions may be relevant to each business but hopefully these items will trigger appropriate action by key decision makers in small firms to address this significant threat in their operating environment. Such questions might include:

- Does the city/county have a living wage? What is the actual amount/level of this living wage? Are health benefits or other benefits such as mandatory vacation or sick leave required as part of the living wage ordinance? Have these increased labor costs been included in a small business's contract pricing?
- How and when will increases in the base wage be determined? Yearly increases pegged to inflation level or poverty level?
- Which of small business employees are covered by the living wage ordinance? Full time or part time or both?
- In some cities there are exceptions for certain businesses due to such things as hardship? How does this apply to a particular small firm?
- Which city/county department will oversee implementation and enforcement of living wage ordinances and how will this impact a specific organization?
- What kind of reporting will be required by participating businesses?
- Who will administer the living wage in the small business?
- If violations occur, what kind of penalties could be imposed on businesses? One-time monetary fines? Fines and back-wages due to covered employees? Immediate suspension of a service contract and/or future prohibition from bidding for other contract awards or financial assistance?
- Are the higher labor costs inherent in living wage ordinances absorbed by contractors

- or can such cost increases be easily passed through to cities?
- Are layoffs an option in addressing increased labor costs?
- With the higher mandated living wage, can small firms recruit more skilled employees?—perhaps employees with more experience, better English language skills, more education?
- To compensate for the higher wage costs, can certain functions be automated?
- Will your organization simply stop bidding on city contracts requiring a living wage to be paid?

## CONCLUSIONS

In recent years, living wage ordinances and campaigns have emerged as a grassroots response to the declining real value of the minimum wage, the growth of a low-wage service sector, and widening economic disparities. While living wage ordinances have been passed in over one hundred jurisdictions, it should be noted that some municipalities and counties have repealed such legislation (ACORN, n.d.b), and some ordinances declared in violation of state constitutions. For example, the city council of Omaha, NE simply repealed the ordinance after one year (over the veto by the mayor) (Employment Policy Foundation, n.d.), and the living wage ordinance passed by the city of New Orleans, LA was subsequently invalidated by the state supreme court as being unconstitutional because it was said to usurp the power of the state (*New Orleans Campaign*, 2002).

Small business owners doing business with (chiefly) cities, considering doing business with cities, or receiving subsidies or assistance from local jurisdictions, should be aware that living wage legislation is increasing significantly and must factor such mandated wage increases into their budgets and proposals to municipal authorities. Failure to do so may result in a seemingly favorable relationship with a city becoming burdensome and potentially unprofitable.

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Table 1. Information on Living Wage Laws (after ACORN\*; Neumark & Adams\*\*)

| <b>City</b>             | <b>Coverage Specified in Legislation</b>   | <b>Wage Provisions</b>   |
|-------------------------|--|--|
| Baltimore, MD           | Construction and service contracts > \$5000.   | Passed in December 1994 but wage requirements were as follows: July 1995 (\$6.10); 2003 (\$8.70)   |
| Cincinnati, OH          | The city itself as well as any city service contractor with a contract > \$20,000  | 2003 (\$8.70, \$10.20 w/o health benefits)   |
| Hartford, CT            | Contractors > \$50,000; commercial development projects receiving subsidies > \$100,000  | 110% of poverty level with health benefits; 2003 (\$9.54; \$11.55 w/o health benefits)   |
| Berkeley, CA and Marina | Direct city employees, businesses with city contracts, financial assistance recipients, and businesses that lease land from the city; later amended to include the Berkeley Marina, which is City-owned public land thereby creating first area-based living wage policy | 2003 (\$10.76; \$12.55 w/o health benefits)  |
| St. Louis, MO           | Contractors and businesses receiving tax breaks  | 130% of poverty level for family of three (assuming 2080 hours annual hours with benefits, plus \$1.39 per hour for health insurance: 2003 (\$9.54, \$11.63 w/o health benefits) |
| Burlington, VT          | Direct city employees and employees working on city service contracts or for businesses that have received grants from the city of at least \$15,000   | 2003 (\$11.67; 13.49 w/o health benefits); wage rate adjusted annually guided by a state-issued "basic needs budget;" at least 12 compensated days of leave                      |

\*ACORN (n.d.b). *Living wage wins*. Retrieved May 27, 2004, from <http://livingwagecampaign.org/shortwins.php>.

\*\*Neumark, D., & Adams, S. (2003a). Do living wage ordinances reduce urban poverty? *The Journal of Human Resources*, 38, 490-521.

# TEACHING ENTREPREURSHIP TO THE CREATIVE ARTS

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## Abstract

### Teaching Entrepreneurship to the Creative Arts

The theory is that students provided with a better understanding of the unique business practices and industry models found within their performance arts career areas of their interest will be better able to complete elements of a typical business plan. This includes market analysis research that corresponds to both the product and service methods of delivery and corresponding historical, current, and future industry trends. In addition, a market analysis in the performance arts industry should consider external and internal influences and financial variables that may positively or negatively affect the success of the company's products which are often based on successful emotional consumer satisfaction.

***"We didn't know this was a business, we just thought it was a rock & roll party."***

— Vince Neil of Motley Crüe<sup>i</sup>

## Introduction

The process of teaching entrepreneurship to the creative arts community is often perceived as the same as teaching entrepreneurship to any business related industry. After all, entrepreneurship is entrepreneurship. However, the purpose of this paper is to theorize that additional industry related concepts, information, constructs, and methods of operations should be added to the curriculum for performance arts students in entrepreneurship classes. Thus, this paper is a concept analysis of the additional subjects that entrepreneurial instructors may want to add to their traditional curriculum and business plan presentations.

***"Entertainment - not autos, not steel, not financial services - is fast becoming the driving wheel of the new world economy."***

— Michael J. Wolf Media Consultant<sup>ii</sup>

## Entrepreneurship Education in the Performance Arts

The Arts, Entertainment and Recreation Industries Report by the United States government, claims that the industry generated about \$128,904,000,000 from taxable and tax exempt employer firms in 2001. Thus, it is important that entrepreneurship classes be offered to individuals interested in careers in this lucrative business.

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The down side is that the entertainment industry is very unique and at the same time, an exceptionally mature business struggling to reinvent itself due to technological, computer, internet, and copyright issues. The shift in the business model is one toward consolidation of traditional media corporations and in unison, entrepreneurial opportunities for creative artists. Hence, it is vital that instructors provide more than a business plan based on the traditional curriculum materials when teaching performing arts students.



**"The brain seems to be a sponge for music and, like a sponge in water, is changed by it."**

**—Newsweek Magazine by Sharon Begley<sup>iii</sup>**

### **Entertainment and Intelligence**

Research appears to support that some forms of human intelligence are actually enhanced by the performing arts (music). There is an indication that our brains may even be pre-wired for it! Scientists have interspersed PET scans and MRIs with snatches of Celine Dion and Stravinsky to show a correlation for the biological foundations of music.<sup>iv</sup> *Music affects the mind in powerful ways: it not only incites passion, belligerence, serenity or fear, but does so even in people who do not know from experience, for instance, that a particular crescendo means the killer is about to pop out on the movie screen.*<sup>v</sup> Research at the University of California and the University of Wisconsin recently found a connection between the use of music and young peoples improved math skills. They found that the neurons connecting the two sides of the brain in young musicians are larger which appears to help planning and foresight skills.

### **Product Value**

Many years ago, a young man walked into a Memphis recording studio, cut a record for his mother, and became at that time, the biggest rock star to grace the planet. Elvis Presley made it happen by having the talent to sing, a passion to entertain, the initiative to learn from others through listening, watching, and asking questions, and, most importantly, by being in the right place at the right time. Elvis didn't, however, become a world famous recording artist by himself. He used his vocal talents, good looks, and assertiveness to get his foot into the door of the music business, and it was the music business, or more precisely, the people who make up the music business, that helped make Elvis "the king" of rock and roll.

Artists often believe it is their "talent" that makes them rich and famous. Sculptors, songwriters, painters, scriptwriters, film producers, actors, and countless others perceive their personal expressions of creativity as valuable. In reality, it is the consumers who buy, rent, lease or simply use products developed out of an artist's creativity that determine its' (and therefore the artists') economic and social value. As a result, instructors in entrepreneurship classes of creative artists should understand and convey the difference between the value of a widget sold to consumers to fulfill a need such as a type of soap or mode of transportation, then a creative product (song, film, book, sculpture, painting) sold, rent, leased or used by consumers to satisfy a personal emotional construct. Thus, the potential value of products created by artists should be based on consumer emotional gratification instead of quality. Consequently, artists with vary limited talent, such as recording star Eninem or film maker Michael Moore, often become very wealthy entrepreneurial "personalities" because of their abilities to provide an emotional message through the entertainment products they create. Consumers discover varies levels of emotional satisfaction from their use of the entertainment products and thus, dive into their pocket books and purses to pay for the products.

Instructors should teach how performing arts products have communicative values instead of projecting potential profits and losses based on an artists' perceived talent. Historical research on the gross income and consumer trends of similar products (film, and music as examples) with similar communicative messages can project market typologies and potential sales quotas. Business plan projections may be tied to best and

worse case scenarios correlated to similar product successes. In addition, the economic value of the performance arts products should be based on copyright ownership valuations tied to income streams and equity multiples. Marketing plans and therefore the cost of distribution, promotion, and publicity, should be based on the communicative message perceived by and used emotionally by various types of consumers to drive sales and usage. Thus, the artist's image (hero, warrior, rebel, or lover as examples), are tied to communicative messages linked to the products being sold or used by consumers. Successful messages (products) generate billions of dollars. Products (songs, movies, books, poems, pictures, painting, and sculptures) that do not communicate a viable and clear message (image or theme) to consumers (no matter how talented the artist and of high quality the product) usually fail to generate profits.

### **Business Plans**

In the performance arts industry the business is often defined as both a product and a service. Different revenue streams correspond to the same message provided as a service (recordings broadcast on radio or sung live on television) as opposed to a same recordings sold on DVD and CD. Market analysis must correspond to both the product and service methods of delivery and corresponding historical, current, and future industry trends. Thus, a market analysis for a business in the performance arts often requires a deep niche of relevant information based on similar products successes and failures that convey emotional communicative constructs to potential consumers. However, to make it even more complicated, consumer's emotional needs are not always stable. Hence, a market analysis should consider external and internal influences that may positively or negatively affect the success of the company's products. Once the proper projections are made a strategic analysis can be used to establish the economic of scale that fit the projected demographic and psychographic consumer typologies. Then, because the instructor has added additional information about the unique variables in the performance arts industries, the projected balance sheets, cash flow analysis, and profit and loss statement may be completed.

### **Entrepreneurial Opportunities**

Internet use and file sharing are causing traditional media and entertainment companies to merge and change their business models. Of course, change in the performance arts industry opens the doors to many creative entrepreneurs who previously sold themselves and their creative products to traditional industry related marketing companies. Now with the use of technology and the ability to link industry related knowledge of entrepreneurship to the performing arts industry, creative artists can actually become financially successful businesses themselves by selling their own image and products and by lowering the economics of scale to a more profitable and controllable margin.

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### **Business Equity and Value**

The artist's and their corresponding products often enhance a listener's constructed pathos. Thus, there is little doubt that the value of an artist's product is tied to consumers' emotional constructs (personal satisfaction) and therefore economic value. It is important for students to understand how business is conducted in each of the unique area of the performing arts. As an example, in the music business thanks to the consumers, fans, and businesses who continue to buy and use music songwriters and

music publishers own valuable assets in the gross potential of their songs (copyrights). The following is a detailed example of information that is important for entrepreneurs who want to start a company in the entertainment business. As an example in the music industry, *publishers* build their company's value through the revenues they generate from the songs they own. *Songwriters* also build a personal/company value through the royalties they have been paid and the potential royalties they are to be paid from the songs they have written and the publishing deals they have made. *Both have financial values far beyond the typical annual royalties paid.*

Therefore, compared to a straight job, payment scheme are often different in the performance arts industries. It is important that instructors provide this information to students. Most of us get paid for the work we do each week. The wonderful thing about the music business, as an example, is that great songs and recordings continue to earn royalties years after they were originally created. As an example, in 1998, the Beatles made more money then when they were together playing concerts and recording. Most artists think they have to work next week to pay the bills from last week. However, in the music business as an example, the money from great songs and recordings just keeps rolling in if, you have a good original deal and didn't get taken when you signed your contract. Music publishers use a *business facto multiple* of between 5-12 times the average gross revenues generated by their business over several years to determine the value of their businesses. Thus, a music publishing company that averages a gross income of \$12 million could be sold (if they can find the right buyer) for as much as \$144 million (12 million dollars average gross times a factor of 12). Songwriters can also leverage their potential royalty revenues for bank loans and stock market mutual funds to banks and companies that work with entertainment personalities. In addition, equity is usually defined as the amount of the company (music publisher) or share of the revenue stream (songwriter) you own.

Permission to use a copyright (a song) is usually granted through the issuing of a license. Compensation for the use of the song is paid as a licensing fee. Both songwriters and music publishers must continually monitor infringement actions. However, songwriters often feel the publisher may have failed to place the song with the right artist, advertising agency and so on. Nevertheless, it is important to remember that honest music publishers are only paid from the royalties they generate. Publishers take a financial risk when they sign a song. They must complete a demo recording, print sheet music, file for a Certificate of Recordation, and pay the salaries of the administrative staff and songpluggers.

Publishers can only be pro-active concerning a song's potential selection by an artist to record and at the chance of placing the song with movie companies, advertisement agencies and other music users. Contracts customarily state that music publishers have satisfied their contractual obligations when they have "*to the best of their ability*" attempted to place a song with music users. It is very difficult for a songwriter (or their attorney) to define and prove that a music publisher did not attempt to place the song with various music users. In addition, publishers can usually provide a stack of invoices and paid statements as "*proof*" of their attempt to place the song with record labels, recording artists and other types of music users. Sometimes the marriage between the songwriter and music publisher fails. The quality of their agreement means very little unless both profit. Written contractual goals that are not fulfilled often lead to either side

terminating the contract. However, legal action is customarily required to prove non-performance of a contractual agreement. Publishers may *default* in their contractual obligation if they fail to provide licenses to music users, fail to pay royalties in a timely manner, fail to place the song with a major recording artist or an artist signed with a record label, fail to provide sheet music (of the song) to music stores and other retail outlets, fail to “place” the song in radio and TV commercials, advertisements, and movie soundtracks, or fail to protect the copyright against infringement.<sup>vi</sup>

Music Publishers offer licenses to music users for the use of their songs. The publishers control the copyright and, therefore, must be paid by the music users for the use of their songs. There are many licenses, each with its own specific purpose:

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Publishers or their *authorized agents* issue mechanical licenses to record labels for the use of a song in a recording. The royalty rate, called the *statutory rate*, is currently 8.5 cents for each song or 1.65 cents per minute for songs over 5 minutes in length.<sup>vii</sup>

Publishers typically split the collected mechanical royalty's 50/50 with the signed songwriters who wrote the songs. However, in reality, most music publishers have the policy of first *recouping* (deducting) any advances paid to the staff writer out of the writer share of the royalties. Therefore, negotiated percentages of profits are paid to the songwriter after recoups are satisfied.

Mechanicals are paid quarterly by record labels, yet as much as 50% of the fees are held in reserve until the products are sold. No mechanicals are paid on promotional copies and free goods, which are promotional albums sent to radio stations, other mass media outlets, and retail stores to increase sales. Mechanicals are paid at 50% of the statutory rate for records sold through record clubs.

Labels use the *controlled composition clause* in the copyright law to negotiate a mechanical royalty of 75% of the statutory rate. To be considered a controlled composition, the recording artist must be a writer, or co-writer or granted part ownership (part of the publishing share) or control of the copyright. Record labels save money by requiring their recording artists and producers to record controlled composition songs. Music publishers and songwriters who do not accept the controlled composition royalty rate may find their songs dropped from an album project. However, if one label requires the song to be a controlled composition, another may not. Labels often pay statutory rates for great songs they think may help one of their artists increase record sales. On the other hand, have you ever wondered why some of your albums have only 8 or 9 songs on them? If the record label determines that it will only pay the controlled composition clause rate per album and the artists or producer want a song(s) licensed at the statutory rate, fewer songs are placed on the album. The controlled composition clause does make a difference in the “bottom line.” It saves the record labels 25% of their mechanical licenses fees.

Unlike the American practice of individual song mechanical licenses, most foreign countries require one mechanical license for all songs on an album. Registration is mandatory. Mechanicals are collected by government-owned agencies and turned over to the foreign music publishers. A percentage of the retail price is collected for the mechanicals royalties that is then split among all the songs on the album and between the foreign and American publishers. Therefore, there is not a set foreign mechanical rate,

and the amount of money collected varies from country to country and album to album. Totals collected also depend on the number of songs on the album and how many albums were sold. Foreign sub-publishers often collect the mechanicals from the government agencies and split the royalties with American publishers by making payments directly or through an American collection agency, such as The Harry Fox Agency.<sup>viii</sup>

In 1967, the United States Supreme Court approved a lower court ruling that upheld the rights of songwriters and music publishers to authorize an agency to represent them in the collection of performance royalties. The ruling states: "... *a central licensing agency, such as ASCAP, is the only practical way that copyright proprietors may enjoy their rights under federal copyright laws and that broadcasters and others may conveniently obtain licenses for the performance of copyrighted music.*"<sup>ix</sup> Hence, performance rights organizations collect performance royalties from the *users of music in a public performance* for their affiliated writers and publishers. *The American Society of Composers, Authors, and Publishers (ASCAP), Broadcast Music Incorporated (BMI), and SESAC* are the three American performance rights organizations. SESAC is now the registered name for The Society of European Stage Authors and Composers, which is not used anymore. After business fees are deducted, the remaining royalties are split 50/50 and sent to the songwriters and music publishers by means of separate checks. Performance royalties are collected for the "performance" of a song, not for the recording artist who sings it. In some European countries, a fee is collected and paid to the recording artist for the number of times their recordings are played on radio stations. There have been several attempts in the United States to change the law to allow recording artists to be paid a "performance" or "play fee."

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Table or Figure about here

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### **Payment Rates and Schedules**

ASCAP and BMI pay competitively but not equally for the same chart placement. Different levels of payment are offered for different genres of music. To make it even more confusing, ASCAP and BMI do not pay the same amount of money for songs within the same genre. In other words, due to the way the charts are compiled, the time of the year, the PRO's payment scheme methodology, and the competition from other records and recording artists, some number one records receive more airplay (performances and, therefore, money) than other number one records. Since ASCAP and BMI pay performance royalties based on the number of performances, plus bonuses, all of the records charted do not receive equal payments. SESAC is unique in that it pays performance royalties based on trade magazine chart placement. SESAC bases its Chart Payment Schedule on a record's placement on the weekly Billboard Magazine, Radio & Records, and The Gavin Report charts.

### **Synchronization, Print, Direct, and Other Licenses**

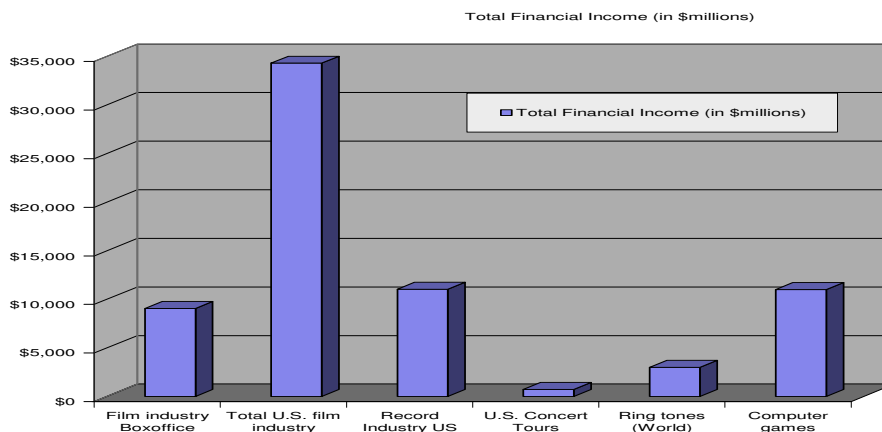
*Sync, grand, transmission, and commercial license fees are negotiated.* Sync license for music videos are often granted free to the record label in exchange for the label's production of a promotional music video. The cost for the music used in the production of motion pictures, TV shows, etc. is ordinarily based on the size of the production budget and the talents of the negotiators. Commercial licenses are commonly paid as a one-time lump sum. It is not unusual for a writer and publisher to receive a million or more dollars for the use of their song in a national major food or soft drink commercial.

## Conclusions

The author recommends that additional research be conducted to determine the validity of the stated theory that creative students in entrepreneurship classes for the performance arts benefit from additional specific industry related information. In the performance arts industry the type of business is often defined as both a product and a service. Different revenue streams correspond to each. In the business plan the market analysis for a business in the performance arts may often requires a deeper niche of relevant information than non performance arts based businesses. Similar product successes and failures that convey similar emotional communicative constructs to potential consumers should be fully examined. Instructors may want to consider providing market analysis research that corresponds to both the product and service methods of delivery and corresponding historical, current, and future industry trends. However, consumer's emotional needs are not always stable. Hence, a market analysis should consider external and internal influences and financial variables that may positively or negatively affect the success of the company's products. Once the proper projections are made a strategic analysis can be used to establish the economic of scale that best fit the projected demographic and psychographic consumer typologies. The premise is that with this type of additional information creative minded performance arts students will be better able to complete the business plan's projected balance sheets, cash flow analysis, and profit and loss statements.

| Industry   | NAICS CODE | <u>2001 Income</u>       |
|--|------------|--------------------------|
| <b>Arts, Entertainment and Recreation</b>            | 71         | <b>\$128,904,000,000</b> |
| Performing arts, spectator sports                    | 711        | \$46,391,000,000         |
| (a) Performing arts companies                        | 7111       | \$9,252,000,000          |
| (b) Spectator sports                                 | 7112       | \$18,416,000,000         |
| Promoters of performing arts events                  | 7113       | \$8,131,000,000          |
| Agents & Managers (artists & public figures)         | 7114       | \$3,468,000,000          |
| Indy artists, entertainers, writers & performers     | 7115       | \$7,125,000,000          |
| <b>Museums, historical institutions</b>              | 712        | \$8,173,000,000          |
| <b>Amusement, gambling and recreation industries</b> | 713        | \$74,331,000,000         |

Source: Library of Congress, U.S. Census Bureau, Statistical Abstract of the United States: 2003.



—Sources:

- {a} MPAA (Motion Picture Association of America: MPA Worldwide Market Research Report 2003
- {b} MPAA (Motion Picture Association of America: MPA Worldwide Market Research Report 2003
- {c} RIAA (Recording Industry Association of America) [www.riaa.com](http://www.riaa.com) Market Research Report 2003
- {d} [Billboard](http://www.billboard.com) BoxScore [www.billboard.com](http://www.billboard.com), 2004
- {e} [Www.informa.com](http://www.informa.com) 2004
- {f} “Hollywood Interest in Video Games Grows” by Mae Wong.; AP Hi Tech, [www.Excitene.com](http://www.Excitene.com) May 15, 2004

| <i>Type of License</i>   | <i>Collection Agency</i>   | <i>Key Issues-Factors</i>  |
|--|--|--|
| <ul style="list-style-type: none"> <li>Mechanical License</li> </ul>                 | <ul style="list-style-type: none"> <li>Harry Fox Agency</li> <li>Copyright Management Inc.</li> </ul>                                      | <ul style="list-style-type: none"> <li>Record Labels</li> <li>Statutory Rate</li> <li>Controlled Composition Clause</li> <li>Internet Downloads</li> <li>Indirect Payment Routine</li> </ul>                             |
| <ul style="list-style-type: none"> <li>Public Performance</li> </ul>                 | <ul style="list-style-type: none"> <li>ASCAP</li> <li>BMI</li> <li>SESAC</li> </ul>  | <ul style="list-style-type: none"> <li>Blanket License</li> <li>Internet Performance</li> <li>Sonny Bono Act and 1999 Copyright law</li> <li>Direct Payment Routine</li> </ul>   |
| <ul style="list-style-type: none"> <li>Synchronization License</li> </ul>            | <ul style="list-style-type: none"> <li>Harry Fox Agency</li> <li>Direct to Publisher</li> </ul>  | <ul style="list-style-type: none"> <li>Internet Movies and Advertisements.</li> <li>Movie, TV, Video Productions</li> <li>Indirect Payment Routine</li> </ul>  |
| <ul style="list-style-type: none"> <li>Foreign, Print &amp; Miscellaneous</li> </ul> | <ul style="list-style-type: none"> <li>ASCAP</li> <li>BMI</li> <li>SESAC</li> <li>Harry Fox Agency</li> <li>Direct to Publisher</li> </ul> | <ul style="list-style-type: none"> <li>Catch-all provisions</li> <li>Internet Downloads</li> <li>Merchandising Rights</li> <li>Advertising Campaign</li> <li>Title use</li> <li>Greeting cards</li> <li>Print</li> </ul> |

| <i>Performance Rights Organization</i> | <i>Type of Business</i> | <i>Membership</i>                      | <i>Year Founded</i> | <i>Owned By</i>      | <i>Operated By</i>                                |
|--|-------------------------|--|---------------------|----------------------|---|
| ASCAP                                  | Non-Profit              | 160,000 Songwriters & Publishers       | 1914                | Members              | 24 member board made up of members                |
| BMI                                    | Non-Profit              | More than 350,000 writers & publishers | 1940                | 675 Radio Stations   | Operations supervised by CEO & Board of Directors |
| SESAC                                  | For Profit              | Less than 15,000                       | 1930                | Private Organization | Private Company                                   |

<sup>i</sup> Behind the Music, VH-1, Intermedia Cable, Nashville, TN. (12/14/98).

<sup>ii</sup> Michel J. Wolf, His new book is The Entertainment Economy: How Mega-Media Forces Are Transforming Our Lives [www.randomhouse.com](http://www.randomhouse.com) (04/12/99).

<sup>iii</sup> Music on the Mind by Sharon Begley, *Newsweek*, (07/24/2000).

<sup>iv</sup> Ibid.

<sup>v</sup> Ibid.

<sup>vi</sup> Placement is defined as the use of the song in an actual master recording that will be released for sale to the public. An artist (or producer) placing a “hold” on a song (for a recording to be made in the future) is not usually considered compliance of the publisher’s obligation to get a song recorded;

<sup>vii</sup> The “Statutory Rate” is scheduled to increase January 1, 2000.

<sup>viii</sup> Foreign Sub-Publisher splits range from 10% to 25% for collecting American product and up to a 50/50 split for foreign-recorded “cover tunes.” Passman, All You Need To Know About the Music Business (1993), pp. 242-243, & The Essential Songwriter’s Contract Handbook by NSAI (The Nashville Songwriters Association International) (1994), p. 50.

<sup>ix</sup> The Music Business Handbook & Career Guide, Baskerville (1990).

# **NO PREREQUISITES FOR ENTREPRENEURSHIP COURSES? ARE YOU CRAZY?**

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## **ABSTRACT**

This paper presents the origins and logic underlying the establishment of the “no course prerequisites” (NCP) policy for entrepreneurship courses. Five key elements influencing this policy include:

1. Prior difficulties with the “by permission of instructor” approach
2. Entrepreneurial Boot Camp for non-business faculty
3. Development of an interdisciplinary, project based learning (IPBL) proposal
4. Creation of a Technology Entrepreneurship Certificate Program
5. Development of new undergraduate and graduate entrepreneurship programs

Finally, in an attempt to assist other universities with solutions to potential opposition, six specific faculty objections are discussed in the second section of the paper that relate to demand, resources, qualifications, impact on enrollments, rigor, and governance.

## **INTRODUCTION**

This paper presents the origins and logic underlying the establishment of the “no course prerequisites” (NCP) policy for all entrepreneurship courses at the authors’ university. This approach is a key step in creating an entrepreneurial university environment. Three points of view are expressed, including a senior faculty member with over 30 years of teaching experience in entrepreneurship, the Dean of the College of Business, and the Dean of the College of Engineering. The NCP approach has resulted in 25% to 30% of enrollment in the new entrepreneurship courses (offered to date) coming from outside the College of Business. Five key elements influencing this policy include:

1. Prior difficulties with the “by permission of instructor” approach
2. Entrepreneurial Boot Camp for non-business faculty and professional staff
3. Development of an interdisciplinary, project based learning (IPBL) grant proposal
4. Creation of a Technology Entrepreneurship Certificate Program
5. Development of new undergraduate and graduate entrepreneurship programs

Each of these is discussed in the following sections. In addition, a section on faculty objections to the NCP policy and the responses to them has been highlighted in an attempt to assist other universities with solutions to potential opposition, if they wish to implement such a policy. Finally, a summary of the goals for the future of entrepreneurship across the curriculum is discussed.



## **I. CORE ELEMENTS OF THE NCP POLICY**

The NCP policy was proposed as a part of the formation of a new entrepreneurship specialization that includes nine undergraduate and three graduate courses. The NCP policy was the result of the vision of the founder of the program, the support of the Provost, and active involvement of two Deans in the process. This vision positively impacts other colleges because those students will be able to enroll in a limited number of business-based courses without having the extensive prerequisites normally associated with typical prerequisite policies. This approach does not assume that the business prerequisites serve no purpose, only that the business students enrolled in these courses will share their knowledge gained from those prerequisites with the interdisciplinary team. Likewise, the engineering student, communications major, health and exercise sciences student, and the arts major will bring unique knowledge, contacts, research skills, and points of view to the team that are consistent with the nature of the proposed entrepreneurship specialization. These include:

- Entrepreneurship is an opportunity seeking mentality.
- Students and faculty from all disciplines will benefit from exposure to entrepreneurial thinking and analysis.
- Waiver of traditional prerequisites is based on the use of project teams that utilize the talents and knowledge of each team member to succeed.
- We do not all need to be the same! We learn from diversity of thought and talents.

The five key elements influencing the policy as noted in the introduction are discussed below.

### **Key Elements Influencing the NCP Policy**

#### **1. Difficulties with the “by permission of instructor” approach**

Teaching experience at two other United States universities and two European universities that used a “by permission of instructor” approach to admitting non-business students to courses pointed to consistent difficulties. The primary problems were the lack of clear “rules” for admission, timing difficulties for students to meet with faculty having limited office hours, and low levels of student requests as a direct result of student reservations regarding course approval and competition from business students. Prior experiences also showed that under circumstances where non-business students were admitted, they typically met or exceeded performance expectations. The epiphany that led to the decision to abandon this approach and move to a NCP policy came from a team of three Master of Fine Arts students who lost their “business” student partner. They completed a four state competitive analysis, a market demand, and a financial feasibility study of an indoor show horse arena and stables without the business student. The analysis showed the project was not viable; opposite to the client’s beliefs and personal desires, but was eventually accepted by the client as a result of the high-quality work. The team’s success and ability to overcome concerns about the capability of “art” students to complete the business portions of the work helped paved the way to create the NCP policy. Teaching experiences have led to a firm belief that the concept of “less is more” can apply to academics where interdisciplinary teams can result in higher quality learning experiences.

#### **2. Entrepreneurial Boot Camps for Non-Business Faculty**

The “Entrepreneurial Boot Camp for Non-Business Faculty” model grew from recognition of the need to provide an opportunity-focused experiential environment to create entrepreneurial

champions for a new program. The overriding goal was to create a way to capture non-business faculty attention to encourage a focus on entrepreneurial concepts to make their research and teaching more effective, while showing methods of professional or financial gain through participation. Additionally, the “Boot Camp” attempted to form a core group of faculty champions to help build support for the entrepreneurship specialization and programs.

The philosophy of the “Boot Camp” concept was grounded in the belief in the importance of ‘idea generation and building on ideas’ in a creative and supportive environment. This pre-supposes the ability of the process to harness the creativity and divergent thinking of academics (non-business in this instance) to the concept of entrepreneurial education and creating supporting champions for innovation. Commitment to a philosophy of entrepreneurship as a foundation for change-based growth in education and business underpinned the objectives of the “Boot Camp.” An overriding university goal was to enhance knowledge and encourage the use of innovative and alternative sources of funding and to apply entrepreneurial project ideas to research, teaching, and commercialization of university generated technologies.

One of the key outcomes of the “Boot Camp” was the need to eliminate the prerequisites for the entrepreneurship courses if faculty and students were going to capitalize on the opportunities identified in the “Boot Camp” projects. Engineering, health and exercise science, art, and communications were especially interested in having their students take courses and build on their program-specific areas of study. Internal surveys of alumni by these colleges showed that approximately 40% of their students ended up running a business within 10 years of graduation. Since the entrepreneurship courses typically involved multiple areas of business in the projects, business plans, and consulting engagements, the consensus was that the students could use the entrepreneurship courses to fulfill their business information needs.

### 3. Interdisciplinary Project Based Learning (IPBL) Initiative

The university has begun a process of creating the IPBL model for university wide adoption. The need for a highly educated citizenry has never been greater, yet U.S. college graduation statistics do not meet many expectations according to the Bureau of Labor Statistics (*Occupational Outlook Handbook, 2004-05 Edition*). Widespread access to higher education has led to a reputation for the “best system in the world” but unfortunately, accessibility and degree completion rates are not one and the same. According to Mourad, (*Guide to Measuring Up*, 7, 2002) in an environment where people must move freely and efficiently between education and jobs, the clear communication of demonstrated learning outcomes is essential and the new currency of the labor market is demonstrated competencies rather than academic degrees. Students must become active participants in their educational process rather than passive recipients of knowledge. Mourad also suggests that rigid disciplinary boundaries often impede the synergies possible in an interdisciplinary environment. The university proposed an IPBL model to address both internal and external problems that existed. Internal problems that can be improved by the IPBL Model Program include:

- **Student retention**-greater focus on student needs and competencies
- **Development of critical thinking skills** – need to work interactively on projects
- **Preparation of students for a more flexible, self-controlling career path**

External problems/issues that can be solved include:

- **Increased access** to a competency based workforce for public and private sectors
- **Increases in external funding** for the university and specific project activities

- **Increased economic growth** from start ups and expansion of existing economic base
- **Creation of a process** that can be replicated in other regions

Thus, IPBL breaks down barriers between disciplines and enables diverse student teams to solve problems that could not be solved by a single discipline. It also considers multiple points of view, emphasizes researching and summarizing skills, and promotes the types of interactions that are goals of the entrepreneurship curriculum.

#### 4. Technology Entrepreneurship Certificate Program

The Technology Entrepreneurship Concentration (TEC) program implemented by the university is an integration of existing, new, and reformatted courses. The concentration leverages resources to develop a high profile, attractive program that can produce entrepreneurial teams (E-teams) that create products or services that can ultimately be commercialized. The curriculum is the first major collaborative effort between the College of Business and the College of Engineering and is seen as a model for expansion to other technology areas. The Technology Entrepreneurship Concentration (TEC) is a concentration and certificate program that integrates the core entrepreneurship concepts that increase the chances of success that reside in the College of Business with the outstanding clinic/project/lab *modus operandi* of the College of Engineering. With the extremely full slate of engineering courses that exist, students needed a NCP policy if this cooperative effort was to be a success.

All four courses in the TEC program are team-based courses. The logic behind this is that one person does not possess all of the knowledge and skills needed to create and launch a successful business. Combining the talents and skill sets from multiple colleges is a way to enhance the performance of each team. Exercises from books like *What a Great Idea* by Chic Thompson, *How to Really Start Your Own Business* by David Gumpert, and repeated iterations of exercises shape ideas into high potential ventures. The goal is to think about “problems” that need to be solved as opposed to technological possibilities. This opportunity/need focus is a basic entrepreneurial tenant and underlines the need for the integration of business and technology.

#### 5. Development of new undergraduate and graduate specializations

The development of the nine new undergraduate courses and three new graduate entrepreneurship courses led to the TEC discussed above and negotiations with other colleges to create similar certificate programs. At the core of these interdisciplinary efforts is the NCP policy. Currently, students from across the campus are enrolling and are learning new ways to interact and to approach problem solving. Initial enrollment records show that students are likely to take the following courses: Entrepreneurship and Innovation, New Venture Development, Financing and Legal Issues, Field Consulting, and Small Business Management. Enrollment outside the college of business of 25% to 30% in each class provides the variety of ideas that help make the entrepreneurship courses a more positive learning experience for all the students. The addition of a New Venture Fund, sponsored by a grant, has also paved the way for the creation of more student “start-up” companies based on interdisciplinary team work.

The expansion of the courses to the graduate level creates new learning and consulting opportunities for the university. Economic development outreach initiatives can link students from all majors into teams with MBA students to conduct projects for local economic

development councils. The NCP policy is essential to this type of outreach and in assembling the skill sets needed for success.

## **II. SURELY IT HASN'T BEEN THAT EASY!**

No good deed ever goes unpunished in academics and the NCP policy is no exception. The Dean and the faculty leading the effort encountered several often highly vocal objections from some faculty members. The following section outlines the key faculty objections to the new NCP policy for the entrepreneurship specialization and presents the written response the Dean of the College of Business provided to the entire faculty prior to an open forum and discussion of the change.

### **Principal Objections to the NCP Policy**

**Objection (1):** There is insufficient documentation of student demand.

**Response:** College of Business (COB) faculty interested in promoting the new specialization polled their classes and determined that there was a significant level of student interest in the entrepreneurship specialization, that a substantial number of students wanted to pursue the entrepreneurship specialization because they intend to start their own business, and that many of the students perceive themselves to be emerging entrepreneurs. Non-COB faculty who participated in entrepreneurship “Boot Camps” provided another gauge of non-business student interest in the program.

The findings which suggest that students are interested in the entrepreneurship specialization are not surprising. The recent Global Entrepreneurship Monitor study by the Kauffman Foundation showed 11.9 percent of people started a business in the last 12 months. The National Federation of Independent Business monograph, *The Public Reviews Small Business (2004)* shows that over 90% of parents would approve of their daughter and/or son starting a business. It further shows that over 70 percent of respondents feel that small business owners have more control and independence in their lives. The report also shows that 66 percent feel ownership is the best way to get ahead in the United States.

In the local area, the average size of business firms is 16 employees and 98% of all firms are classified as small business. Furthermore, estimates are that 35% to 40% of firms are “family businesses.” The mission of the College of Business is to provide “education that allows students to compete and succeed in the 21<sup>st</sup> century workplace.” The entrepreneurship program is designed to respond to student interest in starting a company, working as a “corporate entrepreneur,” engaging in social entrepreneurship, working with economic development groups, and entering family businesses.

**Objection (2):** There will be insufficient full-time faculty to staff the new specialization in entrepreneurship and the program will become a haven for adjunct faculty.

**Response:** Academic Affairs has approved a new faculty position in Entrepreneurship and another faculty position is included in the five-year faculty staffing plan. These new positions do not come at the expense of, or cause a forfeit of an academic position in, any academic department. In addition, several COB faculty members have expressed an interest in teaching in the Entrepreneurship Program even though it requires them to undertake a new course

preparation. While we have included adjunct faculty staffing in the Entrepreneurship Specialization, they will be used in areas of expertise that usually demand practical experience such as the franchising course.

**Objection (3):** The failure of the entrepreneurship specialization to require students outside the COB to have completed prerequisites for the entrepreneurship courses will weaken the rigor of the program and pose difficulties with AACSB accreditation.

**Response:** The Entrepreneurship specialization has a vision that encompasses a university wide perspective and is not only COB specific. Key elements of the vision include:

- Entrepreneurship is an interdisciplinary educational vehicle
- Everyone has some entrepreneurial tendencies
- Teams are key to organizational development and success
- Individuals, not majors, create value
- Prerequisites are motivation and diversity, not specific educational modules

This vision means that teams will be used in a project based learning environment that uses the best each person has to offer to the solution of problems and analysis of opportunities. Other programs and universities have successfully integrated multi-disciplinary teams into courses that expand student learning and expose people to other points of view. The faculty members sponsoring the Entrepreneurship proposal believe that the university has the quality of students and interest in innovation and student development to accept this concept.

Moreover, both the recently approved and the former AACSB accreditation standards encourage curricular innovation, and require not that prerequisites are strictly enforced, but that achievement of the program's learning goals and objectives are clearly demonstrated. The NCP policy for non-COB students is designed to achieve the learning goals of the program: providing different perspectives and viewpoints in a project based curriculum. Business students bring business knowledge to the team; non-business students bring engineering, music, graphic arts, science, health and exercise science, and/or computer science knowledge to the team. In accordance with the additive model of learning, each team member will learn from the others what they need to succeed in the course, and all will be better prepared for the workplace in which they must work in teams of individuals with vastly different areas of expertise. This approach increases the rigor and does not reduce it.

**Objection (4):** The proposed specialization in entrepreneurship may have a negative impact on enrollments in existing specializations.

**Response:** The proposed specialization in entrepreneurship is not based on a zero sum gain model within the COB, but anticipates that 30% to 40% of the enrollments will come from outside the COB and encourages students to take electives in other specializations. Admittedly, some students in existing specializations will be attracted to the entrepreneurship specialization, because it offers them features not available in the other specializations and they may feel that they will be better served by pursuing entrepreneurship studies. Specializations not meeting the needs and expectations of students will inevitably experience a decline in enrollment. That has always been the case in the evolution of academic programs. If there is insufficient demand for the program to justify the specific courses in that specialization, a decision must be made regarding the redeployment and reassignment of faculty resources.

**Objection (5):** The proposed entrepreneurship specialization is interdisciplinary in nature, but is housed within the Management/MIS Department.

**Response:** The proposed entrepreneurship specialization is indeed interdisciplinary in nature, but is more closely identified with the disciplines represented in the Management/MIS Department. Moreover, the faculty who are most supportive of the new specialization and who volunteered to undertake new course preparations, prepared the curriculum proposals, and assisted in the course design, are in the Management/MIS Department. There is no general business department within the COB, and the research related to entrepreneurship has emerged from the field of management.

**Objection (6):** Two faculty members who plan to teach in the program lack journal article publications in the field of entrepreneurship. The lack of sufficient scholarly success in the field of entrepreneurship will impair AACSB accreditation. We should not move forward with any new academic program until we have sufficient faculty in place to meet accreditation standards.

**Response:** The five-year faculty staffing plan includes two new positions in entrepreneurship, and presumably the faculty hired for those positions will have achieved scholarly success in the field of entrepreneurship. Moreover, the approval process for new specializations creates a one to two year window in which faculty can transition their research interest before the courses they teach come on line. AACSB accreditation standards do not mandate the acquisition of academically or professionally qualified faculty before an institution can embark on the creation of new programs. On the contrary, the accreditation standards implicitly recognize that research and teaching interests of faculty change over time, and provide flexibility in the area of faculty resources and credentials to accommodate the evolution of academic programs and faculty interests.

These objections were openly discussed in a faculty forum and the result was that an overwhelming majority of the faculty understood the vision and goals of the program and voted to approve the NCP policy.

### III. SUMMARY AND CONCLUSIONS

In the entrepreneurship specialization, diversity of background is a decided advantage, because the program focuses on an additive, rather than a duplicative, model of learning. In the additive model, students are not required to learn the same body of knowledge; rather, they bring new perspectives and viewpoints to opportunity development. Using this approach, we anticipate enrollments of approximately 30% to 40% non-business students in the entrepreneurship courses based on freshman surveys and discussions with other departments. Prior teaching experiences at the University of Alabama, Bradley University, University College Dublin and Oslo Business School demonstrate that interdisciplinary teams of students from different colleges result in better business plans, more creative problem solving approaches in consulting engagements, and a creative career-development mode of thinking on the part of non-business students. They bring valuable perspectives to the team-based projects required in the entrepreneurship courses. This does not detract from the rigor of the program, but enriches the program.

The following is a testament to the necessity of the NCP policy as it relates to the college of engineering. Several specific observations related to the interdisciplinary nature of the NCP

policy have emerged based on the *Engineer of 2020 National Education Summit* in 2004, attended by Dianne Dorland. The Summit spelled out the need for business and entrepreneurial skill development in the “engineer of 2020.” In addition, the need for more cooperation among the creators and advocates of technology was stressed. The engineer of 2020 faces increased global pressure with commodity engineering tasks being awarded to the lowest bidder. This will mean continued outsourcing of engineering jobs to the mushrooming population of engineers being educated in Asia and India. Consequently, our future engineers must have a value-added facet in their engineering skills and applications to successfully compete in the engineering market. Attributes that focus on interdisciplinary education, innovative projects, entrepreneurial exposure, and development of business acumen firmly grounded on a foundation of engineering provide engineering graduates with a competitive edge. The NCP policy is clearly an approach that is consistent with the Summit discussions. The potential for interdisciplinary teams created as a result of this policy should result in a well-rounded education for all students.

Other universities thinking of adopting such a policy should openly discuss the impacts on rigor, AACSB accreditation, class sizes and demand, and interest of students outside the college of business. The authors’ university used the “Boot Camps,” an Entrepreneurial Fair (E-Fair) event including information and games, the Student Venture Fund, and the certificate programs to gauge the interest of non-business students. The NCP has been successful to date and is continuously reviewed to ensure that the experiences are positive and that both the rigor and results of the courses are maintained. There has been no “lowering” of standards, no reduction in work loads, and no major issues to date. The only area where some additional remedial work has been done is in basic accounting and financial topics. The implementation of this policy revealed that the business students needed the interdisciplinary teamwork as much as the non-business students. Clearly taking a course does not mean understanding how to use the information!

Would we do it again? YES. Do we want to expand the reach of the program? YES. The successes and high quality projects are a testament to the need for the enriching nature of the interdisciplinary teams, resulting from the NCP policy.

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# **LIFE LESSONS FROM THE PROCESS OF DYING AND DEATH: METAPHORICALLY EXPERIENTIAL OPPORTUNITIES FOR ENTREPRENEURIAL EDUCATORS**

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## **ABSTRACT**

Shakespeare offers some provocative lessons about the dawning of life and life's uncertain voyage. For example, Octavius Caesar was successful at work but otherwise a hollow person. Or, Cassius explains to Brutus that responsibility "is not in the stars but in ourselves." End of life concerns provide worthwhile metaphorical associations with entrepreneurship. The authors examine a number of illustrations to relate the dying process to entrepreneurship. There are many profound and distinctive lessons from health care providers and terminally ill patients on the journey of life. The paper provides experiential activities that encourages active student learning by metaphorically connecting the process of dying with the students' own future entrepreneurial philosophy, and lifestyle. The interactive learning includes field trips to a funeral parlor and a cemetery. With specific discussion about the experiential learning activities and anecdotal student feedback, entrepreneurial educators have intriguing opportunities to adopt, modify, or add other experientially learning dimensions for their own teaching style and research agenda.

## **INTRODUCTION**

The literature abounds with the interface of metaphors and entrepreneurship. Metaphors provide an opportunity to encourage customized interactive student learning experiential exercises. In Greek, a metaphor is meant to carry something across or transfer between two disciplines. Aristotle described metaphors as the act of giving something a thing or name that belongs to something else. In fact, in "Poetics," Aristotle notes that the greatest attribute is to be a master of



metaphors. It is a sign of genius since a good metaphor implies an intuitive perception of the similarity in contradictory terms.

Business educators have been using metaphors, such as sports, military, religion, gardening, marriage, parenting, complexity science, science fiction, anthills, biology, health, historical figures, magic, theatre, Aesop's Fables, Shakespeare, and weather for some time. A few of the sample references discuss the use of metaphors (Augustine and Adelman 1999; Dodd 2002; Gassner 1999; Gozzi 1994; Hyrsky 2000; and Perren and Atkin 1997). Popular metaphors can serve as an exciting tool for making practical analogies with entrepreneurship. More specifically, at a recent USASBE conference, Hoy and Farah (2003) offered a discussion on three ways through which films can be adopted to teach practical and theoretical entrepreneurial concepts.

Naturally, the specific process and teaching methods in applying the metaphors to enhance learning and understanding of entrepreneurship may be of concern. Nevertheless, Dodd (2002) notes that, metaphorically, life narratives provide access to the most fundamental and important form of human cognition, which results in a better understanding of our lives. Metaphors therefore constitute a first attempt at creating mental models to make sense of one's life narratives. Hence, a process that encourages people to use metaphors in their life narratives can interest, inform, and provoke (Aldrich, 1992).

## **PURPOSE OF THE PAPER**

Over the years, one of the writers has adopted many metaphors in the teaching of entrepreneurship. However, too often the teaching approach was to merely describe the metaphors and tell how they adeptly relate to some aspect of entrepreneurship. Alternatively, another method was to have students relate a metaphor to a brief question and answer format. These two approaches frequently culminated in passive student learning with a modicum of interactive learning. Furthermore, there seemed to be little creativity among the students.

Consequently, experiential activities were created (see Table 1 for the highlights and brief overview) that recognizes the dying process and death. It was decided to experiment with some new and untested metaphors that bridged the dying process and death, musical lyrics, entrepreneurial behavior, and making life choices. At first glance, the metaphorical fields may seem to be unrelated, but the authors found them to be effective in encouraging students to actively think about their personal future. Since there is strong student interest in career planning, career enrichment, and discovering an enjoyable lifestyle, the subject of dying and the thought of someone facing death might motivate students to think about their own immortality and lifestyle accomplishments.

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Table 1 about here

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To implement the intent of the student assignment and thought process, students took two class field trips to a funeral home and a cemetery. The students then placed themselves in a mental “time machine,” which enabled them to envision the life that they experienced. Although a bodacious objective, it was hoped that the students would try to emotionally and logically think about their own future and final resting place. Concurrently, how can this metaphorically convert to aspects of entrepreneurship?

In a nutshell, the purpose of the paper is to offer a brief discussion on bridging the dying process and death, music, and projecting an entrepreneurial lifestyle. The paper briefly demonstrates the potential value of integrating these fields. Secondly, the authors provide some experiential activities for student learning. The actual assignment and required student deliverables are further explained to the readers. And lastly, the readers are provided some anecdotal student reactions and perceived learning experiences to the assignment. The authors will also provide some professorial observations, limitations, and implications.

### **LIFE LESSONS ON THE PROCESS OF DYING AND DEATH**

Perhaps Shakespeare offers some provocative lessons about the dawning of life and life’s uncertain voyage. Octavius Caesar was successful at work but otherwise a hollow person. And, Macbeth notes that it was too late for an essential quality of life. “My way of life has fallen into the sear. And that which should accompany old age, as honor, love, obedience, troops of friends, I must not look to have.” In addition, Cassius explains to Brutus, and learns that responsibility “is not in our stars but in ourselves.” (Augustine & Adelman, 1999).

Greek and Roman philosophers have recognized that death and life are inextricably related. People arrogantly assign cosmic importance to their day-to-day concerns. Death is always present to restore them to a more appropriate sense of proportion (Gonda & Ruark, 1984). Yalom (1980) profoundly writes that although the physicality of death destroys us, the idea of death saves us.

Since one of the authors has health care experiences in Hospice, Oncology, Gerontology and Palliative Care, it is possible to suggest some anecdotal comments. Terminal sick patients, who were from all socioeconomic and professional groups, have an uncanny perspective on the mysteries of living and life. Although time was relatively short, the dying patients had a keen viewpoint on what was relevant and significant in their lives. In a profound paradoxical way, they felt free from mundane and insignificant worries and established a new freedom. Despite their likely demise, they eventually found peace with themselves and had a better understanding of life itself. They started to do things that they enjoyed and became involved with meaningful projects in their short life expectancy. It was a new form of independence whereby they were in control with how they would spend their time. (Are locus of control or self-employment for self-satisfaction implicit connections for entrepreneurship?) They did not have to impress some “boss” or work at uninteresting tasks. It is beyond the scope of this paper to metaphorically relate this boundless feeling when one is at death’s door. Yet, these feelings have an interesting metaphorical transferability to some of the motivational forces of entrepreneurship. For example, making positive contributions for society before it is too late.

In a fascinating book, *Life Lessons*, one of the authors is a cancer victim and physician. The co-authors offer an interesting and potential parallel between death and an entrepreneurial career. To paraphrase, it is essential to find a balance between our own opposing forces. Life has storms that will always pass. People move back and forth on this pendulum of life, the yin and the yang. And, in the midst of death, people sometimes find life. On thousand deathbeds, people learned that following their dreams was vital in truly enjoying life. (Kubler-Ross & Kessler, 2000).

Adaptation becomes a mantra for many terminal patients. They learn the mystery of “going with the flow.” A few more illustrations can delineate the transferability of lessons from dying to entrepreneurship:

\*\* A team of health providers will use a team approach for “crisis intervention” which enables terminal patients and family members to make decisions and deal with grief (Sheehan, 1996). This could be analogous to a turnaround business situation with a team of turnaround specialists.

\*\*During the course of terminal illnesses, individuals move through denial and isolation; anger; bargaining; depression; and acceptance of death (Gonda & Ruark 1984). This too has interesting connections with small business life cycles as well as encountering the “growth wall.”

\*\*Thoughts of death among terminally ill patients and family members will remind all of us about the value of each moment (Gonda & Ruark, 1984). There is the nagging concern of dealing with the emotional distress of an uncertain future (Preston, 2000). Entrepreneurs certainly must deal with uncertainty and their decisions could easily impact a number of family members and dear friends. Concomitantly, terminal patients will sometimes decide to hide their fatal illness and not tell anyone (Preston, 2000). This behavior is emotionally devastating to family members (Sheehan & Forman, 1996). This attitude is analogous in lacking a succession plan.

\*\*Planning for contingencies is critical: getting one’s estate in order; making sure that one’s house is in order; closure for loved ones; and preserving pleasant memories (Sheehan & Forman 1996). In the entrepreneurial process, there is constant interest with harvesting a business, developing an exit strategy, and concerns with life after a business is sold or closed.

### **BRIDGING THE METAPHORS**

Students, especially 19 to 25 year olds, occasionally have a difficult time in projecting their careers and lifestyles right after graduation. They are frequently myopic with finding a “job” or making money. They seem preoccupied with immediate issues and fail to think strategically about career planning and its associated way of life. Some merely state that they want to be very wealthy and happy. This generalized attitude—with little specifics—creates confusion and a reactive strategy for inspirational lifestyle choices.

The metaphorical experiential activities test the students to think about their future career, expected lifestyle, and eventual demise. Optimistically, the students would formally contemplate their own core values, preferences in a career, preferred lifestyle, and the entrepreneurial philosophy that would be agreeable to them. Moreover, the students have the opportunity to be creative in conjecturing about their own future. The experiential assignment also required the

selection of mentors, possibly some entrepreneurs. Mentoring stressed the importance of networking and learning from successful or unsuccessful careerists. The use of mentors captures the life narratives of influential people that students hypothetically met during their lives.

To create the ideal and surreal environment and take field trips within the context of death, the experiential activity included a trip to a family owned funeral parlor and a local cemetery. A husband-wife team owned four funeral parlors and thus assisted with an interesting discussion on the mysteries of death and entrepreneurship. The aim of the field trips was to craft a proper frame of mind. Although no corpse or embalment was actually viewed, class was held in the funeral parlor, and an informative tour was given. This included viewing various caskets, waiting rooms, hearses, grieving areas, mini chapel, and other rooms. For personal reasons or beliefs, two students did not take the entire tour, such as viewing the caskets that were for sale. But, everyone did participate in the discussion and question/answer session at the end of the tour.

For the next class, the class visited a local city cemetery. An elderly employee of the funeral parlor and one of the owners accompanied the visit. They were able to tell stories of the history of the town and the famous as well as infamous people who were buried in the cemetery. Students asked a few remarkable questions about burials, people, tombstones, and rules and regulations.

### **ANONYMOUS STUDENT COMMENTS AND FEEDBACK**

After the assignment was turned in, the students were asked during class to provide written anonymous comments on the value of the field trip and learning experiences. For sake of brevity, a few of the more representative comments are paraphrase below:

- It is important to do prior planning (both financially and legally) before your death.
- Plan early for your death and funeral. This will help out the family once you pass away.
- Families must communicate the wishes of love ones.
- Just as in life, death is a great responsibility.
- I should plan now for the ultimate exit strategy.
- I never thought of all of the complexities of arranging for death and a funeral.
- I also really liked how you talked about when you have a job; you should put your head, heart, and hands into it. I've always believed in having a passion.
- I was impressed with the counseling services offered by your company. It's that "thinking outside the box" that really makes a difference.
- I also gained a little more insight towards planning ahead for a meaningful life, and I believe it is definitely something more people should think about. Thank you very much!
- Lessons learned: Death is the great equalizer. Your legacy is made by what people think of you, not what is on your resume.
- The reality of life – it's short and valuable and unpredictable.
- Make the most of your life – take risks.
- Try new things – be different because in the end we will all die.
- I had fun doing the funeral/cemetery since it was out of the normal class setting and made us see life from a different perspective.

- It made me appreciate the little things in life that most people (sometimes myself) don't think about much. "Live life to the fullest!!"

## **LIMITATIONS, IMPLICATIONS AND CONCLUSIONS**

The authors thought that the students would enjoy the serenity of the cemetery environment. Students could then let their imagination expand and get a better "feel" about their own possible entrepreneurial lifestyle. Based on the written comments, the students enjoyed the funeral home more than the cemetery visit. Unpredictably, two students could visit the cemetery but not the funeral home, while two others felt more comfortable with a visit to the cemetery. Educators will have to adjust to the students' cultural beliefs and/or any taboos. In this case, the visits were optional if there was an honest personal reason. To compensate for the absence, a couple of students were asked to select one extra song that might reflect their perceived lifestyle. It should be stated that no student missed **both** the funeral home and cemetery visits.

By promoting metaphorically interactive student learning, students had a chance to think about future careers. And, by meditating about the dying process, an entrepreneurial philosophy might come to fruition. This way of thinking might embrace such variables, as freedom, risk taking, social entrepreneurship, career enrichment, opportunity focused, innovation, societal contributions, positive change, and even corporate entrepreneurship.

Those who learned to know death, compared to fearing and fighting it, become our teachers about life and its purposes. Death is shedding the physical body, like the butterfly shedding its cocoon and flying away from fear and into freedom ((Kubler-Ross, 2004). These thoughts may certainly have some interesting and profound implications and meaningful associations.

It is recognized that critics may be concerned with what students may have actually learned from the assignment and field trips. The authors did not undertake a pretest and post-test to measure changes in attitude or the level of student learning. Participants have an opportunity to build on the pedagogical process described herein and empirically research the learning value.

One potential limitation deals with cultural attitudes, beliefs, and behavior of some students. A few students may feel very uneasy or even upset about using the dying process as a metaphor for entrepreneurial behavior. They may feel that it is too morbid or a forbidden topic. In other cases, students may have experienced a recent death of immediate family members or very close friends. Consequently, alternative experiential activities may have to be created and assigned to these students.

Another limitation is the age of some students. Some are relatively young, and it is hard for them to project thirty to seventy years into the future. Since so many life experiences can intervene over the decades, the assignment may seem like pure fantasy. Nonetheless, this may be a good time to pinpoint the opposing forces of planning versus adaptation and controlled chaos.

An interesting sidelight to the experiential learning was giving the students freedom and latitude on how to present their written assignment. They were instructed to be creative and avoid handing in written prose in paragraph format. As a result, a number of students turned in

artwork, mind-mapping visuals, figures, drawings, written student poems, flow charts, timelines, and collages of vignettes that depicted the student's professional life span. The written output gave the students another opportunity to be creative. However, a major caveat is required. It was difficult to grade the assignment. There was a wide range of output, and the content was hypothetical. Consequently, the assignment was graded very liberally, and everyone was rewarded in the senior level course.

In conclusion, the assignment enables them to see how they can apply and transfer the metaphoric lessons of dying to entrepreneurship. There are vast opportunities to illustrate the similarities between the mystery of death and entrepreneurial intensity. Just the Darwinian metaphor of evolution and survival rates of firms (Henderson, 1999) has some intriguing learning applications and implications from the survival process of terminal illness. Or, when one may be near death it is common to rethink one's passion and the meaning of life. Leaving a legacy is sometimes a major consideration, which certainly has some worthwhile metaphorical applications to social entrepreneurship, letting go the business, eschewing micromanaging, as well as overcoming workaholic behavior. There are so many teaching possibilities to expand the experiential activities herein that we only need to use our own creativity.

**Table 1**

| <b>Class Assignment. A Funeral Home and Cemetery Visit<br/>Projecting One's Entrepreneurial Behavior and Philosophy<br/>Written Instructions</b>  |   |
|---|---|
| <p>We will meet at the Hooper Huddleston &amp; Horner funeral home (Wednesday) and on Friday at the Cookeville cemetery. At the funeral home, we will have a tour and mini-lecture on life lessons on death and the mysteries of career planning and lifestyle success. We will then break and for the next class period (Friday) you will drive to the cemetery, carefully walk around and look at tombstones. Please be careful with the flowers and stepping on graves. Also, in case there is a funeral or people paying their respects, please talk softly and look at tombstones that are a distance from the funeral or cemetery visitors. Due to parking, see if you can carpool with a few classmates. If transportation is a problem, feel free to join me in my car.</p> |   |
| <p>At the cemetery, please pay particular attention to the dates that this person lived and the events that were taking place during this period. After picking the person's grave, you should project a hypothetical narrative on the type of entrepreneurial career that this person experienced. We may have a guest from the funeral home to highlight some of the famous people from the region. In your paper, you should explain why this person was "successful or unsuccessful" with this life. Your typewritten paper should reflect:</p>   |   |
| 1.  | The period of time...were the economic conditions (nationally or locally) favorable?  |
| 2.  | Why did the person select entrepreneurship as a career? Motivations?  |
| 3.  | A. Why did this person succeed or not succeed?<br>B. What impact did this person have on planning your own career and philosophy on life?   |
| 4.  | Pick a song that you would like played at your funeral ...with this musical metaphor discuss how the lyrics integrate with your own perceptions on your career and lifestyle that covered your life span. You will hand in the lyrics at the end of your four-page paper. |

5. And finally, what will people be saying and writing about you and your behavior in this career and your entrepreneurial philosophy... Your own obituary and epitaph.

Your paper is due a week later, and it should be approximately four typewritten pages. You can use your books, any experts, and/or internet research for input. Also, you could use the Internet to read anything relevant in writing the paper or about a particular business you started or company that you worked for during your lifetime. If you do any secondary research, just reference the sources on a separate sheet. Please note: you are encouraged to use a lot of visuals and creative tools in your paper. For example, you can use poetry, tombstone drawings, mind mapping, figures, exhibits, and the like. These tools are preferred instead of writing the typical prose and paragraphs. You can even use three or four figures, “tools” on one page.

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# U.S. FEDERAL GOVERNMENT INTERVENTION FOR MINORITY ENTREPRENEURS

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## ABSTRACT

Prior to 1967, minority entrepreneurs experienced barriers to entry into the U.S. federal government marketplace. Then the government intervened with minority business procurement policies geared toward reducing social and economic barriers. This study compares minority-owned businesses to two control groups—small businesses and large businesses. The analysis supports a conclusion that government intervention has contributed to increased growth of minority-owned businesses. It also concludes that competing regulations meant to improve government efficiencies can inhibit minority-owned business growth.

## INTRODUCTION

The United States government spends approximately \$270 billion annually purchasing goods and services (US Census Bureau, 2002) making it the largest single market in the world. These expenditures are greater than the gross domestic product of many nations (S&P, 2000). The source of funds that provides for these expenditures comes from U.S. taxpayers in the form of income taxes (48%), social security (34%), and corporate income taxes (10%) (OMB, 2000).

Because taxpayers provide the funds for these federal expenditures, it is reasonable to assume that all taxpayers will have the right and opportunity to sell goods and services to the federal government in a competitive environment. It follows that minority entrepreneurs will have the same opportunity to access the federal procurement system as any other taxpayer. That was not the case prior to 1967; therefore, the government intervened and continues to intervene through a variety of programs.

The purpose of this study is to determine whether government intervention on behalf of the minority entrepreneur in the federal market is justified and to determine whether any changes are needed. The analysis is based upon federal purchases at three points in time—1979, 1989, and 1999.

The study examines minority-owned business performance in the federal market against that of two control groups—small businesses and large businesses (LB). Since large businesses have traditionally been awarded the majority of federal contract dollars, this study assumes that LB performance is representative of the federal market.

## OBJECTIVES OF THE RESEARCH

The objective of this research is to investigate the thesis that “increased government regulatory intervention in support of small minority-owned businesses improves their economic growth and development.”<sup>1</sup> The thesis can be dissected into three parts for clarification and definition. First, a small minority-owned business is defined by the Small Business Administration (SBA)



as a business that is not dominant in its field of operation and that is owned or controlled by one or more socially or economically disadvantaged persons.<sup>2</sup> Second, this study concerns intervention as promulgated through the SBA 8(a) program and the Small Disadvantaged Business (SDB) program. Extensive definition, rules and regulations surround each of these programs, but in essence—the federal government can set-aside a percentage of contracts for exclusive bidding by SDBs or 8(a)s (commonly referred to as “set-asides”).<sup>3</sup> The third part of the thesis requiring clarification is economic growth and development, which is traditionally measured in a variety of ways including firm creation, job creation, and revenues.

### **General Hypotheses**

Several hypotheses are consistent with the thesis that federal intervention in support of minority-owned businesses improves their performance and capacity. These are:

Hypothesis 1: The SDB and 8(a) programs have contributed to an increase in small minority-owned business capacity.<sup>4</sup>

Hypothesis 2: As a consequence of the SDB and 8(a) programs the capacity of the small minority-owned business community has increased and is now approaching that of the small business community.

Hypothesis 3: As the federal government adopts stronger laws and regulations to increase business and administrative efficiency, the capacity of minority-owned businesses decreases.

Each of the hypotheses is tested in multiple ways by operationalizing capacity using measures derived from prior researchers. These measures include: (1) number of contracts awarded; (2) number of firms in the federal market i.e. actual number of minority-owned businesses or small or large businesses ; (3) average number of contracts per firm; (4) average award amount per firm; (5) number of contract actions; (6) total award value of all contracts; (7) average contract action amount; (8) industry sector; and (9) firm survival rate. (Measures were derived from prior research by (Acs,1998; Boulay, 1984, Skolnik, 1992; Faucett, 1987; and Fullenbaum, 1992). Two additional measures were added that have not previously been addressed in other studies—deobligations and terminations.

Deobligations occur when the government issues a contract modification that removes funds previously awarded to a contract. There are a variety of reasons for these actions including error corrections, change in work requirements or an agency decision to reallocate funds to other projects. Contract deobligations are important because they reduce the value of awards. Terminations are issued for reasons similar to deobligations. It is included as a study element because some observers have argued that more MB contracts are terminated than others.<sup>5</sup>

### **MEASURING THE EFFECTIVENESS OF GOVERNMENT INTERVENTION**

A determination of whether federal procurement policy has been effective for minority entrepreneurs was undertaken by examining performance measures extracted from previous studies and compared minority-owned businesses to two control groups—all small businesses and large businesses as presented in Table 1. The data used for this study comes from the Federal Procurement Data Center (GSA, 2000).

Performance measures for MB's should be similar to those of all small businesses, but based upon performance measures, MB growth for the entire study period has increased and exceeds

that of SBs in a majority of measures. The comparative analysis shows variations in performance between the two groups at different time periods ranging from small to very large differences. One of the important measures for gauging capacity and performance is 'total award value'. From 1979 to 1999, the percentage of total award value for minority-owned businesses increased more than 5 times, while that of all small businesses fluctuated between 11 to 16%. These differences are so large that government intervention is the most likely explanation.

### **Measurements Related to Hypotheses**

Hypothesis one and two questioned whether minority-owned business growth and development increased as a consequence of the SDB and 8(a) programs. As MBs are a subset of the small business community, the expectation is that without intervention MBs should experience at least similar levels of growth. However, the analysis shows large differences in the majority of performance measures across the time periods examined. Following is an overview of the findings.

#### Finding One

There are distinct differences in performance measures between the two study intervals 1979-1989 and 1989-1999, and between the groups being studied. During the first and second intervals, the comparative analysis showed MB performance exceeded that of SBs and LBs in a majority of performance measures. For the entire study period, MB performance exceeded that of SBs, LBs and the overall market in a majority of the performance measures.

#### Finding Two

Procurement for MBs versus SBs is a near zero sum game which results in a seesaw effect (i.e., when an MB performance measure increases then the corresponding SB measure tends to decline).

#### Finding Three

MBs consistently lagged SBs and LBs in two measures—deobligations and terminations. The data do not provide information sufficient for ascertaining the rationale behind the deobligations, but the differences shown in the analyses are significant.

#### Finding Four

The largest positive gain for MBs over the entire period was in the total award value, where MBs increased by 4,650 percent versus 824 percent for SBs and 890 percent for LBs while the number of contract actions for the entire market increased only 206 percent.

#### Finding Five

Analysis shows that awards to SDBs and 8(a)s began to decline in the late 1990s, while awards to WBEs began to grow.<sup>6</sup> This is consistent with previous findings, which showed a general slowing in performance measures during the 1989-1999 interval.

The analytical findings lend strong support to the hypothesis that the SDB and 8(a) programs have contributed to an increase in MB capacity and performance. In terms of market share, the gap between MBs and SBs is narrowing. This supports the hypothesis that the SDB and 8(a) programs aid MBs in reaching the capacity of other SBs.

## **POLICY RECOMMENDATIONS**

When the SBA's 8(a) program was initiated, program managers rushed to utilize 8(a) firms, because it allowed them to reduce contract award times from one to two years down to six months. This was evidenced by the dramatic increases found during the analysis of data during 1979 to 1989. During that time, MBs experienced a 500 percent increase in awards. Reductions in award time afforded by the 8(a) program translated into success not only for program managers, but also for agencies and end users of the products or services. When FASA was implemented, that incentive disappeared.

What is needed today is a new incentive for government program managers to use MBs. As long as agencies are forced to use MBs, SBs or WBEs and other groups, more resources, more oversight and more regulations will be needed. An incentive at the agency level alone will not work because program managers are the ones who make procurement decisions either directly or indirectly. An example of a program with sufficient incentives is Mentor Protégé. Large firms participate in this program because they get paid to mentor. It is self-policing because if the protégé firm is dissatisfied, it can complain and the mentor may lose revenue generated by the relationship. Therefore, it is in the best interest of the mentor to keep their protégés satisfied. There is no cost to the mentor, and they are paid whether the relationship is successful or not—incentives work. It is a matter of finding the right one.

Another recommendation is to increase, monitor and enforce goals for subcontracting. Analysis shows that the small business share of contract dollars is increasingly being subdivided among more groups (i.e. women, 8(a) s, SDBs, and most recently—veterans). Analysis also shows that the white male-owned business has been losing market share though many believe they have been shifting business ownership into the name of female associates.<sup>7</sup> One must keep in mind that business owners who survive in the market tend to be better educated, have more management experience and are more nimble. It follows that a white-male-owned business threatened with loss of market share may be tempted to put ownership of the business in the name of a female associate. Business owners should not be placed in a position where they have to resort to fraudulent activities. The Adarand vs Pena case is an example of what happens when business owners feel that they are unfairly losing to other groups. In light of the new women-owned business goals, incumbent firms will feel additional pressure as contracting officials move to meet the new goals (SupremeCourt, 1995). As stated earlier, the small business community is in a zero-sum relationship—as WBE awards increase, awards to other business groups will decrease.

Currently, the small business goal is set at 23 percent. If small business is essential to the growth and development of this country, then the government should extend the goal to require large prime contractors to subcontract the same amount (23 %) to small businesses. This level of subcontracting would ameliorate the infighting (i.e., Supreme Court cases) between the various small business subgroups that are pitted against one another.

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Table about here

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On average, large prime contractors garner approximately 80 percent of all procurement dollars. Implementation of the 23 percent LB subcontracting goal would benefit small businesses by expanding their market share, while capitalizing on the efficiencies and productivity of large businesses. In order to determine whether subcontracting goals are met, it is necessary to establish systems that are capable of collecting the information. Therefore, a subpart to the subcontracting recommendation is to examine existing data collection procedures to determine the best way to optimize collection and reporting.

Another recommendation concerns economic development versus welfare. GAO reports that Congress is concerned about the large concentration of contracts with a few 8(a) firms (GAO, 1996, 2000, 2001). The SBA states that the concentration of 8(a) contracts is no different than the concentration among other groups of firms—both large and small. In fact, preliminary analysis of data used in this study confirms the concentration of contracts with a few firms for all groups of businesses.

The GAO counters that the Congressional intent was a fair and equitable distribution of contracts (GAO 1996). The idea that contracts should be equitably distributed goes against the grain of business growth and development. In the business world, the strongest, quickest, and most nimble firms grow fastest and gain larger and larger shares of the market. Equitable distribution of contracts has the potential for stunting the growth of MBs, by denying them the opportunity to capitalize on their experience, reputation, and agency knowledge. Therefore, a recommendation is to develop a scheme for awarding contracts that acknowledges and encourages the growth of MBs instead of artificially stunting their growth.

A final and related recommendation concerns the psychology associated with a “disadvantaged business.” Many minority entrepreneurs chafe at being called disadvantaged or 8(a), but must accept the label to participate in minority procurement programs. Additionally, those who are designated as minority business champions are called “small disadvantaged business utilization specialists” or SADBUS—pronounced SADBOOs.

Not only does the term “disadvantaged” have a derogatory connotation to the potential buyer, but it also has the potential to affect the belief system of the firm and those who must champion them. In 1992, the Presidents Commission on Minority Business Development recommended that it be replaced with “historically underutilized business” (HUB) yet the term “disadvantaged” still lingers (Smith 1992). It is time to change the name. If government wants to work more like the private sector then they should take a cue from them and come up with a creative, positive term that goes beyond a 3-letter acronym (i.e., Accelerators, or Triple-A Certified).

As long as Congress views MB procurement as “welfare”, there will be a continuous push to “distribute” contracts among an even larger number of minority-owned firms. As stated by Nixon (1968) “Black Americans - no more than white Americans - want more Government programs, which perpetuate dependency. They don't want to be a colony in a nation. They want the pride and the self-respect and the dignity that can only come if they have an equal chance.” That equal chance is provided through a competitive market that acknowledges that some firms will remain small and others will grow large.

## ENDNOTES

<sup>1</sup> Originally minority referred to African Americans, Native Alaskans, and Native Indians.

<sup>2</sup> Sec. 124.103 of Small Business Act. Who is socially disadvantaged?

(a) General. Socially disadvantaged individuals are those who have been subjected to racial or ethnic prejudice or cultural bias within American society because of their identities as members of groups and without regard to their individual qualities. The social disadvantage must stem from circumstances beyond their control.

(b) Members of designated groups. (1) There is a rebuttable presumption that the following individuals are socially disadvantaged: Black Americans; Hispanic Americans; Native Americans (American Indians, Eskimos, Aleuts, or Native Hawaiians); Asian Pacific Americans... and members of other groups designated from time to time by SBA according to procedures set forth at paragraph (d) of this section. Being born in a country does not, by itself, suffice to make the birth country an individual's country of origin for purposes of inclusion.

<sup>3</sup> For definition of the 8(a) and SDB programs is at website ( <http://www.sba.gov/>).

<sup>4</sup> The term 'capacity' comes from the Small Business Act". Throughout this report the terms capacity and performance are used somewhat interchangeably. For example, if it is the case that the number of minority businesses increased considerably over the study period one could say the capacity of the MB sector has increased (relative to an earlier time). But it may also be said that the MB sector's performance increased because net new MB companies were created.

<sup>5</sup> Suggestion made by Anthony Robinson who is Executive Director of the Minority Business Education Legal Defense (MBELDEF) association formed by U.S. Representative Parren Mitchell. Mr. Robinson stated that his membership, composed exclusively of minority-owned business federal contractors, believes terminations are on the rise.

<sup>6</sup> The SBA defines a small business as one with 500 or fewer employees for services firms and 1,000 employees or less for a manufacturing firm.

<sup>7</sup> Data for women-owned businesses is not shown in this report, but is available upon request.

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Table 1: Performance of Business Groups by Measure and Year (Percentage)

| Growth Measures                                   | 1979 |     |     |           | 1989 |     |     |            | 1999 |     |     |            |
|---|------|-----|-----|-----------|------|-----|-----|------------|------|-----|-----|------------|
|   | MB   | SB  | LB  | Total     | MB   | SB  | LB  | Total      | MB   | SB  | LB  | Total      |
| 1. Number of Contracts                            | 8%   | 51% | 41% | 35,901    | 8%   | 30% | 62% | 55,776     | 18%  | 48% | 34% | 63,121     |
| 2. Number of Firms                                | 8%   | 62% | 30% | 14,004    | 7%   | 35% | 58% | 25,152     | 15%  | 56% | 29% | 31,048     |
| 3. Number of Contract Actions                     | 5%   | 37% | 59% | 75,021    | 10%  | 23% | 67% | 135,120    | 17%  | 32% | 51% | 229,848    |
| 4. Total Award Value                              | 2%   | 16% | 81% | 7,227,580 | 5%   | 11% | 84% | 32,121,452 | 9%   | 14% | 76% | 76,295,751 |
| 5. Number of Deobligations                        | 2%   | 22% | 75% | 2,269     | 8%   | 21% | 71% | 5,084      | 18%  | 25% | 57% | 12,594     |
| 6. Amount of Deobligations                        | 0%   | 26% | 74% | 290,546   | 4%   | 10% | 86% | 798,406    | 9%   | 8%  | 83% | 2,832,824  |
| 7. Number of Contracts Terminated for Convenience | NA   | NA  | NA  | NA        | 7%   | 39% | 53% | 304        | 11%  | 28% | 61% | 400        |
| 8. Amount of Contracts Terminated for Convenience | NA   | NA  | NA  | NA        | 8%   | 19% | 73% | 70,581     | 9%   | 24% | 67% | 61,759     |

Source: GSA, 2000    Dollars are in thousands of 1999's. NA = not available

# **ENTREPRENEURSHIP: A DIVERSE CONCEPT IN A DIVERSE WORLD**

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## **Abstract**

*Entrepreneurship is an ancient concept that is both simple and complex at the same time. Conceptualizations, definitions, understandings of the phenomenon, have eluded scholars and practitioners for a very long time. While we struggle to try and capture it, as we seem to get closer to a satisfactory resolution, we find that the concept continues to evolve. This paper presents a historical summary and synthesis of entrepreneurship and (re)raises some significant issues that are unresolved.*

## **THE HISTORY ENTREPRENEURSHIP**

The concept of entrepreneurship has been around as long as man has existed. Its serious study and documentation, however, has been around only a couple hundred years, and the field of entrepreneurship studies has only been seriously coalescing over the last fifty. A handful of academic programs focused on entrepreneurship by the mid 1970's but has grown to universal acceptance in curriculum, research and practice

Let's go back in time to chronologically reference some of the more important writings on entrepreneurship. Throughout this journey, recognize the many nuances of the definition, causation and person/environment controversies that contribute to the fuzziness of the concept known as entrepreneurship and analyze our conclusion that the field has arrived at an era demanding better entrepreneurship, an entrepreneurship that is more visionary, disciplined and sensitive to the openness of modern systems. We lead you in the application of open systems theory (some other similar theories that we discuss that are closely aligned to open system thinking are complex adaptive theory, systems theory, emergent theory and learning organization theory). We conclude by illustrating how open systems theory has emerged as a point of light from this mass of literature; and how the future study and practice of entrepreneurship might proceed along the systems vein based on some logical assumptions arising from systems theory that helps synthesize a definition that is more operational, capturing behaviors that constitute entrepreneurial events and subsystems epitomized by the American socio-economic system.

## **Diversity of Literature**

The history of entrepreneurship study is multi-disciplinary, multi-national and rather



lengthy and abstruse. The scope of the literature, the number of authors and the multi-disciplinary nature of entrepreneurship complicate any comprehensive literature review. Yet, we'll try to keep it manageable.

The literature on entrepreneurship since Cantillon, 1437 doesn't exactly clean up conceptual, definitional and theoretical matters; in fact, in many ways theoretical progress has left us more puzzled on many issues. For good reason, Wilken (1979) used the search for the Heffalump as a metaphor to describe the search for a definition of entrepreneurship. The mystical Heffalump search is particularly poignant because the Heffalump is a leviathan beast of "Winnie the Pooh" fame, which is a large and intimidating entity that exists in an unknown kingdom that is mysterious and abstract. In our opinion, the connotation of the word entrepreneurship, itself, is leviathan, having many roots, a large trunk and many extremities -- indicative of quite a long and diverse past that has roots in several languages and a variety of nations, eras, cultures and other tributaries, which contributes to its subjective and diverse connotation and annotation. Table I identifies and categorizes entrepreneurial theorists through history.

All the timelines for entrepreneurship in Exhibit I start roughly in the 18<sup>th</sup> century, because the 18<sup>th</sup> century was when entrepreneurship began to be studied and written about in earnest. Cantillon's reference to entrepreneurship is often cited as one of the first, so that's where the literature really begins to take form.

Many of the timelines presented in Exhibit I are traditional views spun a little differently. However, some of the timelines represent non-traditional interpretations of historical phases, stages or transitions in entrepreneurship study and knowledge. All are worth noting. The timelines are amalgams from the historical and current literature.

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Table I about here

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Exhibit I about here

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## **DEFINITIONS OF ENTREPRENEURSHIP**

Many writers have also tried to provide a specific definition for entrepreneurship, identifying what they believe makes entrepreneurship distinct from other forms of economic and management thought and behavior. Table II provides a sampling of definitions covering a variety of perspectives across various eras, with an emphasis on recent developments. These definitions incorporate a wide expanse of skills, thought processes, intentions and actual behaviors. The diversity in the emerging definitions seems to only foil attempts at establishing some universal definition. The diversity and complexity seems to be expanding not contracting, making any condensation into a single summary definition dubious.

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Table II about here

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## SUMMARY

Entrepreneurship is an intriguing and important topic, and has been throughout history. Entrepreneurship is distinguished by a unique managerial style and the interrelationships and outcomes it produces in our organized socio-economic existence. The history of the study of entrepreneurship has considerable literature, which emphasizes the importance and uniqueness of the entrepreneurial style. The entrepreneurial style is compelled to constantly rethink our wisdom about how organizational life works; and the style is always lurking to be creative, innovative and change things. This purest and most powerful form of management strives to advance our potential for organizational excellence to new levels of capability, as it intentionally endeavors to learn more about reality and influence our future more effectively. It's going to take forever to genuinely discover how extremely complex and dynamic concepts like entrepreneurship fit into man's perfect future and how entrepreneurial management can be used to give us ultimate progress. We better get started!!

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**Table I: A Chronological History of Entrepreneurial Theorists**

| <b>CLASSICAL (to about 1850)</b>  |
|---|
| <b>Richard Cantillon (Irish)</b> - (Herbert & Link, 1982, p. 21)            |
| <b>Francois Quesnay (French)</b> - (Herbert & Link, 1982, p. 25)            |
| <b>Anne-Robert, Jacques Turgot (French)</b> - (Herbert & Link, 1982, p. 29) |
| <b>Nicolas Baudeau (French)</b> - (Herbert & Link, 1982, p. 27)             |
| <b>Jeremy Bentham (English)</b> - (Herbert & Link, 1982p. 43)               |
| <b>J. B. Say (French)</b> - (Herbert & Link, 1982, p. 32)                   |
| <b>David Ricardo (English)</b> - (Herbert & Link, 1982, p. 40)              |
| <b>Adam Smith (English)</b> - (Herbert & Link, 1982, p. 38)                 |
| <b>J.H. von Thünen (German)</b> - (Herbert & Link, 1982, p. 45)             |
| <b>John Stuart Mill (English)</b> - (Herbert & Link, 1982, p. 44)           |
| <b>Bruno Hilderbrand (German)</b> - (Herbert & Link, 1982, p. 74)           |
| <b>Gustav (Hans) Schmöller (German)</b> - (Herbert & Link, 1982, p. 75)     |
| <b>H.K. Von Mangoldt (German)</b> - (Herbert & Link, 1982, p. 48)           |
| <b>NEOCLASSICAL (to about 1950)</b>   |
| <b>Karl Marx (German)</b>   |
| <b>Alfred Marshall (English)</b> - (Herbert & Link, 1982, p. 53)            |
| <b>Leon Walras (French)</b> - (Walker, p. 1)                                |
| <b>Carl Menger (Austrian)</b>   |
| <b>Francis Walker (American)</b>  |

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|---|
| <b>Friedrich Von Wieser (Austrian)</b> - (Herbert & Link, 1982, p. 51)  |
| <b>Eugen Von Böhm-Bawerk (Austrian)</b>   |
| <b>Francis Y Edgeworth (1926, English)</b> (Herbert & Link, 1982, p. 51)  |
| <b>F.W. Taussig (American)</b> - (Herbert & Link, 1982, p. 68)  |
| <b>Warner Sombart (German)</b> - (Herbert & Link, 1982, p. 75)  |
| <b>Max Weber (German)</b>   |
| <b>Israel Mayer Kirzner (Austrian)</b> - (Herbert & Link, 1982, pp. 95-96)  |
| <b>John Bates Clark (American)</b>  |
| <b>Harvey Leibenstein (Austrian)</b> - (Herbert & Link, 1982, p. 100)   |
| <b>Edwin F. Gay (American)</b>  |
| <b>A.C. Pigou (English)</b> - (Herbert & Link, 1982, p. 56)   |
| <b>Ludwig von Mises (Austrian)</b>  |
| <b>Schumpeter (German)</b> - (Herbert & Link, 1982, p. 73, p. 75)   |
| <b>John Keynes (English)</b> - (Herbert & Link, 1982, p. 68)  |
| <b>MODERN (to about 1980)</b>   |
| <b>Frank H. Knight (American)</b> - (Herbert & Link, 1982, p. 69)   |
| <b>Arthur Cole (American)</b> - (Herbert & Link, 1982, p. 7)  |
| <b>Arthur Koestler (English)</b> - (Herbert & Link, 1982, p. 3)   |
| <b>Bert Hoselitz (American)</b>   |
| <b>Jacob Bronowski (English)</b> - (Herbert & Link, 1982, p. 2)   |
| <b>G.L.S. Shackle (English)</b> - (Herbert & Link, 1982, p. 3-4)  |
| <b>S. M. Kanbur (American)</b> - (Herbert & Link, 1982, p. 83)  |
| <b>F. B. Hawley (American)</b> - (Herbert & Link, 1982, p. 65)  |
| <b>T. W. Schultz (American)</b> - (Herbert & Link, 1982, p. 104)  |
| <b>David McClelland (American)</b>  |
| <b>MODERN SITUATIONALISTS</b>   |
| <b>Jeffrey A. Timmons, Leonard Smollen and Alexander Dingee</b> – ( <i>New Venture Creation: Entrepreneurship in the 1990s</i> , Homewood, IL: Irwin, 1990)               |
| <b>Robert C. Ronstadt</b> – ( <i>Entrepreneurship</i> , Dover, MA: Lord Publishing, 1984)   |
| <b>Lanny Herron and Harry Sapienza</b> – <i>Entrepreneurship Theory and Practice</i> , 49-55, 1992)   |
| <b>Gifford Pinchot</b> – ( <i>Intrapreneuring: Why You Don't Have to Leave the Corporation to Become an Entrepreneur</i> , 1985)  |
| <b>Hans Schollhammer</b> – ( <i>The Encyclopedia of Entrepreneurship</i> , Prentice Hall: Englewood Cliffs, NJ, 1982)   |
| <b>Karl Vesper</b>  |
| <b>William D. Guth and Ari Ginsberg</b> (Corporate Entrepreneurship, <i>Strategic Management Journal</i> , 11 (1990), 5-15.)  |
| <b>Jeffrey G. Covin and Dennis P. Slevin</b> – <i>Entrepreneurship Theory and Practice</i> , Fall 1991 Vol. 16, No.1 pp. 7-26)  |
| <b>Deborah V. Brazeal</b> – <i>Journal of Business Venturing</i> , 8: 75-100, 1993)   |
| <b>L. Hrebiniak</b> – <i>Administrative Science Quarterly</i> , Vol. 30, pp.: 336-349, 1985)  |
| <b>OPEN SYSTEM THEORISTS</b>  |
| <b>H. Stevenson, H. Irving Grousbeck, M. J. Roberts and A. Bhidé</b> – ( <i>New Business Ventures and the Entrepreneur</i> . 5 <sup>th</sup> ed., Richard D. Irwin, 1999) |
| <b>J.S. Hornsby, D.W. Naffziger, D.F. Kuratko and R.V. Montagno</b> – (An Interactive   |

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| Model of Corporate Entrepreneurship Process. <i>Entrepreneurship Theory and Practice</i> , 17(2), 29-37,1993)   |
| <b>M. B. Low and I. C. MacMillan</b> - (Entrepreneurship: Past Research and Future challenges. <i>Journal of Management</i> , 14, 1988, 339-369)  |
| <b>H. E. Aldrich and M. A. Martinez</b> - (Many Are Called, but Few Are Chosen: An Evolutionary Perspective for the Study of Entrepreneurship. <i>Entrepreneurship Theory and Practice</i> , Summer 2001, 41- 56) |
| <b>B. Bird and M. Jelinek</b> - (The Operation of Entrepreneurial Intentions. <i>Entrepreneurship Theory and Practice</i> , 13 (2): 21- 29,1988)  |
| <b>Chester Barnard</b> - (For instance see, S. Robbins and M. Coulter, <i>Management</i> , Prentice Hall, 2002, p.19)   |
| <b>Peter F. Drucker</b> - (For instance see, <i>Innovation and Entrepreneurship</i> , Harper Business, 1993)  |
| <b>Peter Senge</b> - ( <i>The Fifth Discipline</i> , Doubleday, 1990)   |
| <b>Russell Ackoff</b> - (For instance, see Ackoff Center Weblog)  |
| <b>Daniel Katz and Robert Kahn</b> - ( <i>The Social Psychology of Organizations</i> , Wiley, 1996, p.17)   |
| <b>Tom Peters and Robert Waterman</b> - ( <i>In search of Excellence</i> , Warner Books, 1988)  |
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| <b>Deniz Ucbasaran, Paul Westhead and Mike Wright</b> - (The Focus of Entrepreneurship Research: Context and Process Issues. <i>Entrepreneurship Theory and Practice</i> , Summer 2001                            |
| <b>Hans Landström</b> - (The Roots of Entrepreneurship Research. <i>New England Journal of Entrepreneurship</i> , 1999, p.10 - 20)  |
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| <b>Claudia Bird Schoonhoven and Elaine Romanelli</b> - (The Entrepreneurial Dynamic: Origins of Entrepreneurship and the Evolution of Industries, Stanford, CA: Stanford University Press, 2001)                  |

## Exhibit I: Time Line of Entrepreneurial Thought

| Time                                  | ... 1750                   | 1800                               | 1850                     | 1900                  | 1950                      | 2000                                   |
|---------------------------------------|----------------------------|------------------------------------|--------------------------|-----------------------|---------------------------|--|
| 1. <b>FALCONE/OSBORNE FRAMEWORK</b>   | ... Classical →            |                                    | Neo Classical →          |                       | Modern →                  | Modern Situationists<br>Open systems → |
| 2. <b>TERMS &amp; CONCEPTS</b>        | Risk, Profit<br>Innovation | Freedom Behavior<br>Administration | Thinking<br>Competency   | Change<br>Equilibrium | Regulation<br>Personality | Organic<br>Development                 |
| 3. <b>DEFINITIONS</b>                 | Nominal                    |                                    |                          | Reliable              |                           | Operational                            |
| 4. <b>ORGANIZATION</b>                | Agrarian                   | Mechanistic                        | Scientific               | Humanistic            | Responsible               | Learning Organization                  |
| 5. <b>TYPES OF THEORISTS</b>          | Novices                    | Economic                           | Behavioral               | Scientists            | Organization Theorists    | E-Specialists                          |
| 6. <b>HEBERT AND LINK THEORETICAL</b> | Early                      | Meandering/Classical               | Neo Classical            |                       |                           | Extended Theory                        |
| 7. <b>POLITICAL MARKETS</b>           | Random                     | Legislated                         | Bureaucratic/            | Democratic            | Representative            | Adaptive                               |
| 8. <b>KOTLER'S MARKETS</b>            | Production                 |                                    | Product                  | Sales                 | Marketing concept         | Societal-marketing concept             |
| 9. <b>BEHAVIOR</b>                    | Elitist Freeist            | Physiocrat/Descriptionist          |                          | Structralist          | Keynesian                 | Traitist Leader Situational Proactive  |
| 10. <b>THEORY</b>                     | Describers                 | Prescribers                        |                          | Theorists             |                           | Interveners                            |
| 11. <b>IMPERIALISTS</b>               | Early(English, French)     |                                    | Middle(American, German) |                       | Late(Japanese)            | Globalists/Americans                   |

**Table II: Compilation of Entrepreneurship Definitions**

1. Entrepreneur is a maker of history, but his guide in making it is his judgment of possibilities and not a calculation of certainties (Shackle, in Herbert and Link (Herbert & Link, 1982), p. viii).
  2. Many people set themselves up ... as merchants or entrepreneurs ... They pay a certain price for a product depending on when they purchase it, to resell wholesale or retail at a certain price (Cantillon, in Herbert & Link, 1982, p. 15).
  3. ... must possess art of superintendence and administrator (Say, in Herbert & Link, 1982, p. 32).
  4. Central figure in productive system is the entrepreneur. (He) buy(s) the factors of production, the use of the land, labor, machinery and work(s) them up into half-manufactured or finished products, where he sells to other entrepreneurs or consumers, at a price covering his expenses and remunerating his working and waiting (Edgeworth, in Herbert & Link, 1982, p. 55).
  5. Entrepreneur is legal owner of an enterprise (F. Von Wieser, in Herbert & Link, 1982, p. 51).
  6. Carrying out of new combinations of firm organization -- new products, new services, new sources of raw material, new methods of production, new markets, and new forms of organizations (Schumpeter, 1934, op. cit.).
  7. Uncertainty bearing...coordination of productive resources...introduction of innovations and the provision of capital (Hoselitz, 1952, op. cit.).
  8. Purposeful activity to initiate and develop a profit-oriented business (Cole, 1959, op. cit.).
  9. Creation of new organizations (Gartner, 1985, op cit.).
  10. Entrepreneurship, in reality is an approach to general management that begins with the opportunity recognition and culminates with the exploitation of opportunity (D. L. Sexton & N. B. Bowman - Upton, *Entrepreneurship: Creativity and Growth*, MacMillan, 1991, p. 12).
  11. Entrepreneurship refers to activities involved in creating new resource combinations that did not previously exist (R. A. Burgelman, M. A., Mardique, and S. C. Wheelman, *Strategic Management of Technology and Innovation*, Irwin, 1988, p. 32).
  12. Entrepreneur is one who perceives opportunity and creates organization to pursue it (Bygrane, Ed., *The Portable MBA in Entrepreneurship*, 2nd Edition, John Wiley & Sons, Inc, 1997).
  13. Entrepreneurship is a process by which people pursue opportunities, fulfilling needs and wants through innovation, without regard to the resources they currently control (Stephen Robbins & Mary Coulter, *Management*, 6th Edition, Prentice Hall, Upper Saddle River, NJ, 1999, p. 26).
  14. Entrepreneurship is the pursuit of opportunity beyond the resources available today (Howard Stevenson, USASBE/SBIDA Conference, San Antonio, Plenary Speech, 2/17/00).
  15. Emergent, chaotic, and unpredictable character...termed "newstream activities" (R. M. Kanter and L. Richardson, Engines of Progress: Designing and Running Entrepreneurial Vehicles in Established Organizations: The Enter-Prize Program at Ohio Bell, 1983-1989, *Journal of Business Venturing*, 6 (January 1991): 63-82).
  16. Fundamentally, entrepreneurship is a human creative act. It involves finding personal energy by initiating and building an enterprise or organization, rather than by just watching, analyzing, or describing one. (J. A. Timmons, *New Venture Creation: Entrepreneurship in the 1990's*, 3rd ed., Irwin, Homewood Ill, 1990, p. 5).
  17. Entrepreneurship is the launch and/or growth of ventures through the use of innovative risk-assuming management. (F. L. Fry, *Entrepreneurship: A Planning Approach*, West Publishing, St Paul, Minn., 1993, p.27).
- An integrated concept that permeates an individual's business in an innovative manner (D. F. Karatko and R. M. Hoggets, *Entrepreneurship: A Contemporary Approach*, 4<sup>th</sup> ed., The Dryfus Press, 1998, p.6).

## **“HANDS ACROSS THE PARKING LOT” – LEARNING FROM DOING**

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### **ABSTRACT**

This paper describes the process that evolved from cooperative efforts between faculty in the College of Engineering and in the School of Management at the Florida Institute of Technology. From this experience the authors describe the model for linking Capstone Engineering Senior Design Projects in the College of Engineering to Market Research Projects in the School of Management.

### **INTRODUCTION**

Florida Tech's intensive undergraduate engineering programs (in Electrical and Computer Engineering, Computer Science, Mechanical Engineering, Civil Engineering, Chemical Engineering, Aerospace Engineering, and Ocean Engineering) have resulted in a number of outstanding Senior Design Projects. Examples include STEMSCOPE (a compact scanning tunneling microscope), Marvin (an autonomous robot with GPS navigation and proximity sensors) and Europa (a flying submarine).

During the past two years, the Florida Tech Senior Design programs have become highly coordinated across Engineering Departments and structured for improved effectiveness. To facilitate increased, sustainable product realization success, the senior design experience for computer engineers, electrical engineers, aerospace engineers and mechanical engineers now begins in the spring semester of the junior year.

Within the College of Engineering there exists a Senior Design Commercialization and Entrepreneurship Program (Ports et al 2003) for advanced undergraduate students. Entrepreneurial undergraduates with a GPA of at least 2.75 may be approved to also take the graduate level courses in the program.

During Spring semester 2002, the School of Management at Florida Tech became aware that the College of Engineering was integrating facets of Engineering Senior Design across the



Engineering curriculum. The School of Management was interested in encouraging and supporting the efforts of COE as well as providing management students experience in working with engineering students. The School of Management desired that their graduates have skills in working with engineers and have an understanding and grasp of issues faced in managing in science and technology based companies.

The focus of this paper is on Engineering Design Market Research Projects. These are collaborative projects by Marketing students in the School of Management for senior design engineering teams in the College of Engineering. The projects simulate the realities of defining products for market in an industrial context. In some cases, for entrepreneurial senior design teams intending to start a business around their senior design project, the projects can add considerable value to the evolving business case for the enterprise. The paper describes the goals of the projects, the evolution of a process for completion of the projects, and areas of focus for continual improvement in the undertaking.

## **OVERVIEW OF FLORIDA INSTITUTE OF TECHNOLOGY**

Florida Tech celebrates its 46<sup>th</sup> anniversary this year (2004). The university was founded in 1958, initially to provide convenient, part time, continuing education opportunities to the scientists, engineers and technicians who were working at what is now the Kennedy Space Station. Today the university is an accredited, coeducational, independently controlled and supported university. Over 2,500 students attend full-time at the Melbourne, Florida campus. These students are enrolled in more than 130 degree programs in science and engineering, aviation, management, humanities, psychology and communication. Master's degrees are offered in more than 60 disciplines and Doctoral degrees are offered in 22 disciplines. The 130 acre Florida Tech campus, located in Melbourne, Florida, includes a picturesque botanical garden, is 5 minutes from the Indian River, 10 minutes from the Atlantic Ocean and 50 minutes from Kennedy Space Center.

Because Brevard County is home to Kennedy Space Station and a number of defense and space related companies, the population includes many scientists, researchers and technological employees. Many of our youth are more scientifically aware than populations resident in other locales. In fact, the county has more winners in high school science fairs than any other county in Florida. However, the emphasis on space science and government contracting embedded in the local culture results in little or no training available to youth, researchers, and employees in the multiple steps and decisions that are needed to bring technology products to market. The pervasiveness of the space program in the economic development of the county and the culture of its inhabitants can be seen in many cultural, business, and demographic facets. Twenty percent of the eighty schools in the county carry a name related to the space program. Fourteen of the largest thirty employers are primarily in the space or defense industries. Only 6% of the employees from the top thirty employers do not work in space/defense, government, education, or health industries.

In June 1997, the university received a \$50 million grant from the F. W. Olin Foundation. As a result of this grant, two major facilities were completed in the fall of 1999 – an Engineering Complex and a Life Sciences Building. Construction of the new Charles and Ruth Clemente

Center for Sports and Recreation was made possible by a generous gift from a Florida Tech trustee and his wife, and the F. W. Olin Foundation. Additional new construction includes new student housing and the \$14 million F. W. Olin Physical Sciences Building.

In Spring 2002, two full-time faculty members, one from the College of Engineering and another from the School of Management discovered that each was working to bring more entrepreneurship offerings to their respective environments. One of the programs this collaboration spawned is the **Engineering** Design Market Research Projects discussed in this paper.

### **The Undergraduate Senior Design Sequence in the College of Engineering**

Across the U.S., about 65,000 engineering students work on a development project as the capstone experience of their undergraduate engineering degree each year. At Florida Tech a capstone experience is part of the degrees in electrical, computer, aerospace, mechanical, ocean, civil, and chemical engineering and in computer science. The instructors from the College of Engineering Departments meet regularly to synchronize their courses to advantage.

As an example, consider the electrical and computer engineering department series of three senior design capstone core courses. Beginning with Junior Design in the spring of the Junior year, typically multidisciplinary teams of undergraduates self-form, and spend the next three semesters focused on conceiving, defining, designing, validating and demonstrating innovative new product ideas. System Design I and System Design II are taken in the Fall and Spring terms of the senior year. The students work on cross-functional teams and learn by participating in and delivering results for business planning, new product development, project management, project execution and closure, a little marketing, and the definition and production of launch collateral materials such as articles, patent disclosures and application notes. Each team conceives a new product idea, then defines it, determines its value proposition, designs it, verifies the design, develops and builds it, validates it and prepares for a “whole product” market introduction. The culmination of the course sequence is the Student Design Showcase. The Showcase, spanning all departments in the College of Engineering, is set up in the gymnasium in a “trade show” environment, and is open to all faculty and students, the public, local companies, schools, team sponsors and the press. Each team has its own booth, and demonstrates their project results. Junior design teams also have booths, as do project sponsors, the School of Management, Florida Tech’s business accelerator (Florida TechStart) and an array of invited guests.

The business plans and feasibility studies included in the sequence are abbreviated and intended to introduce engineering students to business considerations beyond technical feasibility. For their feasibility studies, the teams analyze the technical, schedule, marketing and engineering NRE (non-recurring expense) financial feasibility for several potential projects or variations on a basic project, and use this information to help finalize their project choice. The business plans require the teams to outline their projects (a “product” description and early estimates of timelines and bills of materials for construction) and to develop a defensible value proposition for their product (a short statement which explains why anyone would a) buy this product and b) buy it from us). Following this, the business plan contains a risk analysis (technical, schedule, financial and marketing), a competitive analysis, team capability analysis, and initial definitions

of “out-of-bounds” conditions which may arise during the project and require “managerial” (professorial) intervention.

The business plan elements generated by College of Engineering students correspond to the elements of a real business plan that engineers on the product definition team might be expected to provide. Other elements, such as TAM/SAM/SOM (Total Available Market / Served Available Market / Share of Market) analyses, financial analyses (forward costing and pricing models, new product revenue projections, etc), operations planning and the business perspective on market environment and trends, are not done, as these would be done by the finance and business areas of a company.

During the fall semester in 2003, the School of Management collaborator approached the School of Management marketing professor about including engineering senior design projects as market study projects in Marketing classes. The marketing professor agreed to participate and was given the name of the College of Engineering contact. The results of this informal first effort were disappointing. Establishing contact and timeframes was extremely frustrating for the SOM marketing professor. By the end of the semester nine projects were completed. The SOM collaborator in discussions with the SOM marketing professor and the COE senior design coordinator learned the results of the studies did not reach the Engineering students on a consistent basis, the relevance of the content of the studies to the projects was not clear, and there was no mechanism for feedback between management and engineering student groups.

In early January 2004, the School of Management collaborator invited both the COE contact and the SOM marketing professor to discuss the project from each of their perspectives. COE was pleased with the project. The SOM collaborator was under the impression that COE was not viewing the project as beneficial to them but was participating because they were “doing what the SOM wanted us to do.” The COE believed the project was for the benefit of SOM students rather than directed toward benefiting their own students.

After listening to discussion of the project and where the timing difficulties were on “each side of the parking lot” the SOM collaborator suggested she draft a “strawman procedure” and circulate it for comments to both the SOM marketing professor and the COE coordinator of senior design. This draft was exchanged at least twice between the representatives from both schools and the process described in Appendix A of this paper will be tested during the fall semester of 2004. By the time of the conference in which this paper will be presented, we will have an addendum for our Fall 2004 experience.

### **So What?**

All parties to this undertaking believe they needed to have a “learning experience” before they were able to identify a process they believe will work. The nature of the technology based opportunities seeking marketing studies is quite different from the kinds of projects marketing students usually identify and select. The markets for the technology projects challenges the expertise of both students and the marketing professor. Bringing about cultural and capability changes requires all parties to be willing to learn from experience. Students learn that their professors are also learning as they go. All these are situations the students may face in company settings.

## **CONCLUSION**

Our experience has demonstrated that resources other than financial support are required to achieve “Entrepreneurship Across the Curriculum.” Interested and committed faculty cooperating between schools is key. Enabling interested faculty to discover one another is a challenge. Harmonizing class activities between cooperating courses needs early attention. Students need formal mechanisms to initiate discussion and cooperation to jump start the process. Finally, enthusiastic support of pilot projects by the Dean’s of the respective colleges encourages faculty to “make it happen.”

## **APPENDIX A**

### **Draft Procedure**

#### **Market Research for Engineering Design Projects**

### **Background**

The College of Engineering consists of the following engineering programs:

- Chemical Engineering
- Electrical Engineering
- Computer Engineering
- Computer Sciences
- Environmental Science and Environmental Resource Management
- Civil Engineering
- Meteorology
- Ocean Engineering
- Oceanography and Coastal Zone Management
- Mechanical Engineering
- Aerospace Engineering
- Engineering Systems

Undergraduate engineering students are required to complete a design project as part of their curriculum.

In several programs, Junior level students form teams and identify and select their projects in a 1 credit course during the second semester of their junior year.

Senior level students design and build the project selected in the junior year. Occasionally there is a junior level project abandoned or a new senior level project defined. However, this is the exception.

Some of the engineering programs (for instance, Civil Engineering) have no junior level course, doing the entire project during the senior year. In one case, Ocean Engineering, the projects are designed and built during the spring of the junior year, and implemented at sea during the following summer, before the beginning of the senior year.

Sometimes the engineering projects are believed to have commercial potential. Three scenarios are possible:

- 1) Teams working on the design project want to commercialize.

- 2) Engineering faculty believe the product has potential but students are only interested in completing the requirements for their degree and have no continuing interest in the product or technology.
- 3) The product idea was presented to the university by an outside person or firm and that person or firm desires to commercialize the product.

If work done by the Engineering Design students is believed to have commercial value, it can be desirable to have marketing classes prepare a marketing study for the product idea.

The School of Management offers Marketing classes as part of its curriculum.

Three areas needing policy and procedures are identified.

1. How are intellectual property issues handled?
2. How are Engineering Projects nominated for consideration as projects by the marketing students?
3. How do Marketing students select the projects to be completed?

#### **I. INTELLECTUAL PROPERTY OWNERSHIP**

At this time, Florida Tech has no written policy for student IP. Any student who develops intellectual property, even on university property with university tools in a university lab or facility, has full rights to it. There is a policy for professorial IP, however: the university owns the patent and shares any and all IP revenue evenly between the university, the inventor's college or school, and the inventor. IP developed on contract from an external funding source is typically addressed in the terms of the contract. The authors are encouraging the university to develop a written policy regarding student inventors, as more and more senior design projects are entrepreneurial in nature and the university policy, or lack thereof, can be expected to be tested soon.

#### **II. NOMINATING ENGINEERING DESIGN PROJECTS FOR MARKETING STUDIES**

Screening of projects at the senior level for commercial potential will be done in the College of Engineering by the second week of the fall and spring semesters. Short summaries (typically drawn from project team documents) for projects with commercial potential will be compiled by the home department instructor for each senior design course and forwarded to a designated professor in the Florida Tech School of Management for review.

#### **III. SELECTING ENGINEERING DESIGN PROJECTS FOR MARKETING STUDIES**

1. The School of Management professor or designate will review the nominated design projects and select those appropriate for further consideration.
2. The marketing classes will set aside a class period for "pitches" of projects.

3. The marketing professor will coordinate this date with the appropriate engineering professor(s) and will provide an e-mail with dates of times of “pitching” opportunities.
4. Teams desiring to give a “pitch” will “register” with the marketing professor giving a brief description of their project, the name of the person who will make the pitch, and contact information for that person.
5. On the agreed date, one or more members from engineering design team desiring a market study will visit the marketing class and give a 3 minute pitch on their project. Marketing students will have 3 minutes for questions. Not every project pitched will be selected for a market study. The pitches may need to be made in multiple courses or course sections.
6. Marketing students will select projects and the teams requesting projects and their senior design course instructor will be notified by email if they were accepted or not. It is possible for the same project to receive offers for more than 1 marketing study.
7. Marketing students will work with and interact with the engineering students while completing the market study.
8. At the conclusion of the study there will be four copies prepared to be distributed as follows:
  - a. Copy for grading
  - b. Copy to engineering team member
  - c. Copy to the senior design course instructor
  - d. Copy to School of Management Collaborator

Marketing students will make oral presentations to their client – The Engineering Design Team. Presentation time will be coordinated by the Engineering Design Coordinator.

### **REFERENCE**

Ports, Ken, Carmo D’Cruz, Muzaffar Shaikh, and Carolyn Fausnaugh. (2004)/ Taking Senior Design Course Projects to Market. Proceedings of the 2004 American Society for Engineering Education Annual Conference and Exposition. Salt Palace Convention Center. Salt Lake City, Utah. June 20-23, 2004

Teaching non-business majors

RUNNING HEAD: Teaching non-business majors

**The role of entrepreneurship research is to discover and create new knowledge that**

**supports entrepreneurship education and research**

**75% of new business startups are service/retail**

Teaching entrepreneurship to non-business majors: A constructivist learning approach

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Teaching Entrepreneurship To Non-Business Majors: A Constructivist Learning  
Approach

ABSTRACT

This paper describes the Authentic Case Study (ACS) project, which is a comprehensive project that has been successfully used to teach non-business students about entrepreneurship. The project was developed from a constructivist learning perspective, where learning activities are connected to the state of the learner. The project uses self-directed and small group learning activities to teach students basic concepts in entrepreneurship. The primary learning activity is a business plan project which uses an authentic, local setting and draws upon business owners and other individuals embedded in the setting to contribute to student learning.



Teaching Entrepreneurship To Non-Business Majors: A Constructivist Learning  
Approach

EXECUTIVE SUMMARY

This paper describes the Authentic Case Study (ACS) project, which is a comprehensive and collaborative semester-long project that has been successfully used to teach non-business students about entrepreneurship. The project has been used in an undergraduate program where students programs have limited formal business training. The project was developed from a constructivist learning perspective, where activities are connected to the state of the learner. The project uses self-directed and small group learning activities to teach students basic concepts in entrepreneurship. The primary learning activity is a business plan project which uses an authentic, local setting and draws upon business owners and other individuals embedded in the setting to contribute to student learning.

In the ACS project, student teams develop a business plan for a new venture that could be viable in the central business district located in the university community. The Authentic Case Study resembles a traditional case study in that data is presented about a realistic business scenario. In the ACS, students work with 'live' data relating to the central business district to research their target market, assess market conditions, analyze competition and select a location. Entrepreneurs and other business people act as primary

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resources for students as they develop business plans. Community business people also provide authentic assessment of student projects.

Entrepreneurship education continues to broaden its scope to include more nontraditional audiences. In addition to college campuses, entrepreneurship training is being offered to a wide variety of audiences including youth, economically disadvantaged, and older adults (Consortium for Entrepreneurship Education). Educators must consider diverse learning approaches to meet students' needs. Constructivist approaches such as the one outlined in this paper may be useful for educators whose entrepreneurship students have limited business backgrounds.

## Teaching Entrepreneurship to Non-Business Majors: A Constructivist Learning Approach

Entrepreneurship curricula have been standard in business colleges for decades. More recently, in response to a recognition that entrepreneurial activity and interest does not occur exclusively among business majors, universities have begun to offer courses and minors in entrepreneurship to non-business majors. Research has found most entrepreneurs do not graduate with business degrees (Kauffman Foundation). Teaching principles of entrepreneurship and venture creation to individuals who do not have a strong business background requires a different approach than one might use in a business school setting. This paper describes an authentic case study approach to teaching an introductory entrepreneurship course in a non-business curriculum to students with limited business knowledge.

The Authentic Case Study (ACS) project is a comprehensive and collaborative semester-long project which has been successfully used to introduce non-business students to entrepreneurship concepts. The premise that underlies this project is that presenting entrepreneurship knowledge and content using traditional methods does not adequately address non business students' lack of prior business knowledge. The project has been used in an undergraduate program in Family and Consumer Sciences, where students major in dietetics, family studies, food service administration, interior design, and apparel merchandising and design. The entrepreneurship course was developed as a response to the aforementioned broad interest in the topic, as well as advice from alumni and advisory board members. Students in these programs have limited formal business

## Teaching non-business majors

training, yet their career interests are in areas where the majority of entrepreneurial start-up activities are likely to occur.

The project was developed from a constructivist learning perspective, where learning activities are connected to the state of the learner. In the constructivist framework, learning activities provide a path into the subject for the learner based on the learner's previous knowledge. The project uses self-directed and small group learning activities to teach students basic concepts in entrepreneurship. The primary learning activity is a business plan project which uses an authentic, local setting and draws upon business owners and other individuals embedded in the setting to contribute to student learning.

Case studies are often used as teaching tools in entrepreneurship courses. The "case method" involves the reading and discussion of a descriptive document about a business or business scenario called a "case." The case presents data that can be used to offer students an opportunity to apply existing knowledge, and to research, analyze and solve a realistic business problem (Mauffette--Leenders, Erskine, & Leenders, 1997). Business cases usually require that students have a certain level of business knowledge on which they can base their discussion. Most students in the family & consumer sciences programs have not taken courses in finance, accounting, marketing or management, which presents a challenge in understanding the details of a case. Therefore, the ACS project was developed to introduce students in the course to the basics of venture creation and small business management. The project is based in an

## Teaching non-business majors

interactive and realistic setting, allowing students to more easily assess problems and search for solutions.

In the ACS project, student teams develop a business plan for a new venture that could be viable in the central business district located in the university community. The Authentic Case Study resembles a traditional case study in that data is presented about a realistic business scenario. In the ACS, students work with ‘live’ data relating to the central business district to research their target market, assess market conditions, analyze competition and select a location. Entrepreneurs and other business people involved in the business district act as primary resources for students as they develop business plans. Secondary data on market size, economic conditions, competition, space availability and occupancy costs are provided by the downtown business association and local government sources. Community business people also provide authentic assessment of student projects at the end of the semester.

The project employs active learning strategies in student teams to achieve course objectives. The course objectives are to increase students’ knowledge of entrepreneurship and understanding factors involved in startup of a small enterprise. The course is also designed to develop students’ verbal and written communication and critical thinking skills. In addition, students are presented with opportunities to assess personal fitness for an entrepreneurial career in the course.

## PEDAGOGICAL FOUNDATIONS

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### Constructivist approach

The teaching approach used in this course was based on constructivist learning principles. Constructivist learning is predicated on the idea that individuals create their own new understandings on the basis of an interaction between what they already know and believe and ideas and knowledge with which they come into contact (Resnick, 1989). Constructivist principles view learning as a social activity where learning is enhanced by connections with other human beings. Active learning strategies that include interactions with other learners are an essential part of effective constructivist teaching (Richardson, 2003). The consequences of this approach mean that the teacher must focus more on the learner in planning learning activities, and less on the content area. Learners should have opportunities to revisit ideas, and ponder and revise them in order for significant learning to take place. Motivation is essential for learning in the constructivist paradigm. A key element in motivating learners is to help them understand ways in which knowledge can be used.

In a constructivist learning environment, learning takes place in relationship to whatever prior knowledge the learner has. Bloom (1956) suggests that knowledge and comprehension are essential for applying, analyzing and evaluation information about a topic. Prior knowledge includes the factual and practical knowledge that a person possesses in a given domain, and numerous studies on learning have shown that domain-specific prior knowledge facilitates learning (Muller-Kalthoff & Moller, 2003).

Therefore, teaching strategies in entrepreneurship courses for non-business majors need

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to take students' limited prior business knowledge into account when designing learning activities.

The development of constructivist learning environments favors activities that are designed through embedded learning in an authentic environment where the focus is on realistic approaches to solving real-world problems. Discovery methods encourage experiential learning, which involves learning by doing. In this environment, the instructor acts as a coach and analyzer of the strategies used to solve these problems, rather than the source of knowledge. Learning activities stress conceptual interrelatedness, and provide multiple representations or perspectives on the content. Evaluation serves as a self-analysis tool, therefore the instructor must provide tools and environments that help learners interpret the multiple perspectives of the world. The result makes learning internally controlled and mediated by the learner (Jonassen (1991; Wilson & Cole, 1991).

## Active Learning and Small groups.

A constructivist approach uses learning experiences that are active, where a learner can reflect on and evaluate learning experiences, and build on them to construct new knowledge and meanings (Yager, 1991). Active learning strategies, which place students in the center of the learning process, are increasingly being used to enhance student learning in the college classroom (Warren, 1997). Whereas traditional methods of teaching take the view that information is 'owned' by the instructor, active learning methods engage students in the learning through critical problem solving and active application of information. Traditional teaching philosophies place most of the

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responsibility on the teacher, with students perceived as passive receptacles of knowledge. Conversely, active learning methods require students to prepare for learning outside of the classroom, participate in classroom discussion, listen to other class members' ideas, and accept a level of ambiguity (Warren, 1997). Benefits of active learning include better content and critical thinking abilities, improved time management, interpersonal and communication skills, and higher levels of student motivation (Boulmetis, 2000; Salemi, 2002).

The constructivist paradigm stresses the importance of human interactions in the learning process. When peers work together there is a great deal of modeling, cognitive disequilibrium, feedback, and perspective-taking that emerge as students explain and receive explanations from their colleagues. Small groups are effective because they increase student-to-student interaction, shift the responsibility of learning from the instructor to the student, and stress problem-solving skills that enhance student cognition. The positive outcomes of collaborative learning include positive interdependence, individual accountability, interpersonal and communication skills (Johnson, Johnson & Smith 1998). Small-group learning allows students to relate course material into their existing knowledge base, thus producing a deeper, contextualized level of understanding of content (Kurfiss, 1988). Student-centered learning environments can result in richer, deeper, more comprehensive and more complex thinking (Cuseo, 2002).

## THE AUTHENTIC CASE STUDY PROJECT

The ACS project is a teaching tool that was used in an entrepreneurship course in the Department of Family & Consumer sciences at a Midwestern university. Students in



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the course are family and consumer science majors, and have had few if any business courses as part of their programs. The ACS uses a live, concurrent, interactive environment in which course concepts can be applied to the writing of a proposal for a new business. Prior to the start of the semester, the instructor identifies a specific environment in which student teams will create the business plan. The central business district (CBD) in the city where the university is located has been used for this project because it is accessible to students, there is an ample supply of entrepreneurs and other business people willing to act as information resources and informal consultants, and the situational factors fit likely interests of students. The CBD in this community maintains a website rich with data needed for market research. Economic data needed for opportunity assessment is also readily available from county and state government websites. The project is introduced in the first class session, and becomes the focus of learning activities for the entire course. Course activities focus on assessing prior student knowledge, and building a knowledge base via textbook and other readings. Guest speakers and active research provide additional information for students as they create a business plan. Following is an overview of course activities.

*Assessing prior knowledge.* Students are assigned a writing exercise in the first week of class to assess their understanding of entrepreneurship and small business management. The assignment requires them to read several articles on entrepreneurs and entrepreneurship. Students then write a brief essay describing their understanding of what skills and abilities are required to be a successful entrepreneur, as well as a personal assessment of their suitability as an entrepreneur. This exercise provides the instructor

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with a benchmark for evaluating students' level of general knowledge about entrepreneurship, and also serves as an awareness-building exercise for students.

Students are also given a not-for-credit quiz to assess their prior knowledge about the CBD. The quiz follows an assignment to visit the CBD to gather information about the area's features and business activities. These exercises ensure that students have a rudimentary understanding of the environment in which their business plan will be developed. The director of the downtown business association is then invited to class to speak about the history, current state and future plans for the CBD.

*Idea generation.* Creativity and idea generation is a key element of entrepreneurial activity, and the course activity that students seem to enjoy the most. Following exploration of the case study environment, student teams are formed. Teams brainstorm ideas for a business that could be viable in the CBD. From brainstorming sessions, teams create a preliminary description of their business idea, including a brief description of the business, its intended target market and products/services offered. The proposals are then evaluated by other student teams on compelling need, uniqueness, evidence of demand, and potential for competitive advantage. These exercises allow students to both give and receive constructive criticism, and to deliberate on and revise their ideas based on peer reactions. This exercise addresses the social component of constructivist learning, which uses individual contributions and group discussion to construct new meaning.

*Business plan development.* Student teams complete the business plan in three segments. The requirements for each segment are introduced along with appropriate chapters of the text and readings. The first section includes a description of the business

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concept and mission statement. The second section includes a description of the target market and competitive analysis. The third section includes marketing, operational and financial plans. Drafts of each section are reviewed by peers and the instructor before proceeding to the next section, and teams are expected to incorporate suggestions into the final plan. This step is an important learning activity not only for receiving feedback, but for giving it. Students have commented that the activity of giving feedback has led to insights into improving their own projects.

Constructivist learning places emphasis on student input in developing learning outcomes. To create the outline and evaluation criteria for the business plan project, students are first presented with an instructor-generated outline and criteria, which are based on information supplied by the textbook used in the course<sup>1</sup>, and a website sponsored by the Small Business Administration<sup>2</sup>. Students review textbook and Small Business Administration, as well as several completed business plans (both good and bad examples. An entrepreneur and a small business loan officer from an area financial institution are then invited to the class to speak about the process of developing a business plan. The entrepreneur's presentation focuses on the process she followed in developing a business plan, as well as reflections on lessons learned from the process. The loan officer presents the business plan process from the point of view of the lender. After the speaker visits, instructor-guided class discussions are used to modify the original business plan outline and evaluation criteria, and to distribute the 200 evaluation points to each section according to student evaluation of textbook and website materials and speaker input. This process usually results in modification of point distribution

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<sup>1</sup> Zimmerer & Scarborough (2002). *Essentials of Entrepreneurship and Small Business Management*. Prentice Hall.

<sup>2</sup> [http://sba.gov/starting\\_business/planning/writingplan.html](http://sba.gov/starting_business/planning/writingplan.html)

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among business plan sections, but leaves the original parts of the business plan outline intact.

One of the biggest challenges arising from a limited business background for students in this course is developing financial plans. Because it is not reasonable to expect that students with limited background in accounting and finance will become proficient in financial forecasting as a result of this course, a financial profile calculator from a small business website<sup>3</sup> is used to develop a pro forma income statement for the business. The calculator creates a typical income statement for small businesses in a wide range of business sectors by inputting a sales estimate. After a lecture focused on basic elements of financial planning and an in-class activity to develop annual sales estimates for each of the first three years of the business, student teams use the financial profile calculator to develop pro forma income statements for the proposed business. Student teams then confer with local business experts (a small business owner, an accountant and the instructor) during a class session to modify the results of the financial calculator results to fit the students' business concept and local factors. Advisors work with student teams to suggest changes in cost of goods sold and/or expense projections based on the specific characteristics of business concepts.

The 'finished product' required for the project is a professionally presented written proposal, and a poster presentation of the highlights of the plan. Students are also required to develop an 'elevator speech' explaining their business idea. The speech is a 30 second personal introduction and explanation of the business concept.

*Outcome assessment.* There are multiple methods for assessing cognitive and affective achievement of learning objectives in this course. Knowledge, comprehension

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<sup>3</sup> the financial profile calculator is available at <http://www.bizstats.com>

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and application of factual material from the text are assessed through online quizzes and through accurate application of course concepts to the business proposal. Critical analysis and synthesis skills are assessed through a series of writing assignments. These assignments include self-reflection writing assignments, synthesis of speaker presentations, and reactions to various reading assignments..

Affective outcomes include personal awareness (assessed in writing exercises), participation in class activities (measured through attendance and contribution to class discussions), and teamwork (assessed via team evaluations of each member).

The ACS project is the primary tool for assessing students' comprehension of course material, as well as their ability to use course concepts in a meaningful manner. Analysis and synthesis skills are demonstrated through students' ability to gather market research and use it to develop the business plan. The instructor provides assessment on the technical aspects of the plan (completeness, professional presentation, appropriate application of course concepts), which, along with quizzes, in class participation activities and writing assignments, comprise the student's final course grade.

The final exam in the course consists of a 'new venture fair' where student teams present their business plans in a poster session format to local business people. Four or five individuals who have participated in the course as speakers or consultants act as 'judges' of the business plans. Students present their ideas to the judges during a two hour poster session. After discussing student plans with each team, judges award a 'most creative', 'best presentation' and 'most feasible' award. Students know in advance that their grade for the final exam is based on instructor assessment of their performance and are not determined by the awards, although there has been a positive correlation between

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points awarded by the instructor and awards conferred by the judges. This ‘authentic’ assessment is designed to give students the opportunity to demonstrate their learning in a realistic environment. Authentic assessment is a form of assessment in which students perform real-world tasks that demonstrate meaningful application of essential knowledge and skills. The natural competition that arises out of the award system appears to be a highly motivating factor in generating professional-level business plans.

## Project successes and limitations

The methods used in this course have received positive evaluations from students. Student rating of their understanding of factual material in the course was high (3.65 on a 4.0 scale). Guest speakers are often mentioned as highlights of the course. Student comments indicated that they enjoyed the creativity involved in completing the project.

Because the ACS relies on using a real environment, information required to complete the project may be imperfect and incomplete. This can be frustrating to students; however, the instructor regularly reminds students that this is what the real world is like, and the value of getting a realistic experience.

Constructivist learning approaches have been criticized in some circles because students’ learning is considered to be subjective rather than objective. Some scholars believe that constructivist approaches may not be the best way for students to learn basic skills and knowledge. Further, teaching in a constructivist environment requires that the instructor have a depth of understanding of the subject matter in order to guide students in interpreting material (Richardson, 2003). However, considering the experiential focus

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on entrepreneurship education, the constructivist view seems to be an appropriate method of learning about entrepreneurship, especially in this population.

A single entrepreneurship course in a student's undergraduate education is probably not sufficient to create a successful entrepreneur. This course focuses on what entrepreneurs do, and does not address the theories that underlie entrepreneurial behavior. The goal of this course for family and consumer sciences students is to increase their understanding of entrepreneurship, to consider entrepreneurship as a career possibility, and to instill entrepreneurial attitudes that can be used in a variety of life's endeavors.

Entrepreneurship education continues to broaden its scope to include more nontraditional audiences. In addition to college campuses, entrepreneurship training is being offered to a wide variety of audiences including youth, economically disadvantaged, and older adults (Consortium for Entrepreneurship Education). Educators must consider diverse learning approaches to meet students' needs. Constructivist approaches such as the one outlined in this paper may be useful for educators whose entrepreneurship students have limited business backgrounds.

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# **BUSINESS PLAN OR BUSINESS SIMULATION FOR ENTREPRENEURSHIP EDUCATION?**

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## **ABSTRACT**

This paper explores the effectiveness of the business simulation across three entrepreneurship classes at the University of Illinois at Chicago. Its findings are tentative because no other study has reported the efficacy of a business simulation for teaching entrepreneurship. The use of this experiential learning method in entrepreneurship education is important, because entrepreneurship educators prefer experiential learning for their students and recognize the relative shortcomings of a lecture-based entrepreneurship class. The results indicate that a business simulation is a positive learning experience for students.

## **INTRODUCTION**

A business plan writing exercise is a common teaching method for an entrepreneurship course. In a class size of twenty or less, a business plan writing exercise can be an effective pedagogical exercise. However, the value of the exercise diminishes as the enrollment increases. Fewer students are able to pursue their own venture idea, and there is less time to critique a student's individual business plan. Due to these shortcomings, a business simulation was chosen as the term project under the assumption that the simulation will provide students enrolled in larger classes a more effective term project than the business plan writing exercise. The business simulation used for this study is *Threshold Competitor* by Anderson, Beveridge, Scott, and Hofmeister (2003).

### **The Business Plan**

The U.S. Small Business Administration provides the generally accepted rationale for entrepreneurs to write a business plan:

“A business plan precisely defines your business, identifies your goals, and serves as your firm's resume. The basic components include a current and pro forma balance sheet, an income statement, and a cash flow analysis. It helps you allocate resources properly, handle unforeseen complications, and make good business decisions. Because it provides specific and organized information about your company and how you will repay borrowed money, a good business plan is a

crucial part of any loan application. Additionally, it informs sales personnel, suppliers, and others about your operations and goals.” (www.sba.gov)

In spite of these benefits, the business plan exercise has several shortcomings:

- (1) Students never experience the market’s reaction to their decisions.
- (2) The business plan is essentially a static document providing no real insights beyond an understanding of start-up issues and costs within a competitive environment.
- (3) Very little emphasis is placed on the intuitive aspects of opportunity recognition.

David Gumpert in his book, ***Burn Your Business Plan!***, presents a more succinct explanation of the shortcoming of a business plan: “In our society, we love “magic” solutions to our problems ... business plans have become a seemingly magical solution for entrepreneurs trying to figure out an easy way to obtain money from investors – you write a plan, show it to investors, and they write you a check.” (Gumpert, 2002, p29.)

### **Why Leave The Business Plan Behind?**

Originally, the business plan writing exercise worked well because students could select their own venture idea and the class size was small enough to allow sufficient class and instructor time to critically examine each business plan. During these critiques, the student’s vision, market insights, and personal goals can be discussed. Students could work alone or in self-selected teams based on their interest in the venture idea. The result was five to ten business plans per class that is a manageable number of plans to evaluate.

Without a doubt, entrepreneurship has arrived and average class size has significantly increased. The larger classes placed a real burden on the learning experience from the business plan writing exercise. There is not sufficient class time or instructor time to allow 50 or more students to write their own business plan. Teams of four or more became necessary but caused a decrease in the student’s personal interest in the idea. As average class size grew to over 50 students, students could no longer select their partners based on their shared vision of the venture opportunity, and disinterested students approached it with little enthusiasm losing the original purpose of the business plan writing exercise.

The challenge is to find a class exercise that would get more students more engaged in exploring issues they will need to resolve during start-up decisions under considerable uncertainty and to meet the challenges of managing an early start-up business in an emerging industry. The answer was to re-structure the course by eliminating the business plan writing exercise and replacing it with two projects: Opportunity analysis worksheets to allow each student to explore their individual venture ideas and a business simulation.

### **What is wrong with the business plan?**

- (1) In his book, ***Burn Your Business Plan***, David Gumpert presents compelling argument: “. . . why the conventional written business plan has become incompatible with important trends in the business and economic environment.” (Gumpert, 2002, p9). In order to support his argument, Gumpert quotes venture capitalist: “I don’t read business plans . . .

I look at the entrepreneur.” (Gumpert, 2002, p12) and professional investors calling business plans the equivalent of “intellectual push-ups. Nice exercise, but not necessarily relevant to anything in the real world.” (Gumpert, 2002, p14) In addition to investors, three professors studying the value of business plans concluded: “There was no strong relationship between performance and the use of a formal business plan” (Gumpert, 2002, p42). Gumpert believes that “The business plan as it is conceived and used by many entrepreneurs is passé. It has been corrupted to the point that it is over-emphasized by entrepreneurs, and under-utilized by investors (Gumpert, 2002, p13).

### **Business Simulation: *Threshold Competitor***

“Kolb defines learning as the process whereby knowledge is created by the transformation of experience. Business simulations are one form of experiential learning, which often is a very effective way of learning... People learn from their experience.” (Haapasalo and Hyvonen, 2001)

***Threshold Competitor*** provides experiential learning by requiring teams to select a strategy, implement the strategy, experience the results of their decisions, and compete directly with the companies established and run by their classmates. The simulation begins as an early start-up manufacturing firm in an emerging market. After the initial investment, the students must organize a management team to takeover the firm and make thirty decisions each quarter including pricing, marketing, marketing research, production, inventory, employment, employee training, and financial decisions. In addition to these decisions, the simulation has eight management dilemmas to challenge the team. The advantages of the simulation include the following:

- (1) All decisions are interrelated as decisions are in a real business.
- (2) The students experience the growth and maturity of an industry.
- (3) The students learn the value of market research.
- (4) The students are emotionally engaged from the start of the simulation and become more passionate about their firm during the semester.

The value of simulations as a learning method is strongly supported by others. Johne (2003) believes that the simulation’s strongest selling point is its ability to have students learn through experience. To support his point, Johne states: “Studies have shown that people who train on a simulation program retain about 75% of the material. In comparison, lectures yield a retention rate of only about 5%, audio-visual Presentations 20% and discussion groups 50%.”

### **Measuring the Effectiveness of Simulations**

If simulations should be an integral pedagogy in entrepreneurship courses, then the question remains of how the students’ learning experience can be demonstrated. Any attempt to answer this question is filled with challenges, because it is difficult to quantify the learning benefits of a business simulation. Henderson and Lawton (2002, p108) identified two key questions: “Two key questions surrounding the use of simulations have troubled users since the very earliest days of gaming are: (1) What do participants learn from engaging in a simulation experience? (2) Is a simulation better than alternative pedagogies for accomplishing certain learning objectives?”

How can the benefits of the simulation be demonstrated in light of the two problems was also noted by Schumann, Anderson, Scott and Lawton (2001): (1) “There is a void in the literature that reports the effect of simulation exercises on results either from the student’s or from the employer’s perspectives.” (p219) and (2) “The principal obstacle to assessing these higher levels of learning is the lack of suitable assessment instruments.” (p217) After noting these two problems, Schumann (et al) present the following recommendation: “Since business simulations are designed to be a more realistic environment in which to learn, one might therefore hypothesize that the use of simulations will result in improved behaviors.” (p218)

Sauaia and Aidar (1998) struggled with similar problems but they relied on Roger (1972) to help them understand the full meaning of experiential learning. Roger offered the following explanation of experiential learning:

- a) Involves the whole person both affectively and cognitively;
- b) Comes from within the learner. Even when the first stimulus comes from outside, the sense of discovery, achievement and understanding come from within;
- c) Penetrates the learner and bring about changes in his personality;
- d) Can be evaluated by the learner, who will know whether it is meeting his needs and clearing up his doubts;
- e) Is meaningful and is part of the development of the whole of the learner.

Two models have been suggested for use in measuring the efficacy of simulations. Both models will be used to interpret the survey results. The first model is Kirkpatrick’s Framework and the second is a cognitive and affective learning criteria.

Kirkpatrick’s Framework Schumann, et al (2001), recommended Kirkpatrick’s Framework (1998) as a guide for assessing the efficacy of simulations in a college setting. The framework identifies four levels of learning:

Level 1 – Reaction is how the participants in the learning experience feel about the experience. . . . In the context of evaluating a business simulation, reaction measures the simulation participants’ satisfaction with the simulation experience. Level 2 – Learning is the degree to which participants in the course’s change attitudes, improve knowledge, or increase skill as a result of the simulation. Learning can be said to have taken place when attitudes change, knowledge is increased, or skill is improved as a result of the experience (Kirkpatrick, 1998). Assessing learning involves measuring changes – a change in attitudes, or an increase in knowledge, or an increase in skills. Level 3 – Behavior is the degree to which learners have changed their behavior outside of the learning environment because of their participation in the learning activities. (Kirkpatrick, 1998). “. . . behavior refers to whether the learners are actually using what they learned. . . .” (Schumann, et al, 2001) When evaluating business simulations, behavior could be defined as the degree to which learners are exhibiting the attitudes, knowledge, and skills taught in one class to subsequent classes and non-academic settings. (Schumann, et al, 2001). Level 4 - Results refer to the degree to which the output of the participant’s workgroup or organization has improved because of learning simulation. (Schumann, et al, 2001)

Cognitive and Affective Learning is proposed by Sauaia and Aidar, (1998). They used cognitive and affective learning as a basis for evaluating the value of simulations used in Brazil and believed that the student or professional preparing to become a manager is subject to two kinds of demand:

- a) To acquire knowledge pertaining to the science of administration and to continually widen his knowledge base: cognitive learning;
- b) To develop technical and behavioral skills in the application of knowledge, to practice the art of administration, to affectively and emotionally interact with people at work and share a satisfying atmosphere: affective learning.

They concluded that, traditional education, based on accumulating memorized information regarding the management science is no longer suitable. Academic institutions may fail unless they concentrate on the cognitive and affective development of the student; the two areas proposed by Rogers (1972). Sauaia and Aidar went on to identify the central problems of evaluating simulations in Brazil:

1. What are the main variables to be found in business games?
2. What are the critical dimensions summarized by the variables studied?
3. What is the relative importance given by the participants to the elements of satisfaction and learning in business games?

## **DATA COLLECTION**

A questionnaire was developed in order to fill the void in literature. The students' experiential learning experience was examined with two different instruments: (1) a questionnaire that directly asked them to evaluate their learning experience with the simulation. Twenty-three questions were asked using a five-point Likert scale and six questions were asked regarding the student's individual performance as well as the performance of their team, and (2) a peer evaluation that asked them to rate their team members performance in relation to eleven different team activities of which the simulation work represented four of the eleven team activities. In this way we can examine the student's self-reported learning experience and determine the value of the simulation within the context of all the other required team assignments.

### **Analysis - Kirkpatrick's Framework**

Tables<sup>1</sup> 1, 2, 3 and 5 show the questions that were used to measure each level of learning in the Kirkpatrick Framework. A five-point Likert scale was used to measure the students' opinion with the following values: 1=strongly agree, 2= somewhat agree, 3= neither agree or disagree, 4=disagree and 5=strongly disagree.

Overall, the students "somewhat agreed" with all questions regarding the first three levels of learning with an average score of 2.60 (Table 1), 2.60 (Table 2), and 2.71 (Table 3) for levels 1, 2, and 3 respectively. A higher average is certainly desirable. However, these averages are very good when two other measures are considered: (1) only 40.2% of the students agreed that they mastered the simulation by the end of the semester (Table 3) and (2) only 47.6% of the students reported that all team members shared the simulation work equally (Table 5). Consequently, an

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<sup>1</sup> Due to space limitations, tables are not included. Please contact the author for a copy of the tables.

above average rating is good when mastery and participation is below average at best and implies that less skilled and less active students still did learn some skills.

A review of the averages for the first three levels identify the top reasons to explain the efficacy of the simulation. For the reaction level, the students felt that the simulation was a good experience (59.8%), very challenging (61.7%) and that the dilemmas were both interesting (58.1%) as well as challenging (54.2%). On the learning level, students believed the simulation helped them become more proficient at inventory management (67.9%) and managing the price/quality value relationship (66.7%). At the behavior level, the students found that the dilemmas caused their team members to discuss the issues (57.9%) and using the solo version help the student (58.9%).

In order to explore the data further, the percent agreeing and disagreeing with each statement is compared and reported in Table 4. By examining overall percentages, we find half the class agreed that they learned at all levels. Table 4 compares the three levels and shows that Level 2 has the highest ratio of agree to disagree with a ratio of 3.9:1

Kirkpatrick's fourth level of learning, the degree to which the students worked together as a team, is measured by asking about their level of participation. Table 5 reports these results and shows the relatively modest level of participation, 47.6%, as noted above. Interpretation of this data is limited because this is a cross-sectional survey. However, a few additional insights about this learning level can be gained from the data reported in Table 5:

- (1) Students gave a C+ grade for their team's ability to work together.
- (2) One or two students really worked on the simulation for a third of the teams.
- (3) Over 10% of the students reported that they did less than their fair share of work on the simulation.

Overall, this measure of learning clearly shows that all students were not actively engaged in the learning experience of the simulation, but it also shows that a significant percent of the students were fully engaged in the learning experience of the simulation and in some cases over two-thirds of the students reported learning while team participation was below average.

### **Analysis - Cognitive and Affective Learning**

In the spirit of exploratory studies and considering the limitations of the data set, two levels of analyses are performed. First, a correlation analysis is performed to determine the variables that are highly correlated with each of the variables selected to measure each type of learning. Second, regression analysis is performed to determine the ability of the highest correlated variables to explain the change in those variables selected to measure each type of learning. Tables 6 through 9 report the correlations and Table 10 reports the results of the regression analysis.

Interestingly, the top same ten variables that correlate with each of the four measures are the same but in different order. The regression analysis suggests other factors that may contribute to the students' learning experience than is found using Kirkpatrick's Framework. Overall, each

regression explained a considerable amount of variation in the students' learning experience ranging from 33.9% to 63.9%. Four variables are significant in explaining at least one of the dependent measures. Using the Cognitive and Affective Model, students learned the impact of the venture team on the performance of their firm; helped them become more proficient at managing cost of goods sold; exposed them to real-life business decision-making situation; and helped them become more proficient at financial management. The first two variables explained both cognitive and affective learning while the last two explained only affective learning

### **Analysis - Peer Evaluation**

What is the simulation's relative importance to the team's overall performance? This question can be partially be answered by the students' peer evaluation. At the end of every class, each student is required to rate the performance of each team members on eleven different team activities using a ten-point scale. Four of the ten criteria describe work on the simulation while six criteria relation to other team projects and work. Ten represents that the student took a lead role in the particular activity while 1 indicated that the student did not contribute to the particular team activity. On average, students' participation rating ranged from a low of 79.3% to a high of 85.9% (Table 11). Overall, this finding indicates that all teams performed at an above average level and reflects the previously reported rating using the Kirkpatrick Framework findings.

Of the eleven questions, a key question is whether a student would like to work with the same student again. This is a litmus test of a student's performance. The regression analysis (Table 12) explains 67.6% of the variance and shows that three variables explain the variance in a student's preference to work with the student again. The top two reasons are expected: The student's ability to facilitate an excellent working relationship among team members, and the student's regular attendance at meeting. Both factors are fundamental to any group work. However, the third and only other variable that explained a student's desire to work with the student again, at the 95% confidence level, is the student's contribution to the simulation's quarterly decisions. This finding provides indicates the value of the simulation to create a group work ethic.

### **Conclusion**

Entrepreneurship education is finally arriving as a recognized academic discipline, and successful entrepreneurs are recognized as the "hero's" of economic growth. However, the question remains: How do we educate entrepreneurs? We know experience is the greatest teacher for entrepreneurs even though expensive and failure can be devastating for the entrepreneur and his or her family. During the early 80s, entrepreneurship classes were small and educators could effectively use a business plan writing exercise to engage the student into critically examining their venture idea. As enrollment grew significantly during the 90s, the exercise lost its effectiveness to help students evaluate their individual venture idea. Today's challenge is to educate entrepreneurs within the environment of large classes, and this study analyzes the ability of a business simulation to teach students about entrepreneurship through experiential learning.



The value of the business plan writing exercise in teaching entrepreneurship is being challenged by the increasing class size. This paper considered a business simulation as an alternate team project for teaching students entrepreneurial skills. Overall this study suggests that the simulation did teach several essential financial and marketing skills as well as the impact of good team performance.

In addition, this study confirms a common challenge in most classes that require team or group projects: obtaining active participation by all team members. It is not known whether the team participation found in this study is normal, above normal, or below normal. Further studies are certainly needed to assess the level of team participation as well as compare the learning experience of students doing a business plan writing exercise versus a business simulation. In either case, the simulation is worthy of further study and consideration in the teaching of entrepreneurship.

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# **Toward a Framework of Financial Planning in New Venture Creation**

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## **Abstract**

Empirical studies across different industrial countries have shown a positive correlation between planning intensity and the success of a business venture. Nevertheless, financial planning is typically regarded as a major obstacle in the process of new venture creation. Analytical techniques for large-scale and international enterprises are not fully appropriate for dealing with start-up planning. However, the existing literature which focuses on business ventures lacks a clear theoretical approach.

In this article, we develop a coherent comprehensive framework that draws out interdependencies among the financial planning components, elements, and individual items. We also determine a starting point of the planning process, show the linkage to other functional areas of business planning, and emphasize the structure, interdependence, and adjustment of elements within an iterative planning process. This provides the firm founder with a fundamental decision-making instrument, which supports the evaluation and exploitation of entrepreneurial opportunities, as well as the formulation and implementation of the corporate strategy.

The framework comprises five financial planning elements concerning sales, related expenses, investments, capital requirements, and financing, which results in three components: planning of income statement, balance sheet, and cash flow statement. We demonstrate how the robustness of the financial plan can be tested by employing sensitivity analysis, scenario analysis, and simulation. The quantitative result of this process is a consistent financial plan. The components of our approach are fully consistent with generally accepted accounting principles (IAS and U.S. GAAP).

## **1. Introduction**

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 (Gumpert & Stancill, 1986; Hayen, 1982; Hergert, 1987; McGrath & MacMillan, 1995; Pettit & Singer, 1985; Wilkinson, 1987). Yet, there exists no generally accepted guideline for aligning financial planning with the creation process of a start-up. A coherent comprehensive framework which draws out interdependencies among the planning components, elements, and items is still lacking. The importance of planning in new venture creation is supported by recent research which has detected a positive correlation between planning intensity and the success of new

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\* I would like to thank Matthias Raith for critical comments.

ventures (Stewart, Watson, Carland, & Carland, 1999). Delmar and Shane (2003) argue that planning is a significant precursor to action in start-ups. There also exists a significant positive relationship between formal planning by small firms and financial performance (see, for example Bracker & Pearson, 1986; Schwenk & Shrader, 1993).

Our starting point is the framework suggested by Shane and Venkataraman (Shane & Venkataraman, 2000; Venkataraman, 1997). They view entrepreneurship as a nexus of enterprising individuals and valuable opportunities which constitute the process of existence, discovery, and exploitation of entrepreneurial opportunities. Once the opportunity is discovered, its exploitation requires the investment of limited resources. The expected value is determined by four groups of factors: the characteristics of the opportunity itself, psychological factors (such as motivation, core self-evaluation, cognitive properties, risk taking, extraversion), non-psychological factors (as for instance education, career experience, age, social position, opportunity cost) (Shane, 2003; Shane & Venkataraman, 2000), and the entrepreneur's personal characteristics. Together, this leads to significant deviations in the estimation of the expected value of an opportunity and the resulting financial planning process.

As this perspective reveals, the profitable exploitation of opportunities is related to the task of systematic planning and the calculation of costs and revenues. We define *financial planning* as the process of systematic and quantitative forecasting of all cash in and outflows relevant for the exploitation of entrepreneurial opportunities, in order to support financial decisions within the future planning period. The essence is based on the notional anticipation of future outcomes and the application of an appropriate decision making mechanism. Financial planning, viewed in this light, serves as a mechanism for dealing with uncertainties. Distinct from the definition of financial planning, the pro forma *financial plan*, composed of income statement, balance sheet, and cash flow statement, is the numerical result of the financial planning process.

## **2. Conceptual Framework of Financial Planning for Decision Making in New Venture Creation**

The financial planning process, regarded as a set of decision making instruments, includes three core components:

- (i) planning of the income statement,
- (ii) planning of the balance sheet,
- (iii) planning of the cash flow statement,

By definition, the numerical results of the financial planning process are three appropriate pro forma statements. The triad suggested here relies on the internationally accepted accounting principles. If the venture is financed with venture capital or considerable changes in equity are expected, a fourth component, viz. the "statement of stockholders' equity", would provide a better understanding of the equity events and transactions (refer to SFAC 5, IAS 1). A key supplementary instrument, the "footnotes", contains information on principles, assumptions, details, connections, schedules, and methods used to produce the components, elements, and items of the statements. This provides the groundwork for the planning process. The core components require the (monthly or periodically) planning of five elements, defined as financial planning elements:

- (i) planning of revenues;

- (ii) planning of related expenses;
- (iii) planning of investments (all nonrecurring investments);
- (iv) planning of capital requirements (both all nonrecurring investments and recurring expenses);
- (v) planning of financing.

Figure 1 serves as a comprehensive overview for the following discussion. Although the components of balance sheet and income statement planning are simplifications, they are for the present purpose.

### **3. Planning of Financial Elements**

A crucial issue arising with any conceptual framework is the determination of the starting point. This is of particular importance for our purposes, because of the connections between the elements. The planning of sales is a recommended starting point due to existence of interdependencies with other functional areas. An estimate of the sales volume and price can be extracted from the preceding market analysis and estimated market needs, as well as from a written justification of sales forecasting. In contrast to Gumpert and Stancill (1986), we suggest here that the estimation of sales should be divided into two parts: price and volume. Both are based on several factors, e.g. target market, market boundaries, forecasted development of the target market, customer pattern and taste, competitors, marketing mix. The relationship between these two variables characterizes market demand. How many products and services are customers willing to purchase at different price levels? How does this relationship change over time? Subsequently, the entrepreneur is able to calculate the most likely revenues from the expected sales volume and the target price, which provide the input data for further technical methods. Again, both sales volume and target price have to be supplemented with supporting information and detailed explanations in the footnotes, since this provides the basis for further planning elements and should, therefore, be reviewed continuously.

After assessing the planning revenues, the level of sales volume determines two planning elements. Related expenses starting with the cost of goods sold (labor, material, overhead, etc.; except depreciation) can be calculated. Furthermore, a derived production plan specifies the required level of capacity of production and service which ascertains the needs of nonrecurring investments. In order to obtain a clear picture separate schedules for the production plans are recommended. Based on the production level, the entrepreneur calculates the remaining expenses – general and administrative, selling, research and development, and other expenses – to complete the element “planning of expenses”. It is inappropriate to classify these items as percentages of sales. Instead, each item requires a detailed schedule (Gumpert & Stancill, 1986). This is particularly necessary for other expenses that should not be treated as a “pool for residual items”. After finishing the investment plan, the entrepreneur prepares a depreciation plan to include depreciation in cost of goods sold. Once more, all items should be supplemented with detailed information in the footnotes. At this point, however, we cannot yet specify the amount of interest and tax expenses of the income statement.

All cash outflows identified up to this point are aggregated in order to calculate the capital requirements which include nonrecurring investments and recurring expenses. Up to this point,

the revenues and expenses are accounted for in the income statement. Sales and expenses do not always result in cash flows, e.g. invoices are paid and payments are received from customers at a later point in time. Thus, the firm founder has to estimate the percentage of revenues and expenses that are collected this month, the next, and in later months. From this computation, accounts receivable and payable are extracted. For this, a separate schedule is appropriate. The next step is to plan financing. The objective of an optimal capital structure is to minimize the weighted average costs of capital. Based on the financing plan, interest expenses are given. This poses a challenge to the entrepreneur since the whole project depends significantly on the available funds. After finishing the financing and restatement of all other elements, the entrepreneur calculates interest expenses and includes this item in the income statement in order to determine taxes.

#### **4. Planning of the Income Statement**

Overall, the income statement planning is based on the following financial planning elements: planning of revenues, planning of related expenses, a depreciation plan extracted from the planning of investments, and interest payments calculated from the planning of financing. Depending on the opportunity, the simplified income statement of figure 1 can be exhibited in a more detailed plan. Deducting the cost of goods sold from sales results in gross margin. Subtracting further the operating expenses yields operating income. Operating expenses may be broken down into general and administrative expenses, selling expenses, research and development, as well as other expenses. In subsequent steps, the entrepreneur deducts interest and tax expenses. In addition, there are four different methods to account for revenues: completed contract, percentage-of-completion, installment, and cost recovery method. Revenues are included in both the income statement (revenues) and the balance sheet (account receivables), depending on the credit policy. This is important for the estimation of cash flows, because high credit sales, all else being equal, lead to later cash inflows and, thus, to greater capital requirements. When calculating expenses, fixed costs should be separated from variable costs. Consequently, a (cash flow) breakeven analysis can be conducted to find the point where revenues are high enough to cover cash outflows and maintain the level of operations.

#### **5. Planning of the Balance Sheet**

As in the income statement, items in the balance sheet depend on the nature of the entrepreneurial opportunity and should be consistent with accounting standards. Given the planning of investments, capital requirements, and financing, the entrepreneur generates the information necessary for the preparation of the projected balance sheet. Starting with the investment plan, the entrepreneur determines the amount of fixed assets (property, plant, and equipment) required for the production of the desired level of output. This represents the nonrecurring investments. In case the contractor of the PP&E offers financing, this would be recognized in the financing plan. Sources of financing which are particularly interesting for new ventures, due to limited funds, are leases or so called off-balance-sheet financing

As already discussed in section 3, the entrepreneur calculates a separate schedule of what percentage of sales is collected in each month. Accounts receivable and payable are stated in the balance sheet. It is often the case that new companies will not receive credit in order to purchase

raw material, which ultimately requires more committed funds. A more sophisticated task is determining inventories before they are recognized as cost of goods sold. For example, the inventory of a manufacturing company consists of raw material, work-in-process, and finished-goods, whereas a retailer or wholesaler shows unsold goods as merchandise inventory in the balance sheet. They are calculated separately in accordance with the production schedule. In addition, three alternative accounting methods are applicable for inventory and cost of goods sold: last-in, first-out; first-in, first-out; and average cost. For simplification, the average cost method is recommended. Moreover, a fast growing venture must consider a higher requirement of working capital, which will probably not be able to finance all of the growth from internal funds. The planning and management of account receivables, payables, and inventory is a critical task for start-ups. After determining the capital requirements, the most crucial element is the planning of financing which specifies the source of funds available to the enterprise. Typically, the start-up faces considerable difficulties in acquiring funds. As a result, the obtained capital actually narrows not only the other planning elements but also the entire corporate strategy.

## **6. Planning of the Cash Flow Statement**

As figure 1 illustrates, cash flow planning is derived from all other planning components and elements. It strives to identify the optimal amount of cash flows. Most important is maintaining liquidity, since unprofitable firms with positive cash flows may still operate, but profitable ventures with a lack of cash will become insolvent. In addition, a surplus of liquidity is undesirable because this would counteract profitability. International accounting standards provide a structural classification of cash flows in terms of operating, investing, and financing activities. This separation is recommended for business ventures as well, because the amount of cash flows contains little information by itself, whereas the categorization is informative and consistent with generally accepted accounting principles (for an opposing view, see Gumpert & Stancill, 1986; Hayen, 1982). After planning cash flows from operating activities (CFO), available cash flows for investment (CFI) and financing (CFF) are determined. For strict accounting purposes, SFAS 95 and IAS 7 govern the preparation of cash flow statements and permit both the direct and indirect method. However, the Financial Accounting Standards Board and the International Accounting Standards Board encourage use of the direct method (SFAS 95.27, IAS 7.19). Nevertheless, the most widely-used is the indirect method.

## **7. Applied Technical Methods**

Since financial planning is future oriented, all future cash flows have to be estimated in advance: a process that can be accomplished by a variety of forecasting methods. The data reliability heavily depends on the accuracy of the forecasting process. Methods generally fall into three major groups:

- (i) Judgmental methods are non-quantitative, based on individual experience and intuition. Forecasted values are ascertained by individual and group decision making processes.
- (ii) In contrast, extrapolation or series methods are quantitative in nature and typically based on observations made in the past in order to forecast future values. Thus, by investigating past data, we search for underlying patterns and relationships in order to extrapolate historical patterns into future forecasts.
- (iii) Causal methods are based on logical cause and effect relationships by means of linear and non-linear regressions.

Judgmental methods are generally applicable to new venture creation but their judgmental diversity results in a lack of accuracy and is subject to biases, e.g. optimism and overconfidence (Kahneman, Tversky, & Slovic, 1982). However, judgmental methods can be improved considerably by integrating expert opinions using methods for forecasting from “intentions data” (MacGregor, 2001; Morwitz, 2001; Rowe & Wright, 2001). The second approach is inappropriate in the context of startup financing since historical values are unavailable. Furthermore, causal methods can only be employed when the logical cause and effect relationships are not based on past data. In case the null hypothesis of the cause and effect relationship can be approved, the forecasted value will occur at a specific confidence level. In general, there is a significant difference between existing firms and new ventures: in the latter case, input data from past events are not available for the planning process, and there is no controlling system to rely on. Supplemental comments on assumed forecasting relationships are especially imperative for causal methods.

## **8. Decision Making**

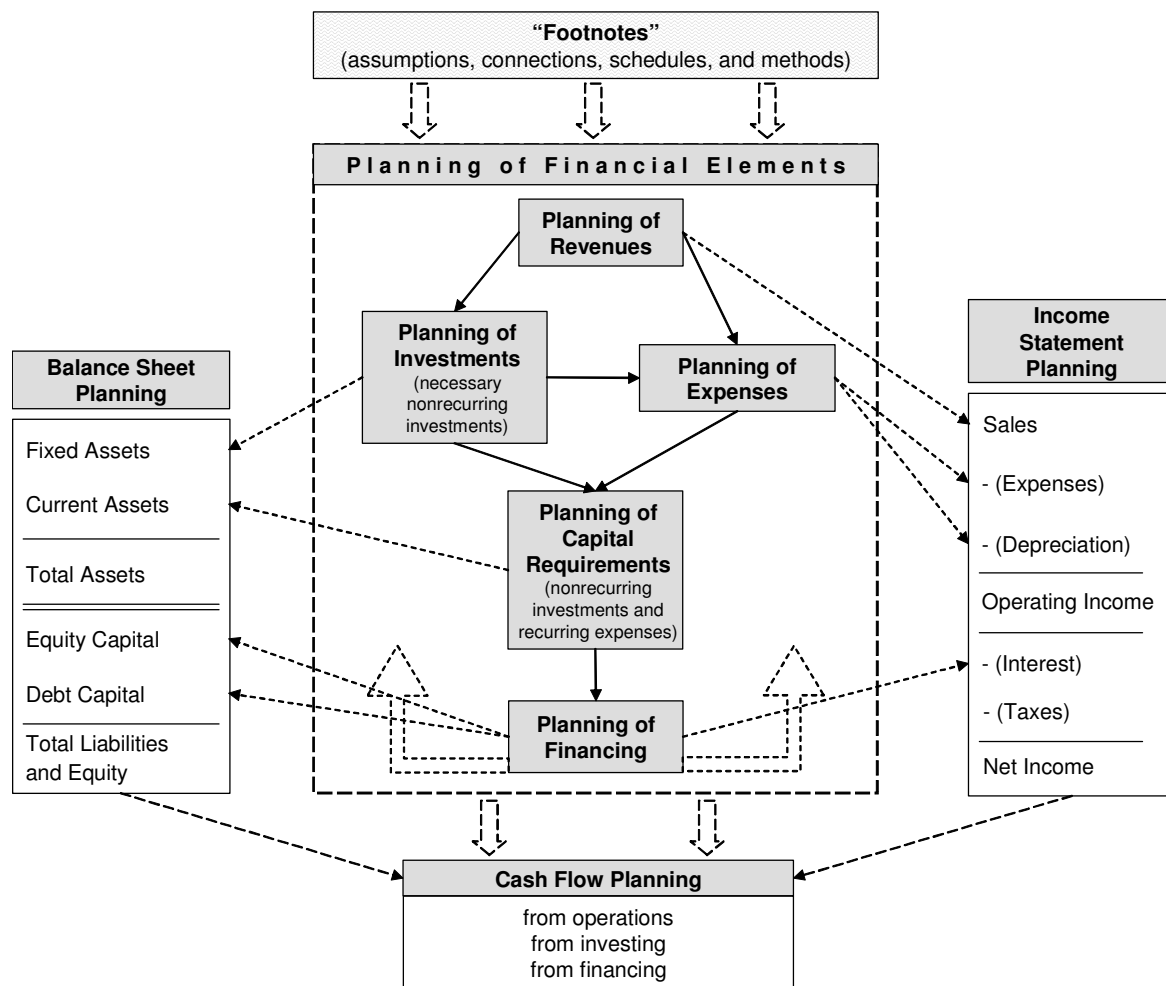
The issue that needs to be addressed is which approach should guide the entrepreneur in her future decisions. Besides factors such as intuition, feeling, and experience, other important methods include systematic planning and forecasting. Relying on intuition (Allinson, Chell, & Hayes, 2000; Bird, 1988; 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 forecasting the timing of cash flows, the firm founder anticipates bottlenecks and financial slacks which enhance the allocation of scarce resources. A decision made today creates a set of subsequent decisions and alternatives tomorrow (Hammond, Keeney, & Raiffa, 2002). The framework supports the firm founder 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). Planning also reduces uncertainties in the process of decision making. Castrogiovanni (1996) defines this as a direct learning benefit by means of “proactive learning” which is generally incorporated in the planning process. The firm founder attempts to identify potential scenarios and causal relationships. Thus, uncertainty may stimulate planning and planning results in “proactive learning” (Castrogiovanni, 1996). Consequently, nascent entrepreneurs should conduct their own planning process to accomplish the most learning benefits (Castrogiovanni, 1996).

## **9. Conclusion**

In this article, we develop a coherent, theoretically grounded comprehensive framework for financial planning in new venture creation. Before starting with any quantitative projection, the entrepreneur gathers and analyses information concerning the new venture, conducts a thorough market analysis to specify market needs, evaluate relevant external threats and opportunities, as well as internal strength and weaknesses. This leads to assumptions and connections which build up the foundation of the whole financial planning process. Thus, the sales volume and price can be extracted from the preceding analyses and written justification. The revenues determines related expenses and a derived production plan specifies the needs of capital investments. By

aggregation, the entrepreneur calculates capital requirements. The next step is the planning of financing which initiates an adjustment mechanism due to financial “bottlenecks” that leads to an iterative planning process. The described process defines the five financial planning elements: planning of revenues, planning of related expenses, planning of investments, planning of capital requirements (all nonrecurring investments and recurring expenses), and planning of financing. Finally, the robustness of the financial plan can be tested by employing sensitivity analysis, scenario analysis, and simulation. These methods are applied to financial planning elements and components. Because all cash flows have to be estimated in advance, appropriate forecasting methods must be employed.

**Figure 1: Conceptual framework of financial planning in new venture creation**



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CAN MUSIC EDUCATION ENCOURAGE ENTREPRENEURIAL THINKING?  
AN ALTERNATIVE APPROACH TO GENERAL MUSIC EDUCATION  
CURRICULUM DEVELOPMENT

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Abstract

*This paper opens a discussion of an alternative approach to music education, one that strives to encourage the growth of entrepreneurial thinking through the use of curriculum integration, problem-based learning and project-based learning in a general music curriculum. The case is made that creative thinking is the nexus between the two seemingly disparate subject areas of music and entrepreneurship, and that music can contribute significantly to the development of the kind of thinking needed by future entrepreneurs. A general music curriculum framework is under development and will be made available upon request.*

## **INTRODUCTION**

Entrepreneurship education is an exciting and emerging field of study in K-12 education. Although still in its infancy (Watson, 2001), this field of study is generating many initiatives that offer opportunities to revitalize classrooms and curricula in a time when teachers are faced with the daunting task of “leaving no child behind.” This paper discusses the traditional and contemporary ideologies of entrepreneurship education, the desired student outcomes that come from using entrepreneurial thinking, the components that are needed to accomplish the inclusion of entrepreneurship initiatives in a K-12 setting and finally the research-based support for using an approach that encourages entrepreneurial thinking through a general music education curriculum that includes creativity-, problem- and project-based learning.

## **TRADITIONAL AND CONTEMPORARY IDEOLOGIES**

Because entrepreneurship education was born in the business schools it is not surprising that early coursework and curricular models reflected a focus on business. Core areas of entrepreneurship were identified, including: 1) identification of an idea or opportunity that was marketable as a service or product, 2) acquiring or getting commitment for funds, in spite of risks, to pursue market potentials, and 3) creation of a business or organization to implement the opportunity in reality (Kourilsky & Carlson, 1997). Curricular models reflecting this focus at the university level have gradually been passed down to secondary and even elementary schools. In the K-12 setting, the standard elements that are considered vital by most traditional entrepreneurship educators are:

- The curriculum must be about entrepreneurship
- The curriculum should be experience-based or experiential
- The curriculum should be based on learning theory principles
- The curriculum should grow slowly, beginning with a pilot stage, then an enhancement stage, evolve through a custom transfer stage and end with a mass transfer stage of development
- The final stage should be taught by certified instructors and should offer certification courses
- The curriculum should fit the target group and environmental constructs
- The curriculum should regularly undergo evaluation and enhancement (Kourilsky & Carlson, 1997).

Some are beginning to shift the focus from business only. One indication of this comes from Calvin A. Kent, whose following remarks seem to support a broader definition of the field.

Entrepreneurship should be defined, in the broadest possible context, as a process of creative change. It may result in the formation of a new business, but then again it may not. The purpose of entrepreneurship education should be to foster creative activity and independent action wherever it is needed. What is traditionally viewed as entrepreneurial activity (starting a business) should not be the only goal or outcome of an entrepreneurship education program. There are tremendous benefits to be gained from entrepreneurship education in addition to that of spawning the next generation of business initiators. A population that is more creative, innovative, risk-taking, and acclimated to change is a population that is more likely to be successful in all its endeavors. Narrowing the limits of an entrepreneurship education program to just a single goal of producing more new business start-ups would be folly (Kent, 1990, p. 6).

There is growing interest in understanding how to encourage entrepreneurial thinking. One Vanderbilt University project, entitled *Entrepreneurs In Action!*, was designed so that new ideas about the entrepreneurial nature of teaching and learning could be employed. The project combined entrepreneurship education fundamentals with new constructs of learning theory to foster independent thinking, creativity and problem solving skills in the belief that such skills are a necessary part of “entrepreneurial thinking” (Goodin, 2003). *Entrepreneurs in Action!* was intended to build on the successes of such programs as *The Jasper Project*, developed by the Cognition and Technology Group of Vanderbilt University (CTGV). *Jasper* is a series of videodisc-based adventures using problem-solving, social interaction, and integration of subject areas to help improve mathematical cognition in 5<sup>th</sup> grade children and up. Both projects reveal that creativity-, problem-, and project-based approaches that are founded in real life stories bring significant meaning to learning (CTGV, 1997). Four pedagogical components consistently emerge: 1) strategies that foster creative thinking, 2) problem-based instruction, 3) project-based instruction, and 4) strategies that lead to experiential or experience-based knowledge from cross-disciplines (Kent, 1990). The contemporary approach is different than the traditional approach, in which students start with an introduction to new facts or principles and are taught to access this new information by the use of applications problems. In this case knowledge may become inert, not active (CTGV, 1997). Contemporary approaches use real-life scenarios that are problem-, or project-based so that the learning of new concepts and principles is active and dynamic. The scope is holistic, cross-disciplinary and relevant to the local community.

### **DESIRED STUDENT OUTCOMES FROM ENTREPRENEURIAL THINKING**

Knowing how entrepreneurs think and how they process information and learn is vital in developing curricula for K-12 students (Young, 1997). Practicing entrepreneurs acquire knowledge for completely different reasons than students. This is because they are faced with truly novel problems or, at least, problems that they have not faced before. Novelty comes from changing goals or from new ideas or ways of looking at or doing some task. They must learn how to draw from their experiences and they need to be less subject-centered in their application of knowledge and more focused on how knowledge can be applied in a problem-centered situation (Kourilsky, 1990). These are the characteristics that must be developed in a student to make an entrepreneurship education program effective (Kent, 1990). Two curricular approaches have been used to advance these desired student outcomes. The first, a composite model, provides instruction to a student from a traditional academic department, usually a “business track.” The second is an integrated model. Specialists from the community and university, who have a vested interest in entrepreneurial processes, have direct involvement in this type of program (Clouse & Goodin, 2001-2002).

### **COMPONENTS TO INCLUDE IN K-12 SETTINGS**

Researchers and educators agree on the importance of strategies that foster creative thinking, problem-based instruction, project-based instruction and cross-discipline strategies that lead to experiential or experience-based knowledge. Current research informs us regarding the nature of

creativity and the ways that creative thought processes are enhanced through problem-based learning and project-based learning as part of a curriculum.

### **Creativity and the Development of Creative Thought Processes**

As one entrepreneurship educator said, “Not all creative people are entrepreneurs nor are all entrepreneurs creative.” Still, the key to great entrepreneurial success lies in the ability to innovate (Kao, 1990). What is creativity and how can curricula help develop creativity? One definition is as follows:

A product or response will be judged as creative to the extent that (a) it is both a novel and an appropriate, useful, correct, or valuable response to the task at hand, and (b) the task is open-ended with more than one way of doing it (Hennessey & Amiable, 1987).

Scientist Antonio Zuchichi (1996) stressed that creativity requires memory and imagination. If we accept that the background elements of creativity include memory and imagination, it is easy to assume that there is a relationship between creativity and intelligence. However, brain research has shown that while low intelligence yields low creativity, higher intelligence yields both lower and higher levels of creativity. Social psychologists suggest that creativity arises from three components: 1) domain-relevant skills, including factual knowledge, sets of cognitive pathways, technical skills and special talents, 2) creativity-relevant skills, which are defined by personality dispositions that are given to risk-taking, deep concentration and the ability to readily take on problems and imagine new ways to solve them, and 3) intrinsic task motivation, meaning the variables of motivation a person has with a particular problem or task. This component, according to some, is the most neglected in the classroom (Hennessey & Amiable, 1987).

Prior to the lesson/activity these strategies will foster classroom creativity: 1) confront a new, ambiguous uncertainty by building anticipation and expectation, 2) make the familiar strange (or the strange familiar) by analogies, 3) look at something from every point of view as is reasonably possible, 4) ask for predictions, 5) ask questions that make students look at knowledge or experiences in a new way, and 6) structure tasks just enough to give direction or clues and encourage risk-taking or going beyond what is known. Remember that creative learning develops best when methods are varied and informal. During the lesson/activity the following should be used: 1) keep anticipation as the motivation for learning, 2) do not limit possibilities but encourage constructive, creative responses, 3) make the exploration of missing pieces and possibilities systematic and deliberate, 4) use open-ended strategies, 5) use surprises deliberately, 6) juxtapose seemingly unrelated ideas, 7) allow time to think, experiment and test ideas, and 8) encourage visualizations. Following the lesson/activity, teachers should: 1) revise predictions, 2) reorganize and review the knowledge gained from the experiences, and 3) encourage digging deeper beyond the obvious solutions (Torrance & Myers, 1970).

Teachers sometimes do not fully understand what type of creativity they are trying to develop in students. Anna Craft (2000) calls the creativity of all people “little ‘c’ creativity,” noting the fact that all children possess some amounts of this type. She asserts that the vast majority of children need opportunities to use this type of creativity often, and that teachers must choose pedagogical approaches that invite it. She proposes that teachers misunderstand what creativity is and mistakenly strive to develop “high ‘c’ creativity.” This type of creativity is like that of historical

figures that society deems as geniuses or as profound (Craft, 2000). Strategies that support little 'c' development includes those that incorporate the use of multiple intelligences in the classroom, call for both convergent and divergent thought processes and promote imagination, play, and invite questions and "possibility thinking" (Craft, 2000). For learning activities to foster creativity in students they must be allowed to become solvers of real problems, not just absorbers of knowledge. Teachers must become problem setters, problem seekers, coaches, listeners, promoters and creative thinkers, not just knowledge givers (Starko, 2001). Entrepreneurship educators value creativity, as is shown by the following 12 strategies, grounded in creativity research, that will develop creative initiative in students:

1. Serve as a role model of creativity
2. Encourage the questioning of assumptions
3. Allow for mistakes
4. Encourage sensible risk-taking
5. Design creative assignments and assessments
6. Let the students define the problems for themselves
7. Value creative ideas and products
8. Allow time to think creatively
9. Tolerate and encourage toleration of ambiguity
10. Prepare students to face obstacles
11. Be willing to grow and adapt
12. Have a nurturing environment (Sternberg, 1996).

One way to learn how to develop an environment conducive to creative thought is to know what will not work. Researchers have identified 5 teaching "don'ts" that can kill creativity:

1. Having children do work for an expected award – Evidence shows that this undermines internal motivation and creativity of performance.
2. Using a lot of surveillance – Evidence shows that all children were less motivated to solve problems or play. Older students responded as though they were being evaluated.
3. Restricting choices of how to do an activity – Evidence shows that constraints of any type lower interest in creative activity.
4. Set up of competitive situations – Evidence shows that competition between peers for recognition or reward is undermining to the intrinsic motivation needed for creativity.
5. Have children focus on expected evaluation – Research shows that evaluations increase extrinsic motivation, not intrinsic motivation, which is not conducive to creative thought processes (Hennessey & Amiable, 1987).

### **Problem- and Project-Based Learning Using Cross-Disciplinary, Experiential Knowledge**

All of the previously listed strategies for fostering creativity contain one common feature– the requirement of a problem. The underpinnings for project-based and problem-based learning (PBL) were originally conceived in the work of philosophers like Bruner, Gagne and Dewey (Barrows, 2000). These philosophers promoted strategies of self-directed learning that fostered the flexible transfer of knowledge. Students solving real problems gain experience that is connected to knowledge in a deeper way and develop a flexible and creative cognitive style (Evenson & Hmelo, 2000).

Problem- and project-based learning methods are holistic, experiential and in harmony with Gardner's multiple intelligences research (Fogarty, 1997). They match the curricular reform movement in schools today (Lambros, 2002). Teachers must embed national standards in the objectives of each problem in such a way that students accomplish the objectives even if they find multiple solutions for the problem (Bridges & Hallinger, 1995). Teachers may combine these models or develop them separately. They may use this approach in one classroom or across the entire school curriculum.

To implement a problem- and project-based curriculum the following steps should be included: 1) use faculty and community experts as consultants in designing the overall problem or for project development, 2) use faculty and community experts as consultants for student learning and as panelists for the students' projects, 3) let events and local issues open opportunities for discussions of problems and projects with students and faculty, and 4) share student products and solutions with faculty and community experts. Teachers must verify the relevance of the problem, understand its context and develop assessment tools that match. They should allow for time constraints, resources, preparation of the environment, assignment of teams or groups and guidelines for the role of the primary leader in a project (Bridges & Hallinger, 1995).

As stated earlier, entrepreneurship education includes these pedagogic elements in both traditional and contemporary approaches. However, present approaches to entrepreneurship education and to entrepreneurial learning are possibly becoming two sub-related fields within entrepreneurship. Fresh approaches are currently trending toward the encouragement of entrepreneurial thinking, rather than simply the creation of new business ventures (Clouse & Goodin, 2001; Young, 1997).

## **ENTREPRENEURIAL THINKING IN THE GENERAL MUSIC CURRICULUM**

The discussion thus far has laid the groundwork for a problem-based approach to entrepreneurship education, but has not yet addressed the role of a K-12 general music education program in the encouragement of entrepreneurial thinking. Our research reveals that this is a relatively unexplored area but that there are some important areas of commonality.

Many methodologies are available to music educators who are designing a general music education curriculum (Atterbury, 1992). In contrast to the contemporary models of entrepreneurship education, the general model for teaching music is based on the conservatory teacher, where learning occurs through imitation of the master teacher; it is "teacher centered." While this may work for musically motivated students (high "c"), it results in many students dropping out of music because the experiences they have had are not relevant, internalized or personalized. Tait (1992) states that "society is going to need many more creative people in the next decade, and knowledge of the creative process is going to help fulfill that need."

Creativity and problem solving go hand in hand with song writing and improvisation; the main difference is the timeframe it takes to create or get feedback (Bean, 2000; Csikszentmihalyi & Rich, 1997). Research shows that writing music contributes to aesthetic works, increases higher order thinking and flexible problem solving, builds a tolerance for ambiguity between content

and concept, builds a community feeling, gives students a sense of ownership and offers another integrative tool in content area learning (Bean, 2000).

The Music Educators National Conference (1999) conveyed twelve imperatives in what was called the *Housewright Declaration: Vision 20/20*. This project was designed to indicate, for music educators, the possible future direction that music education was taking and made suggestions on how to best meet the future demands that could be placed on music educators. Several of the open-ended imperatives given could allow for the inclusion of entrepreneurship education and entrepreneurial learning in a general music program, as follows:

- Number one – participation and experience (which gives rise to experience-based knowledge and active learning)
- Number six – involvement of professional community (opens the doors to those who can help conduct problem- and project-based learning methods)
- Number seven – formal and informal curricular integration (which supports the cross-disciplinary requirement needed to include entrepreneurial ways of thinking)
- Number twelve – identify barriers (which means music educators must be able to recognize a problem and then be innovative problem solvers)

Bennett Reimer (1999) points out that music yields products and is a process. Entrepreneurship education directly relates to processes that bring products into being and offers new ways to look at the products or processes that are constructed (Kent, 1990). In another section of the *Vision 2020* document, Carlesta Elliot Spearman, a professor of music at Keene State College, NH, states that the 21<sup>st</sup> Century will bring “innovations and creative adaptation of teaching methodologies and materials in music education” (Spearman, 1999).

## **CONCLUSIONS AND RECOMMENDATIONS**

There are many examples of areas where convergence between a music education curriculum and entrepreneurial thinking could occur. The National Advisory Committee on Creative and Cultural Education stressed the “nurturing of individual expression, often through self-directed learning and creative activity” (Adams, 2001). The committee goes on to say that academic skills are still highly valued by employers, but words like flexibility, adaptability, social skills, communication skills, cultural awareness, and creative thinking are part of the vocabulary of governments and employers today. Research validates that when learning experiences are based on inquiry students become self-directed problem seekers and solvers through creativity, innovation and critical thinking skills (McLaughlin, 2000). These are the same basic components that research has prescribed for entrepreneurship education.

If, as we propose in this paper, all children have a certain degree of creativity (small “c”), then the following beliefs naturally follow: 1) creative education can foster creative thinking and problem-solving, 2) the effective combination of creative thinking and problem-solving will bring about what we term “entrepreneurial thinking,” and 3) entrepreneurial thinking is a prerequisite to entrepreneurship. Our recommendations for blending the two fields are built on these beliefs, and are structured around three main points: 1) infusing music education throughout the K-12 experience while 2) seeking deep curricular connections with specific



entrepreneurship education goals, and 3) following up with specific entrepreneurial ventures as culminating educational experiences.

Much work remains to be done in the development of a curriculum that effectively combines music with entrepreneurship. The temptation is to simply provide students with the opportunity to start a music publishing business, or to create a performance group, or to connect them with the Songwriter's Guild. Such approaches, in our view, shortchange the very real possibility that a fusion of arts and entrepreneurship offers. The field of curriculum development is crying out for the kind of fresh approach that brings relevance to learning. When our students grasp the deeper similarities that exist between creative fields like music and the entrepreneurial thinking so necessary to business venture development, when they see that creativity is required in both venues, then perhaps they will be less likely to "turn off" the entrepreneurial spirit that is a part of their very makeup.

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**COMMON PROBLEMS OF RURAL SMALL BUSINESSES:  
A COMPARISON OF AFRICAN AMERICAN- AND WHITE-OWNED FORMATION AND  
EARLY GROWTH FIRMS**

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**ABSTRACT**

This study investigated the types of problems encountered by rural businesses that used Small Business Centers for counseling. The sample included 250 retail and service firms and their problems were stratified according to Chrisman and Leslie's (1989) integrative problem classification system. Analyses were conducted to determine the most common types of problems encountered by these businesses and the relationship between the types of problems reported and the owner's race and firm's developmental stage. Strategic problems (55.6%) were the most commonly encountered problems by business owners in the sample, regardless of race or developmental stage. The second most common type of problems was administrative (33.6%), while the least common type of problems was in the area of operations (10.8%). Although no significance was found between the type of problems and the owner's race, a significant relationship was found between problem type and the firm's developmental stage such that businesses in the formation stage are more likely to encounter strategic problems and early growth firms more often experience administrative problems.

**INTRODUCTION**

According to the Small Business Administration (SBA), approximately 66% of small businesses survive their first two years of existence. The survival rate drops to only 39.5% after six years of operation (SBA Office of Advocacy, May 2002). These statistics serve only to confirm that starting and maintaining a successful small business is difficult at best. However, within the classification of small businesses, there is a subset of small businesses that has an even greater failure rate. According to the SBA, of the African American businesses with employees and positive payrolls that started in 1992, only 34.7% survived after four years of operation (SBA Office of Advocacy, November 2001). In addition, for the time period 1992 to 1997, all minority classifications except African American-owned businesses surpassed the gross receipts growth rate of all U.S. small businesses (Minority Business Development Agency, July 2001). Two contributing factors that generally lead to higher failure rates for African American-owned small businesses are less access to capital and a need for better management and technical training (Thompson, 1991).

Research points out that small businesses are more likely to be located in rural areas with less access to resources (Headd, 2000). A weak infrastructure often makes it difficult for business owners to take full advantage of economic opportunities. As indicated in a 2003 report from the Kellogg Foundation, entitled *Mapping Rural Entrepreneurship*, some of the obstacles in rural regions include limited networks, financial constraints, low demand levels, unskilled labor, and cultural barriers. As outlined in the report, the keys to improving entrepreneurial activity in rural communities is to promote entrepreneurship education, provide greater access to capital, and offer high-quality business assistance. Entrepreneurship can become a substantial component of rural economic development if the business climate is improved in these areas. Eastern North Carolina relies heavily on small businesses to provide jobs and economic growth. However, like many other rural areas, this region is faced with a high business failure rate and a low business startup rate (NC Department of Commerce, March 10, 2004).

### **PURPOSE OF STUDY**

The purpose of this study was to determine the types of problems encountered by rural businesses that use Small Business Centers for counseling and the relationship between these problems and the owner's race and the firm's developmental stage. This study focused specifically on businesses in the formation and early growth stages of development. According to Dodge and Robbins (1992), business owners in the formation stage develop a business plan and attract financial support to allow their ideas to become a reality. The early growth stage, while still presenting a high level of uncertainty, is often characterized by steadily increasing sales as business owners become keenly aware of customer demands.

In order to be effective, small business assistance programs must develop a proper match between the needs of their clients and their program offerings (Nahavandi & Chesteen, 1988; Chrisman, 1999). As pointed out by Chrisman and Leslie (1989), a better understanding of the problems faced by small business owners leads to more effective outside assistance that can have a direct impact on the management practices of these firms. Rice and Matthews (1995) noted that business counselors must understand the developmental stage of their clients in order to effectively identify and serve their most critical needs. Prior research by Olson (1987), Kuratko and Hodgetts (1989), and Dodge and Robbins (1992) examined the types of problems most prevalent in the different developmental stages of a small business. Olson (1987) proposed that a start-up business is more apt to encounter problems related to product creation and development. Kuratko and Hodgetts (1989) and Dodge and Robbins (1992) found that problems in the areas of marketing, finance, and capital acquisition are the most prevalent in the startup phase of a small business.

Later, as a business enters its growth and maturity stages, Olson (1987) and Kuratko and Hodgetts (1989) found that administrative and managerial problems are more prevalent. Dodge and Robbins (1992) suggest that external problems become less important and internal problems increase as a small business moves through its developmental cycle. However, Dodge and Robbins warned that problems may carry over from stage to stage if they are not properly resolved. A more thorough understanding of the types of problems encountered by African American-owned business, and in which stage they are encountered, may help increase their ability to develop and position their firms for long-term success.

The welfare and success of minority-owned small businesses is very important, especially in rural areas such as eastern North Carolina. Interestingly, based on our random sample, a surprisingly high percentage (45.2%) of the business owners that sought assistance were African American. The health and growth of African American-owned small businesses often serves as a strong barometer for the overall progress made by minorities in the U.S. (Feldman, Koberg & Dean, 1991; Thompson, 1991). Acs, Tarpley, and Phillips (1998) suggest that one of the main contributions small businesses make is to allow millions of people, especially minorities groups, to enter the economical and social mainstream of American society. Because the success of minority-owned small businesses is so important to the economy and because these businesses report such different growth and success rates (SBA Office of Advocacy, November 2001), additional research is needed to help understand any differences between the types of assistance needed based on the owners' race and the firm's developmental stage.

### **CLASSIFICATION OF PROBLEMS**

Chrisman and Leslie's (1989) integrative system was designed to classify the types of decisions needed to start and maintain a successful business and to help analyze the common problems faced by small business owners. Small business problems are classified into administrative, operating, or strategic categories. Administrative problems center on the organizational structure of a business and its ability to acquire and develop resources (Chrisman & Leslie, p. 42). These problems generally include accounting, finance, personnel, and general management issues. Operating problems are more common in the functional areas of a business, including issues in the areas of marketing, production, operations, and inventory control (Chrisman & Leslie, p. 42). Strategic problems involve the ability of small business owners to match their product or service offering with the demands of the external environment. This requires the business owners to understand the focus of their business and the needs of their target market. Business owners with strategic problems often need assistance with a feasibility study, business plan, pro-forma financial analysis, or market research (Chrisman & Leslie, p. 42).

### **SMALL BUSINESS CENTERS (SBCS)**

For a variety of reasons, entrepreneurs often turn to community colleges for assistance before making a commitment to start a new business venture (Warford & Flynn, 2000). North Carolina, in particular, has used its community college system as a strong economic development tool (Dougherty & Bakia, 1999). The primary community college program in North Carolina aimed specifically at serving the needs of small business owners is the Small Business Center. Each of North Carolina's 58 community college campuses houses its own SBC. North Carolina's network of SBCs is one of the largest state sponsored small business assistance systems of its type in country. The primary goal of these centers is to increase the success rate and the number of viable small businesses by providing personalized assistance to prospective and existing small business owners (North Carolina Community College System, March 10, 2004). Given the striking differences in minority representation, success rates and income, the following research questions have been derived to increase our understanding of any differences in problems experienced by business owners receiving assistance from SBCs as a result of race and organizational development.

## **RESEARCH QUESTIONS**

Research Question 1: What types of problems are encountered by rural small businesses that use SBCs for counseling based on the owners' race (African American or White) and the firm's developmental stage (formation or early growth)?

Research Question 2: Is there a relationship between the types of problems encountered by rural small businesses that use SBCs for counseling and the owners' race (African American or White) and the firm's developmental stage (formation and early growth)?

## **METHODOLOGY**

A random sample of 250 small businesses from the retail and service sectors was taken from clients that received confidential counseling from SBCs in eastern North Carolina between 2001 and 2003. A detailed breakdown of the sample is shown in Table 1. The data was collected during the spring of 2004. Each client that receives counseling from a SBC must complete a "Request for Counseling" form. These forms are used to record a client's problem(s) and to note the type of counseling provided at the SBC. Administrative records can offer a large amount of rich data in a variety of areas, such as client characteristics, services provided, and services needed (Rothman & Gant, 1987). Chrisman and Leslie (1989) recommend the use of clients' files as an importance source of information for studying small business assistance programs.

## **RESULTS**

Frequency crosstabulation counts were used to answer the first question. These counts indicated the types of problems encountered by the 250 small businesses in the sample based on the owner's race and the firm's developmental stage. Strategic problems (55.6%) were the most commonly encountered type of problems by small business owners in the sample, regardless of race or developmental stage. The second most common type of problems was administrative (33.6%), while the least common type of problems was in the area of operations (10.8%).

As seen in Table 2, the distribution of problems encountered by African American-owned and White-owned firms was very consistent. Of the 113 businesses that were African American-owned, 64 (56.6%) firms experienced strategic problems, 39 (34.5%) firms experienced administrative problems, and 10 (8.9%) firms experienced operating problems. The problems encountered by the 137 White-owned firms included 75 (54.7%) firms with strategic problems, 45 (32.9%) firms with administrative problems, and 17 (12.4%) firms with operating problems.

The distribution of problems encountered by formation and early growth businesses varied according to their developmental stage (see Table 3). Whereas the most common problems encountered by businesses in the formation stage (71.8%) were strategic, early growth businesses (48.5%) more often faced administrative problems. Also of importance was that 19.8% of early growth businesses experienced operating problems, while only 4.7% of businesses in the formation stage experienced these types of problems. Overall, the distribution of problems for

early growth businesses was much more evenly distributed than with businesses in the formation stage, which overwhelmingly faced problems that were strategic in nature.

A crosstabulation between type of problems and the owner's race and firm's developmental stage was also calculated to uncover any patterns when the variables were examined in conjunction with each other (see Table 4). The most common type of problem facing African American-owned firms in the formation stage was strategic (69.3%), while the African American-owned early growth firms most often encountered administrative problems (50%). Similarly, strategic problems (74.3%) were the most common for White-owned businesses in the formation stage and administrative problems (47.6%) were more common for White-owned business in the early growth stage. Regardless of race, the most common type of problem encountered by firms in the formation stage was strategic (71.8%) and the most common type of problem facing early growth firms was administrative (48.5%). The least common type of problems for firms, regardless of race or developmental stage, was operating problems. Early growth firms, however, experienced the greatest number of operating problems. Approximately 20% of the White-owned early growth businesses and 18.4% of the African American-owned early growth firms encountered operating problems.

The second research question examined the possible existence, and strength, of relationships between the type of problems encountered by rural small businesses and the owner's race and the firm's developmental stage. Pearson's chi-square was used to determine whether or not a relationship existed between these variables. If a significant relationship was found, lambda was used to determine the strength of the relationship.

Based on the results of the Pearson's chi-square test (see Table 5), no significant relationship existed between the types of problems encountered by rural small businesses that use SBCs for counseling and the owners' race. However, the developmental stage of the business was found to have a significant relationship ( $p < .001$ ) with the type of problems encountered by firms in the sample. In addition, significance ( $p < .001$ ) was found when developmental stage was examined in conjunction with race.

Because significance was discovered between the type of problems and the firm's developmental stage, and between development stage and race when examined together, lambda was calculated to determine the strength of these association. The results indicated that a moderate association existed between the types of problems encountered by small businesses and their developmental stage such that businesses in the formation stage are more likely to need assistance with strategic problems, whereas early growth firms are more likely to need administrative assistance. In addition, a moderate relationship continued to exist between the type of problems encountered by small businesses and the firm's developmental stage when the owner's race was held constant. Regardless of race, businesses in the formation stage are more likely to need assistance with strategic problems and early growth firms are more likely to need administrative assistance.

## **CONCLUSIONS**

The findings of this study indicated that the majority of small business owners with firms in the formation stage rely on counseling to help them resolve strategic issues that are core to the

development of a successful enterprise. Conversely, owners of businesses in the early growth stage were more apt to seek counseling for administrative problems. Whereas both African American and White owners of early growth businesses are searching for ways to improve administrative tasks and reduce expenses, most owners of businesses in the formation stage, regardless of race, need help establishing a solid foundation for their business. Although this does not help explain the lagging performance of African American-owned small businesses, it does help us better understand the needs of small business owners. A better understanding of the types of problems prevalent in the various developmental stages allows business counselors to offer more effective assistance that can have a direct impact on the success of their clients (Rice & Matthews, 1995). Strategic assistance at the onset of an entrepreneurial venture is paramount.

As indicated in *Mapping Rural Entrepreneurship*, many states do not focus on the needs of business owners during the startup stage of business development. SBCs can serve as the one of the primary vehicles in rural North Carolina for helping emerging business owners develop a strong foundation for their enterprises, thereby improving their chances for long-term survival. Past research has shown that entrepreneurs often turn to community colleges for assistance before making a commitment to start a new business venture (Warford & Flynn, 2000).

Interestingly, in a prior study on business counseling, Chrisman and Leslie (1989) suggest that clients should rely primarily on small business assistance programs for help with administrative and operating problems. They concluded that these programs are better able to provide assistance that allows businesses owners reduce their costs, rather than help with strategic issues such as business planning or market analysis. The insights gained from the current study can be used by small business assistance programs to create better counseling services aimed at meeting the strategic needs of business owners. Specifically, SBCs should consider concentrating on counseling owners of newly formed businesses, allowing other programs, such as Small Business Development Centers, to focus on serving the needs of firms in the growth stages of development.

## **FUTURE RESEARCH**

There are four main limitations we believe future research should address. First, the present study was unable to compare the problems encountered by businesses from other minority classifications and business development stages. No other minority class or developmental stage was sufficiently represented in our sample data. Future research should include other minority classifications and business development stages when available. Next, our sample was limited to retail and service organizations because of a lack of representation from other business sectors. Involving different business classifications can only add to our understanding of the types of problems encountered by rural small business owners. Third, because the data was archival and did not include information about the availability of startup capital, we were unable to investigate how capital may have affected the different subgroups. Minorities often have more difficulty acquiring startup capital but we were unable to investigate if there were actual differences in startup capital between subgroups and how that may have affected the different ventures. Finally, we were unable to investigate the economy's impact on the various ventures. Although the economy may play a role in the types of problems experienced by the different ventures, because the data was collected from businesses operating during the same period of



time in eastern North Carolina it is presumed that the ventures were subjected to similar economic forces. Future research may investigate the impact of the economy on the problems encountered by small businesses with longitudinal studies.

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Table 1. Race and Developmental Stage Breakdown

|                  | Devel Stage | Percent | Devel Stage  | Percent | Totals |
|------------------|-------------|---------|--------------|---------|--------|
| Race             | Formation   |         | Early Growth |         |        |
| African American | 75          | 30.0%   | 38           | 15.2%   | 113    |
| White            | 74          | 29.6%   | 63           | 25.2%   | 137    |
| <b>Totals</b>    | 149         |         | 101          |         | 250    |

Table 2. Problems and Race Crosstabulation

|                | Race             | Percent | Race  | Percent | Totals |
|----------------|------------------|---------|-------|---------|--------|
| Problems       | African American |         | White |         |        |
| Administrative | 39               | 34.5%   | 45    | 32.9%   | 84     |
| Operating      | 10               | 8.9%    | 17    | 12.4%   | 27     |
| Strategic      | 64               | 56.6%   | 75    | 54.7%   | 139    |
| <b>Totals</b>  | 113              |         | 137   |         | 250    |

Table 3. Problems and Developmental Stage Crosstabulation

|                | Devel Stage | Percent | Devel Stage  | Percent | Totals |
|----------------|-------------|---------|--------------|---------|--------|
| Problems       | Formation   |         | Early Growth |         |        |
| Administrative | 35          | 23.5%   | 49           | 48.5%   | 84     |
| Operating      | 7           | 4.7%    | 20           | 19.8%   | 27     |
| Strategic      | 107         | 71.8%   | 32           | 31.7%   | 139    |
| <b>Totals</b>  | 149         |         | 101          |         | 250    |

Table 4. Problems and Race & Developmental Stage Crosstabulation

|          |                | Devel Stage | Percent | Devel Stage | Percent | Totals |
|----------|----------------|-------------|---------|-------------|---------|--------|
| Race     | Problems       | Formation   |         | E. Growth   |         |        |
| African  | Administrative | 20          | 26.7%   | 19          | 50.0%   | 39     |
| American | Operating      | 3           | 4.0%    | 7           | 18.4%   | 10     |
|          | Strategic      | 52          | 69.3%   | 12          | 31.6%   | 64     |
|          | <b>Totals</b>  | 75          |         | 38          |         | 113    |
| White    | Administrative | 15          | 20.3%   | 30          | 47.6%   | 45     |
|          | Operating      | 4           | 5.4%    | 13          | 20.6%   | 17     |
|          | Strategic      | 55          | 74.3%   | 20          | 31.8%   | 75     |
|          | <b>Totals</b>  | 74          |         | 63          |         | 137    |

Table 5. Pearson's Chi-square and Lambda Results

| Independent Variable                          | Dependent Variable | p-value | df | Lambda |
|---|--------------------|---------|----|--------|
| Race  | Problems           | .665    | 2  | na     |
| Developmental Stage                           | Problems           | .0001   | 2  | .153   |
| Race-African American<br>Developmental Status | Problems           | .0001   | 2  | .143   |
| Race-White<br>Developmental Status            | Problems           | .0001   | 2  | .161   |

# **DIVERSITY IN SMALL AND LARGE WORK ENVIRONMENTS: WHY THE SEMANTIC AMBIGUITY?**

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## **ABSTRACT**

Diversity is not a term or concept that is easily understood by employers, whether small or large. This paper provides a number of definitions of diversity including dictionary, ascribed status traits, achievement status traits, resource-based view, evolutionary, and political ideology definitions. There is also discussion on how and what an organization of any size may do to deal with diversity in the workplace and possibly leverage it to create a competitive advantage. Ultimately, the discussion focuses on the problems and consequences of not having a consensus on the meaning of diversity.

## **INTRODUCTION**

Ask 10 people to define the term diversity, and you will more than likely get 10 different responses. This is hardly surprising but perhaps one of the most challenging issues in today's diverse business environment. By and large, everyone, both small and large employers and those in between, "values diversity," but as will soon be revealed, the "diversity" they are valuing may vary greatly from person to person and organization to organization.

Though many academicians, consultants, and politicians have attempted to define this ambiguous term, general consensus has yet to materialize, and may never emerge. Diversity has already achieved the status of being one of those concepts that is, by its very nature, a paradox. Diversity is simple, yet complicated. It has, over time, taken on a life of its own with different connotations for different constituencies. In fact, diversity's evolving symbolic meanings "serve as a simple verbal code for the complex problem from which it originated, but no one is really sure any longer what it actually means" (Thomas, 1996, p. 6). Given the lack of consensus in the ever-growing body of diversity literature, it seems that the term itself may be in danger of being relegated to the role of just another "buzzword." Yet, this "buzzword" has now been adopted as justification for preferential college admissions (*Grutter v. Bollinger*, 2003) and may soon become a justification for public sector hiring decisions as well.

There is no one unifying definition of diversity from which the fields of management study or practice may receive direction. Still, if a single, unifying definition of "diversity" could be adopted, a more focused analysis on the diversity of intellectual business knowledge might occur.

This paper presents a wide range of definitions of diversity. Based on each definition, there is some discussion on how and what an organization, whether small or large, may do to handle diversity and possibly use diversity to create a competitive advantage. In the end, the focus turns

to the problems and consequences of not having a consensus on “diversity,” but unfortunately, offers no unifying definition of the term.

## **DEFINITIONS OF DIVERSITY**

Diversity, as a term, is not a recent addition to the English language. Linguistically, “diversity” first appeared in the 12<sup>th</sup> century as a word implying “difference, oddness, wickedness, perversity” (Digh, 1998, p. 117). While most of those meanings have disappeared over time, one of them, “difference,” has persevered to become closely intertwined with today’s meaning of diversity in the workplace.

### **Dictionary Definition**

Though it may appear trite, one of the first sources typically consulted when attempting to discover the meaning of a word is a dictionary. *The Merriam-Webster Collegiate Dictionary* (1997) defines diversity as “the condition of being diverse” (p. 244) where diverse is defined as “composed of distinct or unlike elements or qualities” (p. 244). This definition provides a valuable reference point from which other definitions of diversity may follow. Under this definition, diversity focuses on unlikeness or differences as the core element of the definition. As will be seen, this term rapidly expanded in a number of directions to reflect similar meanings in some instances and much different meanings in others.

The federal government has shown interest in the term, particularly during the previous two decades. United States equal employment opportunity (EEO) laws, the common sources from which the subject of diversity usually confronts the business environment, define “diversity” in terms of race, gender, ethnicity, age, national origin, religion, and disability (Wheeler, 1994). Once again, when examining the criteria that compose diversity, the Equal Employment Opportunity Commission (EEOC), the regulatory agency for most EEO laws, focuses on unlikeness or difference between individuals in terms of physical characteristics (with the exception of religion). As an example, if diversity was being examined from the perspective of gender, an organization may observe that its workforce is composed of substantially more men than women. Thus, in order to make the workforce more “diverse,” an effort will be made to employ more women. Similarly, if diversity was being sought from the perspective of race, an employer may find that there are substantially more non-Hispanic whites in the workforce than individuals from other racial backgrounds. As a result, a diversifying approach may be to increase the effort to recruit individuals from racial backgrounds other than non-Hispanic whites.

### **Ascribed Status Traits Definition**

This particular federal government frame of reference, attaining diversity based on race, gender, ethnicity, age, national origin, religion, or disability, views diversity from the perspective of an individual’s ascribed status traits. Ascribed status traits are traits assigned to an individual without reference to innate differences or abilities of the individual (Linton, 1936; Foladare, 1969). In other words, individuals cannot control these status traits (e.g., an individual cannot control his or her age or gender). This federal government frame of reference seems to parallel *The Merriam-Webster Collegiate Dictionary* definition of diversity, since both focus on unlikeness and difference. Eligibility for government contracts, grants, and aid money is

predicated on organizations achieving certain levels of this form of “diversity” in their workforces (41 U.S.C. Part 60).

From a business perspective, diversity promulgated on the basis of race, gender, ethnicity, age, national origin, religion, or disability may have the tendency to push organizations to “hire by the numbers” (e.g., a certain percentage of the workforce must be women, Hispanics, African Americans, etc.), an action that may actually violate Title VII’s prohibition on employment decisions that consider race, etc. (Robinson, Franklin, and Wayland, 2002). This situation may contribute to why both small and large businesses have such difficulty with diversity as defined by the federal government. Additionally, it may also contribute to an employer’s reluctance to accept a different and broader definition of diversity. Such a perspective presents no obstacle to measuring diversity. Ascribed status traits are readily observable and permit easy recording and reporting to federal agencies. Because of its ease of measurement and the tangible consequences associated with achieving or progressing toward it, this concept of diversity enjoys wide currency in business organizations.

### **Achievement Status Traits Definition**

A more broad definition of diversity would include the elements previously mentioned associated with the federal government definition of diversity (i.e., race, color, religion, sex, national origin, age, and disability), along with, but not limited to, elements such as sexual orientation, value systems, personality characteristics, education, language, physical appearance, dress, marital status, lifestyle, beliefs, tenure with an organization, and economic status (Carr, 1993; Thomas, 1992). There is a distinct change in definition that occurs with the inclusion of these new elements into the diversity definition. No longer is diversity confined to the boundaries associated with ascribed status traits but it further encompasses personal decisions. Now the concept and definition have been expanded. Achieved status traits are open to individual achievement, thus requiring special qualities or skills (Linton, 1936; Foladare, 1969). Examples of achieved status traits are the education level and language proficiency of an individual, because these elements are based on the individual’s ability to apply his or her cognitive abilities toward a certain area of study or expertise.

To the list of achieved status traits, personal decisions may be added. Elements associated with personal decisions become a facet of this definition of diversity because diversity no longer has to be viewed solely from a numbers perspective (e.g., the percentage of women in the organization’s workforce, etc.). These are characteristics unique to individuals that are less readily observable, and therefore, more difficult to measure. For example, an individual that has strong environmental beliefs, or a male that wears his hair in a pony tail, can be thought of as a new dimension of diversity. Diversity is defined along any number of dimensions including tolerating, valuing, celebrating, managing, harnessing, or leveraging diversity (Digh, 1998).

### **Resource-Based View Definition**

The resource-based definition of diversity has led to new interpretations that diverge from the achieved status definition. One of the most recognizable definitions that fit this new interpretation comes from Roosevelt Thomas. Thomas (1992; 1996) defines diversity as a comprehensive managerial process for developing an environment that works for all employees. He further, paradoxically, explains diversity as all the ways in which people are different and

similar. This new word, “similar,” was a dramatic change in the definition of diversity. No longer was diversity being promoted under the auspices of difference; it was now being promoted with the seemingly semantically, contradictory term of “similar.” This raises the question, given the definition of diversity having been traditionally based on the core issues of difference, how can there be a new definition based on difference and similarity, if these two terms, difference and similar, are antonyms? Thomas (1996) attempts to explain this apparent paradox through an analogy of jelly beans:

. . . visualize a jar of red jelly beans; now imagine adding some green and purple jelly beans. Many would believe that the green and purple jelly beans represent diversity. I suggest that the diversity instead is represented by the resultant mixture of red, green and purple jelly beans. It is easy to see these jelly beans as a metaphor for employees . . . It could also easily represent the mixture of product lines, functions, marketing strategies, or operating philosophies (p. 6).

This change in definitions has prompted an entirely new school of thought around diversity that appears to be related to the resource-based view of the firm. In short, the resource-based view of the firm suggests that a business may be able to create competitive advantages from resources that are internal to the organization (e.g., employees, human resource functions, etc.) instead of relying on competitive advantages that are external to the firm (e.g., natural resources used for products, political/tax climate of a country, etc.). These internal resources become the new energy resources of the company with the distinguishing feature that they must be created, not bought (Zou and Cavusgil, 1995). For example, if a small business operates in an industry that is plagued by high employee turnover (e.g., the health care industry which has a chronic shortage of registered nurses), a potential competitive advantage exists for a small health care facility that is able to substantially decrease and maintain low turnover rates over its competitors. The ability to decrease and maintain the desired turnover rate may need to incorporate some changes in organizational structure and in the organization’s human resource policies and procedures to avoid simple duplication of this effort by competitors. In other words, the ability to achieve and maintain a low turnover rate must be systematic, yet complex, so as to preclude competitors from duplicating the small organization’s efforts (Porter, 1987).

Diversity fits well with the model of the resource-based view of the firm. This “fit,” of sorts, is perhaps why the definition of diversity has taken on a meaning characterized by differences and similarities. To illustrate this “fit,” consider the following basic tenets of the resource-based view of the firm which are then compared and interrelated to diversity.

The first tenet of the resource-based view of the firm is that it suggests that organizations are packages of tangible and intangible resources. Thus, it can be assumed that intangible resources, like employees and the reputations of organizations, are becoming equally as important as the fixed assets that businesses actually own. This is particularly true of smaller organizations. Second, the resource-based view of the firm suggests that managerial and organizational culture affect those aforementioned intangible resources. Based on this, it seems logical to conclude that organizational culture can affect new ways of approaching a challenge which can then create new ways of thinking and a new knowledge base. Third, especially in an increasingly global marketplace, the resource-based view of the firm implies that demand and supply forces drive resource management. Given this situation, an organization that understands these forces and is

best able to determine what is needed, where it is needed, and for what length of time, while doing it at relatively lower cost, may be able to create a competitive advantage. Finally, the resource-based view of the firm suggests that resource management is no longer about controlling products or services, but also about controlling functions and processes. Thus, technical competence may only be one component of what a successful employee will need to possess to be successful in an organization (Zou and Cavusgil, 1995). Interestingly, Williams' and O'Reilly's (1998) 40-year review of diversity research suggests that diversity can produce negative or positive consequences for organizations depending upon how researchers operationally defined diversity and the organizational constraints under which work groups operated.

How does diversity relate to these tenets of the resource-based view of the firm? Every single one of these tenets revolved around the issue of people and their skills/contributions to the organization. As an example, the ability to create an intangible resource based on employees may be achieved by employing individuals who are diverse (different and similar) from the perspective of the ascribed and achieved status traits and elements of personal characteristics. These diverse individuals have a variety of different life experiences, cultural backgrounds, and varying skill sets and thus can provide new approaches to challenges, new experiences, and new thoughts toward these challenges. The goal, from the organization's perspective, may not necessarily be simply finding a way to solve the challenges. Even more, the goal is to create intellectual knowledge and capital within the organization that can be applied, not just toward solving the challenge, but more importantly, toward creating a competitive advantage that cannot be easily duplicated. No doubt, there are significant implications for small firms.

The previous description of how diversity interrelates with the resource-based view of the firm is important because it provides one explanation of why the definition of diversity has taken on so many different meanings. In an ever-increasing hypercompetitive marketplace where it is becoming increasingly difficult to differentiate and squeeze further efficiency out of products/services, external resources, value-chain activities, and so forth, organizational leaders and academicians have set out to change the mindset of competition by focusing on issues such as diversity from which to create competitive advantages. A new definition of diversity, which is inevitably followed by a new strategy from which to capture its synergies, is an opportunity to discover and develop a new competitive advantage from which to make an organization more successful. Furthermore, diversity no longer has the negative connotation of "hiring by the numbers." Instead, diversity is viewed as an organizational asset that is sought after because of the possible competitive advantage that may result.

### **An Evolutionary Definition**

Diversity can also be defined outside the realms of the resource-based view of the firm. Levine (1991) has tracked the definition of diversity for more than 40 years, and he classifies these definitions into four categories. The first category, born of the 1960s era, is labeled as "representation," and its focus revolved around bringing more underrepresented identifiable groups of individuals into an organization. The second category is termed as "support." This definition of diversity, a product of the 1970s, was focused on retaining underrepresented groups of individuals who had joined the organization. "Integration" is the third category by which diversity was defined. This effort, a development of the 1980s, attempted to make underrepresented individuals an integral part of the organization. Finally, the 1990s coined the

category “multiculturalism.” The emphasis surrounding diversity during this timeframe was on creating a shared community that simultaneously maintains the distinctiveness of the groups of which it is composed.

Looking back over time, it becomes apparent that the ever mutating definition of diversity, no doubt, adds to the confusion over what is exactly meant by “diversity.” It may be argued that 10-year time periods are a substantial amount of time from which to achieve diversity within an organization, but when considering the change in attitudes toward diversity that has taken place, the struggles of how to change employee mindsets on the subject, the complexities associated with measuring diversity, and most importantly, the difficulty in simply defining the term, 10-year time periods appear very short. In fact, the definition of diversity oftentimes changed before organizations could complete any of the goals associated with these aforementioned categories of diversity (e.g., representation, support, integration, and multiculturalism) (Levine, 1991). Given this situation, Levine (1991, p. 5) argues that today’s definition of diversity is nothing more than “a jumble of definitions and an assortment of incomplete agendas--a prescription for turmoil.” In such an environment, attempting to achieve diversity is aiming at a moving target.

### **A Political Ideology Definition**

As might be expected, there are still other ways to view diversity. For example, one can define “diversity” through politically conservative and liberal lenses. Lynch (1997) presents the “conservative view” of diversity as “civil rights moralism” and the “liberal view” as “business-demography pragmatism.” Perhaps by viewing diversity from these two extremes, an organization may be able to frame its definition of diversity.

Civil rights moralism was founded on three premises: proportional representation, cultural relativism, and identity politics (Lynch, 1997). Proportional representation grew from the core ideas of the civil rights movement and affirmative action. It suggested that these mechanisms were necessary to eradicate the deeply held racial and sexual biases in the United States, and thus, the only way to measure progress was through ethnic and gender proportionalism in an organization’s workforce. In this regard, we have returned to ascribed traits view.

Cultural relativism held that universalistic standards (e.g., test scores, grades, etc.) were biased toward white males, and therefore placed other groups at a disadvantage. As a consequence, such standard had the effect, in practice, of making workplaces less diverse.

Identity politics presumed that only members of a given group that fully understood its culture could communicate effectively to that group. For example, only an African American manager will represent the interests and feelings of other African American managers and customers. Civil rights moralism primarily focused its efforts on organizational change (e.g., CEO change agents, sensitivity training, etc.). Over time, this school of thought has undergone considerable change similar to the change that has affected affirmative action. This change can be best characterized as a shift from “equality of opportunity for individuals” to “proportional representation for women and minorities” (Lynch, 1997, pp. 26-27).



Business-demography pragmatism was developed in an effort to distance diversity from the generally negative attitudes associated with affirmative action (Lynch, 1997). Roosevelt Thomas has been one of the leaders associated with this school of thought. He suggests that diversity is a business necessity that avoids the divisiveness that can occur when considering diversity strictly on the basis of race and gender (Thomas, 1996; Lynch, 1997). Diversity is a “living concept” that will take the shape of the influences affecting that organization. This broad definition, which is ethical in nature, may seem to dilute the diversity issue. However, Thomas (1996) argues that it forces manager to understand diversity, causing them to consider whether action should be taken. The challenge is in understanding what diversity is, beyond the rhetoric and slogans. The business-demography pragmatism view of diversity pushes all organizations, small and large, to focus their diversity efforts on understanding how other groups may view and react to organizational policies and practices. At this time, the employee is able to view situations from a different vantage point whereby he or she does not accept only dichotomous actions or thinking patterns, but instead becomes open to new ways to approach and address situations involving diversity (Gentile, 1996). This “living concept” of diversity is more concerned with questions that are subsumed with diversity. For example, answering the question, “how and why we, as individuals, perceive, feel about, and behave toward groups to which we do not belong?” (Gentile, 1996, p. 12) may uncover issues about human potential and need for learning and growth. Depending on the answer to a question such as this, one’s strengths and weaknesses may be discovered which may then be operationalized into strategies and outcomes that benefit the organization.

Clearly, these two approaches, civil rights moralism and business-demography pragmatism, are at opposite ends of the spectrum when considering the definition of diversity. Diversity does not, unfortunately, get much clearer when defining it as it applies to the federal government, resource-based view of the firm, or through evolution (i.e., representation, support, integration, and multiculturalism). There are many other ways from which to approach the definition of diversity, but it is debatable over whether any conclusive definition could be reached. There is, however, one common theme that ripples throughout the diversity literature. This theme suggests that regardless of the definition of diversity an organization may adopt, how and what the organization does to handle diversity is what is important.

## **SO WHAT?**

Diversity is not an easy concept to understand. This may come from attempting to cover too many concepts under a single word. Initially, this paper outlined and discussed various definitions of diversity. The conclusion drawn from this review is that the definition of diversity varies greatly from organization to organization, regardless of size, and no single definition is likely to gain universal acceptance. As a consequence, the ability of organizations to deal with diversity in their workplaces will continue to spark much debate. Yet, without a common definition, the debate is likely to go no where. No meaningful research on the topic can be attempted so long as there is no general consensus as to what “diversity” really is. Nor can there be any real guidance offered to small or large organizations to change their structures, policies, and procedures in order to handle diversity and reap the benefits resulting from diversity. If we do not really know what diversity is, we can hardly know when we benefit from it. In such an instance, the ability to fall back on the core values of the organization will be the foundation by which to create consensus and decide on whether to act on diversity-related issues.

## CONCLUDING REMARKS

It is likely that for the majority of organizations diversity will continue to be a trait ascribed concept (race, color, religion, sex, etc.). Why? This definition of “diversity” can be readily observed and measured. Also, though the benefits of a diverse workforce may not be easily discerned, the costs for not diversifying are very real and will continue to focus more on legal consequences (litigation, fines, court costs, loss of contracts, etc.) related to proportional representation. Still, in today’s global environment, it is to the advantage of all organizations, particularly small ones, to seek competitive advantages. Under the resource-based view, diversity may be used to create such a competitive advantage, and at the same time, such focus should overcome the obstacles of not diversifying.

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**HAVE FINANCE COMPANIES GAINED SHARES IN THE SMALL BUSINESS  
LOAN MARKET DURING THE 1990S: EVIDENCE FROM THE 1993 AND 1998  
SURVEYS OF SMALL BUSINESS FINANCES**

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**ABSTRACT**

This study utilizes the National Surveys of Small Business Finances in 1993 and 1998 to examine changes in the use of finance companies by small business borrowers. In the 1990s finance company receivables increased by over 7 percent annually. Did small businesses benefit from this increased lending activity? This analysis of 1998 and 1993 Surveys of Small Business Finances confirmed the importance of finance companies as the second most important institutional suppliers of credit to small business borrowers--they remained as important providers of credit in vehicle loans, equipment loans, and lease financing. While on surface, small business borrowers were more likely to utilize finance company for traditional loans in 1998 than 1993, this result held only for capital leases and mortgage loans which were not major sources of financing to small firms--less than three percent of small business borrowers hold a lease or mortgage loan from a finance company in 1998. This research suggests that the share of total debt held by finance companies has remained remarkable stable since 1993. In addition, this study suggests that the relationship between small businesses and finance companies has remained virtually unchanged from 1993 through 1998-- Finance companies continued to attract low credit risk clients, similar to commercial banks. These findings are important to practitioners and small business owners as they explore financing options for specific types of loans.

## **INTRODUCTION**

Finance companies play an important role in providing short- and intermediate-term financial capital to small business borrowers. Finance companies had roughly \$1 trillion in financial assets in 2000, which positioned them between commercial banks and credit unions (Dynan, Johnson and Slowinski, 2002). About 1,000 companies make up the finance company sector, which is about twice as large as the credit union sector, but only about 20 percent of the size of the commercial banking sector (Dynan et al, 2002). Finance companies realized a substantial growth in their owned and securitized receivables over the 1990s, however it appears that finance company involvement with the small business customers has remained relatively static. The purpose of this study is to use the most recent high quality data on small business finances to evaluate the importance of finance companies and other lenders and assesses changes in borrowing behavior of small business owners.

## **LITERATURE REVIEW AND PUBLIC POLICY RELEVANCE**

Finance companies are a major supplier of financial capital to businesses with over \$500 billion of business receivables outstanding in 2000 (Dynan et al, 2002). Finance companies are an important source of capital (primarily for vehicle loans, capital leases and other asset backed credit) for small business borrowers. Earlier research suggests that finance companies are not the "pawn shops" of the small business lending market (Haynes, 1995). However, more recent research suggests that financial companies are especially important to riskier borrowers, especially highly leveraged borrowers (Carey, et al, 1998). While finance company receivables grew at an annual rate of just over 7 percent in the mid-1990s, finance company receivables to small businesses appear to have been very stable (to slightly declining) over this period of time. Even though a higher percentage of small businesses were using finance companies in 1998 than in 1993 (Bitler, Robb and Wolken, 2001), the share of total small business debt held by finance companies appears to have declined.

Are finance companies becoming less interested in providing financial capital to small business borrowers? The robust economy of the mid-1990s created substantial wealth in the U.S. economy, however the growth in aggregate wealth was higher among households without any business ownership than among households owning one or more businesses (Haynes and Ou, 2002b). Recent evidence reported by Carey, et al (1998) suggests that finance companies are important to riskier borrowers. Finance companies have been important lending organizations for small businesses because they have been more likely to assist riskier borrowers in preparing their loan package and monitoring their loan. If finance companies are less likely to supply financial capital to small business (and especially to riskier small businesses) then these businesses must search for other lenders. These riskier borrowers will likely find other lenders in this competitive market, however these lenders may be more likely to charge higher prices and be less likely to engage in business planning and monitoring efforts that decrease the default rate

of these riskier businesses. If these riskier borrowers are more likely to fail, then the taxpayer cost of subsidizing SBA loan guarantees and other loans increases.

## EMPIRICAL CONSIDERATIONS

### Data

This study utilizes the 1993 and 1998 Surveys of Small Business Finances (SSBF). The SSBF is the national survey conducted by the Federal Reserve's Board of Governors for information on small businesses on their uses of different financing sources. The 1993 survey has 4,638 observations representing nearly 5 million small businesses while the 1998 survey has 3,561 observations representing 5.2 million small businesses. All analyses in this study utilize the population weights provided in the data set. All loan amounts were adjusted for inflation from 1992 to 1998 using the Producer Price Index as reported by the U.S. Department of Labor (Bureau of Labor Statistics, 2004).

### Models

This study will utilize descriptive statistics and other linear and non-linear statistics to test the hypotheses proposed by this study. The objective of this study is to determine if finance companies are more significant sources of financial capital in 1998 than in 1993. Over the period of time from 1987 to 1998, commercial banks and thrifts have realized a less stringent regulatory environment and unprecedented merger and acquisition activity. This environment should allow commercial banks and thrifts to be more competitive and enable them to capture a higher percentage of the financial capital market. Therefore, one would expect finance companies to serve a smaller percentage of all firms and supply a smaller percentage of the total financial capital borrowed by small businesses in 1998 than in 1993.

This segment of the study will be analyzed by comparing descriptive statistics on the percentage of firms using finance companies for at least one loan or lease and the market share held by finance companies and other lenders for 1993 and 1998. The variable of interest in this model is the data collection year. If finance companies are expected to reach a smaller percentage of firms in 1998 than 1993, then the sign on the dummy variable for year (1993) would be positive. These analyses employ two regression models and the concatenated data from the 1993 and 1998 Surveys of Small Business Finances. The first model utilizes a logistic regression algorithm to assess whether small businesses are more likely to hold a finance company loan or lease in 1998 than 1993 and is specified as follows:

$$FINC_i = f(\text{year}; \text{risk}, \text{relation}, \text{age}, \text{size}, \text{legal}, \text{industry}, \text{urban}, \text{woman}, \text{minority})$$

where  $FINC_i$  is a dummy variable for owners holding a loan or lease from a finance company; *year* is dummy variable for 1993 SSBF data; *risk* is a continuous variable measuring the firm quality or credit risk of the business using the Altman Z statistic; *relation* is a dummy variable indicating a lending

relationship with a commercial bank; *age* is a continuous variable indicating the age of the firm; *size* is a continuous variable of the number of employees in the firm; *legal* is a series of dummy variables indicating the legal organization of the firm (sole proprietorship, partnership, subchapter s corporation and regular corporation); *industry* is a series of dummy variables indicating the standard industrial classification of the firm (mining/construction, manufacturing, transportation, wholesale, retail, FIRE and services); *urban* is a dummy variable indicating urban location; *woman* is a dummy variable indicating that a majority of the business is woman-owned; and *minority* is a dummy variable indicating that a majority of the business is minority-owned.

The second model utilizes a Tobit regression algorithm to assess whether small businesses held a larger share of outstanding debt in finance company loans or leases in 1998 than 1993. About one-third of the sample holds no loans or leases, therefore loan shares are clustered around zero. A Tobit analysis addresses the problem of ordinary least squares estimates that are inconsistent (biased toward zero). The second set of models is very similar to the first set, except for the dependent variable being the share of outstanding debt held by finance companies for each type of loan or lease.

## RESULTS

This study utilizes the Surveys of Small Business Finances (SSBF) for two years, 1993 and 1998 to examine who uses finance companies. This section compares the samples in 1993 and 1998; and examines the probability of holding a finance company loan in 1993 and 1998 and the share of aggregate value of finance company loans in 1993 and 1998.

The two installments of the SSBF utilized similar sampling frames, but the characteristics of the small businesses differed substantially. Utilizing the population weights, the 1998 SSBF small businesses surveyed were somewhat younger (14.3 years old in 1993 versus 13.3 years old in 1998); more likely to be sole proprietors or subchapter s corporations and less likely to be regular corporations; more likely to be engaged in the transportation or services industries; less likely to be engaged in mining/construction, wholesale or retail trade; and more likely to be owned by a woman or minority.

This study examines whether finance companies are more significant sources of financial capital in 1998 than in 1993. This examination of the significance of finance companies assesses the probability that a small business borrower would utilize a finance company for any loan or lease and assesses the share of total finance capital borrowed from a finance company. A higher percentage of all small businesses indicated that they had utilized a finance company in 1998 than in 1993 (12.4 percent in 1993 versus 13.3 percent in 1998). The likelihood of holding any particular type of loan was remarkably constant over the two years, where these small businesses were most likely to hold vehicle or equipment loans or leases from a finance company. The regression analysis provides evidence of minor changes in the use of finance companies from 1993 to 1998. Small business borrowers are somewhat more likely to hold a finance company loan in

1998 than 1993 with the most significant positive changes occurring in mortgage loans and leases (Table 1).

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Table 1 about here

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Finance companies held over 12 percent of the value of all loans held by small business borrowers in 1993 and 1998. They appeared to lose market share in line of credit and vehicle loans and increase market share in equipment loans.

A Tobit regression analysis was employed to examine the share of total debt held by finance companies in 1993 and 1998 (Table 2). This analysis supports the previous logistic regression analysis by suggesting that small business borrowers held a larger share of total debt with finance companies in 1998 than 1993. The increases in the share of total debt occurred only in leases and mortgage loans held by finance companies.

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Table 2 about here

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## CONCLUSIONS

A previous study of finance companies in 1995 suggested that finance companies were not the "pawn shops" of the financial capital business, attracting high risk borrowers and charging high prices; but, lenders attracting borrowers with similar risk profiles to commercial banks and charging them competitive prices for their loans (Haynes, 1995e). This current study suggests that small businesses relationships with finance companies have remained virtually unchanged from 1993 through 1998.

The univariate analysis suggests that small businesses are somewhat more likely to utilize a finance company in 1998 than 1993 (12.4 percent in 1993 versus 13.3 percent in 1998), however the share of aggregate loans actually declined slightly from nearly 13 percent in 1993 to 12.3 percent in 1998. The multivariate regression analyses suggest that small business borrowers were more likely to utilize a finance company in 1998, but only for leases and mortgage loans. Small business use of the major products marketed by finance companies, vehicle and equipment loans, remained unchanged.

The less stringent regulatory environment faced by finance companies would suggest that finance companies would have the opportunity to encroach on the market share of commercial banks. However, it was the commercial banks gaining market share from 1993 to 1998 in all categories of loans, except leases. While finance companies appear to have gained some market share for equipment loans, there appears to be no evidence of finance company encroachment on the market share held by commercial banks. The

most substantial negative changes in market share were realized by leasing companies and other businesses loaning money to small businesses.

Commercial banks are providing larger amounts of money to about the same percentage of all small businesses in 1998 as they did in 1993. In contrast, finance companies appear to be providing about the same amount of money to about the same percentage of all small businesses. While the total business debt held by finance companies has increased substantially during this time (Dynan et al, 2002), it appears that this increase in business debt held by finance companies is for large businesses (assuming that the number of small businesses has remained relatively constant, around 5 million small businesses). Other sectors, especially real estate, seem to have captured the attention of finance companies.

Finance companies clearly are important to small business borrowers, but finance companies appear to be satisfied with the status quo (attracting about 12 to 14 percent of small businesses and providing about 12 to 13 percent of their financial capital). While this analysis has proceeded under the assumption that commercial banks and finance companies are essentially competing with substitute products, the complementary relationships between commercial banks and finance companies may be more important. Further research is needed to explore this critically important relationship between the number one and two lenders of financial capital to small business borrowers.

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Table 1 Logistic Regression Summary

| Dependent Variable                    | Any Finance |         | Line of Credit |         | Lease    |         | Mortgage |         | Vehicle  |         | Equipment |         | Other    |         |
|---------------------------------------|-------------|---------|----------------|---------|----------|---------|----------|---------|----------|---------|-----------|---------|----------|---------|
| Variable <sup>1</sup>                 | Estimate    | p-value | Estimate       | p-value | Estimate | p-value | Estimate | p-value | Estimate | p-value | Estimate  | p-value | Estimate | p-value |
| Intercept                             | -0.8716     | 0.0001  | -3.7832        | 0.0001  | -3.6424  | 0.0001  | -3.1521  | 0.0002  | -1.4492  | 0.0001  | -2.3810   | 0.0001  | -8.5841  | 0.0148  |
| Year dummy (1993)                     | -0.1886     | 0.0063  | 0.0472         | 0.8208  | -0.3146  | 0.0308  | -0.8467  | 0.0104  | -0.1295  | 0.1220  | -0.1319   | 0.3984  | -0.5769  | 0.1151  |
| Firm quality (Altman Z)               | -0.1420     | 0.0001  | -0.1786        | 0.0001  | -0.1464  | 0.0001  | -0.3061  | 0.0001  | -0.1080  | 0.0001  | -0.1511   | 0.0001  | -0.2503  | 0.0028  |
| Commercial bank relationship          | 0.2290      | 0.0013  | 0.0543         | 0.7966  | 0.3817   | 0.0119  | -0.0664  | 0.8463  | 0.1473   | 0.0889  | 0.4289    | 0.0084  | 0.3635   | 0.3368  |
| Age of the firm                       | -0.0126     | 0.0002  | -0.0275        | 0.0167  | -0.0102  | 0.1453  | -0.0323  | 0.1123  | -0.0078  | 0.0490  | -0.0188   | 0.0196  | -0.0035  | 0.8421  |
| Number of employee                    | 0.0045      | 0.0001  | 0.0069         | 0.0008  | 0.0049   | 0.0030  | 0.0088   | 0.0138  | 0.0030   | 0.0269  | 0.0040    | 0.0338  | 0.0042   | 0.2972  |
| Legal organization: partnership       | -0.1277     | 0.4013  | 0.6213         | 0.0776  | -0.0760  | 0.8400  | -0.9270  | 0.2184  | -0.2294  | 0.2376  | 0.3109    | 0.3292  | -2.8647  | 0.2797  |
| Legal organization: sub s corporation | 0.3394      | 0.0002  | 0.1886         | 0.4906  | 0.6995   | 0.0006  | -0.2925  | 0.4562  | 0.3411   | 0.0018  | 0.3314    | 0.1289  | -0.0073  | 0.9871  |
| Legal organization: corporation       | 0.4196      | 0.0001  | 0.0961         | 0.7294  | 0.8981   | 0.0001  | -1.0376  | 0.0422  | 0.3719   | 0.0006  | 0.6114    | 0.0031  | -0.5012  | 0.3196  |
| Manufacturing                         | -0.3406     | 0.0146  | 0.2444         | 0.6343  | 0.4718   | 0.1405  | -1.5570  | 0.1819  | -0.5441  | 0.0009  | 0.0517    | 0.8457  | 4.5706   | 0.1837  |
| Transportation                        | 0.1172      | 0.5034  | 1.2297         | 0.0164  | 0.9556   | 0.0084  | -0.3126  | 0.7457  | -0.2071  | 0.3246  | 0.9160    | 0.0011  | 5.0020   | 0.1473  |
| Wholesale trade                       | -0.3246     | 0.0213  | 0.5324         | 0.2802  | 0.4782   | 0.1418  | -2.1875  | 0.2245  | -0.4343  | 0.0072  | -0.5076   | 0.1106  | 4.0309   | 0.2444  |
| Retail trade                          | -0.4034     | 0.0004  | 1.2688         | 0.0011  | 0.1070   | 0.7201  | -0.2437  | 0.6788  | -0.6316  | 0.0001  | -0.8066   | 0.0026  | 4.2906   | 0.2107  |
| Finance, insurance & real estate      | -0.8892     | 0.0001  | -0.7909        | 0.3164  | 0.2001   | 0.5989  | 0.8975   | 0.1410  | -1.3506  | 0.0001  | -0.8379   | 0.0332  | -10.8408 | 0.9920  |
| Services                              | -0.4278     | 0.0001  | 0.1870         | 0.6462  | 0.5445   | 0.0386  | -0.0123  | 0.9811  | -0.6992  | 0.0001  | -0.7009   | 0.0024  | 3.4558   | 0.3138  |
| Urban                                 | 0.2484      | 0.0059  | 0.2736         | 0.3033  | 0.1790   | 0.3606  | 0.6561   | 0.1814  | 0.2680   | 0.0157  | -0.2405   | 0.1896  | 1.0858   | 0.0821  |
| Woman-owned business                  | -0.2450     | 0.0056  | -0.8749        | 0.0057  | -0.2490  | 0.1952  | 0.8476   | 0.0100  | -0.1847  | 0.0852  | -0.6638   | 0.0055  | 0.3559   | 0.3698  |
| Minority-owned business               | 0.0370      | 0.7660  | -0.3472        | 0.4127  | -0.1387  | 0.6317  | 0.3909   | 0.4011  | 0.0266   | 0.8609  | -0.2940   | 0.3880  | 0.3262   | 0.5668  |
| -2 log likelihood                     | 5,947       |         | 1,011          |         | 1,777    |         | 456      |         | 4,432    |         | 1,583     |         | 367      |         |
| Number of Observations                | 8,198       |         |                |         |          |         |          |         |          |         |           |         |          |         |

<sup>1</sup> The left out categories are sole proprietorship in the legal organization classification and mining/construction in the industrial classification.

Table 2 Tobit Regression Summary, All Owners

| Dependent Variable                    | Any Finance<br>Company Loans |         | Line of Credit |         | Lease    |         | Mortgage |         | Vehicle  |         | Equipment |         | Other    |         |
|---------------------------------------|------------------------------|---------|----------------|---------|----------|---------|----------|---------|----------|---------|-----------|---------|----------|---------|
| Variables <sup>1</sup>                | Estimate                     | p-value | Estimate       | p-value | Estimate | p-value | Estimate | p-value | Estimate | p-value | Estimate  | p-value | Estimate | p-value |
| Intercept                             | -0.5464                      | 0.0001  | -4.1449        | 0.0001  | -3.7401  | 0.0001  | -3.8512  | 0.0001  | -1.4959  | 0.0001  | -2.9008   | 0.0001  | -8.3063  | 0.0012  |
| Year dummy (1993)                     | -0.0911                      | 0.0132  | 0.0314         | 0.8629  | -0.2993  | 0.0165  | -0.8238  | 0.0071  | -0.0985  | 0.1551  | -0.1113   | 0.3977  | -0.4948  | 0.1238  |
| Firm quality (Altman Z)               | -0.0719                      | 0.0001  | -0.1636        | 0.0001  | -0.1217  | 0.0001  | -0.2719  | 0.0001  | -0.0924  | 0.0001  | -0.1252   | 0.0001  | -0.2056  | 0.0088  |
| Commercial bank relationship          | -0.0069                      | 0.8570  | 0.0252         | 0.8913  | 0.2716   | 0.0344  | -0.2412  | 0.4104  | 0.0887   | 0.2183  | 0.3286    | 0.0164  | 0.3392   | 0.2982  |
| Age of the firm                       | -0.0064                      | 0.0003  | -0.0270        | 0.0073  | -0.0087  | 0.1367  | -0.0169  | 0.2800  | -0.0063  | 0.0515  | -0.0150   | 0.0198  | 0.0006   | 0.9659  |
| Number of employee                    | 0.0022                       | 0.0010  | 0.0071         | 0.0032  | 0.0051   | 0.0039  | 0.0084   | 0.0227  | 0.0026   | 0.0449  | 0.0039    | 0.0457  | 0.0037   | 0.3869  |
| Legal organization: partnership       | -0.0774                      | 0.3171  | 0.4639         | 0.1426  | -0.1240  | 0.6738  | -0.5789  | 0.3369  | -0.1814  | 0.2299  | 0.2856    | 0.2695  | -11.6812 | 0.9997  |
| Legal organization: sub s corporation | 0.1443                       | 0.0027  | 0.0901         | 0.7030  | 0.5470   | 0.0012  | -0.2997  | 0.3814  | 0.2722   | 0.0026  | 0.2704    | 0.1308  | -0.0063  | 0.9868  |
| Legal organization: corporation       | 0.1917                       | 0.0001  | 0.0068         | 0.9773  | 0.7051   | 0.0001  | -0.7449  | 0.0754  | 0.2955   | 0.0009  | 0.5121    | 0.0031  | -0.4292  | 0.3106  |
| Manufacturing                         | -0.2176                      | 0.0041  | 0.1404         | 0.7415  | 0.3739   | 0.1642  | -1.1472  | 0.1818  | -0.4458  | 0.0014  | 0.1020    | 0.6639  | 3.2754   | 0.1239  |
| Transportation                        | 0.0825                       | 0.3978  | 1.0241         | 0.0261  | 0.8665   | 0.0067  | -0.2095  | 0.7893  | -0.2037  | 0.2719  | 0.9226    | 0.0007  | 3.8090   | 0.0796  |
| Wholesale trade                       | -0.1940                      | 0.0113  | 0.4227         | 0.3025  | 0.3703   | 0.1760  | -1.4503  | 0.2125  | -0.3548  | 0.0104  | -0.3874   | 0.1506  | 2.9010   | 0.1746  |
| Retail trade                          | -0.2301                      | 0.0002  | 1.0374         | 0.0018  | 0.1055   | 0.6593  | -0.2913  | 0.5538  | -0.5285  | 0.0001  | -0.6443   | 0.0046  | 3.0041   | 0.1539  |
| Finance, insurance & real estate      | -0.5285                      | 0.0001  | -0.4763        | 0.4046  | 0.2013   | 0.5105  | 0.4623   | 0.4037  | -1.0989  | 0.0001  | -0.6064   | 0.0541  | -8.6365  | 0.9998  |
| Services                              | -0.2537                      | 0.0001  | 0.1207         | 0.7124  | 0.4298   | 0.0451  | 0.0076   | 0.9857  | -0.5937  | 0.0001  | -0.5058   | 0.0099  | 2.3565   | 0.2584  |
| Urban                                 | 0.1545                       | 0.0011  | 0.2066         | 0.3679  | 0.1201   | 0.4519  | 0.4557   | 0.2420  | 0.2431   | 0.0072  | -0.1466   | 0.3539  | 0.8592   | 0.0892  |
| Woman-owned business                  | -0.1326                      | 0.0039  | -0.8420        | 0.0026  | -0.2295  | 0.1488  | 0.8046   | 0.0079  | -0.1593  | 0.0667  | -0.5267   | 0.0058  | 0.3270   | 0.3442  |
| Minority-owned business               | 0.0003                       | 0.9964  | -0.2894        | 0.4193  | -0.1393  | 0.5590  | 0.3910   | 0.3316  | 0.0340   | 0.7842  | -0.2141   | 0.4260  | 0.3421   | 0.4837  |
| -log likelihood                       |                              | 3,365   |                | 562     |          | 1,046   |          | 246     |          | 2,756   |           | 934     |          | 207     |
| Number of Observations                |                              | 8,198   |                |         |          |         |          |         |          |         |           |         |          |         |

<sup>1</sup> The left out categories are sole proprietorship in the legal organization classification and mining/construction in the industrial classification.

# **A NEW APPROACH TO RURAL ENTREPRENEURSHIP: A CASE STUDY OF TWO RURAL ELECTRIC COOPERATIVES**

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## **ABSTRACT**

This paper develops a model for rural entrepreneurship as a means for developing new businesses. The purpose of the paper is to propose an approach to economic development that is well suited to rural locations. In the first section, we describe the current literature. In the next section, we describe the rural electric cooperative. In the third section, we build on work Wortman (1990) and Lyons (2002) to propose a new approach to economic development that is built around a cooperative model using rural electric cooperatives as the lead institution for stimulating entrepreneurship in rural communities. We believe this model provides the basis for future development of entrepreneurship in rural areas throughout the United States. In the following section, we demonstrate the efficacy of this model through a case study of two electric cooperatives that have engaged in economic development. The paper concludes by discussing how the electric cooperative incubator model is well suited to stimulating entrepreneurship in rural areas.

## **INTRODUCTION**

Entrepreneurship and the role of small businesses in economic development in the U.S. has been widely established (Sherman and Cappell, 1998). The United States Small Business Administration (SBA) maintains descriptive statistics emphasizing the enormous contributions that small firms have had on the American economy, such as 53.7% of all employment in the U.S. and 55% of all innovations. Yet this good news is tempered by statistics indicating failure rates over 50% for firms during their first four years of operation among small firms (SBA, 2003; SBA, 2002). Although small-firm growth accounts for a significant share of net new employment in this country, failure rates of small firms are particularly high in rural areas, where jobs are needed most.

Because of the importance of small firms and their high failure rates, government initiatives at the federal, state, local levels-as well as private intervention programs-have been created to assist in the creation and growth of small start-up businesses in rural areas. The best known programs include Small Business Development Centers (SBDC), Small Business Institute (SBI), Service Corp of Retired Executives (SCORE), and small business incubators (See Wortman, 1990a for a detailed list of other types of policies and programs).

The Small Business Administration (SBA) provides assistance to rural small businesses through their Small Business Development Center (SBDC) programs, and each SBDC is tasked with assisting rural small businesses. Yet Van Horn and Harvey point out that despite the efforts of the SBA and other organizations, "entrepreneurial firms ... in rural areas, face a host of difficulties related to their external and internal environment. They are small and isolated. The people and information base to provide expert support for critical decisions and functions do not exist internally or externally in the rural location" (Van Horn and Harvey, pg. 157-158,1998).

The problems facing small firms in rural areas are compounded by a combination of logistics and reduced federal funding. The SBA has suffered cutbacks in many programs, such as the

elimination of the Small Business Institute program. This predicament means the rural small business must choose to seek assistance from a SBDC that may be geographically distant, unaffordable due to travel time and distance, or simply unavailable. This leaves the rural small firms in these remote areas with few options for assistance.

Despite our knowledge regarding business assistance programs in the United States, stimulating business growth in rural areas continues to be a challenge. In particular, we seem to lack a consistent model or framework for economic development in rural areas. The purpose of this research is to recommend a framework for economic development that is well-suited to a rural environment and builds upon our understanding of business assistance. Our emphasis is to propose a specific model of business assistance for rural areas that can easily be duplicated in a variety of rural settings. Other researchers have proposed general models of assistance programs for rural areas that are so general that they may prove difficult to duplicate across the diversity of rural settings that exist in the U.S.

We highlight the problems traditionally facing these would-be entrepreneurs. Then, building on the work of Wortman (1990) and Lyons (2002), we then propose a systemic approach where rural entrepreneurship is developed around a network supported by a rural electric cooperative that receives support from other committed institutions. The use of a variety of supporting institutions ensures that value is added at every stage of the process. The paper concludes by discussing how this model is well suited for creating incubators or other support programs in rural America. The implications for policy makers, economic development leaders, and academicians are discussed.

## **LITERATURE REVIEW**

### **Entrepreneurship in Rural America**

Rasmussen (1985) points out that, as of 1985, the federal government had analyzed rural development for over 90 years. Many of the economic problems facing rural America are driven by demographic changes such as depopulation and an aging populace. Rural development as defined by Sauer (1986) includes issues such as encouragement of farm-related enterprises, technical and management assistance for rural entrepreneurs, analysis of federal farm policies, technical assistance to local governments located in rural areas, rural transportation, rural telephone service and information systems, natural resource management, rural financial history, rural families, and family management in rural areas.

Wortman (1990) points out that rural development has been equated with rural industrialization, community economic development, community development, and cultural assessment of rural resources. Thus, rural economic development is merely a point along a continuum ranging from economic well-being to overall well-being (Sears, Reid, Rowley, and Yetley (1989, referred to by Wortman, 1990)).

Wortman argues, "Economic development and entrepreneurship are clearly related. Year in, year out, the Annual Report of the Small Business Administration has reported that more than two-thirds of all new jobs that are created in the U.S. are developed through the entrepreneurial spirit involved in small businesses. Therefore, rural economic development and rural entrepreneurship are also clearly related" (Wortman, 1990, p. 222). He defines the term rural entrepreneurship as "the creation of a new organization that introduces a new product, serves or creates a new market, or utilizes a new technology in a rural environment" (Wortman, 1990a, p. 222).

## **Economic Assistance in Rural America**

Rural Americans have limited access to economic assistance from the federal government. The page restrictions of the proceedings limit our ability to describe the programs that are prevalent in rural areas, except to list them: 1) The SBA has limited funds and tends to emphasize assistance in densely populated areas; 2) The Small Business Institute (SBI) was once an SBA program, but is now administered by a non-profit organization. It was once located in over 500 universities and colleges throughout the U.S. It has fewer than 150 locations today. Incubators are another means of economic assistance in rural areas. Incubators nurture young firms, helping them to survive and grow during the start-up period when they are most vulnerable. Incubators provide hands-on management assistance, access to financing and orchestrated exposure to critical business or technical support services. Research on incubators has emerged as one of the most topical debates in business schools, among business leaders, and by those formulating public policy over the past quarter century (Brandt, 1991; Sherman and Cappell, 1998; Bearse, 1998). Interestingly, however, very few studies have evaluated *rural* incubators. Nonetheless, incubators show some promise as a means of economic development in rural areas as the NBIA reports over thirty percent of all incubators in the U.S. are located in rural areas, although many of them tend to be adjacent to urban areas. The remaining problem is determining who will be the catalyst to initiate the process required to create an incubator. Culp (1990) and Sherman (1999), and the NBIA (NBIA Website) point out that it takes a considerable amount of time to create an incubator.

## **A Systemic Approach**

Wortman argues “there is no single approach for the support of rural entrepreneurship” (Wortman, 1990, p. 229). Traditional attempts to stimulate economic growth by luring big businesses to rural communities have largely failed. Other programs aimed at creating local small businesses have similarly failed. Wortman contends that their collective failures may lie in the lack of interrelationships between the many types of programs. Each of the many programs and policies he describes operate independently. Programs, policies, agencies, banks, and other institutions are stretched too thinly to serve the needs of far flung enterprises in rural areas. Thus, he calls for a unified public-private approach whereby governmental agencies and private organizations work together to stimulate entrepreneurship in rural regions. Wortman (1990) describes in detail what he calls Rural Economic Development Zones (REDZs) that would span as many as four county governments. He goes into great detail to describe how to locate these REDZs in the most efficient manner and even explains how they might overcome political and institutional problems.

Twelve years after Wortman’s discussion of how to develop rural entrepreneurship, Lyons (2002) points out that none of the many economic development strategies has been very successful in turning U.S. rural economies around (Lyons, 2002). He points out, “Rural poverty for the past few decades has been, and continues to be, a nagging problem in the U.S.” (Lyons, 2002, p. 194).

Lyons (2002) and Wortman (1990a) argue that the most current response to these challenges in rural America are the development of strategies for encouraging “home grown” (Lyons, 2002, p. 194) businesses. The basic idea is that these “new ventures will provide jobs or at least self-employment; will remain in the areas where they were spawned as they grow; and will export their goods and services outside the community, attracting much-needed income” (Lyons, 2002, p. 195).

However, considerable debate exists as to how to best accomplish this daunting task. Lyons points out that the many initiatives employed in the U.S. are done so in isolation. While there are examples of attempts to coordinate entrepreneurial development on regional scales, Reynolds and White (1997) point out that most efforts to stimulate entrepreneurship in rural areas are highly fragmented. Lichtenstein and Lyons (1996) argue that in order to be successful in developing entrepreneurship, rural areas must overcome the barriers to successful entrepreneurship, specifically fragmented internal linkages (among community members) and external linkages (with other communities). Thus, the solution to the problem of rural economic development is the creation of linkages among regional entities that combine their resources to support entrepreneurship.

Unfortunately, the frameworks provided by Wortman (1990) and Lyons (2002) are so broadly described they beg the question exactly how might a rural community actually implement their ideas? Lyons (2002) argues that his recommendation for networks that build on social capital can be highly tailored to the situation. He specifically avoids providing solutions that he labels “cookie cutter” or “one size fits all” (Lyons, 2002, p. 198). We concur that both he and Wortman have separately captured the essence of a successful answer to the problems facing rural communities. While they use different terminology and approach the problems from different perspectives, they are essentially advocating a cooperative approach to rural economic development that attempts to stimulate the creation and sustainability of entrepreneurial firms. We believe this approach represents a good starting point, but believe that rural areas require something more concrete in order to actually apply what Lyons and Wortman recommend.

### **Rural Electric Cooperatives**

Most Americans take for granted the electricity, telephones, water and waste disposal services available to them. Yet, this was not the case as recently as 60 years ago. In 1932, only 10 percent of the nation’s farms had electricity compared to 70 percent of urban dwellers (USDA Website, 2004). It is highly likely that one went without these necessities of modern life and the standard of living they make possible. In 1936, modern utilities came to rural America through the creation of the Rural Electrical Administration. Within the federal legislation, Title V, Sections 501 and 502 address economic development; Section 501 of Title V authorizes the US Department of Agriculture to provide technical advice and assistance to borrowers utilizing the authority under section 312 to engage in rural economic development activity. Section 502 of Title V established a Rural Business Incubator fund, its uses, eligibility, and funding. To implement its goals the administration made long-term, self-liquidating loans to state and local governments, to farmers' cooperatives, and to nonprofit organizations; no loans were made directly to consumers. In 1949 the Rural Electric Administration (REA) was authorized to make loans for telephone improvements; in 1988, REA was permitted to give interest-free loans for job creation and rural electric systems. By the early 1970s about 98% of all farms in the United States had electric service, a demonstration of REA's success. Since 1994, the REA has been called the now called the Rural Utilities Service.

[Figure 1 about here]

Today, 1,000 rural electric cooperatives serve 30 million Americans in 48 states — 10 percent of the U.S. population.<sup>1</sup> Figure 1 below shows the extent of rural electric cooperatives in the U.S. Electric cooperatives own and maintain nearly half of all distribution lines in the

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<sup>1</sup> According to Mr. Blaine Stockton of the USDA Public Utilities Service.

country, which cover three-fourths of the nation's land area. Rural electric cooperatives average 5.8 consumers and generate about \$7,000 per mile of line. In contrast, investor-owned utilities, or public utility districts, average 35 consumers and collect \$59,000 per mile of line.

## **THE RURAL ENTREPRENEURSHIP MODEL**

The constraints that arise when trying to develop entrepreneurship in a rural location have been described in detail. These regions of the country often lack the coordinated public-private arrangements needed to fulfill the incubation and assessment processes and lack the cross-institutional coordination to successfully encourage entrepreneurship (Lyons, 2002).

Thus, we propose the model shown in Figure 2 as a framework for developing entrepreneurship in rural communities. Lyons (1999) argues that successful economic interventions take place only in win-win scenarios characterized by a collective economic strategy; a situation is highlighted by a number of elements: a sense of community and networking, dynamic sponsorship based upon competitive pressures (the sponsoring agencies stand to gain when entrepreneurs are successfully fostered), knowledge and technology transfer, leveraging entrepreneurs' capabilities and skills (through expert training and mentoring), and facilitating access to capital (through a mix of public-private mechanisms) (Lyons, 1999).

[Figure 2 about here]

Our proposed model emphasizes the electric cooperative as the catalyst for change. The National Rural Electric Cooperative Association (NRECA) points out that rural electric cooperatives have been involved with economic development for over 60 years. They have been involved with economic development even when there was not a formal process as they "brought new business, new services, and new facilities to rural America.... But community and economic development today requires new funding, new partners, and new strategies (NRECA, 2003, p. 3).

Rural electric cooperatives are an unusual business organization because they belong to their members. They share a responsibility to their members to preserve and promote what is in the best interest for their community. Thus, they have a unique self-interest in the economic well-being of the communities they serve. "Commitment to community and economic development is a necessity in order for a rural electric cooperative to survive" (NRECA, 2003, p. 5).

From a theoretical perspective, the model of rural entrepreneurship that we propose can be extended to many rural communities because of the commonality that exists among the central figure in our model, the rural electric cooperative. Building a model around rural electric cooperatives takes advantage of the predisposition of rural electric cooperatives to engage in economic development (NRECA Website, 2004). As Figure 1 demonstrated, rural electric cooperatives are located throughout most of the continental U.S. Thus, the proposed model can be implemented in a variety of locations, with only minor modifications to the overall structure based upon the potential partners available to the individual electric cooperative.

## **RESEARCH DESIGN**

We propose to extend Lyons (2002) and Wortman's (1990) perspectives on rural economic development by evaluating a similar, but somewhat different approach to economic development based upon case studies of two rural electric cooperatives. Previous research has emphasized the value of the case-study method as a qualitative research strategy (St. John and Heriot, 1991; Audet and d'Amoise, 1998). In particular, Yin (1994) and Earnstadt (1989) have explained the value of the case method. The choice of a case study method is theoretically driven. Case research has high exploratory power and allows dynamic, decision-making processes to be more deeply investigated (Audet and d'Amoise, 1998).

The selection of the two locations was not random. It was purposeful as is appropriate in a case study where the researcher seeks a deeper, richer understanding of a process or phenomena (Yin, 1994). Each of these electric cooperatives is highlighted in material developed by the National Rural Electric Cooperative Association that was made available to the researchers. Additionally, the researchers were able to speak with the general managers of each of the electric cooperatives in order to gain a deeper insight into their situation.

## **The Case Study**

### Whiteville, North Carolina

The Brunswick Electric Membership Cooperative (BEMC) service area is in southeastern North Carolina, a region that has suffered economically in recent years due to shutdowns in local manufacturing and declining farm incomes. The co-op has responded to the situation in a number of ways, including providing facilities to encourage the development of small businesses.

BEMC supports three business development centers through its Rural Consumer Services Corporation (RCSC) located in Winnabow, Whiteville, and Tabor City, NC. We focus on the Whiteville location. The Whiteville location provides affordable, commercial space for new and expanding businesses. This location is a mixed-use incubator that supports professional, service, manufacturing or light assembly businesses. The facility also provides a supportive environment for entrepreneurs that includes business counseling, access to high speed internet, light office equipment, secretarial support, general interior and exterior maintenance, and a shared conference room and training facility.

In 1989 BEMC worked to develop partnerships and build a nonprofit business incubator facility in southeastern North Carolina. This was one of the first applications approved under a new program funded by (then) Rural Electrification Administration (REA) to stimulate economic development in rural areas in the U.S. BEMC tackled the project by setting up a spin-off corporation, the Rural Consumer Services Corporation (RCSC), in 1989. The co-op financed RCSC through partnerships with a number of local and national entities, including the Rural Electrification Administration (now USDA Rural Development's Rural Utilities Service), the Farmers Home Administration (whose business, community and housing programs are now part of Rural Development), and the North Carolina Technological Development Authority. Further funding and other support came from local community colleges, local development organizations and local businesses and individuals. The first funds were used as seed money to open a Business Development Center in Whiteville, N.C., in 1991.

Two more centers were later opened using additional funding in nearby Winnebow and Tabor City. According to Chip Leavitt, CEO and General Manager of BEMC, the co-op minimized



expenditures of members' funds. "The basic approach was for BEMC to serve as a catalyst for the project," he says. "Our investment was not in membership dollars, but primarily in staff and management resources to develop partnerships, pursue other financing sources and garner community support for the project" (NRECA, 2003, p. 29). BEMC provided a loan of \$128,000 to help finance the building in Winnabow.

RCSC is now self-supporting from rental income. Annual expenditures for the business centers total \$160,000, including management and technical support, maintenance, utilities, etc. Since the first center opened in 1991, the overall program has housed 32 businesses and helped create almost 800 new jobs.

Table 1 summarizes the financial resources necessary to make the Whiteville Business Development Center a reality. RCSC has not accomplished everything on its own. As researchers suggest (see, e.g., Lyons, 2002), they have partnered their efforts with public and private organizations to help create opportunities for small start-up businesses. The ongoing management of RCSC Business Development Centers is made possible by the continuing partnership between BEMC, RCSC and the Small Business Development Center. Southeastern Community College provides on-site management for the Whiteville facility. The community college also provides business counseling services and entrepreneurial training programs (USDA Website, 2004).

[Table 1 about here]

#### Black River Falls, Wisconsin

Much like the facility in Whiteville, NC, the facility in Black River Falls, Wisconsin is the result of the efforts of the Jackson Electric Co-op. Since the 1970s Jackson Electric Co-op (JEC) in Black River Falls has been the moving force in the development of an industrial park, a business incubator and a satellite of the Western Wisconsin Technical College in its service area. The co-op receives 50 percent of its commercial and industrial KWh sales from the 76-acre industrial park, in which all sites are sold. The business incubator graduated eight small businesses totaling 100-plus employees. Major employers are: Leeson Electric Motor Company (250 employees) and Nelson Industries (100 employees). Recently, Jackson Electric Co-op competed with 40 other communities to win the site for a Land O' Lakes animal milk replacement plant, employing 45 people at a total cost of \$15 million. Since the original park sites are filled, a new adjoining park is under development. Adjacent to the park is a medium security prison (350 employees) and the Ho-Chunk Tribal Corporate Headquarters (350 employees).

From 1970 to 1978, JEC manager Mike Anderson, then manager of Customer Services, served as mayor of the City of Black River Falls. He was able to obtain 90 grants from the US. Economic Development Administration and the Upper Great Lakes Regional Planning Commission to develop the 76-acre industrial park. He also created a \$500,000 city of Black River Falls revolving loan fund, to be used to assist in the financing for business and industries that were locating in the park.

The Jackson Economic Development Corporation (JEDC), established by Jackson Electric Co-op, has a \$480,000 revolving loan fund. JEDC has a \$4 million portfolio, the result of funding from the Cooperative Finance Corporation (CFC), the RUS, Dairyland Power Cooperative (G&T), the state of Wisconsin and the use of the revolving loan fund.

This \$4 million has generated an additional \$35 million of investments in the industrial park and other area businesses. Private and public sector funders provide \$1.5 million in loans at low interest rates. Public sector funds are provided through the US Department of Agriculture's Rural Business Services program (formerly the Rural Utilities Service).

[Insert Table 2 about here]

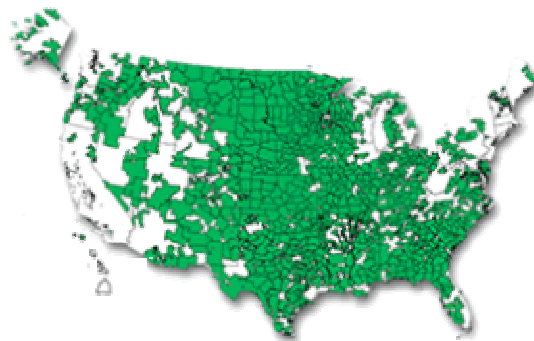
Black River Falls project has not accomplished everything on its own. As researchers suggest (See, e.g., Lyons, 2002), they have partnered their efforts with public and private organizations to help create opportunities for small start-up businesses. The ongoing management of the facility is provided by Marilyn Vasquez. The original industrial park, business incubator, and the satellite campus of a nearby technical college are the result of partnerships between JEC and several organizations, both public and private. Western Wisconsin Technical College offers special courses for small businesses. Enrollment in this satellite campus of the technical college has grown to over 1,400 students in a county with only 18,000 citizens. JEC created the Jackson Economic Development Corporation to manage the overall project.

## CONCLUSION

The two case studies in this paper demonstrate the potential for developing entrepreneurship in rural areas of America by building a network of economic support with a rural electric cooperative as the "hub". The research model proposed in this study emphasizes the electric cooperative as the catalyst for developing rural entrepreneurship. However, a perusal of the model shows that partnerships are critical to its overall success. The proposed model is good business for electric cooperatives and the regions they serve. The U.S. government regularly publishes statistics that demonstrate the strong impact that small new business ventures have on our nation's vitality (SBA, 2002). By trying to develop new businesses and new jobs, rural electric cooperatives are able to ensure that people will continue to want to live and work in their region.

**References** Available Upon Request.

Figure 1. Location of America's Cooperative Electric Utilities



Source: National Rural Electric Cooperative Association Website  
([http://www.nreca.org/nreca/About\\_Us/Our\\_Members/Our\\_Members](http://www.nreca.org/nreca/About_Us/Our_Members/Our_Members))

Figure 2. A Model for Building and Sustaining Rural Entrepreneurship

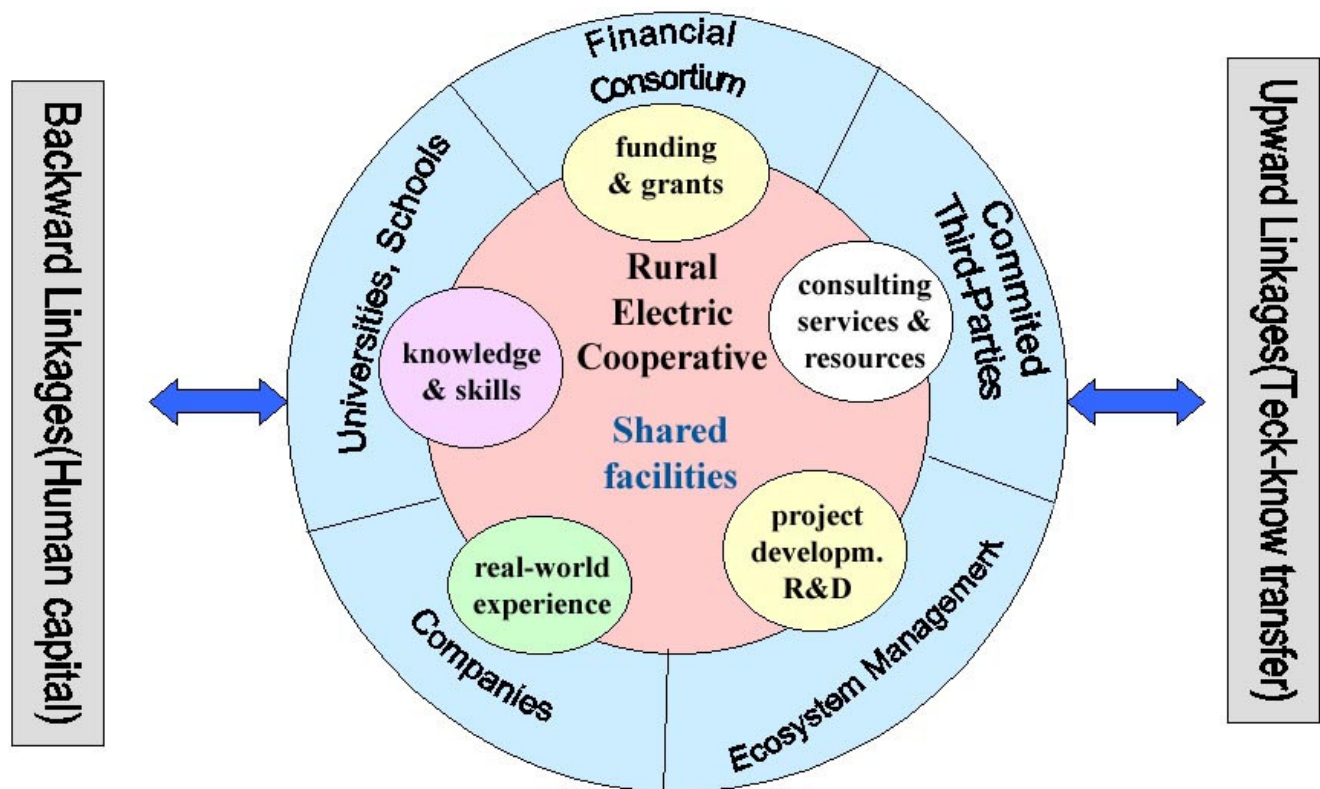


Table 1. Funding of the Whiteville, NC Rural Electric Co-op's Facility. <sup>2</sup>

| <i>Source of Funds</i>  | <i>Amount of Funds</i> |
|---|------------------------|
| USDA Rural Economic Development Loan (repaid)                 | \$100,000              |
| North Carolina Technological Development Authority            | \$100,000              |
| <i>North Carolina Rural Economic Development Center, Inc.</i> | \$30,000               |
| <i>USDA Industrial Development Center</i>                     | \$32,000               |
| <b>Columbus County, NC</b>                                    | \$32,000               |
| <b>Total</b>  | <b>\$379,000</b>       |

<sup>2</sup> The road and building are owned by BEMC and leased to RCSC.

Table 2. Funding of the Black River Falls, WI Rural Electric Co-op's Facility.

| <i><b>Source of Funds</b></i>                | <i><b>Amount of Funds</b></i> |
|--|-------------------------------|
| <i><b>City of Black River Falls</b></i>      | \$80,000                      |
| <i><b>Dairyland Power Cooperative</b></i>    | \$100,00                      |
| <i><b>State of Wisconsin</b></i>             | \$100,000                     |
| <i><b>Rural Utilities Service (USDA)</b></i> | \$100,000                     |
| <b>Total Loans</b>                           | \$380,000                     |

## **BUSINESS OPPORTUNITIES FOR INTERNATIONAL ENTREPRENEURSHIP**

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## **ABSTRACT**

The last decade of the 20<sup>th</sup> century has shown that modern changes can occur in a short period of time in our modern economic history. If we take a look in our rear view mirror, we will notice our bridges for travel no longer constrain us to a limited portion of a specific state, county or governing country. The roadmap has been extended beyond borders, which has changed the scope of our national and global marketplace. Many people have cruised the globalization steering wheel down the information superhighway. Many organizations have sped this journey up through the development and changes of corporate compatibility. Some people have placed their vehicle on cruise control making sure to stay on the path that leads through each valley, canyon, and causeway.

What is their purpose? Who will be the one behind the wheel establishing the new face of international expansion? The spirit of International Entrepreneurship is a major contributing factor that has affected the way people expands their horizons. No longer does one feel that their road to Entrepreneurism stops within the borders of their own country. The key elements of entrepreneurial drive and the economical, political, technological and social changes that have occurred over the last decade have dramatically created business opportunities for global business.

International Entrepreneurship has led pioneers and others down the paths of entrepreneurship freedom stopping at every nook, corner, and valley to find out the opportunities that will unfold in today's emerging international markets.

## **INTRODUCTION**

### **ENTREPRENEURIAL COMPATIBILITY**

Entrepreneurial Drive is a society that is unlike other organizations existence in today's global economies of scale. The Entrepreneur's passion is to conquer and seize opportunities that most individuals would not tackle and do not have the emotions to stomach. Their motivation is one of pro-activeness in their initiatives to be a steward for change through innovative products or services. They have a creative mind that can think independently about ideas of success and failure. Most Entrepreneurs are known for their hard work and their dedication to their respective businesses. Entrepreneurs have established themselves as taking risk and leaders of optimism. These unique men and women make up a strong percentage of today's innovator's to be the leaders of global expansion in the 21<sup>st</sup> century.

### **Keys of Entrepreneurial Drive**

Entrepreneurs have a unique form of identity from their inception as being leaders in our business forefront. These keen attributes lead highly talented individuals to be less resistant to change and provides them with a burning desire of resiliency to succeed. The entrepreneurial drive sets the table for everyone to have the business savvy or opportunity to succeed.

The Key Ingredients to Entrepreneurial Drive:

- ❖ *Seizes opportunities* for personal and professional benefit
- ❖ The *creative* Ability to develop business opportunities
- ❖ Entrepreneurs are *Independent thinkers*
- ❖ *Hard worker* and so is their environment
- ❖ *Optimistic*-Uncertainty does not bother these types of individuals.
- ❖ *Innovator*- The strongest quality of an Entrepreneur
- ❖ The ability to be a *Risk taker*
- ❖ The ability of an entrepreneur linked to their leadership as a *Visionary*
- ❖ An Entrepreneur is a *Leader*

The Entrepreneurial drive *seizes opportunities* that will benefit them both personally and professionally. Entrepreneurs have a tendency to be a *hard worker* and they carry these same expectations into their environment. *Optimism* drives their spirit and the *uncertainty* does not bother these type of individuals. The entrepreneurial spirit establishes ones ability to be a *risk taker* and have a *vision* for the success of their idea. They have to be *innovators* to the products and services they sell and a leader that reflects the environment of their strategic vision.

### **Multi National Corporations and Global Markets**

From the late 1940's through the late 1960's, multinational corporations (MNCs) from the United States had little competition in global markets.<sup>i</sup> In fact, Multinational corporations were the only forms of organizations allowed to eat in the lion's den of China for several years. Today, smaller firms have the *created ability to develop business opportunities* through smaller companies who take less resources and operational cost to secure an opportunity in the global marketplace.

More and more American entrepreneurs are embarking on the road to China and many have found their fortunes. Over the past two decades, as China has liberalized its economy, several large companies have prospered by moving manufacturing into China or more rarely, by producing goods for the Chinese Market.<sup>ii</sup> Investments by major organizations like GM, Volkswagen and other major automobile manufactures are drastically expanding their operations in China. The behemoths have faced several roads that are hard to overcome because of their intensive size and labor costs. The corporate streamline of a major multinational organization only absorbs the ideas of a loose idea thinker.

### **Global Opportunities for Small Businesses**

Yet more than often not, major multi nationals have found making money in China considerably harder than expected.<sup>iii</sup> With intensive operational cost, small entrepreneurs and businesses have been able to seize the opportunity in the international markets of China.

Many corporations have faced the difficulties of working with Multi national corporations and the powers of strategic alliances in the China markets. Small businesses like Robert Kushner's Pacific China Industries Ltd. have been able to open the gates of China and have been well received in the Chinese market. One contributing factor to their success as a small business entrepreneur is the research and study time placed in the international markets with a smaller

team focus and a smaller scales strategy that has captured the short-term audience of the Chinese market.<sup>iv</sup> Robert's personal savvy led him to China. His professional drive helped him to understand the cultural differences that would lead to the expansion of his company's products and services.

### **The Entrepreneurial Test**

Entrepreneurial compadibility is influenced by people who think *independently*. The people who are "outside the box" and have difficulty conforming to structure remove themselves from the foundation of a corporation. Some major corporations embrace this spirit and formulate the ideas to be incorporated with their strategic plans and vision. If they are unsuccessful in their environment, the entrepreneurial tendency is to take the optimistic approach and leave the corporate structure and develop a flat structure with the correct environment for business.

## **ECONOMICAL CHALLENGES OF INTERNATIONAL ENTREPRENEURSHIP**

The economic compatibility that will lead the wave of International expansion through hearts of compassion and new ventured entrepreneurs will have to *adapt* and *change* to the constant economic filters of geographic economics. The issues of *foreign trade* have conducted barriers for entry for all opportunists who would like to expand their business into global markets.

The United States has seen a rise in debt over the past few years. From mid-2000, the U.S. and *global economy* has weakened significantly following one of the largest stock market declines in the postwar period, the terrorist attacks of September 11, 2001, major internal combustion in major corporations leading to corporate failure, and the wars in Iraq.<sup>v</sup>

These economic events have played a significant impact on the judgment for idealist to produce opportunities in the national and global markets. The economic picture in the United States has played a major role in the impact on the emerging markets in Eastern Europe, Asia and Latin America. The United States budget deficit, *global interest rates*, and *the U.S. dollar* have been exposed by the debt linked to the United State government and policy.<sup>vi</sup> It has developed adverse effects on short and long-term interest rates. The traditional distribution structures in Japan, Europe and other countries have seen rapid changes to entry barriers into key markets for small business that offer products and services.

### **Global Market Integration**

The economic picture today is one of several bundled hot buttons. Each geographical region of the world now has been integrated to the advancement in technology and services. This threshold has developed several key communication channels that have broken down the environment of semantics and sparked the interest for organizations to consider global integration.

Though many U.S. consumers associate *globalization* with leading multinationals like Coca-Cola or GE that have huge operations in many countries, small businesses have actually been one of the main drivers of global integration. According to the U.S. Department of Commerce, between



1987 and 1999, the number of small and mid-sized U.S. exporters more than tripled, to 224,000.<sup>vii</sup> By 1999, 97 percent of American exporters were small businesses, though smaller exporters still only accounted for one-third of total U.S. export sales.<sup>viii</sup>

## **Global Inflation**

According to *Grolier's On-line Encyclopedia*, *Inflation* is a process in which the average level of prices increases at a substantial rate over a considerable period of time. In short, more money is required to buy a given amount of goods and services. An understanding of *global inflation* is key to build opportunities in international entrepreneurship simply because it is a foothold to your revenue streamline in your international venture(s) of business. For the first time in the history of the world, inflation is a universal phenomenon with all currencies tied together. Global inflation outlines the environment for which you formulate certain strategies as they affect different segments of the global market space.

## **THE INTERNATIONAL ENTREPRENEUR POLITICAL PERSPECTIVE**

The emerging global economy brings together unity and global nations, which provides outlets of competition. Worldwide competition gives an opportunity for entrepreneurs as well as the buying consumer population. The roadways that open also creates a market capitalization which endorses free enterprise in new markets and small markets that are considered large enough to become viable opportunities.

The main concern of the 21<sup>st</sup> century will be the geopolitical forces that monitor and issue policy for the exchange of goods and services in the global markets. As competition develops in certain markets the contingency for *protectionism* will become the hot button in most respective markets. The passions for trade will grow and has already established this trend in the last decade of the 20<sup>th</sup> century. The economies of industrialized world have entered their mature state of the product life cycle and will be more than modest over the next twenty years.

The Organization for Economic Cooperation and Development estimates that the economies of the OECD member countries will expand about 3 percent annually for the next 25 years, the same rate as the past 25 years.<sup>ix</sup> Organizations like the World Trade Organization (WTO) was formed to help the social, political, and economic changes that will lead the global economy to the future victories in the International Trade and Policy.

When an entrepreneur is formulating a strategic decision to enter a global market you should keep in mind the different geopolitical challenges. You should know your state of controllable and uncontrollable initiatives when entering a market. With the continued strengthening for opportunities in international entrepreneurship one must focus on the continued strengthening and creation of regional market groups:

European Union (EU)

ASEAN Free Trade Area (AFTA)

Southern Cone Free Trade Area (Mercosur)

North American Free Trade Agreement (NAFTA)

Free Trade Area of America (FTAA)

Asia-Pacific Economic Cooperation (APEC)

The market groups have enabled entrepreneurs into emerging markets and help to protect policy and practices of business worldwide. Entrepreneurs will constantly have to examine the way they conduct business and remain flexible enough to react to the rapidly changing global trends to be competitive.

When an entrepreneur seizes an opportunity in global markets there are several factors he or she should consider to entering an emerging market for global business:

Key Areas for an entrepreneur to understand when researching opportunities in global markets:

1. Understanding the balance of trade relationship between merchandise imports and exports in prospective target markets.
2. Extensive research on the political forces of the global environment to have alternatives outlines for strategy and implementation for barriers to enter market(s).
3. Understand the development of domestic industry and how countries will protect existing industry by establishing tariffs, quotas, boycotts, monetary barriers, non-tariff barrier, and market barriers.<sup>x</sup>

The market groups and research techniques will be explored in later chapters of experimental exercises and the areas of study chapters of this book. The Political and Legal issues for an entrepreneur will be a challenging process for one to win in their quest for International emergence for global markets.

## **SOCIAL AND CULTURAL DIFFERENCES IN INTERNATIONAL MARKETS**

### **Corporate Culture and Entrepreneurship**

Since the 1990's, the need to pursue corporate entrepreneurship has arisen from a variety of pressing problems including: technological changes, innovations, and improvements in the marketplace.<sup>xi</sup>

The Corporate Culture has also formed a relative deprivation towards many entrepreneurial spirits that exist in this organizational culture. The spirit of the entrepreneur has perceived weakness in the traditional methods of corporate management.<sup>xii</sup> Most of this is caused by power and influence from top-level management and corporate streamlining. The chain of command takes control and the end result is the loss of entrepreneurial-minded employees who are disenchanted with bureaucratic organizations.<sup>xiii</sup>

The bureaucracy enables other organizations to find opportunities and opens the door for organizations that possess a flatter structure. The word globalization has helped link doors that used to be closed. New technologies and the pursuit for core competencies has led to growing levels of international competition

The pursuit of corporate entrepreneurship as a strategy to counter these problems, however, creates a newer and potentially more complex set of challenges on both a practical and a

theoretical level. On a practical level, organizations need guidelines to direct or redirect resources towards establishing effective entrepreneurial strategies. On a theoretical level, researchers need to continually reassess the components or dimensions that explain and shape the environment in which corporate entrepreneurship flourishes.

### **Workforce Diversity and Globalization**

Organizations understand that they are no longer constrained to their natural national borders. A British firm owns Burger King, and McDonald's sells burgers in many different eastern countries. American companies receive almost 75 percent of their revenues from sales outside the United States.<sup>xiv</sup> These examples illustrate that the world has become a global outlet and community. In return, entrepreneurs have become capable of working with people from different cultures. *Globalization* has led many organizations to *adapt* to working with people of different ethnic decent and understanding the opportunities to work with managers in different markets representing different cultures. To work effectively in different cultures, entrepreneurs must understand the significance of the cultures they wish to build relationship and customer rapport as well as adapt their management style to their differences.

### **THE TECHNOLOGICAL EFFECT ON INTERNATIONAL ENTREPRENEURSHIP**

Technology has been a key to help moving products from manufacturer to end-user, providing local inventory, technical product support, sales and service. Technology moves at a record pace and sometimes when obtained is already obsolete. In today's world technology is a challenging and ever evolving field. New computer technologies, increased competition and continued growth in global markets make today's opportunities to entrepreneurship remarkably different from what it was only a few years ago.

### **WHAT CAN BE LEARNED**

#### **Successful Business Opportunities in International Entrepreneurship**

Most people understand the challenges they face when they opt to go into business for themselves. Everyone knows the road of having success in the corporate environment of small, medium and large corporations. *Free Enterprise* has been an incredible advantage to Americans in our national democracy. The freedom of private business to organize and operate for profit in a competitive system without interference by government beyond regulation necessary to protect public interest and keep the national economy in balance only exists in democratic forms similar to the United States.<sup>xv</sup> So how does that affect pursuing opportunities in our global society? Our assumption must take us back to the most important questions that anyone pursuing or seeking a business opportunity must face. Do you know if you are entrepreneurial compatible?

#### **Entrepreneurial Savvy**

The professional benefit of being successful with an International business opportunity will depend on one's self as well as enabling others to act and share in the creative of the organization's mission. The *entrepreneurial drive* must lead others to understand their

importance of ownership and empowerment in the organization. They must ask as stewards who understand the organizational culture and environment. The organization as a whole must be optimistic and look for the opportunity to produce results. The entrepreneurial leader must model the way for the organizational community to understand their vision and purpose. Allot of soul searching will transpire for the entrepreneurial drive to catch on as a fever that is burning hot through their entire organizational community. Encouraging others and building an organizational environment that shares the optimistic uncertainty with a vision end mind will lead to a successful organization in today and tomorrow's global society.

### **Alternative Approaches of International Entrepreneurship**

The International Entrepreneur must know that he will place allot of emphasis on work ethic Through the power of a vision or growth image even if it is only an illusion. In perhaps the most crucial strategy that must be set in motion early for a business opportunity to be successful from it's embryonic beginnings.

The opportunities for business opportunities in the international market place for an entrepreneur are not as challenging as they were just one decade ago. There are several alternative approaches that can be utilized as a competitive advantage for the emergence into global markets.

- ⇒ The Internet and its expanding role in International markets
- ⇒ The Political and Social Integration of big emerging Markets (Asia, Eastern Europe, Japan, and China).
- ⇒ The economic spurt evolving in global middle-income households.
- ⇒ The collaborative qualitative and quantitative research conducted by organizations through strategic alliances, corporate and functional development in major corporation and small business.
- ⇒ Trends in channel structures in Europe, Japan, and developing structures
- ⇒ Ethics and Social Responsibility in today's global environment.<sup>1</sup>

An entrepreneur must understand all of the facts and assumptions to entering his idea into the global market space. Once this steward has assessed their organizational core competencies, they must evaluate the alternative approaches to make a successful launch into the 21<sup>st</sup> century with their newfound business product or services. These strategies will be discussed in later chapters of this book. The Macroenviroments, Economical, Political, Social, and Market driven/technology demands need to be examined as possible causal factors in the success or failure of international entrepreneurship. The right drive, the right passion and the right strategic window will lead unique men and women to be the revolutionary business leaders of global expansion in the 21<sup>st</sup> century.

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## **CHARITIES & ENTREPRENEURSHIP: WHAT TO DO WHEN THE MONEY RUNS OUT**

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## **CHARITIES & ENTREPRENEURSHIP: WHAT TO DO WHEN THE MONEY RUNS OUT**

### **Abstract**

The role of the social entrepreneur, the challenges he/she faces when working with the changing environment of charities, and the steps that have been successfully taken by some charitable organizations to secure funding are detailed. A framework to guide charities seeking funding in the world of for-profit companies is proposed. Steps include (1) fill an existing need in the marketplace, (2) build on existing human resources, (3) teach business skills as you bring in money, (4) provide employment opportunity as you develop funding, (5) take advantage of special governmental opportunities, and (6) build on successes to become serial entrepreneurs.

### **Introduction**

The current environment for charities is undergoing radical change. Gift giving by individuals has been decreasing because of poor general economic conditions and people are becoming more skeptical about the way their donations have been used by charities. Federal and state funding is drying up as government agencies wrestle with decreased tax revenues, increased demand for services, changing priorities, and other budget drains. As jobs have continued to move abroad and the demand for unskilled workers has decreased, more people are looking for charitable institutions to help in times of crisis. These increased needs are stretching meager resources to the breaking point. Compounding these problems is the lack of coordination and communication among charities which results in fragmented services. Finally, many charities are now being asked to match a percentage of funding received from governmental agencies before the award is made. Charitable organizations are breaking new ground and pioneering new approaches for generating funding on their own so that they can fulfill their missions. Social entrepreneurs are building new models for the charitable organizations of the future.

What lessons can we learn from the pioneers already innovating in the marketplace? For practitioners, researchers and the groups and individuals trying to guide the development of these organizations, those are the questions that must be answered for success in the future.

Steps that have been successfully taken by some charitable organizations to secure funding are detailed. A framework to guide charities seeking funding in the world of for-profit companies is proposed. Steps include (1) fill an existing need in the marketplace, (2) build on existing human resources, (3) teach business skills as

you bring in money, (4) provide employment opportunity as you develop funding, (5) take advantage of special governmental opportunities, and (6) build on successes to become serial entrepreneurs.

## **WHAT TO DO WHEN THE MONEY RUNS OUT**

People are becoming more skeptical about the way their donations have been used by charities. News reports and other research have shown that a much larger percentage of each dollar donated has been going to administration rather than to provide the charitable assistance that individuals thought they were supporting. At the same time, federal and state funding is drying up as government agencies wrestle with decreased tax revenues, increased demand for services, changing priorities, and other budget drains. As jobs have continued to move abroad and the demand for unskilled workers has decreased, more people are looking for charitable institutions to step in and help in times of crisis. These increased needs are stretching meager resources to the breaking point.

Compounding these problems is the lack of coordination and communication among charities which results in fragmented services. The needy are the losers when they cannot discover where to go and who to see for help. Finally, many charities are now being asked to match a percentage of funding received from governmental agencies before the award is made. This means that organizations must be proactive in generating additional funds. Into this environment, we are now seeing that social entrepreneurship is on the rise. Organizations are breaking new ground and pioneering new approaches for generating funding on their own so that they can fulfill their missions. Many are just beginning to identify and pursue opportunities to become more self-sufficient. As they move into new areas, they must innovate, adapt and learn from their successes and failures. It is a brave new world for charities and the people they must serve. Social entrepreneurs are building new models for the charitable organizations of the future. The purpose of this research was (1) to survey current efforts by non-profit charitable institutions for innovative new ways to solve some of the funding problems they now face and (2) to develop a framework that other organizations may use in making their own decisions for action in this area.

What avenues to self-sustaining funding will be open to charitable organizations in the near future? What lessons can we learn from the pioneers already innovating in the marketplace? Are some strategies more successful than others? For practitioners, researchers and the groups and individuals trying to guide the development of these organizations, those are the questions that must be answered for success in the future.

## **Forces Creating the Need for Diversified Funding**

Recent history shows the current economic climate coupled with federal and state funding trends leave many non-profits with flat or reduced budgets. Either of these elements could drastically affect the delivery of social services. Combined they are often fatal to charities in a number of ways.

The effect of poor economic conditions on non-profits is multi-faceted. A lagging economy influences both small and large-scale charitable donations. As businesses down-size, corporate giving decreases substantially. A December, 2002, *Newsweek* article that reports corporate philanthropic donations shows that they declined by 14.5 percent the previous year. (1) This figure takes into account the sizeable donations given after the September 11<sup>th</sup> terrorists attacks. More recent studies show this trend has continued. In a new survey, the *Chronicle of Philanthropy* reports the country's largest corporations cut their charitable donations in 2002 and 2003. (2) These corporate cut backs also affected individuals and charities on a more personal level.

As companies tighten their belts in reaction to hard economic times, so do those who are caught in the corporate crunch. For typical middle class families struggling to provide for themselves, donating to charities they strongly believe in is simply out of reach. As a result, gift giving is left in the hands of a small number of

philanthropists who typically support a single cause. Additionally a weak economy generates a surge in individuals and families seeking assistance. As these individuals join the ranks of others already in need of services, many non-profits are scrambling to acquire additional dollars - putting them in direct competition with each other. Unfortunately as these agencies seek much needed funding, trends in government spending are going in the opposite direction.

Federal and state funding has decreased substantially over the last several years. In addition to slashing budgets of government run programs, charities that typically rely on federal and state dollars have also taken a beating. Fewer dollars are being allocated for social services while the need for these services continues to increase. As operation costs continue to climb and the number of those needing assistance sky rockets, many agencies struggle to stay afloat. For example, many HUD funded programs are now being required to provide a twenty five percent match as part of their grant requirements. These new stipulations place an additional burden on the already strained budgets of a number of charities. As operational costs continue to climb, the financial responsibilities of charities grow, and the number of those in need escalates, agencies are increasingly seeking private donations to expand their revenue. Like state and federal funding, charitable donations are declining. In addition to the current economy, gift giving has also been affected by recent negative media coverage of a few major non-profits, including the United Way and American Red Cross. As reported by *USA Today*, charities raised more than \$2 billion related to the events of 9/11. (3) As the media began to report discrepancies in the amount of donations received compared to the amount going directly to victims of terrorism, many donors began to question exactly how their donations were being spent. Because individuals are more inclined to give when they know their money is going directly to those in need, many became disillusioned to find out not all donations made to charities, the Red Cross in particular, were going specifically to the victims of terrorism. Even though the Liberty Fund was later established to earmark donation for victims, the public's perception had already been changed by the previous reports. This uneasiness has led many to think twice before giving to charities in the future.

Like the Red Cross, the United Way has seen a drop in overall donations as their use of funds and accounting practices were questioned in a scandal involving a past CEO of the agency. Publicity surrounding United Way of the National Capital Area's former CEO, Oral Suer admitted theft of over \$500,000 evoked suspicion in the agency's overall monitoring of funds. According to the *Washington Post*, the National Capital Area saw a decline in donations from \$90 million in 2001 to \$19 million in 2002. (4) As a result of the scandal, United Way chapters across the nation have been hit hard by a decrease in support and social service agencies are feeling the brunt of it. As a number of programs rely on agencies like the United Way for a large portion of their funding, many are left seeking new alternatives to supplement their flat or decreased sources of revenue. The question is: how do they continue to provide services to the growing number of those in need and at the same time make up for the decline in donations to support these services? In the sections that follow, we survey current research on these topics and present examples of some innovative ideas agencies have come up with to answer this question.

## **Research on charities and entrepreneurship**

The search for prior academic research on charities and entrepreneurship was difficult. Little has been written specifically about this particular area. Therefore, the search was broadened to include the larger domain of social entrepreneurship. Social entrepreneurship is not a new phenomenon. It has been around for a very long time. However, it has been difficult to establish conceptual boundaries for the term because of the many different approaches and perspectives used when discussing it. Current usage of the term includes two different approaches: the leader and the organization. The problem comes in trying to separate the leader from the venture. Just as with mainstream entrepreneurs, it is difficult to divide the two. (5) Researchers are only now



beginning to converge on some of the conceptual aspects of this phenomenon. Some researchers have tried to conceptualize social entrepreneurship as it pertains to leadership of public organizations (6) or development of public policy. (7) Others have defined social entrepreneurs by their missions which differ from those of business entrepreneurs. Dees (8) states that for social entrepreneurs, the social mission is explicit and central, a fact that affects how social entrepreneurs perceive and assess opportunities. The primary mission of the social enterprise is to create superior social value for its clients. In order to do this, social entrepreneurs must find innovative ways to ensure that their ventures will have access to resources as long as they are creating social value. Dees goes on to state that “Any definition of social entrepreneurship should reflect the need for a substitute for the market discipline that works for business entrepreneurs. We cannot assume that market discipline will automatically weed out social ventures that are not effectively and efficiently utilizing resources. The following definition combines an emphasis on discipline and accountability with the notions of value creation taken from Say, innovation and change agents from Schumpeter, pursuit of opportunity from Drucker, and resourcefulness from Stevenson. In brief, this definition can be stated as follows: Social entrepreneurs play the role of change agents in the social sector, by: Adopting a mission to create and sustain social value (not just private value); recognizing and relentlessly pursuing new opportunities to serve that mission; engaging in a process of continuous innovation, adaptation, and learning; acting boldly without being limited by resources currently in hand, and exhibiting a heightened sense of accountability to the constituencies served and for the outcomes created.”

The authors have used this definition of social entrepreneurs to guide this study. What follows is identification of ventures created by social entrepreneurs as they pursued opportunities to serve their various missions.

### **Searching for solutions in a changing environment**

So far, we have discussed who the social entrepreneur (actor) is and what challenges he/she may face when working with the changing environment of charities (context). Our next step is to identify the steps (actions) some organizations have taken to secure funding for their organizations in this changing world. What have some charities and not-for-profits done to compensate for the decrease in funding and gift-giving from the general public? In doing our research, we have come across numerous examples of how charities and not-for-profits (NFPs) have augmented their budgets and cash inflow.

**Benhaven**, a New Haven, Conn. charity, operates a school for autistic children (9). For numerous years, Benhaven received many inquiries from local school districts on how best to educate autistic students. While Benhaven provided answers to these requests, responding took staff members away from programs at Benhaven. The officials at Benhaven decided to start a consulting business (Benhaven's Learning Network) to provide the needed assistance to the local community. The consulting firm expects to break-even this year and to add additional consultants as it continues to expand.

**The Boys and Girls Clubs (BGC) of Western Pennsylvania** (10) which is classified as a 501(C)3 organization opened the Outlet Connection a number of years ago to provide additional funds to the parent organization BGC. The Outlet Connection teaches at-risk youth entrepreneurial skills that they might not get elsewhere, such as interacting with customers, ordering and displaying merchandise, taking inventory, and even policing for shoplifters. Everyone that works at the Outlet Connection takes pride in the store and no task is too menial for anyone, that even includes unloading trucks and making sure the bathrooms are kept clean. The kids from the BGC even go on buying trips with the store manager, because she believes that the kids have a better notion of what customers want.

**The Tomorrow Project** started in 1994 as the San Diego Women's Bean Project, which has its roots in the Catholic Charities Department of Homeless Women's Services in San Diego, California. It is sponsored by Rachel's Women Center and Catholic Charities of San Diego. (11) The mission of The Tomorrow Project is to

provide very low-income women the opportunity to change their lives in three specific areas: lack of viable skills, poor self-image, and alienation from mainstream USA. The Tomorrow Project provides training and workshops where the women can learn new skills and social and job skills. The Tomorrow Project manufactured and sold 2,500 soups in 1994, with sales increasing every year. In 2003, the project produced and sold 12,500 soup products. The homeless shelter benefits monetarily through the sale of soups manufactured by the women.

In 2002, **The Northwest Center**, a local charity in Seattle, Washington, generated \$22 million in revenue from its 10 commercial businesses(12). Charities throughout the US and abroad have been facing falling donations and contributions and, unlike many other charities, The Center engages in minimal fundraising. Approximately a third of its income comes from federal contracts: The Center has contracts to clean all of the buildings in downtown Seattle that are federally owned. The Wagner-O'Day Act of 1938, mandated employment opportunities for individuals with disabilities; these mandates were strengthened by the Javits-Wagner-O'Day Act of 1971, which sets aside some federal jobs for disabled workers. "The Wagner-O'Day Act mandated that the federal government purchase brooms, mops and other suitable commodities furnished by community programs employing people who are blind." (13) "The expanded (1971) Javits-Wagner-O'Day (JWOD) Act (41 U.S.C. 46-48c) permitted nonprofit agencies serving people with other severe disabilities to participate in the program and authorized nonprofit agencies to provide not only supplies, but also services to the federal government." (13)

**St. Vincent dePaul Rehabilitation Services (SVdP)**, now know as St. Vincent DePaul Enterprises, started in Portland, Oregon, in 1972 as a sheltered workshop with only five disabled clients.(14) Over the years, SVdP has started and operated numerous for-profit endeavors, such as temporary staffing services, production of outdoor furniture, bus shelter cleaning and security services, and electronic document conversion service. In 1996, SVdP had an operating budget of \$15 million and over 800 employees and was recognized as one the fastest growing organizations in the Portland area.(14) The organization has not only developed its own sources of funding, it has also built organizations that can offer employment to its disabled clients.

**Pioneer Human Services** organized as a non-profit, provides employment, training, and rehabilitation for socially handicapped individuals (ex-cons, parolees, recovering alcoholics and substance abusers) in Seattle. (15) Pioneer has an annual operating budget of \$30 million which comes from its 10 businesses, including a wholesale food business, a corporate cafeteria for Starbucks Coffee, a daily institutional food business, a hotel in downtown Seattle, and a property management company.

**The Pittsburgh Center for Creative Play (TPCCP)** (16) is a charity that teaches children with different skill levels to play. The organization used both grants and loans to purchase a building which it partially occupies, and rents out approximately 12,000 feet to four other entities that bring in \$70,000 in rent a year. In November, 2001, the Center released a CD of children's songs slowed down so that kids with disabilities could sign along. The Center currently is about 50% self-sufficient, but hopes to increase that percentage to 80% by 2007. The down side to this growth is that the Center probably needs to restructure because the business end has become so profitable. Originally, TPCCP believed that sales would total approximately 2,500 copies, but, the Center ended up selling 25,000 copies of the CD. The Center had a "hit" on its hands, and is branching out into holiday music that will be promoted by a national advertising campaign and TV commercials, with hopes of netting \$116,000 from sales.

**Life's Work of Western Pennsylvania** (16) is a charity that helps people with disabilities and employment barriers. The organization was founded in 1927 to assist immigrants who needed vocational help finding jobs. Bob Mather, Life's Work director, got a personal insight into handling disabilities after a head-on car accident that left him in a wheelchair. While recuperating, he developed an initiative to help transform the agency into a more competitive business venture which Mather calls a "mission-based social enterprise." Life's Work has a partnership with an entity that created Jurassic Dog Products. The partnership shares the same facility which

allows Life's Work clients to package and label the products. Life's Work has started 3 for-profit businesses and is in the process of opening a Ben & Jerry's partner shop. "Ben & Jerry's PartnerShop Program is a form of social enterprise, a growing movement in which nonprofit organization leverage the power of business for community benefit." (17)

**The Delancey Street Foundation** in San Francisco was founded in 1971 by an ex-addict/convict with money borrowed from a loan shark. (15) Delancey Street is a multi-million dollar rehab program for addicts, prostitutes and ex-cons. The foundation, which has expanded into five other locations throughout the U.S. (Brewster, NY; Greensboro, NC; San Juan Pueblo, NM; and Los Angeles, CA), has multiple for-profit businesses that it operates, although not all locations have all businesses.

**Rubicon Programs** (15), located in San Francisco, is a non-profit supported by social purpose enterprises that produce approximately \$3 million yearly. Rubicon has several for-profit businesses that include Rubicon Bakery, Rubicon Buildings and Grounds, and Rubicon Employment Services. "The employment services business provides a variety of job training, employment, housing, and mental health services for the disabled, homeless, and ex-welfare recipients." (15)

### **A framework for action**

So what can we learn from the experiences of these diverse organizations? While each entity has a unique story to tell, there are some actions that have application for a wide array of charitable organizations. Development of for-profit enterprises to provide funding for parent charitable organizations seems to be a wave of the future. The organizations in our study were tenacious in their endeavors. They assessed the market to identify any niches that they might fill. When doing so, they kept in mind that their missions were social in nature and took advantage of any opportunities to combine their social mission with their for-profit activities. In some cases, they were able to build ventures for training their clients. In other cases, the new for-profit ventures actually were sources of permanent employment for their clients. These organizations took advantage of all opportunities they could find, especially the existing governmental opportunities available to them. Finally, in several cases, the organizations learned from their early successes and failures and went back into the marketplace to build a series of new ventures. These specific actions could be integrated into many charitable organizations as they search for stability and constant sources of at least a portion of their funding. The foundations for building new ventures are well known. However, their application to charitable organizations is a new. We can see from this research that a number of charitable institutions have been successful in creating innovative businesses to aid them in fulfilling their social missions.

### **A Framework to Guide Charities Seeking Funding in the World of For-Profit Companies**

- \*Fill an existing need in the marketplace* (Benhaven, Pittsburgh Center for Creative Play)
- \*Build on existing human resources* (BGC of America, Pioneer Human Resources)
- \*Teach business skills as you bring in money to support charitable activities* (Tomorrow Project)
- \*Provide employment opportunity as you develop funding streams* (Rubicon Programs)
- \*Take advantage of special governmental opportunities* (The Northwest Center, SVdP Enterprises)
- \*Build on successes in the market to become serial entrepreneurs* (Life's Work of Western PA, Delancey Street Foundation)

## **CONCLUSION AND IMPLICATIONS**

The research presented here has illuminated the various ways that not-for-profits and, more particularly, charitable organizations have developed to generate reliable streams of funding so that they can fulfill their social missions. Results show that these pioneering entrepreneurial efforts have allowed the organizations to

become self-sustaining in some instances and certainly less dependent upon contributions in others. Many of these efforts have created new jobs and opportunities for the individuals that the organizations were originally created to serve. While there is no "one-size-fits-all" solution to the differing needs of so many charitable institutions, different approaches have proved successful for different situations and groups. This study has presented a framework which can be used as a guide for charities seeking funding in the world of for-profit companies.

The results of this research are important in a number of areas. As teachers lead individuals into the field of entrepreneurship, they now have yet another path to show to potential entrepreneurs. Many students do want to contribute to society and are looking for ways to do just that. They will be able to identify ways to combine their entrepreneurial talents with a genuine desire to serve as they see the successes enjoyed by these organizations.

This research has just touched the surface of one area of social entrepreneurship. Much more needs to be done in understanding the specific problems and issues that charitable organizations face today. In addition to identifying various paths to self-sufficiency for these organizations, researchers need to learn which path is most likely to result in success for which type of organization. There is a need for models to help understand this phenomenon. This is an area that will provide opportunity for research for many years to come.

Finally, providing this information to would-be social entrepreneurs is a first step. The information currently available is very general in nature. Social entrepreneurs need specificity and models for success that they can emulate as they move into uncharted waters. However, this early effort at building awareness and knowledge in the area is welcome and should be followed by much more.

The authors feel this area of social entrepreneurship is one that is vital to the social fabric of our communities. There is a need for both practitioners and academics to come together to help to build knowledge and understanding for those social institutions that act as a safety net for the less-advantaged of the world.

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# **LEARNING FROM FAILURE: HARD LESSONS ON LAUNCHING NEW TECHNOLOGIES FOR OLD MARKETS.**

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## **ABSTRACT**

The case study tracks the trials and tribulations of a new venture launched to provide leading edge, vertical market software in an established industry. The experiences of the protagonists in the case validate long held theories, concepts and models that inform the study of entrepreneurship, most important of which is the need to research and assess the environment (both macro and micro) before launching a new venture.

The learning from the case of Entrada Technologies provides a compelling example of the need for entrepreneurs to clearly understand the environment into which they are planning to launch any new venture, particularly one targeted at an industry dominated by complex information technology supply chain. This start up software company learns some very hard lessons when the owners assume that they can be successful with a product that provides elaborate functionality to a market that demands the basics. Technical integration with disparate, customized backend systems, reliance on hardware that changes faster than Moore's Law estimates, and a supply chain with little tolerance for low margins are just some of the barriers exacerbating this new venture's problems.

## **Background**

Entrada Technologies began operations with the launch of an order management software application for vertical markets, which was designed to run on mobile computing hardware known as "pen tablets." With the pen tablet hardware, a field sales rep could navigate the computer screen using a stylus rather than a mouse, and use advanced software applications to enter data while in retail outlets. At the time of the company's launch, the pen tablet hardware was the first generation of devices that enabled field sales reps to enjoy full screen Windows functionality while away from their desktop PC back at the office. Mobile access to Windows' advanced feature set through the pen tablet hardware represented a significant productivity improvement opportunity for organizations that relied on a mobile sales force to create orders and manage their product inventories in retail outlets.

Entrada's initial software offering that ran on the pen tablet hardware was trademarked the Virtual Cooler, because it enabled sales reps in the beer industry to view a graphic representation of their products, in addition to a standard text view. With the Virtual Cooler software, beer industry sales reps simply used the stylus for their pen tablet hardware to "tap" the graphic image of their products on the hardware screen, and then enter their order quantities. The Virtual

Cooler application also allowed sales reps to collect other information while visiting retail customers, such as product inventories and competitive pricing data.

## **The Launch**

The Virtual Cooler was originally created by a programmer named Larry Brown, who had developed the software for internal use within the beer distributorship that he had inherited from his father. The programmer's concept of using the graphic images of a product to build orders and collect data was innovative enough for Mr. Brown to apply for a patent on the process. After months of revisions and resubmissions, Mr. Brown was awarded the patent, which ultimately led to his decision to "go to market" with his invention.

From the outset, Mr. Brown recognized that his expertise was primarily technical. In an effort to ramp up his new venture quickly, he decided to sign an exclusive software distribution contract with Intermec, a leading mobile computing hardware company. Under the contract, Intermec was given the exclusive right to market and sell the Virtual Cooler software either directly to potential end users, or through their nationwide network of hardware/software resellers known in the industry as Independent Software Vendors (ISV's). In exchange for the exclusive distribution rights, Intermec paid Entrada \$500 per licensed user of the Virtual Cooler software, and agreed to provide all necessary technical support and end user/ISV training.

After establishing the Intermec distribution arrangement, Mr. Brown was challenged with the laborious task of insuring technical integration between his Virtual Cooler software and the various enterprise systems used by the distributors within the beer industry. The accuracy of the data transmitted by the field sales reps, as well as the timeliness of those transmissions was critical to the efficient operations of Entrada's potential customers. When the substantial challenges associated with securing seamless technical integration began to require more and more of Mr. Brown's time, he realized he needed someone to focus on increasing the company's sales and managing Entrada's internal operations. To attack those issues, Mr. Brown recruited a long time friend from the beer industry, Tim Kane, to fill the role of President for the new company. Mr. Kane's short-term focus was to assist Intermec in the marketing and sales of the Virtual Cooler software. Part of Mr. Kane's compensation package included a share of ownership in the company.

Mr. Brown employed a third individual from his beer distribution business, Tom Hugle, to manage the product quality and provide technical support to Intermec. Mr. Hugle had contributed some of the programming code to the Virtual Cooler, so he was the logical choice to fill the role of product support. Mr. Hugle was also given a share of ownership in the company. The three partners agreed that Mr. Brown would be responsible for providing financial support during Entrada's start up phase. The actual funding came from Mr. Brown's beer distributorship. The required monthly cash infusions were transferred from a beer company expense account into Entrada's general ledger as part of a "monthly technical support contract." It was understood that Entrada would provide technical development and support for the beer company in return for funds to cover Entrada's monthly expenses until they reached profitability.

## **The Virtual Cooler Product Strategy**

Mr. Brown's original strategy was to use the resources of his strategic partner Intermec to market the Virtual Cooler software. His belief was that by partnering with a leader in mobile computing hardware to vertical markets, Entrada would reap the benefits of an established supply chain through Intermec's extensive Independent Software Vendor network. In addition, Mr. Brown saw potential operating efficiencies for Entrada by relying on Intermec's vast training and support resources to deploy the Virtual Cooler software to potential end users in the beer industry. Mr. Brown assumed that the advanced functionality of the Virtual Cooler software would create an immediate surge in demand for the product once they had completed the technical integration with the Intermec pen tablet hardware and the disparate enterprise systems used by the various beer distributors across the country.

Intermec's product strategy for the Virtual Cooler software was to market it as a "bundled" solution to their resellers and end users. The approach allowed Intermec to sell an integrated mobile computing solution that included Entrada's Virtual Cooler software, Intermec's pen tablet hardware, and all the peripherals needed to take orders and collect data from retail outlets. Intermec priced the Virtual Cooler bundle as a high-end niche product for sales reps that needed to do more than simply take an order. The entire bundle would cost the end user \$5,000 per route. Intermec established the Virtual Cooler bundle margin for their Independent Software Vendors at around 20%. The margin was significantly less than the ISV's made selling Intermec's primary mobile computing order management system, which was a keypad type hardware device that ran a DOS based application. The average selling price for the keypad bundle was around \$4,500 per route. Intermec's ISV's typically made a 40% margin on the keypad bundle.

## **Trouble in Product Paradise**

Technical integration with the existing information supply chain in the beer industry was proving to be a bigger challenge than originally anticipated by Mr. Brown and his limited support staff. As the Entrada technical staff was just beginning to understand the issues associated with transmitting data from the Virtual Cooler user in the field to the various enterprise systems used by their initial customers, they were also experiencing problems running the Virtual Cooler software on Intermec's pen tablet hardware. In early installations, sales reps were experiencing "lock-ups" where the software would stop working in the field, forcing the sales reps to restart their units while in their retail accounts. The technical issues usually resulted in orders and data being lost, which required the sales reps to rebuild their orders and re-transmit the data a second time while in the field.

The ongoing technical integration issues meant that Intermec and Entrada had to spend an inordinate amount of time trying to enable the initial users of the Virtual Cooler bundle to execute their basic order taking processes without failure. As a result, Intermec was not able to focus any resources on training their internal technical support staff on the Virtual Cooler software. Since Intermec's own technical staff never received training, there was no one



available to train their network of ISV's. Most of the onus for resolving the technical issues and getting the ISV's trained then fell back on Entrada's limited resources.

Within six months, Intermec's ISV network had concluded that the Virtual Cooler software bundle was not providing their customers with enough value to warrant its premium pricing. The ISV's were not willing to spend extra time and money to "test" the Virtual Cooler bundle, so they began replacing any Virtual Cooler bundles that they had sold to that point with the less functional, but highly reliable, keypad solution. The fact that the keypad bundle also provided the ISV's with higher profit margins than the Virtual Cooler bundle only expedited their decision to stop selling the Virtual Cooler bundle.

With their staff working long hours on resolving the technical issues, and support from their supply chain waning, Entrada was facing the prospect of going out of business practically before they had even begun. In the face of disaster, the partners regrouped to discuss their options. Mr. Kane took the lead in outlining an alternative business model for the company that required several critical changes to the original approach designed by Mr. Brown.

### **The New Business Model**

The first major change Mr. Kane suggested was a redesigned product strategy to allow Entrada to enter potential markets beyond the beer industry. The company would need to develop a full line of software products designed to meet the needs of any consumer packaged good company, from the basic end user to the most advanced. Critical to the new product strategy would be the development of a low cost, Pocket PC based order management software, designed to replace the less functional, but very expensive keypad hardware running the DOS based application. The goal was to use the Pocket PC product to build their customer base, then trade those customers up to Entrada's more functional, and more profitable, products as the customers' needs evolved. The positioning of the company's product portfolio was key, both from a functionality and a pricing perspective.

The next change Mr. Kane proposed was to eliminate the exclusive software distribution contract with Intermec, and become hardware resellers for all the major manufacturers of mobile computing hardware in the vertical market space. The goal was to focus potential customers on the range of functionality available across Entrada's software product portfolio, then present hardware options that allowed end users to choose whatever hardware they wanted.

Part of the elimination of their Intermec contract required Entrada to establish a direct relationship with a network of ISV's, many of which were existing resellers for most of the major hardware manufacturers anyway. Entrada would attempt to sign reseller contracts with the largest ISV's in the nation primarily through offering higher margins for selling the company's software. The goal was to provide an incentive to the ISV's with a 40% margin, thus enabling the ISV's to make the type of margins they had come to expect when reselling other mobile computing solutions. The final piece of the revised business model Mr. Kane developed was to raise the awareness and credibility of the company and its products through aggressive target marketing and high profile strategic alliances.

The other partners agreed to Mr. Kane's plan for the redesigned business model. The responsibility for executing the plan was Mr. Kane's, who was given the title of Chief Executive Officer to go along with his additional responsibilities. Mr. Hogle would oversee the new product development and support, which would be the critical foundation for the successful implementation of the new business model. Mr. Hogle and his development staff estimated that the new products would take approximately six months to complete. Mr. Brown agreed to continue providing the funding for the company through the existing arrangement with his beer distributorship for the new product development period.

Over the ensuing six months the company made tremendous strides toward creating a high demand for the soon to be released products. The company's targeted print campaign was raising awareness and demand in the beverage industry. Anticipation of the company's new products also provided Entrada with credibility when negotiating reseller contracts with the various Independent Software Vendors across the country. The company had even connected with software giant Microsoft, who had been looking for any vertical market opportunities to seed their rewritten Pocket PC operating system. Since Entrada's forthcoming Pocket Routebook was being designed to run on the Pocket PC platform, Microsoft signed Entrada to a Joint Developer contract to help them to expedite the development of the new software. Entrada reaped numerous benefits from the new partnership, including a case study on Microsoft's website and opportunities to present their new product suite to major consumer packaged goods companies like PepsiCo.

## **Paradise Lost**

The new business model appeared to be working with all aspects of the plan successfully implemented ahead of schedule, except for the completion of the new products. The company added six new employees to focus on expediting the development of the new software. While the additional employees relieved some of the burden on the existing development staff, the company was still having trouble meeting product delivery timelines. In spite of those issues, Entrada was able to maintain the perception in the marketplace that they were still a leading supplier of mobile computing software, primarily due to the strong relationships the company had built with their strategic partners like Microsoft.

Early test releases of the Entrada's new products proved unsuccessful in spite of the development staff working overtime for weeks on end. It was clear to Mr. Brown and Mr. Kane that the company needed additional resources and competencies to complete and deploy the new products. Mr. Brown was reluctant to continue providing funding through his beer distributorships, as he felt the additional resources would create too large of a financial drain on his personal assets. Mr. Kane and Mr. Brown agreed that the only solution was to seek outside funding for the company. Mr. Brown did agree to fund Entrada's monthly expenses out of his own personal accounts until outside investors were found.

Mr. Kane spent the next few weeks writing the business plan to present to investors. In the development of the business plan, the question of how to represent Mr. Brown's ongoing financial support to potential investors became an issue. Mr. Brown wanted to continue accounting for the cash infusions to the company as income to Entrada in return for their ongoing

technical support of his beer distributorships. Mr. Brown believed that showing his financial support as long-term debt in the financials of the business plan would make Entrada look less inviting to outside investors. However, Mr. Brown made it clear that he did want to be compensated by any outside investors for the money he had put into the company up until that point. Mr. Kane disagreed with Mr. Brown's approach because he believed it would be a confusing story to try and explain to potential investors. A compromise was reached, and it was agreed that the details of Mr. Brown's investment would be provided to each potential investor when their respective due diligence process began.

Within three months, Mr. Kane had engaged several serious investors for potential funding. The effort was timely, as Mr. Brown had grown increasingly frustrated by the financial commitment required to cover Entrada's overhead during the protracted product development cycle. However, when negotiations with the potential investors reached the point of discussing ownership shares in exchange for investment dollars, Mr. Brown felt very strongly that he should not have to give up more than 10 – 15% of the company. Unfortunately, most investors that were interested in Entrada were asking for a minimum of 25% of the company for the amount of dollars required to reach profitability. When Mr. Brown refused to compromise on the question of ownership, the search for outside investors stalled. Mr. Brown continued to cover the significant monthly expenses for the company in the hope that the new products would soon be completed and begin to provide increased revenue.

### **A Light at the End of the Tunnel**

Just when it appeared there were no further options, Entrada was invited to participate in a trade show at the national convention of the brewer for which Mr. Kane had worked for twenty years. Only five other software companies were invited to participate in the trade show. During the opening meetings of the convention, all of the brewer's seven hundred beer distributors from across the nation were assembled to hear presentations from key management. During the speeches on the first morning of the convention, the Vice President of Sales made a surprise announcement that all distributors would be required to move to "a common mobile computing software and hardware platform for all their sales reps within two years." The audience of beer distributors was surprised to see Entrada's software as the visual on the forty-foot screen behind the VP of Sales.

After the speech, the beer distributors descended upon Entrada's booth at the trade show to discuss purchasing the company's software. While Entrada was not necessarily the only software option distributors would have for their sales reps, the fact that it was shown on the screen during the speech created a huge impression on the audience. Mr. Brown seized the opportunity and began soliciting some of the other software vendors at the trade show to buy Entrada.

Within two weeks of the trade show, Mr. Brown had secured a preliminary purchase offer from a competitive software company located in Canada. The Canadian company was pursuing a "roll up" strategy in the marketplace through attempting to purchase its competitors for shares of stock in their company. Their stated goal was to acquire a large customer base from competitors, then

execute an initial public offering. Their original offer made to Mr. Brown for Entrada and all its assets was 1,000,000 shares of stock that the privately held company valued at \$2.50 per share.

Mr. Brown offered a portion of the shares of stock from the Canadian company to the other partners. Mr. Hogle went along with the sale, however, Mr. Kane had several concerns about the details of the sale. First, he had evidence that the Canadian company had engaged in questionable business practices in the past with regard to the treatment of their customers. Second, the deal did not include any assurances of future employment to Entrada's twenty employees. Finally, since the Canadian company was privately held, Mr. Kane asked to see a detailed shareholder's agreement that defined the valuation formula for their stock, the restrictions on the future sale of the stock, and other related information. No documentation was ever provided.

As a limited partner, Mr. Kane refused to agree to the sale of the company. The Canadian company's offer did include a time limit, so Mr. Brown ultimately agreed to buy Mr. Kane's share of Entrada so he could dispose of the company with no potential legal barriers.

## **EPILOGUE**

The Canadian company began their due diligence process on Entrada shortly after Mr. Brown had secured all ownership shares of Entrada. Once the process was complete, the Canadian company reduced the amount of their initial offer significantly. Mr. Brown still agreed to sell Entrada in spite of the lower offer. By June of 2004, the Canadian company had reduced the Entrada staff to three individuals and closed the company's offices in West Palm Beach. All Entrada customers were forced to sign revised annual maintenance contracts that included increased fees for customer support. In a stunning announcement, the beer company that had implied its endorsement of the Entrada software a year earlier informed all its distributors that they were going to be forced to purchase a customized mobile computing software application that the brewer itself had developed internally.

## **“SO WHAT?”**

This case study provides several practical lessons, particularly for entrepreneurs attempting to launch technology-based ventures in vertical markets. Each lesson is a validation of past learning in the field of entrepreneurial studies.

**Lesson 1:** Engaging in effective environmental assessment prior to launching a new venture is essential (Wheelen and Hunger, 2004). Conducting research and analysis of the industry in which the new enterprise will compete can clarify the competitive environment and help the entrepreneur understand the potential barriers to entry (Porter, 1985). In the case study, the protagonist, Mr. Brown had the means and opportunity to understand the potential supply chain barriers to successful launch of his software product. Instead, in an effort to move quickly, he signed an exclusive distribution contract with Intermec, the leading provider of the keypad hardware, to take his product to market.

**Lesson 2:** An objective reflection of the internal strengths and weaknesses in terms of structure, resources, culture, competencies and responsibilities will illuminate “gaps” when attempting to conduct effective scenario planning (Day and Shoemaker 2000). While the initial software product developed for internal use in Mr. Brown’s beer operation had promise, the skills required to accomplish complex data integration with disparate enterprise architectures were low. Additionally, Mr. Brown could have better understood his financial risk through effectively building scenarios that accounted for the competency gaps.

**Lesson 3:** Defining and evaluating dependencies that create uncertainty when attempting to take an idea from research and development to market is a critical planning objective for technology entrepreneurship. Selecting the optimal alliances that provide access to contingent technology and mitigate potential technology barriers can improve the chances for success (Balakrishnan and Wernerfelt, 1986). In the case study, partnering with Intermec was one alternative that proved ineffective. The redesigned business model required multiple strategic alliances in an attempt to reduce dependencies on one hardware partner and one reseller network. However, the timing was poor since the window of opportunity for funding was closing faster than the new products could be developed.

**Lesson 4:** Prior to seeking outside funding, develop realistic expectations based on objective assessment of an organization’s relative position in the market. Additionally, insure complete “transparency” when presenting the venture to potential investors (DeCeglelie, 2000). Entrada’s partners had not agreed on the specifics of an acceptable deal with potential investors, nor had they been completely honest about the financials. The end result was that Mr. Brown did not get his initial investment back, and he ended selling the entire enterprise just to get out of the business.

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## **SMALL BUSINESS DEVELOPMENT IN POLAND: A REMEDY FOR HIGH UNEMPLOYMENT**

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### **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 paper discusses small business development in Poland, one of the Central and Eastern European Countries transforming from a command economy into a market-oriented economy. The paper is primarily concerned with the key components of transition: restructuring of the ownership, changing the character of firms into private enterprises and creating a complex labor market. The paper gives an overview of how small business development generates employment in the economy and shows one of the critical problems in the transition, high unemployment rate. The study shows that small business development plays a very important role in the process of transition from command to market oriented economy in Poland. Expansion of free enterprise in Poland constitutes an important factor in economic development, stimulating output, creating employment and lowering the high level of unemployed in the Polish economy ([www.parp.gov.pl/publikacja17.php](http://www.parp.gov.pl/publikacja17.php)).

### **INTRODUCTION**

Development of the private business sector in Poland constitutes an important component of economic development and is an essential factor in decreasing the level of unemployed 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, 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.

The first section of the paper deals with the transformation from a centrally planned economy to market oriented economy and examines macroeconomic indicators with the focus on high unemployment rate. The second section compares the dynamic growth of GDP with the growing number of firms in the private sector, particularly small and medium size firms. It also shows the increasing share of the private sector in GDP. The third section examines the role of the private sector, particularly small and medium firms, in generating employment in the Polish economy. Since the private sector now constitutes the base of employment in Poland, this section examines how development of small and medium business firms can hamper the growth of unemployment in Polish economy. The final section shows the result of the globalization process and the strong involvement of small and medium firms in foreign trade.

## **TRANSFORMATION FROM A COMMAND INTO A MARKET-ORIENTED ECONOMY**

### **Assessing Transition**

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 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 to Poland's economy began in 1980 with the Solidarity movement, followed by martial law in 1981. 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. Privatization took place, as state owned firms were converted to private ownership. 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)).

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).

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 gross domestic product (GDP), unemployment, and inflation.

### **GDP per Capita and Economic Growth**

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 1) 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%.

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Figure 1 about here

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## Unemployment Rate

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 2). 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.

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Figure 2 about here

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## Inflation

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*. 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.

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Figure 3 about here

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## **Globalization of the Polish Economy; The European Union**

The centrally planned economies were isolated from the global markets and world competitive forces. Sudden transition in 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. 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. The top priorities in Polish economy are the competitiveness of exports, the problem of unemployment and budget deficits, and the development of financial markets.

## **SMALL BUSINESS DEVELOPMENT AND EMPLOYMENT CREATION**

### **Number and Size of the Small Business Firms in Poland**

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. 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 1).

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Table 1 about here  
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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. 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.

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Table 2 about here  
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## The Share of Private Sector in Gross Domestic Product

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 3). 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 share 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.

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Table 3 about here

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## 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).

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Figure 4 about here

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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 nr 4). 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.

## Share of Private Sector in Employment

**Dynamic development of the private sector in the Polish economy constitutes the most important factor generating employment in the economy and the key factor decreasing the number of unemployed. 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 labor units in 2001 was as follows: micro firms employed 14.72%, small firms 20.85% and medium firms 26.58% of the national employment.**

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Table 4 about here

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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*, 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 ([www.parp.gov.pl](http://www.parp.gov.pl)).

## SUMMARY

This paper has found that private business enterprise development plays an important role in the acceleration of economic growth and constitutes a crucial factor in building labor markets, creating employment, and lowering the number of unemployed in Polish economy. 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. 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.

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## FIGURES AND TABLES

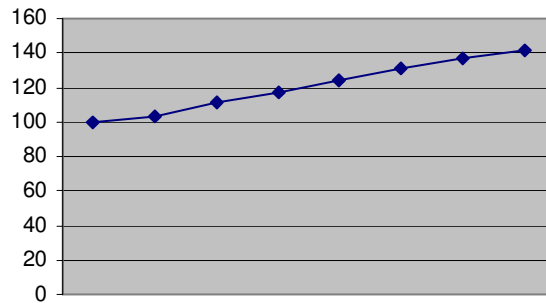


Figure 1. Gross Domestic Product per capita (1990 - 2000)

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)

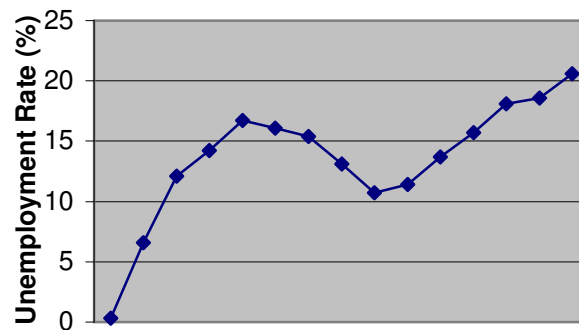


Figure 2: Unemployment Rate in Poland 1990 – 2004

Source: Polish Official Statistics [www.stat.gov.pl](http://www.stat.gov.pl)

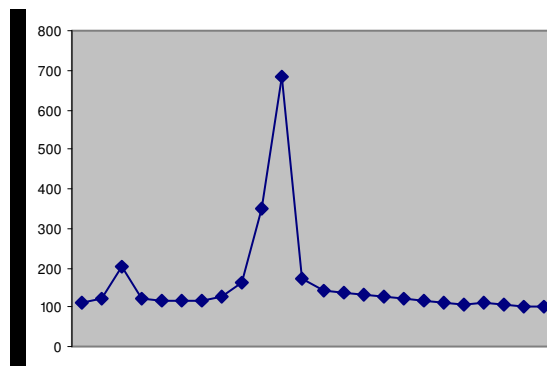


Figure 3: Consumer Price Index 1980 – 2003 (previous year = 100)

Source: Polish Official Statistics [www.stat.gov.pl](http://www.stat.gov.pl)

Table 1: 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 2. Number and Size of Firms in Private Sector in Poland in % (1999-2002)

| Private Sector |           | Firms            | Micro | small | medium |              |
|----------------|-----------|------------------|-------|-------|--------|--------------|
| year           | All firms | 1 - 249 employee | 1-9   | 10-49 | 50-249 | large (250+) |
| 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 3. Share of Private Sector in GDP in Poland (%): 1999-2002

| Private sector |           | Firms            | micro | small | medium |              |
|----------------|-----------|------------------|-------|-------|--------|--------------|
| year           | All firms | 1 – 249 employee | 1-9   | 10-49 | 50-249 | large (250+) |
| 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)

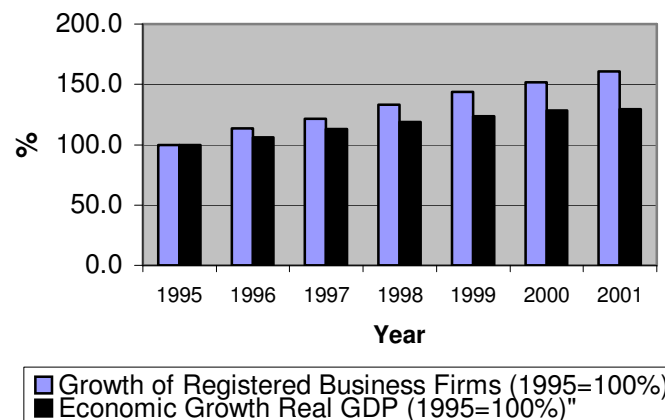


Figure 4. Economic Growth vs. Growth of Registered Business Firms

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 4. Employment in Private Sector in Poland (%)

|      | Private Sector | Firms            | micro | small | medium |              |
|------|----------------|------------------|-------|-------|--------|--------------|
| year | All firms      | 1 – 249 employee | 1-9   | 10-49 | 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)

**Sustainable Entrepreneurship:  
Broadening the Definition of ‘Opportunity’**

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**Notes:** This version draws heavily on past work by the author. Also, the author wishes to thank many who have selflessly offered advice and support, especially John Baden and Dean Shepherd for their keen insights and tireless efforts.

# **Sustainable Entrepreneurship: Broadening the Definition of ‘Opportunity’**

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## **Abstract**

The ‘New Economy’ and its offspring, the ‘New Competitive Landscape’, are oft-characterized as producing ‘new forms’ and ‘new functions’, often from ‘new voices’. This paper discusses one set of under-appreciated ‘new voices’ producing ‘new winners’ that are arising from proactively seeking opportunities that are sustainable not just on the economic dimension but also on social and environmental dimensions. Over the last several years, a working group of scholars and practitioners has focused on a broader definition of ‘opportunity’, broadening the construct of ‘opportunity’ to include social and environmental dimensions. It is a most opportune time to recognize that, for entrepreneurial managers, ‘opportunity’ is much more than economic.

## **Introduction**

Opportunity-seeking is essential for organizations to survive in the new competitive landscape. One aspect of increased competitive pressure arises from an expanded set of pressures which push the organization to ‘add value’ to their environments, especially social and environmental. However, we also observe that individuals and organizations are increasingly focused on the ‘pull’ of environmental and social opportunities (e.g., Hawken 1993; Porter & van der Linde, 1995). That is, there exist significant perceived opportunities that are both economically sustainable and environmentally beneficial.

An important question is “Why do strategic decision makers of some firms fail to see what appears objectively to be a lucrative new opportunity (from the environmental perspective of stakeholders)?” In short, how do we encourage the identification of viable, environmental opportunities? We must recognize that opportunity is in the eye of the beholder. That is, we construct or enact opportunities; we do not ‘find’ them.

Well-developed theory and robust empirical evidence demonstrates how perceptions of organization members, channeled through intentions, can inhibit - or enhance - the pursuit of new opportunities. This analysis proposes an intentions-based model of how environmental opportunities emerge and offers suggestions how to develop a cognitive infrastructure that is opportunity-friendly. *How then do we develop such ventures? Do they really exist? If so, how can we sustain the sustainability?*

## **The Nature of ‘Sustainable’ Opportunity: Theory and Evidence**

First, we must consider the nature of entrepreneurship itself. If voluntary forces such as markets are to benefit the environment or other social issues, some person must identify an opportunity sufficiently enticing to motivate action. That’s what entrepreneurs do; they are alert to opportunities, motivated to act on them, and able to mobilize resources to pursue them.

Acting on an opportunity requires that someone first see that opportunity. However, seeing opportunities can be more difficult than it seems. Entrepreneurial thinking requires a cognitive focus on seeking opportunities, while bureaucratic thinking emphasizes avoiding threats.



Fortunately, we already know the critical antecedents of entrepreneurial thinking: A potential opportunity must be perceived as both desirable and feasible. This is just as true for environmentally-friendly opportunities.

### **A COGNITION-BASED MODEL OF ENVIRONMENTAL OPPORTUNITIES**

The centrality of perceptions in opportunity identification argues for taking a cognitive approach for insights into the nature of innovative activity and how to nurture it. In particular, social psychology offers the construct of intentions as a consistently useful device to integrate past findings from a theory-driven, empirically robust vantage (Ajzen, 1987; Tubbs & Ekeberg, 1991). Intentions models prove consistently robust both in explanatory power and predictive validity. This conceptual framework thus offers a parsimonious mechanism for diagnosing barriers to the pursuit of environmental opportunities.

#### **How Are Environment-Based Opportunities Perceived?**

**First**, organizations do not see opportunities, individuals do. In Krueger and Brazeal's words, entrepreneurial potential requires potential entrepreneurs (1994). An organization with a strong orientation toward seeing opportunities must support individual organization members who have that orientation toward opportunities. **Second**, we have a natural tendency to simplify the world by categorizing situations. Here, we tend to categorize environmental issues (from a strategic perspective) into opportunities and threats in an ongoing, continuous process. We also know that perceptions of opportunity depend closely on perceptions that a situation is positive and that it is controllable (Dutton, 1993). **Third**, opportunity perceptions reflect an intentional process. In short, intentions are driven by perceptions of feasibility (e.g., controllability) and by perceptions of desirability (e.g., positiveness). Fishbein and Ajzen have developed a theoretically sound, empirically robust framework for understanding intentions that appears applicable to most planned behaviors, specific or general, proximal or distal. **Fourth**, we have some understanding of the mental models that entrepreneurs (innovators) share, the scripts and schema that differentiate entrepreneurs from non-entrepreneurs (Bird, 1988; Mitchell & Chesteen, 1996). It seems probable that we have cognitive access to both an opportunity schema and a threat schema. Which schema is activated first (or activated more strongly) depends on critical cues from the environment. **Fifth**, a review of the literatures on entrepreneurship and innovation finds strong arguments for intentionality (Bird, 1988; Katz & Gartner, 1988), existing applications of intentions models and the impact of self-efficacy (Krueger & Brazeal, 1994).

#### **Increasing An Organization's Potential for Seeking Environmental Opportunities**

What influences an organization's readiness for the change required to pursue new opportunities? What is necessary for an organization to learn how to identify new opportunities? Senge (1992) focuses on what he labels simply "mental models": Managers' and employees' internalized cognitive schemata that guide much of their daily activity. We all need multiple schemata to adapt to a changing world. In turn, this requires that we learn multiple mental models and that we learn how to learn new schemata.

Intentions are at the heart of all this. Intentionality is deeply ingrained in how we process information into action. Any planned behavior is intentional by definition, thus strategic behaviors are inherently intentional. As such, it becomes useful to understand that intentions depend on a handful of critical antecedents. Personal and situational influences affect intent only

by affecting these critical antecedents. The latest version of the intentions framework, Ajzen's 'theory of planned behavior' posits that intentions toward a given target behavior depend on certain fundamental underlying attitudes. These specific attitudes reflect decision makers' attributions about a potential course of action. Decision makers should perceive the course of action as **(a)** within their competence and control (thus feasible), as **(b)** personally desirable and **(c)** consonant with social norms. Barriers to any of the critical antecedents will represent a substantive inhibition to an organization's intent to seek and act on opportunities. If we inhibit the intent, we inhibit the action.

### **Insert Figure 1 about here**

**Critical Attitudes:** Ajzen's theory of planned behavior argues that perceptions of desirability and feasibility explain (and predict) intentions significantly. Intentions are driven by perceptions that outcomes from the behavior are personally desirable and that they are socially desirable. Figure 1 shows that intentions toward adopting an environmental opportunity are best predicted by three critical perceptions: **(a)** that the innovative activity is **(a)** perceived as personally desirable, **(b)** perceived as supported by social norms, and **(c)** perceived as feasible.

**Exogenous Factors:** How do intentions models handle other variables, those that are exogenous to the attitude-intention-behavior process? Exogenous factors such as individual differences and purely situational influences operate indirectly on intentions (and thus behavior) by changing these antecedents, not by directly affecting intentions.

**Precipitating Factors:** Research also suggests that certain exogenous variables can serve to facilitate or 'precipitate' the realization of intentions into behavior (Shapero, 1982; Krueger & Brazeal, 1994; Stopford & Baden-Fuller, 1994).

### **Demonstrated Antecedents of Intentions**

Perceived Desirability - Personal Attitude: In the Ajzen-Fishbein framework, personal attitude depends on perceptions of the consequences of outcomes from performing the target behavior: their likelihood as well as magnitude, negative consequences as well as positive, and especially intrinsic rewards as well as extrinsic (in short, an expectancy framework). However, the model also argues that these perceptions are learned.

Perceived Desirability - Social Norms: Social norms represent perhaps the most interesting component of the Ajzen-Fishbein framework. This measure is a function of perceived normative beliefs of significant others (e.g., family, friends, co-workers, etc.) weighted by the individual's motive to comply with each normative belief. Social norms often reflect the influence of organizational (or community) culture. That is, the impact of climate and culture on intent operates by its impact on perceptions of desirability (and perhaps feasibility as well). For example, work group relationships do influence individual innovation (Scott & Bruce, 1994).

Perceptions of Feasibility - Self-Efficacy: Albert Bandura and his associates have developed and elaborated a social-cognitive model of human agency (e.g., Bandura, 1986, 1995). This model argues that taking action requires consideration of not just outcome expectancies (i.e., desirability) but also perceived self-efficacy (i.e., feasibility). This becomes particularly critical with significant strategic change (e.g., a new venture into a range of environmentally friendly products). Bandura defines self-efficacy as an individual's perceived ability to execute some

target behavior. Thus, it reflects the perception of a personal capability to do a particular job or set of tasks. Measuring perceived efficacy is relatively straightforward; one can use simple self-report measures (Bandura, 1986; Eden, 1992).

Perceptions of Feasibility - Collective Efficacy: However, perceptions of personal competence need not translate into perceptions of organizational competence. If fellow organization members are needed to support an intention, perceptions of collective efficacy are likely to be important (Bandura 1986, 1995). This point is crucial: Organization members may be perfectly capable of finding and promoting new opportunities and their self-efficacy beliefs may be high. Yet, perceptions that collective efficacy is low can inhibit opportunity seeking.

Exogenous Factors: Research often examines variables other than attitudes and intentions, but intentions models posit that these exogenous variables operate indirectly on intentions (and thus behavior). As the model suggests, most exogenous factors influence intentions (and behavior) through influencing one or more critical attitudes.

Precipitating Factors: As Figure 1 suggests, exogenous factors may also influence the intention-behavior relationship by precipitating, or facilitating the realization of intentions (Shapero, 1982; Ajzen, 1987; Stopford-Fuller & Baden, 1994). One such factor may be perceptions of resource availability (Triandis, 1967) or a personal propensity to act on environmental opportunities (Shapero, 1982).

### **Building a Supportive Cognitive Infrastructure**

Shapero (1982, 1985) argues that for an organization to maintain a reasonable supply of opportunity-seeking individuals requires that organizations provide a congenial environment - from the perspective of the prospective opportunity-seekers. Opportunity-seekers may enact an organizational environment that is personally favorable, but doing so requires a learning-supportive cognitive infrastructure. How do we help organization members perceive more environmental opportunities as desirable and feasible?

Shapero proposed that communities and organizations seeking to innovate should provide what he called a 'nutrient-rich' environment for potential entrepreneurs. This 'seedbed' would provide intangible 'nutrients' such as credible information, credible role models, visible social norms, and emotional/psychological support as well as more tangible resources. McGrath (1995) points out that organizations need to support its members in learning from adversity. Organizations should provide opportunities to attempt innovative strategies at relatively low risk (i.e., trying and failing is not career-threatening).

Consider the useful metaphor of the antenna. We are much more likely to notice (and take seriously) signals from directions we are already looking. Intentions contribute to how an organization's antennae are 'tuned.' We are less likely to notice opportunities from directions that do not appear desirable and feasible. Increasing the perceived desirability and feasibility of environmental opportunities should 'tune' the antenna in that direction. As such, organization members are obviously more likely to respond to highly credible cues. Increasing the credibility of cues that encourage the pursuit of environmental opportunities may require the perception of signals from more credible sources such as top management, a visible champion, or a trusted

mentor. The cognitive infrastructure should enhance perceptions in organization members that an environmental opportunity is personally and socially desirable and that members are personally and collectively competent to pursue environmental opportunities. Such a cognitive infrastructure would provide the empowerment needed to promote more proactive seeking of environmental opportunities.

**(a) Increasing Feasibility Perceptions:** To promote feasibility perceptions about environmental opportunities, we need to increase perceptions of personal ("I can do this") and collective ("We can do this") efficacy. Perceived feasibility entails perceptions that resources are available and obstacles are surmountable (including the obstacle of having tried and failed). Fortunately, promoting perceived efficacy is relatively straightforward and reasonably well understood; we already know how to do this (Eden, 1992). Organizations and communities need to be vigilant in providing the necessary explicit cues and explicit support. As already noted, providing hands-on (and generalizable) mastery experiences that increase perceptions of personal (and collective) efficacy are invaluable.

**(b) Increasing Desirability Perceptions:** However, desirability perceptions may require more complicated interventions. Increasing perceived desirability requires that individuals perceive mostly positive outcomes for their innovative activity, including intrinsic rewards such as a supportive culture. Again, objectively supportive reward systems need not be perceived as such by the person rewarded. Supportive formal rewards can be trumped by informal punishments (Brazeal & Weaver, 1990).

## CONCLUSIONS

Understanding what inhibits entrepreneurial activity in an organization activity requires understanding how we construct intentions toward a prospective course of action. Mental models of what we intend reflect why we intend an action. Intentions-based models capture how individuals really formulate mental models. Perceptions of desirability (personal and social) and perceptions of feasibility (personal and organizational) are critical to the construction of intentions toward important behaviors. An organization's cognitive infrastructure should enhance, not impede, these critical perceptions.

The pursuit of entrepreneurial opportunities appears quite amenable to the use of such models in teaching and practice as well as research. We look forward to further testing the model.

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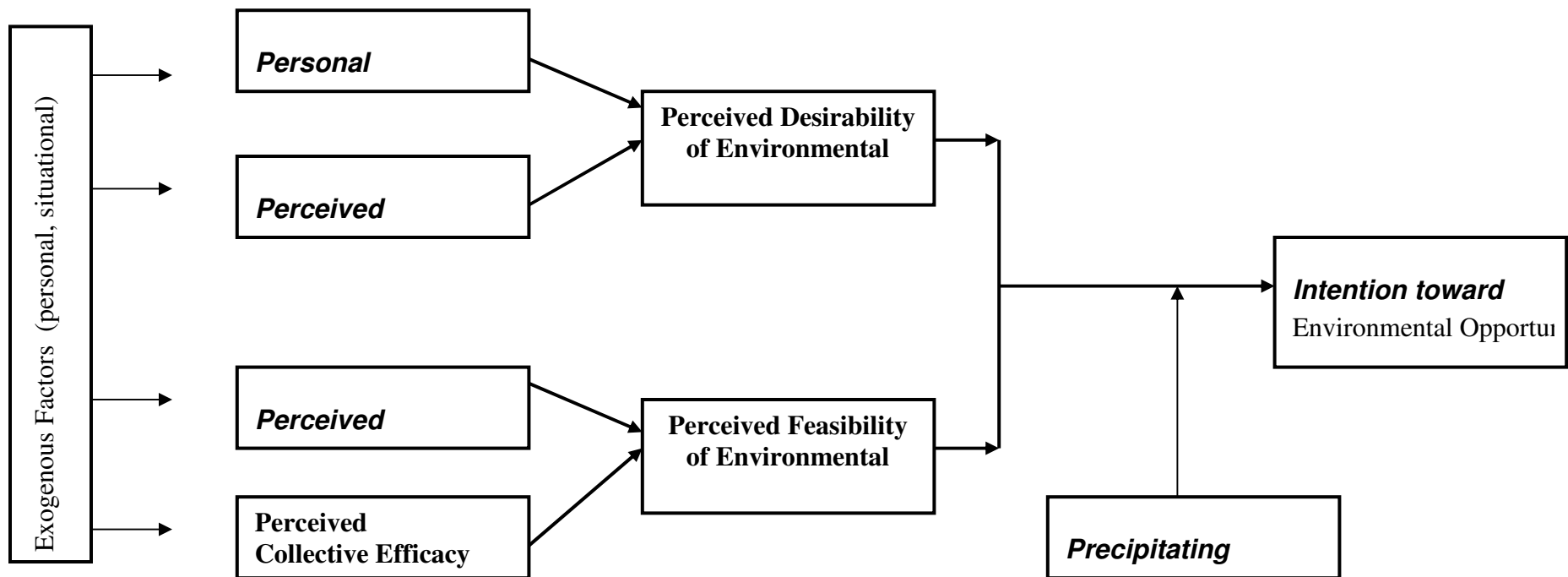
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**Figure 1. Intentions Model (Shapero, 1982; Krueger, 1993)**

**IDENTIFYING GROWTH OPPORTUNITIES:  
TESTING A PERSONAL 'ENTREPRENEURIAL ORIENTATION'**

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# **IDENTIFYING GROWTH OPPORTUNITIES: TESTING A PERSONAL 'ENTREPRENEURIAL ORIENTATION'**

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## **Abstract**

Does there exist a personal (individual-level) 'entrepreneurial orientation' analogous to Covin and Slevin's (organization-level) entrepreneurial orientation? If the entrepreneurial organization tends to reflect strong organizational biases toward being innovative, independent/autonomous, proactive, risk-accepting, and aggressively competitive, it would make sense that its managers (and perhaps employees) would share these biases. However, these biases are attitudinal and thus malleable. If we can identify components of a personal entrepreneurial orientation we should be able to influence those in desirable directions through education, training and organizational (or community) interventions. Results suggest that we can identify valid (and malleable) components of a personal entrepreneurial orientation (e.g., associated with significant opportunity-seeking behavior)

## **INTRODUCTION**

Hamel and Prahalad (1989, 1994) argue persuasively that the attitudes and actions of senior managers are absolutely vital to a firm developing and maintaining a 'strategic intent'. Managers must devote considerable attention toward continuously seeking out new opportunities, often outside the firm and usually beyond present conditions. They argue that for an organization to have a strong strategic intent, its managers must also have their own strategic intent.

Can we identify measures that capture a personal analog to each EO dimension? Using the dimensions proposed by Covin and Slevin (1991) and extended by Lumpkin and Dess (1996), we will identify appropriate measures as described below. Following past researchers, Covin and Slevin (1991) map out three dimensions: Innovativeness, Proactiveness, and Risk-Taking. Lumpkin and Dess (1996) suggest the inclusion of Competitiveness and Autonomy. Hamel's and Prahalad's 1994 arguments also suggest that an organization's strategic intent should include a strong future orientation, an equally strong orientation toward boundary-spanning with external environments, and a significant resilience to setbacks in the opportunity search process, thus we include these three dimensions as well. Finally, if we seek to identify a healthy entrepreneurial orientation, we must also look for the "dark side" (to use Kets de Vries's felicitous phrase). Is the growth entrepreneur seeking the opportunity to grow a firm or grow his reputation? However, there is a more dangerous barrier to strategic thinking: the relative absence of critical thinking. If we are at all concerned about successful (or healthy) strategic thinking, then we need to consider the "dark side" carefully.

## **STRATEGIC THINKING; ENTREPRENEURIAL THINKING**

If there is one thing that strategy scholars, consultants, entrepreneurs, and managers agree on -- it is the need for more strategic thinking. Thinking strategically appears to overlap considerably



with the notion of thinking entrepreneurially. That is, both entail a strong, committed orientation toward seeking opportunities. Thinking strategically (i.e., entrepreneurially) seems absolutely central for organizations (and individuals) whether for survival or growth in these times of rapid and accelerating change. Most of us certainly need to enhance our abilities to identify opportunities that we can act upon. While this growing focus on strategic thinking seems most timely and needed, we still need to understand this concept both in terms of more intellectual rigor and in terms of practical utility.

### **What Is 'Strategic Vision' Anyway?**

'Strategic Vision' reflects the result of strategic thinking processes. Thus, let us consider strategic thinking. A review of both practitioner and scholarly publications finds that 'strategic thinking' as a term is growing rapidly in prominence. However, it is striking that there is little or no consensus on a definition, beyond the ability and willingness to identify new opportunities (often opportunities for growth). As such, it has much in common with Hamel and Prahalad's notion of 'strategic intent' (1989). If this isn't to be just the "Buzzphrase of the Day", we need a more rigorous look, especially about how to define it and how to nurture it! The practitioner and scholarly literatures do seem to converge on four key things.

First and most important, like strategic thinking, strategic vision is an outcome. It does not exist in a vacuum; it is an emergent phenomenon. However, there is a growing consensus of what strategic vision "looks like" - or should (e.g., Baum, 1995). The 'heart' of strategic thinking ultimately remains: The ability and willingness to identify, analyze, and pursue new opportunities; the 'heart' of strategic vision emerges from the opportunities identified.

Still, the crucial question remains: How does strategic vision emerge?

Second, this outcome is multi-faceted. That is, there are multiple dimensions that drive the emergence of strategic thinking and thus strategic vision. The practitioner and scholarly literatures offer three useful dimensions, each of which can be measured rigorously and each of which can be used readily by managers and consultants. These include:

*Entrepreneurial orientation:* This orientation toward opportunities obviously suggests parallels with entrepreneurship research on how organizations seek opportunities, especially the notion of a firm's "entrepreneurial orientation" toward identifying opportunities for growth. EO was first suggested by Covin and Slevin (1991) and extended by Lumpkin and Dess (1994) and has been empirically validated at the firm-level. The dimensions of EO include: Innovativeness, Competitiveness, Risk-Accepting, Autonomy, and Proactiveness. We will propose below how this framework can be readily adapted to individuals.

*Future orientation:* Hamel and Prahalad (1994) more recently show the power of simply asking managers how much time they spend looking at future possibilities. Moreover, the needed ability for managers to think more than one move ahead

*External orientation:* Similarly, Hamel and Prahalad ask how much time is spent looking outside the organization, as does Peter Drucker (e.g., 1985).

*The 'Dark Side'*: Kets de Vries (1989) points out that entrepreneurs who seek opportunity can easily cross the line into a more dysfunctional opportunism. In fact, many business leaders' opportunity-seeking reflects certain pathologies (e.g., narcissism). Similarly, Winslow and Solomon (1989) note that many entrepreneurs might be easily classified as "mildly sociopathic." In short, opportunity-seeking can be for the wrong reasons. As such, it might make sense to explore narcissism and other characteristics.

Third, it is not just a trait or set of traits. Nor is it just a skill or set of skills. It does reflect certain trait-level phenomena (such as a tolerance for uncertainty) and certain necessary skills (such as critical thinking). However, situational phenomena are vital too: The organizational context should actively support strategic thinking (e.g., Senge, 1992). Strategic thinking is unlikely to surface in organizations where it is unrewarded.

However, the cognitive processes of senior management has long been seen as a significant influence on strategy in general and on identifying opportunities in specific. While personality and demographic data – even attitude data – have rarely predicted entrepreneurial behavior, such data can predict what types of opportunity are perceived.

In particular, Sexton and Upton (e.g., 1991) have shown that growth-oriented entrepreneurs do share certain characteristics. Covin and Slevin (1991), followed by Lumpkin and Dess (1996), show that growth-seeking firms also share certain characteristics.

Thus, to nurture strategic thinking requires consideration of both personal and situational factors:

- \* Some set of individual attitudes toward thinking strategically (relatively stable, yet malleable, person-based measures)
- \* Some set of learnable attitudes (e.g., critical thinking and creativity)
- \* A supportive cognitive infrastructure: An organizational context that rewards strategic thinking and supports the acquisition of requisite skills and attitudes (Krueger, 1999). McCall (1992) argues for providing specific developmental experiences that provide specific 'lessons' for strategic managers. Why not 'lessons' re strategic thinking?

In this research we examine the first component. If we select appropriately, we should be able to identify attitude-type measures that predict opportunity-seeking. Having done that, we can then use that knowledge to help nurture those attitudes. To do this requires selection based on both sound theory and sound psychometric properties.

## RESEARCH QUESTIONS

- (1) Can we identify measures analogous to EO at the individual level of analysis?
- (2) Are such measures associated with opportunity-seeking?
- (3) Can these findings be translated into a valid, reliable instrument?

## RESEARCH DESIGN

*Design:* We collected data on opportunity-seeking from multiple sources, then analyzed each proposed measure separately and collectively with respect to the PEO measures. We tested subjects by comparing subject scores on PEO measures to their scores on opportunity identification. A pilot study and univariate analysis suggested that correlation analysis was appropriate and adequate. Note that we collected multiple measures for each construct.

*Dispositional Measures:* The measures we propose for such a study need to be relatively proven. That is, they have already demonstrated exceptional validity, stability, and reliability in samples of managers and entrepreneurs and in other achievement-related circumstances. However, additional pretesting on a comparable sample is desirable. Measures should also be plausibly analogous to the EO and related dimensions noted above. In particular, each scale has seen prior usage in entrepreneurial or managerial settings. Table 1 offers an overview of the measures employed. The author re-validated each scale employed on a separate sample, finding excellent stability and reliability for each.

*Dependent Measures:* Global opportunity perceptions (3) distinct measures, collected separately.

Level of Opportunity: Ss were given multiple scenarios and asked to rate the level of opportunity in terms of the perceived probability that a “good” (significant and personally-viable) opportunity exists. This offers a measure of willingness to seek opportunities.

Opportunity-Identification (2): Ss were given additional scenarios where they were asked to identify as many “good” opportunities as they could think of in 5 minutes. These were rated both on (a) quantity and on (b) quality of opportunities identified. This offers a measure of skill at identifying opportunities.

*Sample:* 103 Ss (46 entrepreneurs; 57 non-entrepreneurs), diverse across age, gender, education, ethnicity, and SES, drawn from a population of self-reported intending entrepreneurs seeking training.

(insert Table 1 about here)

## RESULTS AND DISCUSSION

As Table 2 suggests, these measures do appear to be significantly associated with the composite measure of opportunity-seeking, although not completely. Note that the time allocation measures as proposed by Hamel and Prahalad for both external orientation and future orientation was not significant. This may reflect a weak measure or may simply have no association with opportunity-seeking. More interesting perhaps is the significant positive correlation between narcissism scores and opportunity-seeking. (This was confirmed *post hoc* by examining the subscales of the Narcissistic Personality Inventory.) Does being mildly narcissistic aid one in being more opportunity-seeking? Similarly, we notice a significant negative correlation with the

measure of competition versus cooperation. This suggests that a bias toward cooperative approaches to achievement is beneficial for opportunity-seeking. While this might appear to contradict the premise that EO is enhanced by competitiveness, it might also mean that opportunity-seeking is enhanced by cooperation. Thus, opportunity-seeking may benefit from being both competitive and cooperative. Still, the overall picture appears both significant and useful to scholars (and trainers) of entrepreneurship.

## IMPLICATIONS

For practice and teaching, we see evidence that opportunity-seeking is associated significantly with measures that correspond to the dimensions of strategic thinking, especially key dimensions of entrepreneurial orientation. This suggests that we can enhance opportunity-seeking by influencing key components of strategic thinking, as we have chosen attitude measures that are potentially malleable –that is, teachable/learnable. For researchers, the lack of correlation between these measures and a measure of past self-employment suggests that these measures do not predict or explain entrepreneurial behavior per se, rather they are specific to the domain of seeking growth opportunities.

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## *Dimensions of Entrepreneurial Orientation*

| <u>Organizational-Level</u> | <u>Personal-Level Measures</u>                            |
|-----------------------------|---|
| Innovativeness              | Adaptive-Innovativeness (Kirton); Creativity (ACL)        |
| Proactive                   | Action Orientation (Kuhl); Hope (Snyder, et al.)          |
| Risk-taking                 | Venturesomeness (Eysenck)                                 |
| Competitiveness             | Competitiveness-Cooperation , Machiavellianism            |
| Autonomy                    | Desire for Control (Burger); Ambiguity Tolerance (Lorsch) |
| Future Orientation          | 3 measures (Lorsch & Morse; Hamel & Prahalad; Gjesme)     |
| External Orientation        | Items adapted from Hamel and Prahalad;                    |
| Network Orientation         |   |
| Resilience                  | Learned optimism (adapted from Seligman)                  |
| 'Dark Side'                 | Narcissism (Hogan); Constructive Thinking (Epstein)       |

*Table 1.* Basic Variables and Measures

|                               |                      |
|-------------------------------|----------------------|
| <b><i>Innovativeness</i></b>  |                      |
| Innovativeness                | <b>.322</b> (p<.002) |
| Creativity                    | <b>.214</b> (p<.05)  |
| <b><i>Proactiveness</i></b>   |                      |
| Action Orientation            | <b>.310</b> (p<.003) |
| Hope                          | <b>.298</b> (p<.005) |
| <b><i>Risk-Accepting</i></b>  |                      |
| Venturesomeness               | <b>.286</b> (p<.005) |
| Risk-seeking                  | <b>n.s.</b>          |
| <b><i>Competitiveness</i></b> |                      |
| Competitiveness-Cooperation   | <b>-.182</b> (p<.09) |
| Machiavellianism              | <b>.190</b> (p<.09)  |

|                                    |                      |
|------------------------------------|----------------------|
| <b><i>Autonomy</i></b>             |                      |
| Ambiguity Tolerance                | <b>.251</b> (p<.02)  |
| Desire for Control                 | <b>.332</b> (p<.002) |
| <b><i>Future Orientation</i></b>   |                      |
| Time Horizon                       | <b>n.s.</b>          |
| Attitudes toward the Future        | <b>.177</b> (p<.09)  |
| Time Allocation                    | <b>n.s.</b>          |
| <b><i>External Orientation</i></b> |                      |
| Time Allocation                    | <b>n.s.</b>          |
| Network Orientation                | <b>.190</b> (p<.09)  |
| <b><i>Resilience</i></b>           |                      |
| Learned Optimism                   | <b>.366</b> (p<.001) |
| <b><i>Dark Side</i></b>            |                      |
| Narcissism                         | <b>.181</b> (p<.08)  |
| Constructive Thinking              | <b>.241</b> (p<.03)  |

*EO Constructs*  
PEO Measures

Pearson Correlations with  
Composite Measure of  
Opportunity-Seeking (p-value)

*Table 2.* Correlations between PEO Measures and Opportunity-Seeking

# **Entrepreneurship Learning Across the Curriculum**

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## **ABSTRACT**

Four faculty members, an artist, a business person, a nurse practitioner, and engineer and a specialist in multicultural affairs, provide ideas on improving learning in Entrepreneurship. This paper offers three examples of things that can be borrowed from other disciplines to use in Entrepreneurial Courses. The Professional Presentation Board, which incorporates visual learning styles; the Source Book which incorporates hands on, visual, and analytical learning styles; and the exciting Reality Opportunity Identification exercise in aging. Here are three tools that can enliven the entrepreneurship learning environment and help it to be more inclusive of people from multiple learning styles and disciplines of study.

## **INTRODUCTION**

Entrepreneurship is an inclusive field of study. This is what makes it so rich as a learning tool for interdisciplinary and multicultural work. In the process of preparing two entrepreneurship courses to be taught to non-engineering and non business students, many new concepts were learned from other disciplines. These concepts were reworked

into tools and techniques to teach the entrepreneurial process. This paper describes three specific concepts and how the concepts are applied to the teaching of entrepreneurship.

The university is committed to offering an Entrepreneurship program to students from any discipline. This commitment arises from the results of a student survey. (1) The results showed that students outside of business and engineering were more likely to have entrepreneurial ideas and ambitions than business and engineering students. In response the survey an entrepreneurship minor was created and marketed to students outside of business and engineering. This paper describes teaching methods that appear in the first two courses in the minor. In the first course entitled “The Entrepreneurial Quest,” students explore the entrepreneurial journey beginning with the myths and realities of entrepreneurs, student self-analysis, creativity and idea generation through to the recognition of a business opportunity as indicated by a customer feedback and the introduction of the concept of a business plan. The second course entitled “New Venture Feasibility”, focuses on the design and development of a product and a preliminary assessment of market entry feasibility. Two of the authors’ team taught the initial offering of these courses and create reusable teaching modules to aid in scaling up the entrepreneurship program. Unfortunately the professors’ backgrounds in business and engineering are not sufficient to develop an effective interdisciplinary course in entrepreneurship. You may ask why?

At 2003 the national conferences of the United States Association for Small Business and Entrepreneurship (USASBE) and the National Collegiate Inventors and Innovators Alliance (NCIIA) the authors learned two important lessons about teaching entrepreneurship. First leading schools in this area draw upon the expertise of many different disciplines to teach the knowledge and skills required to be a successful entrepreneur. Not only did these educators believe that this strategy was successful, they also believed that the approach showed students the value of disciplines other than their own. Second the authors learned that entrepreneurship education could be used to motivate at risk or marginalized students to stay in school by addressing multiple learning styles and tapping into students’ passion for their own ideas.

## **Background**

The lead two authors received a grant which enabled the authors to work with faculty from eight different disciplines outside their own professional areas. Creating a series of week long modules for the entrepreneurship class was the goal of this collaborative effort. The lead two authors spent at least two days with each outside faculty consultant to develop each module. The modules have been documented so that the authors and other faculty who will teach the courses in the future can deliver the modules effectively. During the development of the modules faculty from different fields shared their teaching philosophies, strategies and tactics. This exchange of ideas will not only benefit students in the Entrepreneurship program but also benefit students in other classes taught by participating faculty.

The objective of this grant was to develop eight interdisciplinary learning modules to teach the students how to take an idea from conception to market.



Each learning module consists of the following:

1. Pre-class meeting reading assignment.
2. Blackboard class preparedness assessment.
3. Class presentation material.
4. In class active learning exercise.
5. Out of class assignment.
6. Grading criteria for the out of class assignment.
7. Sample test questions.

Two days of face to face meetings were allotted for the development of each module

### **THREE BORROWED IDEAS**

In the course of this work many things were learned. For the purpose of this paper three borrowed ideas from three disciplines will be shared. Many papers would be required to describe all of the ideas generated with the faculty consultants. The project presentation board, the source book and the exercise in opportunity identification are presented in this paper. The idea of the project presentation board was embraced and modified by the faculty consultant from the office Multi Cultural Affairs. The source book technique was presented by the faculty consultant from the art department and the exercise on opportunity identification was developed with the faculty consultant from the College of Nursing.

#### **Project Presentation Board**

The faculty consultant from the office of Multi Cultural Affairs insisted that the courses address multiple learning styles. This was reinforced by the presentations at the 2004 USASBE meeting and some luncheon table conversations where two of the authors were challenged to think about how to help African American students learn about entrepreneurship. As a direct result the lead authors had developed a visual tool for tracking project progress on a Display Board. The foam core Board has areas devoted to each section of the course and is referred to as a project presentation board (PPD). The PPD contains a sketch of the product, a written description of the product, a description of potential customers, results efforts to gather customer feedback and a place for the student's vision, and mission statements. The PPD board is shown in Exhibit 1. The PPD allows students and faculty to quickly determine the status of a project and what needs to be done next.

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Figure 1 about here

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The staff of the university Multicultural Office enthusiastically embraced the idea of the project presentation board. They believed that the PPB could be a valuable teaching tool but they had two caveats. First the board would have to be reviewed multiple times during the semester to help the students perceive the value of the tool. Second the faculty would have to be willing to let students improve any part of the board each time it was reviewed. Both suggestions have been incorporated into the syllabus for the class.

The PPB has become one of the structural supports for the entire first course and the link to the second course. The second course in the program entitled “New Product Feasibility” and is built around determining what potential customers think about the entrepreneurial idea and whether the product can be made for a price the customers are willing to pay. Here the board continues to fill critical need. It serves as a visual tie throughout both semesters, growing changing, being refined but always reflecting the status of the project. If you track the development of a representation of the product through the semesters, it may start as a rough pencil sketch, or a collage of design pieces. It may progress to a more refined sketch, or a sketch produced on a computer. Then the representation may be further refined to a picture of a foam model or a solid model produced with Computer Aided Design (CAD) software.

Visual learning and other types of learning styles have been integrated into the courses. While those who will guide the entrepreneurship courses are not experts in learning styles, assistance was received from many faculty members who have experience in his area. The growth of the board concept has helped build visual learning as an integral learning style into the new program.

### **Source Book**

The source book idea combines hands-on and visual learning style. The concept was borrowed from field of art. The creative processes and techniques used by artists can be harnessed to generate and improve entrepreneurial ideas. The professor of art who specializes in jewelry design introduced the concept of a source book. Some creative people record ideas related to their project in a source book. These related but different ideas are used to stimulate and refine new ideas. This simple concept grew and grew until it became the creative backbone for the courses in Entrepreneurship.

The idea behind the source book is to use a sketch book (blank pages) to collect anything that might be related to the design of your product, store, website, logo and so forth. It might be as simple as a color. It might be as complex as a technology. It could be a swatch of material, it could be an advertisement from a magazine, or it could be a photograph that you have taken in your travels. It could be something off a competitive website, it could be sketch or tracing, in fact the source book entries are only limited by your imagination. This is a valuable tool for the hands on learner as well as the visual learners. The hands-on learner can get involved in the touch and feel of materials, even physical shapes can be translated by photography, or sketch into the source book.

The power in the source book is that students are constantly thinking about the new product they are trying to develop. At first they are collecting anything they like. After the first review of the source book, the faculty led a discussion about how to synthesize and combine ideas from different sources. While any idea is welcome in the source book as the students move through the entrepreneurial process, they see the benefit of reviewing the source book and begin to focus on their final choices. This review of the source book provides an opportunity to learn its real power. It is far easier to work from a sketchbook full of ideas then to stare a blank paper when thinking about a new idea.

Frequently in the process of developing products, services, or revitalizing organizations customers are consulted. The lucky entrepreneur will find immediate total customer acceptance. Most however will be forced to go through and iterative process. In these cases the source book can be a tremendous asset. When the customer has made it clear they do not like an idea or design, a sourcebook can be consulted to generate new ideas to overcome customer's resistance.

### **Opportunity Identification**

One of the most difficult areas of entrepreneurship to teach is opportunity identification. It became more puzzling when thinking about Entrepreneurship class where the students were supposed to enroll with a product idea. Experience has taught faculty that student's ideas have a marginal success rate. Some excited and passionate students knock you down to get help in going to the next step. Other students have ideas that are clearly not feasible. The problem faced is how to get students to think beyond their product or reevaluate their idea. How can students learn to question their product on their own? How can this be taught without forcing students to move away from their idea?

The answer that has been developed requires students to learn about opportunity identification by thinking about products the baby boom generation may need. There are 77 million people in this category and they are quickly approaching their sixties. What will they need in the way of products? The baby boomers have changed almost everything else how will they change aging? How will they change products? What are their unmet needs? Almost all products can be redesigned to better serve the needs of the aging population. When students think about this scenario, one of three things might happen:

1. Students might see even more benefits of their own product.
2. Students might have an entirely new product idea.
3. Students might learn how to go about thinking about the opportunities for products provided by a macro event.

How can 18-22 year old students learn about developing products design for older people? The nursing professor who was a faculty consultant suggested an in-class aging exercise that would allow students to experience the effects of aging. This hopefully will lead students to think about new products, product modifications, and the ramifications to their own products.

### **Aging in Class – a Reality Exercise**

The exercise simulates the effects of aging and then the students try to perform everyday tasks with familiar tools. This exercise is derived from exercises commonly used in nursing and the health professions to develop a student's empathy toward older patients. Upon entering the class students are asked to take a pair of heavy gloves and keep them on all the time for the class period.

While class is starting a bowl of candies is passed around the room. Unwrapping the candy requires fine motor skills which many older people have lost or are losing. After some more discussion about the difficulty encountered, students are equipped with industrial safety glasses previously sprayed with soap and sawdust. The glasses simulate

impaired vision experienced by older people. Then students are asked to use computers located in the classroom to find and record information from the internet. After the exercise a discussion of the difficulties is lead by the faculty. Students are asked to think about what could be done to make the task easier. Students may learn why older people do not like small gadgets and find surfing the internet frustrating not fun. Next students are provided with industrial ear protection. The students are asked to complete a task requiring communication and cooperation. The one that worked well for students was having them use their cell phone and attempt to email their faculty members.

On the second day of class the students are fitted with the equipment listed above and given several in class projects to complete. The one that seemed to be the most eye opening was sending them across the campus in pairs with walkers, wheel chairs, crutches and other mobility aids to get a cup a drink at the café. It is important to point out that participation in all activities is voluntary. The goal is to allow students to experience what aging might be like.

Students were encouraged to take their own gloves, glasses, and ear plugs, home so that they can experiment safely trying all kinds of things.

Some of the things that students are encouraged to try at home are:

- Buttoning Buttons
- Flossing your teeth (heart health)
- Putting pills in boxes
- Fastening and unfastening jewelry clasp
- Lacing shoes
- Zippping garments
- Eating a meal with family (safety)

In class students will try and develop a longer list. This is added to by conversations with older family members. In fact, students are invited to bring people of their grand parent's generation. These activities are fun and intended to open students' minds to the many unmet needs of a large population. In the next class students brainstorm product ideas to meet the unmet needs identified.

### **Opening the Opportunity Box**

The fun begins when class resumes and the students begin an ideation process to develop product ideas. Students are encouraged to bring friends and family to the ideation session. The authors have found in other classes that diverse participants improve the number, quality and diversity of the ideas generated. What would it be like to have some grandparents or great grandparents join in the educational process? How many ideas would they help generate? What would the internal reward be to the student who would bring a grand parent?

In the ideation session students will be encouraged to freely think up ideas no matter how simple, how seemingly ridiculous. It does not matter. The class starts the process with some of the things learned directly from the aging experience. Then it will progress into ideas for product modifications focusing on some products, for example, cell phones, stoves, automobile sound systems, and so forth.

After the ideation is well underway and many opportunities have been considered then the faculty leader will take volunteers from the class to expose their product idea to the active minds and see what happens.

### **SO WHAT DOES ALL THIS MEAN?**

These three ideas are small set of many that the authors developed working across the disciplines in entrepreneurship. There must be many more ideas to be borrowed and shared at every school. Are you ready to let entrepreneurship be the catalyst?

The Product Presentation Board is a class tool that can bring to life the product or the project. Power points are nice and living without today's amazing technologies would be difficult. These classes reside basically on the web. However, are multicultural consultants and our colleagues with expertise in learning styles have persuasive arguments that the visual learner needs a tool where they can see and grasp the whole product. The Product Presentation Board is an attempt to fill that need. Do you have students who could learn more if they were provided such a visual aid? Do you have employees who would understand more or make better presentations if they had a visual tool like the Product Presentation Board?

The Source Book is a creative tool for everyone. It is of particular help to the hands-on and the visual learners but it is good for everyone to use for collecting ideas. Could you use a shot in the arm in the creativity department? Could your students use a way of collecting all their ideas so they could later go back and sort through them? Would you like to increase the creative productivity of your staff, or of your product design group? The art professor was extremely innovative and full of thought when she handed the faculty team sketch books, and showed them how to go forth and collect ideas. She recognized a way to give us results. Would the source book give your students or workers better results? Would it help you? When a student is stuck paging through the source book can help faculty ignite the fire again.

Opportunity Identification is such an important area. The faculty was stumped as to how to gently work with students and their ideas. How do you encourage them to evaluate their opportunity with their product by comparing to some other ideas? How do you gracefully allow them to change without negative connotation? How do you keep the passion for the new product process and entrepreneurship while changing the product? The answer of all places was in the College of Nursing. The exercises developed allow for a wide range of products, product modifications and evaluations. Could this contextual experience help your students develop better products? Could your work force develop products to meet the needs faster and better with contextualized situations like this?

**Entrepreneurship does span the curriculum and there is synergy to be had.**

Thank you USASBE and other organizations that pull people together who are pioneers in looking beyond their disciplines. Thank you to nameless meal companions at USASBE 2004 who challenged us to look at our colleagues in Nursing, Art, Multi

Cultural Affairs, Writing, Psychology, Communications, Law, and so many more areas. You set us out on a course that has taken on its own life.

Entrepreneurship does have the ability to span the curriculums of many areas. There is much to be learned in an entrepreneurial spirit by consulting those in other disciplines. There is much that can help to guide the wonderful excitement and passion of young entrepreneurs to be found outside the business and engineering schools. Some of this can be imported back for regular use in other courses. With one small grant and sixteen days with colleagues the authors are overwhelmed with ideas and materials. What would happen if this was repeated with more disciplines at more schools? Imagine the inclusiveness that could be Entrepreneurship.

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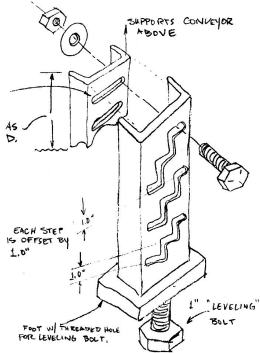
|  |  |  |
|--|--|--|
| <p><b>What is the product?</b></p> <p>Product Description:</p>                                       | <p><b>What does it look like?</b></p>  | <p><b>How is it made?</b></p> <p>Materials:</p> <p>Processes:</p>                                  |
| <p><b>Who will buy it?</b></p> <p>Groups:</p> <p>Attributes of members:</p>                          | <p><b>Mission &amp; Vision</b></p> <p>Mission:</p> <p>Vision:</p>  | <p><b>What do others think?</b></p> <p>Key Questions:</p> <p>Statistics:</p>                       |
| <p><b>Who is the competition?</b></p> <p>Competitor 1:</p> <p>Competitor 2:</p> <p>Competitor 3:</p> | <p><b>What is the need?</b></p> <p>Benefit 1:</p> <p>Benefit 2:</p> <p>Benefit 3:</p>                                    | <p><b>How will it get to the customer?</b></p> <p>Method 1:</p> <p>Method 2:</p>                   |
| <p><b>What makes my product different?</b></p> <p>Groups:</p> <p>Attributes of members:</p>          |  | <p><b>What are the next steps?</b></p> <p>Objective 1:</p> <p>Objective 2:</p> <p>Objective 3:</p> |

Exhibit 1. The Project Presentation Board

# **DOWNSIZING, MIDDLE MANAGERS AND THEIR DESIRES TO START ENTREPRENEURIAL BUSINESSES**

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## **ABSTRACT**

The effect of downsizing on middle managers was studied, with the purpose of measuring the desire of middle managers to start entrepreneurial businesses, and to determine whether desire was influenced by the phenomenon of downsizing.

Research considered the effects by examining attitudes of middle managers in companies that have been and have not been downsized. The findings suggest that downsizing is related to other factors, specifically morale and desires to start entrepreneurial ventures.

The study examined 129 middle managers, and separated the findings between those who have and who have not experienced downsizing. Results suggest that entrepreneurial desire increases with age, especially for those over 50 who have experienced downsizing.

## **INTRODUCTION**

An increasing trend in American and European corporations is the phenomenon of downsizing (sometimes related to terms such as cost cutting and mergers) to remain competitive and responsive to industry trends. McKinley and Mone (McKinley, W. & Mone, M. A., 1998) noted that organizations have implemented downsizing as a means of cost containment, especially when faced with financial crises. Indications are that downsizing is now perceived as a way for healthy organizations to become more productive and efficient. These environments require significantly greater corporate speed and efficiency (D'Aveni, R. A., 1994). Downsizing is recommended as a way to create organizations that are more productive and flexible (Hammer, M. & Champy, J., 1993). Some of these studies suggest that there is an increase in the number of middle managers leaving their positions to start entrepreneurial businesses. It appears that downsizing might have some direct impact on the desire of people to start their own businesses.

Remaining employees must develop flexibility and adaptability to survive (Dunford, R., Bramble, T., & Littler, C. R., 1998).

According to Kozlowski, Chao, Smith, and Hedlund (1993), downsizing is a "deliberate organizational decision to reduce the workforce that is intended to improve organizational performance" (p. 267). Research suggests that the benefits include improvements in quality, and increased efficiency and productivity (Freeman & Cameron, 1993; Tomasko, 1990). But, there is

considerable evidence that downsizing does not reduce expenses as much as desired, and that expenses may actually increase. A survey by Slocum et al. indicated that companies using restructuring as a method of achieving superior financial performance did not outperform companies in their industries (Slocum, Morris, Cascio, & Young, 1999).

Tomasko (1992) noted that only one-fourth of the firms that downsized achieved these benefits. Downsizing is now viewed as having unintended negative consequences for staff personnel, managers, and the organization as a whole (Cameron, 1994; Cascio, 1993; Kozlowski et al., 1993).

## **PROBLEM BACKGROUND AND PURPOSE OF THE STUDY**

Little research was found that specifically examined employee attitude towards outcomes of downsizing such as future employment within the company, with another company, or in starting entrepreneurial ventures. Even less was found that specifically focused on middle managers. Specifically, the purpose of the study was to explore how middle managers are affected by such efforts, and the associated stress and morale problems that may occur. The purpose of the study examined possible and potential reasons why middle managers are leaving their current positions, and how those reasons may be related to their desire to start entrepreneurial businesses. This study further examined the desire of middle managers to leave and start their own businesses, and how that desire might be affected by morale, stress, and other related demographic variables.

## **RESEARCH QUESTIONS**

In light of the purpose of the study and the statement of the problem, a number of research questions were posed by the present study. These are stated as follows:

1. For middle managers, is the desire to start an entrepreneurial business influenced by the phenomenon of downsizing, while controlling for morale, stress, and related demographic variables (age, gender, marital status, and race?)
2. For middle managers, is the desire to start an entrepreneurial business influenced by morale?
3. For middle managers, is the desire to start an entrepreneurial business influenced by stress?
4. For middle managers, is the desire to start an entrepreneurial business influenced by related demographic variables (age, gender, and marital status?)

## **LIMITATIONS AND ASSUMPTIONS**

Note should be made of several limitations within the present study. First, the sample of the study was limited to only middle management employees. The adult student population of a major university provided the subject sample and is comprised of adults who are returning to college during mid-life to work towards higher-level positions requiring further education. University records indicated that the majority of these students were employed in middle management positions, most similar in size. The questionnaire was also administered to a group of middle managers who were not attending college classes, but who were on the campus for a



corporate-sponsored sales and management training seminar during the Summer. There were two major companies participating in this study, in addition to the adult students on campus attending regular classes. All of the participants in the present study were middle managers.

## **RESEARCH APPROACH**

The research was accomplished through dissemination of a survey questionnaire instrument to a sample. Quantitative research data was collected, employing a survey, regarding the perceptions of middle managers' levels of morale, job-related stress, and desire (or motivation) to leave the corporate environment to start an entrepreneurial business, under downsizing, or about to be downsized, conditions.

Comparisons were made between middle manager respondents who have and have not been employed in organizations that have downsized or are about to downsize.

## **RESEARCH STEPS**

The research used a cross-sectional analysis design. Six steps comprised the method of the study, which will be discussed in greater detail in following sections:

1. The sample is defined.
2. The procedure for collecting data from two research groups (middle managers with experience of downsizing and middle managers without experience of downsizing) is discussed.
3. The survey instrument (MAQ) is described, and reliability and validity testing are discussed.
4. Hypotheses are proposed.
5. Statistical analyses are discussed.

## **DESCRIPTION OF THE SAMPLE**

The targeted sample of the study consisted of 200-300 middle management personnel drawn from an adult university population. The actual sample size used was 129. The survey instrument was administered to another sample of middle managers who were on the same campus, but were not college students, and they fit the profile of middle managers needed for this study.

## **THE RESEARCH INSTRUMENT**

A survey questionnaire, the *Managerial Attitudes Questionnaire*, (MAQ), was specifically designed by this researcher to collect data pertinent to the attitudes of middle managers concerning such issues as downsizing, the desire to start an entrepreneurial venture, morale, stress, and related demographic variables. The instrument was tested for reliability and validity.

Reliability was established using coefficient Alpha as a measure of internal consistency of the instrument, after the data were collected.

## **HYPOTHESES**

For the purposes of statistical analysis, the research questions, were combined, translated into hypotheses, and presented in the null form.

Null Hypothesis 1: For middle managers, the desire to start an entrepreneurial business is not related to downsizing when controlling for morale, stress, and demographic variables (sex, age, marital status, and race).

Null Hypothesis 2: For middle managers, the desire to start an entrepreneurial business is not related to morale.

Null Hypothesis 3: For middle managers, the desire to start an entrepreneurial business is not related to stress.

Null Hypothesis 4: For middle managers, the desire to start an entrepreneurial business is not related to demographic variables (sex, age, marital status, and race.)

## **DATA ANALYSIS**

The statistical tool chosen for analyzing Hypothesis One was ANCOVA (Analysis of Covariance). This procedure tested for differences in the means between the two groups examined. The analysis examined the differences in the desire to start an entrepreneurial business. In addition, it tested for the differences after the means have been adjusted for any difference in stress, morale, and the related demographic variables.

The study adjusted the mean desire for the group who has experienced downsizing versus the group who has not experienced downsizing, as if they had the same morale, same stress, and same demographics.

The statistical test for Hypotheses Two and Three utilized correlation to determine the relationship.

The statistical test for Hypothesis Four used One-Way ANOVA (Analysis of Variance) to see if there was a difference in the averages.

## **HYPOTHESES RESULTS**

H1<sub>0</sub>: For middle managers, the desire to start an entrepreneurial business is not related to downsizing when controlling for morale, stress, and demographic variables (sex, age, marital status, and race).

H2<sub>0</sub>: For middle managers, the desire to start an entrepreneurial business is not related to morale.

H3<sub>0</sub>: For middle managers, the desire to start an entrepreneurial business is not related to stress.

H4<sub>0</sub>: For middle managers, the desire to start an entrepreneurial business is not related to demographic variables (sex, age, marital status, and race).

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Figure 1 about here

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Figure 2 about here

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*Figure 1.* Adjusted means for desire to start one's own business (grouped by marital status and gender).

*Figure 2.* Adjusted means for desire to start one's own business (grouped by marital status and age).

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Figure 3 about here

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*Figure 3.* Adjusted means for desire to start one's own business (grouped by experience with downsizing and age).

Of interest was the fact that this difference was not as great for those managers who are separated. The second figure shows a decreasing trend in entrepreneurial desire among single managers as they grow older. Married and singles generally had greater entrepreneurial desire. The third interaction (Figure 3) indicates that, for all age groups (except those over 50), managers who have not had experience with downsizing had greater entrepreneurial desire. Managers over 50 who had experienced downsizing, however, indicated greater entrepreneurial desire. The managers who had not experienced downsizing tended to show less entrepreneurial desire as they aged. For those who have experienced downsizing, entrepreneurial desire increased in the 50+ age group.

## **SUMMARY, CONCLUSIONS, AND RECOMMENDATIONS**

Previous portions of the investigation presented modular components of the study. The purpose of this section is to bring together these separate components into a unified whole. The following portion presents conclusions based on the findings. The final section concludes with recommendations for future research.

### **CONCLUSIONS**

1. Findings showed that downsizing could have a positive side and could be the reason why the morale of downsized respondents increased with age.
2. The study also concluded that research linking downsizing effects on managers with increased stress, decreased job satisfaction, and morale needs to take other factors into consideration.
3. When the morale, stress, and demographic variables were controlled, there was no significant difference in entrepreneurial desire between those who experienced downsizing and those who did not. Entrepreneurial desire did decrease with age for those who had not experienced downsizing, but increased with age for those who had been downsized.

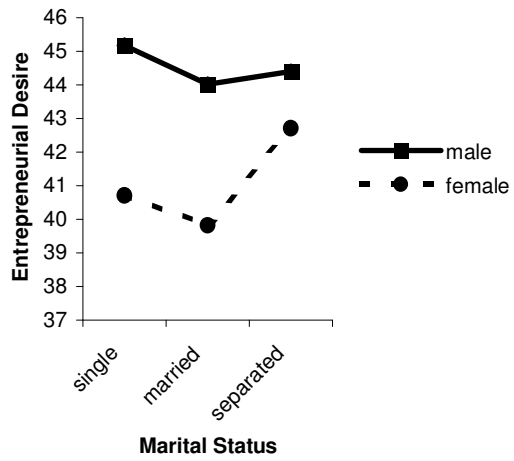
### **RECOMMENDATIONS**

1. To support the empirical findings of the present investigation, future research should conduct follow-up studies, in regard to a broader sample size and diversity, and number of factors associated with the psychological, physical, and cognitive effects of downsizing.
2. Replication of the present investigation should be made at future intervals in an effort to empirically detect changing trends related to age, morale, and the desire of downsized middle managers to start their own entrepreneurial businesses.

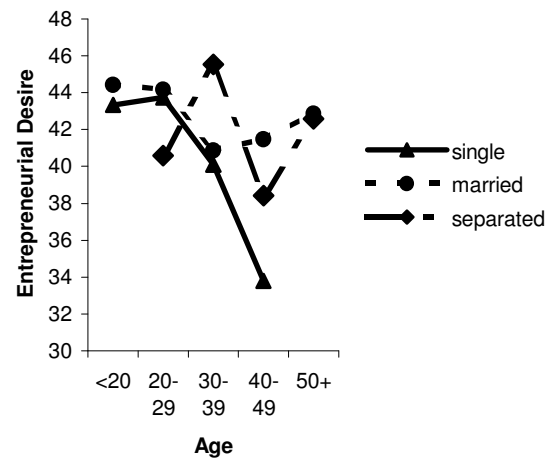
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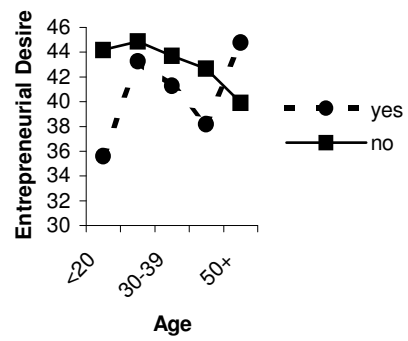
**Figure 1**



**Figure 2**



**Figure 3**



## **HETEROGENEITIES IN ENTREPRENEURIAL PERCEPTIONS: DOES PREVIOUS LINE EXPERIENCE MATTER?**

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### **ABSTRACT**

Entrepreneurship theories often focus on entrepreneurial individuals, environment where entrepreneurs are found, or some combination between the two. Researchers are still trying to put pieces of puzzles together to construct a unique domain of understanding entrepreneurship and its impact on our economy. Starting a new venture is often more complicated and challenging than entrepreneurs and their families have imagined, while entrepreneurs' perceptions on personal goals, business performance, and family issues need more exploration. This article presents results of an on-going study to explore the differences and hierarchical structures of entrepreneurial perceptions related to impacts of starting and managing new manufacturing ventures on entrepreneurs and their families in the United States, by comparing those entrepreneurs who have previous line experience to those who do not. The findings uncover different levels of assessment in personal, business, and family objectives before and after new venture formation. Those entrepreneurs with previous line experience reveal more conservative expectations before embarking in new ventures, which also yield more satisfactions after starting businesses. While personal characteristics seem to be common among all entrepreneurs, financial goals and family welfare are valued at different levels between experienced and inexperienced entrepreneurs. Ultimately diverse entrepreneurial perceptions lead to various learning procedures that entrepreneurs would apply to modify decisions of future new venture formation.

### **INTRODUCTION**

A common argument usually exists between parents and children: "Child, I just know your decision is wrong, because I have been there and done that!" It seems natural to assume that someone with previous experiences in any event would understand this event and its associated consequences better, either to avoid reoccurring errors or to recapture glories. But will this assumption hold when we deal with entrepreneurs in all perspectives and all developmental stages? Researchers have argued about different approaches to formulate entrepreneurship theories based on some necessary, may not be sufficient, conditions to define entrepreneurship from either personal characteristics about who she/he is, or business actions oriented by exogenous factors such as environment and opportunities (Shane & Venkataraman, 2000). It is critical to distinguish the studies of entrepreneurship from other economic theories, due to the complexity of understanding entrepreneurship. Researchers recognized the lack of a unique conceptual domain in entrepreneurship theory, and previous studies seemed to have two

divisive views in the field of entrepreneurship – either to focus on individuals who are “entrepreneurs”, or to focus on external forces that support that creation of the entrepreneurship (Shane, 2003). This paper presented results of an on-going study to explore entrepreneurial perceptions related to business decisions and family issues, as an attempt to contribute to the discovery of a unique domain of entrepreneurship theory.

More specifically this paper provided discussions of the potential heterogeneities existed in manufacturing entrepreneurs’ assessment of the impact of the new venture creation on business objectives and family relationship, by comparing those entrepreneurs with previous line experiences to those entrepreneurs without previous line experiences. The review of literature found very few studies that examined the impact of new manufacture venture creation on entrepreneurs by comparing those with experience in the line of business to those without (Liang & Dunn, 2002; Liang, 2002). Some questions remain undiscovered in other literature - Are there differences between experienced and inexperienced entrepreneurs in the perceptions and decisions of the new venture creation? What are the feelings and expectations of experienced and inexperienced entrepreneurs and their families before they start the new venture? How does the new venture impact family relationships given some entrepreneurs have more experiences than others? Do entrepreneurs and their spouses realize the same reality as the results of the business given some entrepreneurs have more experiences than others? These are a few questions that this article would explore and hope to build a bridge between individualization theories and outcome based theories in other entrepreneurship studies.

The results of this exploratory study will be presented in two ways. First, entrepreneurs’ perceptions on business performance will be discussed based on the survey results from manufacture entrepreneurs in the United States. Some comparisons in personal profiles and in business profiles will be discussed between entrepreneurs who have line experience and those without. Second, heterogeneities of entrepreneurs’ perceptions on business decisions and family relationships will be discussed and compared between entrepreneurs who have line experience and those without. These results would be beneficial to other researchers and professionals who work closely with entrepreneurs and their families and attempt to better understand personal and family issues. Several assumptions need to be introduced in this study: (1) the focused businesses in this study are “new ventures” that have high potential in job creation and wealth accumulation from the societal perspective, instead of “micro-businesses” that are generally defined as small scales in operation or organization (Friar & Meyer, 2003). (2) Wealth creation, sustainable profitability, personal satisfaction, and family welfare are simultaneously valued by entrepreneurs, not necessarily in any particular ranks or with equal share of the importance. (3) Both “entrepreneurial individuals” and “environment in which entrepreneurs have been found” contribute to the success or failure of the new venture creation, so as to the entrepreneurs’ perceptions of success or failure.

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 would 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 relationship, this article hopes to present some outcomes that would be interested by 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 (Glaser & Strauss, 1967).



## REVIEW OF THE LITERATURE

There seemed to be three different approaches in studying entrepreneurship – individual-centric approach that focuses on entrepreneurial people themselves; environment-centric approach that examines situations in which entrepreneurial activities is more likely to occur; and individual-opportunity nexus that examines the characteristics of opportunities, the individuals who discover and exploit them, the processes of resource acquisition and organizing, and the strategies used to exploit and protect the profits from those efforts (Shane, 2003). There has been limited discussion about the interactions between entrepreneurs and their family members in previous theories. In reality, entrepreneurs usually start new ventures based on their own assessment of the situation, may or may not consult and involve their spouses and children in the planning, start up and management process. The family's assessment of the new venture possibilities is usually based on trust in and feelings for the entrepreneurs (Liang, 2002; Liang & Dunn, 2002). As a result of potential variations in perspectives, entrepreneurs with the tacit consent of their families could expose themselves and their families to a future that they might not anticipate.

The typical list of entrepreneurial traits include high achievement drive, action orientation, an internal locus of control, a tolerance for ambiguity, calculated or moderate risk taking, and entrepreneurial commitment, optimism, opportunism, initiative and independence, personal values, work experience, family background, education and some or all of these. (Stevenson, Grousbeck, Roberts, & Bhide, 1999; Longenecker, Moore, & Petty, 2000; Scarborough & Zimmerer, 2000; Bhide, 2000; Bygrave, 1999; Kuratko & Hodgetts, 1998; Vesper, 1996; Hodgetts & Kuratko, 1995; Timmons, 1999; Jennings, 1994; Lambing & Kuehl, 1997; Liang & Dunn, 2002; Liang, 2002). The motivation of entrepreneurs examined in other studies include the desire for control over their lives/independence, profits/financial rewards, enjoy what they are doing, achieve their personal goals and recognition, to make a difference/contribute to society (Stevenson, Grousbeck, Roberts, & Bhide, 1999; Longenecker, Moore, & Petty, 2000; Scarborough & Zimmerer, 2000; Bhide, 2000; Bygrave, 1999; Kuratko & Hodgetts, 1998; Vesper, 1996; Timmons, 1999; Liang & Dunn, 2002; Liang, 2002). Pinfold (2001) discovered that entrepreneurs, optimistic as they were, probably overestimated their chances of success and expected rate of return. In addition, he concluded that financial incentives were ranked fourth in motivation. Entrepreneurs ranked employment, independence, and family and community welfare above “instrumentality of wealth.” (Pinfold, 2001) These studies primarily focused on the entrepreneurs – who they are and what they are like, yet failed to link the personal traits to consequences of business decisions in new venture creation.

There is some literature that discusses the impact of starting and early stage development on the entrepreneurs and their families (Liang, 2002; Liang & Dunn, 2000). Some literature discusses the negative side of entrepreneurial behaviors from the family's perspective, such as lose of quality time, uncertain or lower income, risk of loss of family financial resources, long hours and hard work, lower quality lifestyle, high stress, and overwhelming responsibility (Liang, 2002; Longenecker, Moore, & Petty, 2000; Scarborough & Zimmerer, 2000; Hodgetts & Kuratko, 1995). Older entrepreneurs have more difficulties in starting as a result of marital obligations, children, mortgages, car payments, and a good current source of income (Bygrave, 1999). Often entrepreneurs must choose between business and family obligations and interests. However there has not been enough information to show how experienced entrepreneurs deal

with the intertwined relationship between businesses and family issues compared with inexperienced entrepreneurs.

Watson (2003), in a study of discontinuances among male and female owned SME firms in Australia, discovered that discontinuance rates among manufacturing and other more technical and higher capitalization firms might be lower because they had to spend more preparation time required to get the needed financial and other collaborative support needed to start. If that is true, manufacture entrepreneurs with experience in the line of business should have a better match between expectations and reality. Career experiences, general business experiences, functional experiences, industry experiences, and start-up experiences all contributed to some forms of information development, skill development, and exploitation of entrepreneurial opportunities (Shane, 2003). These different varieties of experiences would assist entrepreneurs to develop information and skills that facilitate the formulation of the entrepreneurial strategies, the acquisition of resource, and the process of organizing (Shane, 2003). Various studies in the United States and other countries also agreed that these experiences would reduce uncertainty in new venture creation process, reduce the likelihood of failure, increase a person's intention to start a business, increase new venture performance, and improve the potential for growth and expansion of the businesses (Shane, 2003). It seems that any experiences in previous career and business functions would lead to a more prosperous future for entrepreneurs. However there has no sufficient information to relate the "factor of experiences" to the "factors of expectations, reality, and learning" in new venture creation theories.

To summarize, previous studies provided a rich background of this study that identified several critical variables in studying entrepreneurship – personal traits, cognition, and economic and non-economic factors influencing entrepreneurial decisions. This study was designed to further understand and explore the impact of experience in the line of business on manufacturing entrepreneurs' expectations, reality, and learning from starting and early stage development of their new ventures.

## **MAILED SURVEY AND SAMPLE**

A probability sample of 1009 manufacturing 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, 2000. This database has been commonly utilized by the Small Business Development Centers and other institutions to study entrepreneurship development in the United States. The questionnaire was developed, pre tested, and revised for data collection. There were two kinds of measurements used to gather entrepreneurs' responses – (1) one was a "level category" such as years of experience in the line of business versus no experience in the line of business, male or female, or white or minority; and (2) the other was "perceptive category" where entrepreneurs could either agree or disagree with specific statements, such as "I was optimistic before starting the business", or "My family would support me to start a new venture again".

Four sets of questions were asked in the questionnaire. The first set of questions was to determine the business situation such as business location, sales, profits, and costs and the entrepreneur's demographics such as age, gender, marital situation, business experience, and family involvement. The second set of the questions asked about the "entrepreneurial drivers" or "expectations" before starting – for example, how they started the new venture, their financial expectations, their expectations in sales and profits, their expected goals and achievement, their perceptions of expectations of family members, and their expectations of personal and family

happiness. The third set of the questions was to determine the entrepreneurs' perceptions of the "consequences" or reality as a result of starting the businesses - for example, their perceptions of real sales and profits, their perceptions about the reality of working together, and their perceptions of personal and family happiness after starting the new ventures. The last set of the questions related to the "learning experience" including changes in business strategy or tactics and if they would start again, and their expectations of family support in future ventures.

The survey was designed for the entrepreneurs to answer only. There was no expectation that family members would respond because family members might not live in the business addresses for manufacturing businesses, where the questionnaires were mailed to in 2002. The responses reflected the owner's personal view regarding her/his personal perceptions for themselves, their spouse, and children. From the 1009 questionnaires mailed to manufacture entrepreneurs, 258 were returned as not deliverable. One hundred thirty-seven completed manufacture questionnaires were returned. This resulted in a 14 percent response rate

Here is a summary of the sample profile: out of 137 respondents - 107 people were male and 27 were female; 120 people were white and 13 were non-white; 82 businesses were in urban area and 49 were in rural area; 102 people were married with children; 61 people had not worked with spouses in businesses and 53 had spouse worked in businesses either full-time or part-time; 71 people had not worked with children in businesses and 38 had children worked in the businesses either full-time or part-time; 51 businesses had less than 5 paid employees and 69 had more than 5 paid employees other than family members; 42 people started business less than 5 years and 83 had been in businesses for more than 6 years; 65 people used personal savings to start businesses and 66 used other fund. Notice that the summation of each category may not add up to 137 due to missing values.

### **LINE EXPERIENCES RELATE TO ENTREPRENEURS' PERCEPTIONS OF BUSINESS PERFORMANCE**

More male respondents (88 percent of 83 people who had previous line experience) had line experience than female respondents, and those with line experience tended to use personal savings and loans more than those without line experience. White respondents (91.6 percent of 83 people who had previous line experience) tended to be more likely to have line experience, as did urban respondents (66.7 percent of 83 people who had previous line experience), younger entrepreneurs (57 percent of 79 people who had previous line experience) and those with less full-time employees (39.7 percent of 78 people who had previous line experience).

Out of 76 respondents who had previous line experience, 90.8 percent had at least one year operational experience in other businesses while 9.2 percent did not have any operational experience at all. Out of 72 respondents who had previous line experience, 75 percent had more than one year of managerial experience in other businesses and 25 percent did not had any managerial experience. It would not be a surprise to know that those respondents with line experience had more managerial and operational experiences. However it was interesting to discover some manufacture entrepreneurs did not have any line experience and did not have any other operational or managerial experiences at all before they started the new ventures.

If experience matters, certainly having more managerial and operational experiences should make a difference among entrepreneurs in their expectations and performance of the new ventures. Most of our sample entrepreneurs with line experience did not think that their sales and profits were higher than expected (70 percent to 80 percent of 83 people who had previous

line experience). The actual sales were higher for those with previous line experiences with 55.4 percent of 83 people who had previous line experience earning more than \$500,000 annually. Ninety percent of respondents of 83 people who had previous line experience believed that their businesses were up and running well, while only 76.5 percent of the respondents out of 51 people who did not have line experience believed that their businesses were up and running well. Interestingly, at least 50 percent of respondents thought starting the business was harder and took longer than they had expected, no matter they had line experience or not.

Out of 80 respondents who had previous line experience, 71.3 percent expected to be happier before starting the new ventures. Sixty-four percent of the 47 respondents who had no previous line experience expected to be happier before starting the new ventures. After starting and running the new ventures, 88.9 percent of 81 respondents who had previous line experience believed that they were happier and 76.5 percent of 51 respondents who had no previous line experience agreed that they were happier. Those with line experience seemed to have more confidence regarding personal happiness and more were personally happier. Two-thirds of our respondents expected their families to be happier, and an even larger portion (72.6 percent of 73 people) of those who had previous line experience felt their families were actually happier as a result of starting the new venture compared with those without line experience.

Eighty-six percent of respondents, with line experience or without line experience, indicated that their income was good before starting the new ventures. A significantly larger proportion of those without experience, 80.4 percent of 51 respondents, expected the new ventures to improve personal financial situations before starting. Fewer respondents with line experience (72.2 percent of 79 respondents) expected new ventures to improve their personal financial situations. Interestingly 64.9 percent of 77 respondents with line experience versus only 34.7 percent of 49 respondents without line experience agreed that their family income was better after starting the new ventures. What was even worse showed in the personal financial goals – only 46.9 percent of 49 respondents who did not have any line experiences agreed that their personal financial goals were achieved after starting and running the new ventures. It was possible for those without line experience to have higher expectations about being financially better off, therefore inexperienced entrepreneurs revealed less satisfaction in reality.

## **LINE EXPERIENCES RELATE TO ENTREPRENEURS' PERCEPTIONS OF FAMILY RELATIONSHIPS**

Literature had discussed the relationship between new venture creation and quality of life for entrepreneurs and their families (Liang, 2002). One of the motives for entrepreneurs to start businesses was to improve families' wealth and welfare. According to our sample, approximately 60 percent of the respondents, either with or without line experiences, hoped the new ventures to improve the welfare of the families. Entrepreneurs with line experience, 62.9 percent, concurred that their families felt better off compared to those without line experience, 46.9 percent. Even though most entrepreneurs with line experience felt positively about starting the new venture, 37.1 percent felt their families did not feel better off. The new ventures obviously did not excite most of the family members of inexperienced entrepreneurs in our sample. This data seemed to indicate that entrepreneurs with line experience had a better match between expectations and reality than entrepreneurs without line experience.

Given some negative feedback of the new venture creation from our sample related to business performance and welfare, what was the further impact of starting the new venture on

family relationships? Almost 60 percent of 75 respondents with line experience revealed that they had less time for themselves, and 47.3 percent of 74 respondents with line experience felt that they did not spend enough time with their spouses. Interestingly less inexperienced respondents reported that they did not have time for themselves (52 percent of 50 people) and did not spend enough time with their spouses (35.6 percent of 45 people). Over 55 percent of the respondents, either with or without line experiences, still believed that they had spent enough time with their children.

Those without line experience were more likely to feel that the new venture had no effect on their marriage (64.6 percent of 45 respondents), compared to those with line experience (56.2 percent of 73 respondents). The specific impact on their marriage tended to indicate that while entrepreneurs with line experience had some problems in their marriage, those without line experience seemed to be more optimistic about their marriage situation. While answering if they would start new ventures again, the responses were extremely positive from everyone, regardless with or without line experience. Our sample entrepreneurs had revealed many negative perceptions in new venture creation - lower sales, lower profits, more challenges in start-up process, unfulfilled personal and families' dreams, and less satisfying experiences in quality of life. Most respondents, however, would start again and almost 90 percent felt their families would still be supportive.

### **LINE EXPERIENCES RELATE TO ENTREPRENEURS' PERCEPTIONS OF ENTREPRENEURIAL LEARNING**

Entrepreneurial learning has been discussed in recent literature (Liang, 2002) and still needs more attention to be included in the entrepreneurship theories. Entrepreneurs learn from both success and failure, while failure might lead to a more dramatic perspective change in future venture decisions and strategies. When asked what they would do differently, our sample respondents with line experience tended to be more inclined to have more cash, followed by writing a better business plan, and getting more training in business skills. Those without line experiences, on the other hand, were more inclined to have more cash, better define target market, prepare for a better business plan, and conduct more research about their market. Surprisingly only 3.9 percent of the inexperienced respondents would not involve family members in the venture process, while 12.2 percent of experienced respondents would not involved their families if they were to start again. A large portion of both groups would involve their families in the next new venture. Some literature had discussed positive interactions in entrepreneurial families that could reduce stress of work, improve communications, and share responsibilities (Liang, 2002). It seemed that our respondents highly value family's inputs and reactions in the process of new venture creation.

### **CLUSTER ANALYSIS OF ENTREPRENEURS' PERCEPTIONS**

With or without previous line experiences seemed to differently influence entrepreneurs' assessment of business performance, personal goals, and family relationship given our sample information in previous sections. Literature often discussed entrepreneurial traits and cognition that related to decision making process and business strategies (Liang & Dunn, 2001; Liang, 2002). There has little information on heterogeneities in entrepreneurial perceptions – Do entrepreneurs evaluate themselves in the same way, such as who they are and how they assess

the new venture creation process? Does it make any difference in this entrepreneurial self-assessing process whether entrepreneurs have previous line experience or not? Cluster Analysis was applied in this study to further explore any potential differences in entrepreneurial characteristics, business performance, and business decisions corresponding to personal and family evaluations. Cluster Analysis, or Grouping Technique, could provide an informal means for assessing dimensionality, identifying outliers, and suggesting interesting hypotheses concerning relationships among the variables (Johnson & Wichern, 1992). Cluster is distinct from the classification methods. Cluster analysis is a more primitive technique in that no assumptions are made concerning the similarities (or dissimilarities). There are several algorithms that can be applied to group data or observations. Our study applied Hierarchical Clustering technique which proceeded by a series of successive mergers. We started with the individual responses of entrepreneurs corresponding to each question. The most similar responses were first grouped by questions, and these initial groups were merged according to their similarities in each question calculated by Euclidean distance. The results of this merging process were displayed in the form of a two-dimensional diagram known as a “dendrogram”. A dendrogram illustrated the merging process by the relative distances between different clusters.

Our sample entrepreneurs who had previous line experiences tended to provide the most similar responses by identifying themselves as being creative and being willing to take risks. These experienced entrepreneurs also provided similar responses to questions related to wanting to be in control and to be independent (Table 1 and Figure 1). These experienced entrepreneurs seemed to have quite diverse responses to questions regarding whether business was up and running well, whether their spouses involved in businesses, and where they received the funding from to start the businesses (Table 1 and Figure 1).

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Table 1 and Figure 1 about here

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Our sample entrepreneurs who had no previous line experience before starting the business had the most similarities when responding to questions related to wanting to be in control and to be independent as the motives to start new ventures (Table 2 and Figure 2). These inexperienced entrepreneurs also showed some similar patterns in their answers to questions such as they were creative and they were willing to take risks in the process of new venture creation. Just like those sample entrepreneurs with line experiences, inexperienced entrepreneurs seemed to have various perceptions on whether business was up and running well, whether spouses were involved in the businesses, and how they acquired start up fund (Table 2 and Figure 2).

Although creativity and risk factors seemed to have the most similar perceptions to those entrepreneurs with previous line experience, inexperienced entrepreneurs were more closely to hope that the new ventures would assist them to be in control and to be independent in their career locus. These four factors – creativity, risk taking, being in control, and being independent – have been discussed extensively in previous literature. Our results agreed with other researchers, yet also revealed some discrepancies between experienced entrepreneurs and inexperienced entrepreneurs.

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Table 2 and Figure 2 about here

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Experienced and inexperienced entrepreneurs in our sample both revealed most similar patterns in their answers to questions regarding personal happiness and family happiness before they started new ventures (Table 3, Table 4, Figure 3, and Figure 4). It would be reasonable to conclude that our sample seemed to expect the new ventures to improve personal happiness and family happiness, thus these two factors were evaluated by entrepreneurs extremely closely. Another two factors that seemed to have some consistent similarities in entrepreneurs' responses, with or without line experience, were related to expectation in improvement of family welfare and family financial situation (Table 3, Table 4, Figure 3, and Figure 4). However, entrepreneurs with previous line experience also showed higher potential to have similar answers towards questions regarding pre-business income issues and personal enthusiasm of creating the new ventures (Table 3 and Figure 3). Presumably entrepreneurs with previous line experience in our sample would understand new venture creation better, and would be more enthusiastic in the new venture creation process that linked to expectations on personal/family income issues.

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Table 3, Table 4, Figure 3, and Figure 4 about here

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After having started and run the business, experienced entrepreneurs who had previous line experience revealed quite different patterns in their responses about the reality of new venture creation compared with those without any line experience according to our sample information. Those with previous line experience presented the most consistent responses in questions related to improvement in the reality associated with family income and personal/family financial situation (Table 5 and Figure 5). Entrepreneurs with line experience also had some similar responding patterns in willingness to start again and assessment of family support, also somewhat linked to personal happiness, family happiness, and time constraints in family life (Table 5 and Figure 5). Those entrepreneurs with previous line experience in our sample revealed quite diverse perceptions in issues such as optimism towards new venture creation, quality of family life, and the assessment of the challenges in start up process.

To those entrepreneurs who did not have previous line experience before starting the new ventures, they showed highly consistency when responding to questions regarding willingness to start again and family support (Table 6 and Figure 6). Personal and family happiness were the next two factors that inexperienced entrepreneurs would evaluate closely. Inexperienced entrepreneurs did not seem to assess the personal/family financial goals as consistently as experienced entrepreneurs. However time constraints, challenges in the start up process, and impacts of new venture creation on the quality of family life were also closely related according to those inexperienced entrepreneurs (Table 6 and Figure 6).

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Table 5, Table 6, Figure 5, and Figure 6 about here

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## **CONCLUSIONS AND IMPLICATIONS**

Researchers have attempted to construct various models to simulate entrepreneurial activities from either micro or macro perspectives. It might be a danger of implicitly promoting a particular business model without a comprehensive understanding entrepreneurial paths that should include individualization, environment, and organization (Quince & Whittaker, 2003). Working experiences could become an important intangible asset to entrepreneurs who decide to

develop and implement new venture ideas. Entrepreneurs who have had previous working experience could be found in high-growth ventures, where these entrepreneurs utilize their experience to nurture business decisions or to create innovative strategies that leads to continuation of growth (Friar & Meyer, 2003).

The outcomes of the new venture creation had different impacts on personal goals, family relationship, and business strategies for future ventures. According to our sample, entrepreneurs who had previous line experience tended to have some operational or managerial experiences in other businesses. These experienced entrepreneurs probably understood the process of new venture formation better, such as time constraints and personal sacrifice. Their experiences linked to more conservative expectations before they started the new ventures in personal satisfaction, family welfare, wealth accumulation, and future outlook. Eventually these experienced entrepreneurs would be more likely to realize positive consequences after starting the new ventures. For inexperienced entrepreneurs in our study, they seemed to have more optimistic expectations before starting the new ventures, expected new ventures to improve personal and family welfare, and expected new ventures to improve personal and family financial situations. However the reality of the new venture creation also brought more disappointment to inexperienced entrepreneurs. Without previous line experience, these entrepreneurs realized that the business process was more complicated than they thought, and there was a significant trade-off between business and quality of life to their families.

Our study also discovered some hierarchical structures in entrepreneurs' perceptions of personal characteristics, business performance, and family relationship. These hierarchical perceptions have been overlooked in other literature, and would deserve more expensive studies in the future. Experienced entrepreneurs in our sample had very close perceptions in creativity and willingness to take risks, while inexperienced entrepreneurs had very close perceptions in being in control and being independent. Personal happiness and family happiness were two most common factors that all entrepreneurs agreed upon before embarking in the new ventures, regardless they had previous line experience or not. However experienced entrepreneurs believed that personal enthusiasm very closely related to income that was a major indicator of business performance. More interestingly, inexperienced entrepreneurs were still very optimistic after they encountered challenges, uncertainty, and sacrifice in personal and family life – they still firmly believed that family support would continue in future new venture formation process for those who would start new businesses again. For those entrepreneurs who had line experience, they seemed to evaluate family income and other financial objectives more closely than other factors such as happiness and trade-offs between business and quality of life.

It is true that entrepreneurship theories cover a wide spectrum of underpinning subjects – existence of opportunities, discovery of opportunities, individual differences, psychological factors, decisions to exploit entrepreneurial activities, industry differences, environment, resource acquisition, strategies, organizing process, and other “white noises” in our economy. The intricacy remains in entrepreneurial world. Our study provided an example to uncover potential interactions between individual factors, business factors, and family factors; and how these interactions influenced entrepreneurs' perceptions of the process and consequences of new venture formation. Using previous line experience as one component to examine entrepreneurs' perceptions, it is refreshing to see how entrepreneurs evaluate a group of economic and non-economic factors differently. Future studies should be expanded to several industries beyond manufacturing, sample size should be enlarged, and long term studies should be established to capture any continuities (or discontinuities) across time. Does previous line experience matter?



The answer seems to be “yes” – it matters to entrepreneurs who hope to establish reachable goals, to create a more fruitful career, and to achieve the balance between business and family life.

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Table 1. Personal Characteristics - Hierarchical Cluster Analysis For Experienced Manufacturers

### Agglomeration Schedule

|       | Cluster Combined |           | Coefficient | Stage Cluster First Appears | Next Stage |   |
|-------|------------------|-----------|-------------|-----------------------------|------------|---|
| Stage | Cluster 1        | Cluster 2 |             | Cluster 1                   | Cluster 2  |   |
| 1     | 5                | 6         | 4.000       | 0                           | 0          | 2 |
| 2     | 4                | 5         | 5.000       | 0                           | 1          | 3 |
| 3     | 3                | 4         | 5.667       | 0                           | 2          | 4 |
| 4     | 3                | 7         | 13.250      | 3                           | 0          | 5 |
| 5     | 2                | 3         | 101.800     | 0                           | 4          | 6 |
| 6     | 1                | 2         | 153.833     | 0                           | 5          | 0 |

*Note: The Agglomeration Schedule shows the values of the Euclidean distances, indicated by "coefficient" in the table, between two factors. Number of stages represents the number of steps to cluster observations. Numbers under cluster 1 and cluster 2 represent the specific factors that have been combined into one cluster. These factors are also labeled by their corresponding numbers in the dendrogram.*

Figure 1. Personal Characteristics—Dendrogram Using Average Between Group Linkage For Experienced Manufacturers

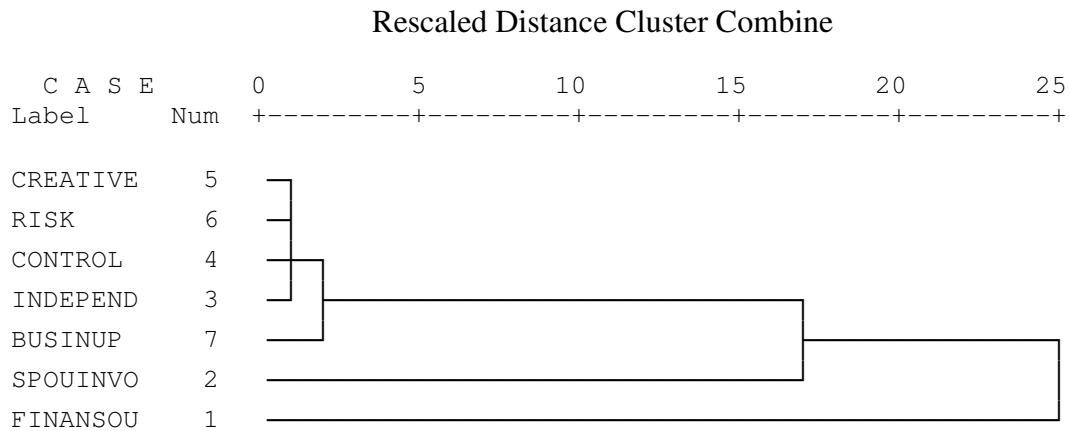


Table 2. Personal Characteristics - Hierarchical Cluster Analysis For Inexperienced Manufacturers

Agglomeration Schedule

|       | Cluster Combined |           | Coefficients | Stage Cluster First Appears |           | Next Stage |
|-------|------------------|-----------|--------------|-----------------------------|-----------|------------|
| Stage | Cluster 1        | Cluster 2 |              | Cluster 1                   | Cluster 2 |            |
| 1     | 3                | 4         | 3.000        | 0                           | 0         | 2          |
| 2     | 1                | 3         | 5.500        | 0                           | 1         | 3          |
| 3     | 1                | 2         | 9.667        | 2                           | 0         | 4          |
| 4     | 1                | 5         | 13.250       | 3                           | 0         | 5          |
| 5     | 1                | 6         | 80.400       | 4                           | 0         | 6          |
| 6     | 1                | 7         | 103.333      | 5                           | 0         | 0          |

Figure 2. Personal Characteristics—Dendrogram Using Average between Group Linkage For Inexperienced Manufacturers

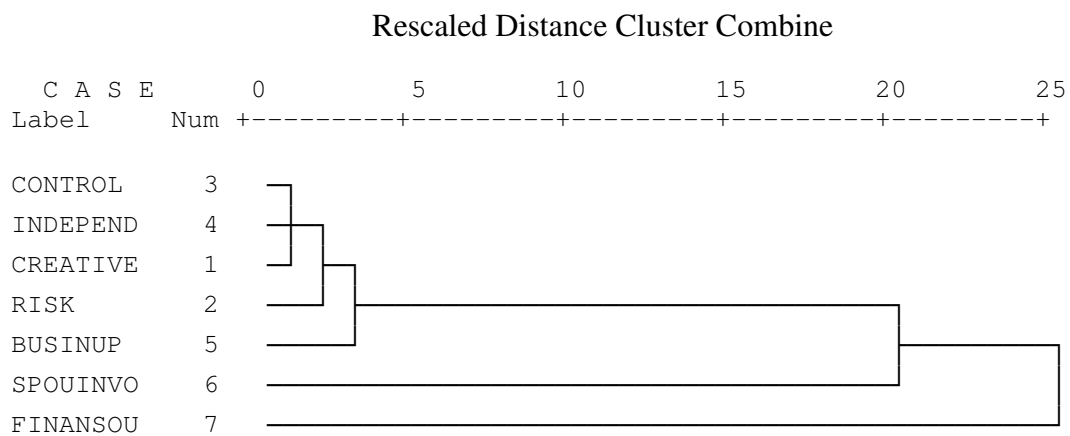


Table 3. Expectations Before Starting Businesses - Hierarchical Cluster Analysis For Experienced Manufacturers

### Agglomeration Schedule

|       | Cluster Combined |           | Coefficient | Stage Cluster First Appears |           | Next Stage |
|-------|------------------|-----------|-------------|-----------------------------|-----------|------------|
| Stage | Cluster 1        | Cluster 2 |             | Cluster 1                   | Cluster 2 |            |
| 1     | 5                | 6         | 8.000       | 0                           | 0         | 3          |
| 2     | 1                | 2         | 8.000       | 0                           | 0         | 4          |
| 3     | 5                | 7         | 9.000       | 1                           | 0         | 5          |
| 4     | 1                | 3         | 14.000      | 2                           | 0         | 6          |
| 5     | 5                | 8         | 14.333      | 3                           | 0         | 7          |
| 6     | 1                | 4         | 16.667      | 4                           | 0         | 7          |
| 7     | 1                | 5         | 20.750      | 6                           | 5         | 0          |

Figure 3. Expectations Before Starting Businesses – Dendrogram Using Average Between Group Linkage For Experienced Manufacturers

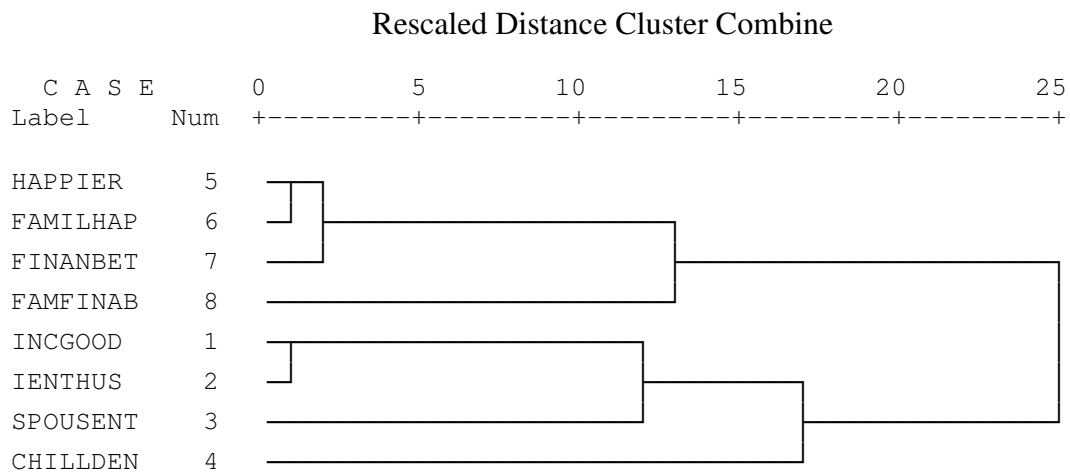


Table 4. Expectations Before Starting Businesses - Hierarchical Cluster Analysis For Inexperienced Manufacturers Expectations

#### Agglomeration Schedule

|       | Cluster Combined |           | Coefficients | Stage Cluster First Appears |           | Next Stage |
|-------|------------------|-----------|--------------|-----------------------------|-----------|------------|
| Stage | Cluster 1        | Cluster 2 |              | Cluster 1                   | Cluster 2 |            |
| 1     | 5                | 6         | 3.000        | 0                           | 0         | 2          |
| 2     | 5                | 7         | 7.500        | 1                           | 0         | 5          |
| 3     | 3                | 4         | 9.000        | 0                           | 0         | 6          |
| 4     | 1                | 2         | 10.000       | 0                           | 0         | 6          |
| 5     | 5                | 8         | 11.667       | 2                           | 0         | 7          |
| 6     | 1                | 3         | 14.500       | 4                           | 3         | 7          |
| 7     | 1                | 5         | 16.500       | 6                           | 5         | 0          |

Figure 4. Expectations Before Starting Businesses – Dendrogram Using Average Between Group Linkage For Inexperienced Manufacturers

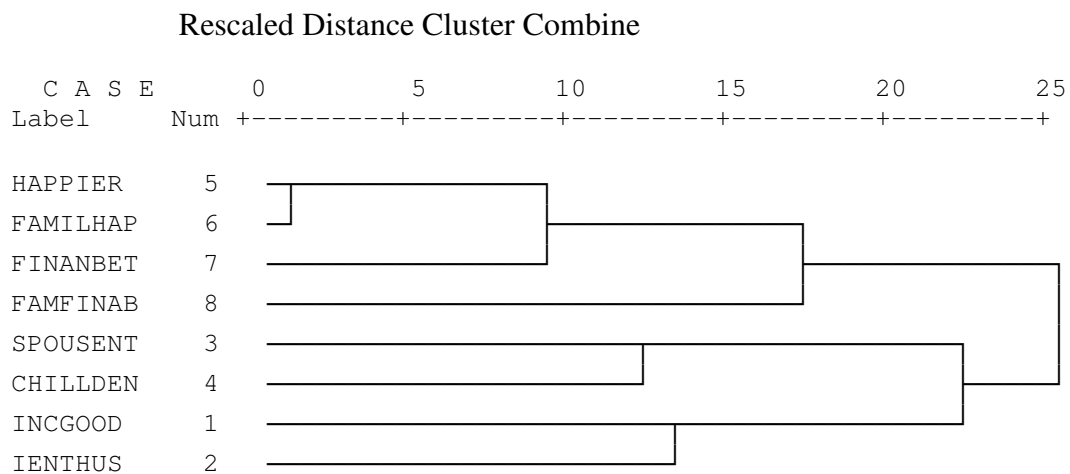


Table 5. Results After Starting A New Venture - Hierarchical Cluster Analysis For Experienced Manufacturers

Agglomeration Schedule

|       | Cluster Combined |           | Coefficient | Stage Cluster First Appears |           | Next Stage |
|-------|------------------|-----------|-------------|-----------------------------|-----------|------------|
| Stage | Cluster 1        | Cluster 2 |             | Cluster 1                   | Cluster 2 |            |
| 1     | 6                | 9         | 4.000       | 0                           | 0         | 5          |
| 2     | 11               | 12        | 7.000       | 0                           | 0         | 3          |
| 3     | 8                | 11        | 8.500       | 0                           | 2         | 7          |
| 4     | 2                | 13        | 9.000       | 0                           | 0         | 10         |
| 5     | 6                | 10        | 11.000      | 1                           | 0         | 8          |
| 6     | 4                | 5         | 13.000      | 0                           | 0         | 11         |
| 7     | 7                | 8         | 14.000      | 0                           | 3         | 8          |
| 8     | 6                | 7         | 15.833      | 5                           | 7         | 12         |
| 9     | 1                | 3         | 16.000      | 0                           | 0         | 10         |
| 10    | 1                | 2         | 20.500      | 9                           | 4         | 11         |
| 11    | 1                | 4         | 24.500      | 10                          | 6         | 12         |
| 12    | 1                | 6         | 27.476      | 11                          | 8         | 0          |

Figure 5. Results After Starting A New Venture – Dendrogram Using Average Between Group Linkage For Experienced Manufacturers

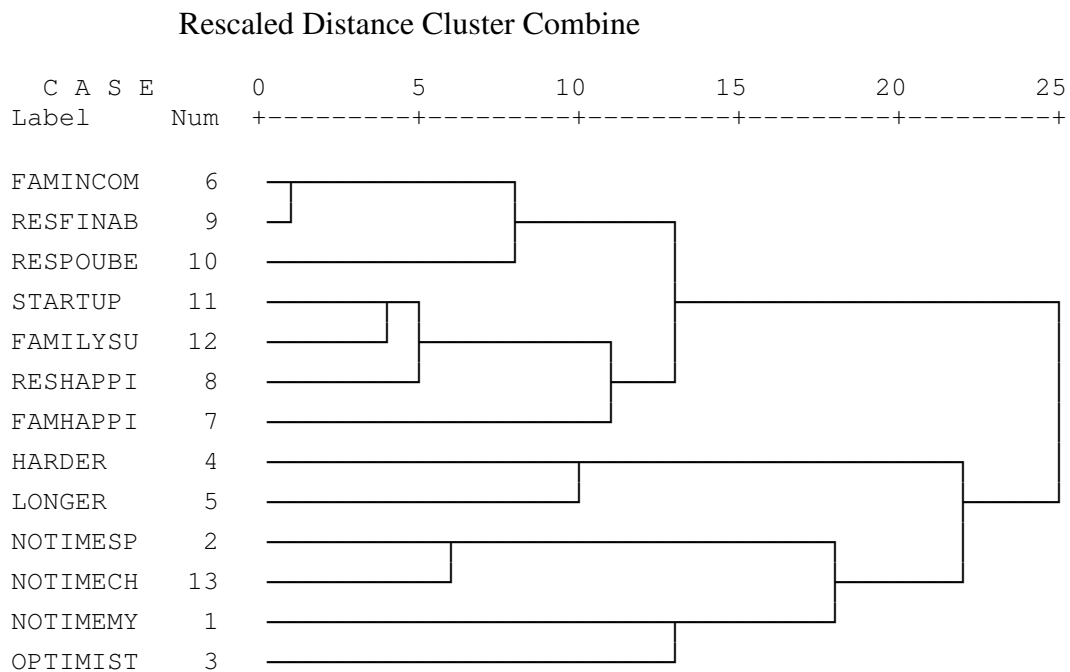
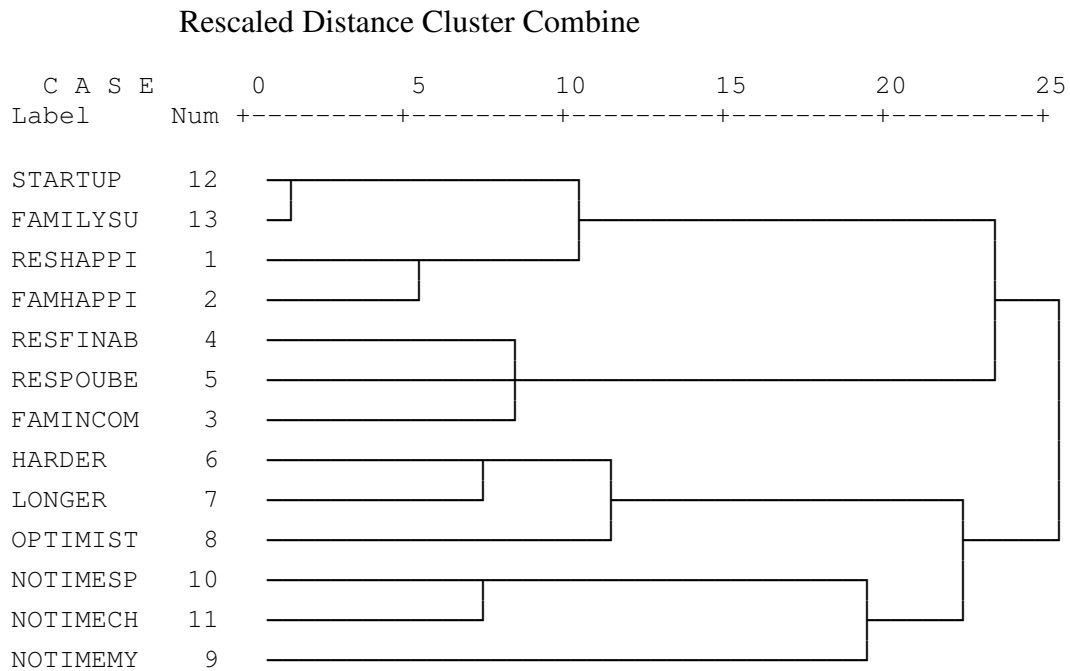


Table 6. Results After Starting A New Venture - Hierarchical Cluster Analysis For Entrepreneurs Without Experience

| Agglomeration Schedule |                  |           |              |                             |           |            |
|------------------------|------------------|-----------|--------------|-----------------------------|-----------|------------|
|                        | Cluster Combined |           | Coefficients | Stage Cluster First Appears |           | Next Stage |
| Stage                  | Cluster 1        | Cluster 2 |              | Cluster 1                   | Cluster 2 |            |
| 1                      | 12               | 13        | .000         | 0                           | 0         | 7          |
| 2                      | 1                | 2         | 4.000        | 0                           | 0         | 7          |
| 3                      | 10               | 11        | 5.000        | 0                           | 0         | 9          |
| 4                      | 6                | 7         | 5.000        | 0                           | 0         | 8          |
| 5                      | 4                | 5         | 6.000        | 0                           | 0         | 6          |
| 6                      | 3                | 4         | 6.000        | 0                           | 5         | 11         |
| 7                      | 1                | 12        | 8.000        | 2                           | 1         | 11         |
| 8                      | 6                | 8         | 8.500        | 4                           | 0         | 10         |
| 9                      | 9                | 10        | 14.500       | 0                           | 3         | 10         |
| 10                     | 6                | 9         | 17.000       | 8                           | 9         | 12         |
| 11                     | 1                | 3         | 18.000       | 7                           | 6         | 12         |
| 12                     | 1                | 6         | 20.119       | 11                          | 10        | 0          |

Figure 6. Results After Starting A New Venture – Dendrogram Using Average Between Group Linkage For Inexperienced Manufacturers





# **AN IMMERSION INTO THE DYNAMIC CAPABILITY MODEL OF INNOVATION: AN EMPIRICAL TEST INVOLVING E-ENTREPRENEURS**

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## **INTRODUCTION**

Traditionally, entrepreneurs rest their competitive advantage on mainstream variables such as efficiency, quality, customer responsiveness and speed. However, in recent years, control over these variables represents the minimum threshold to stay and play in the game. Today's entrepreneurial firms are increasingly facing additional challenges – to be continuously innovative. As a result, the innovativeness in the design of products/services and the implementation of key processes become the critical sources of competitive and sustainable advantages.

This is especially true for e-commerce based firms. The characteristics of the e-business environment, combined with accessing the technology required to capitalize on new opportunities, have created one of the most challenging environments for entrepreneurs across industries (Vachani, 2002). In particular, e-commerce technology has pressed many entrepreneurs to engage in careful assessment of how their firms gather, synthesize, utilize, and disseminate information across customers, employees, and supplier networks, while also being innovative in their ability to create business models and deliver value effectively and efficiently to all parties. Past research has demonstrated that entrepreneurs who are willing to provide innovative product and service offerings will be positioned to compete most effectively (Hodgetts, Luthans, and Slocum, 1999).

From the perspective of dynamic capability, this study contends that entrepreneurial innovative capabilities in internet-based firms come from their ability to create, deploy, integrate and reconfigure organizationally embedded and rent-generating resources. We distinguish three types of capabilities based on the type of knowledge they contain: functional, integrative and innovative capabilities (Verona, 1999). Functional capabilities allow a firm to develop technical knowledge within an organization (Amit & Schoemaker, 1993; Pisano, 1997). Integrative capabilities allow a firm to acquire, absorb and assimilate internal and external sources of knowledge (Cohen & Levinthal, 1990; Henderson & Clark, 1990). Innovative capabilities, as a higher-order of integrative capabilities, refer to a firm's ability to develop new products, services and/or processes.

Specifically, we focus on two inter-related research questions that focus on e-entrepreneurs and their organizations. First, to what extent, do organizational capability possession affects its internal and external integrative capabilities? Second, to what

extent, do organizational capability possession and capability integration affect its innovative capabilities? By analyzing these two interrelated questions, we extend the current entrepreneurial literature in two significant ways by:

1. *Testing the differential impact that an entrepreneur's firm core capabilities has on its ability to integrate its internal and external sources of knowledge in its pursuit for innovation and,*
2. *Examining the relative importance and link that these sources of knowledge have on the firm's innovation capabilities.*

## **THEORETICAL FRAMEWORK & HYPOTHESIS DEVELOPMENT**

### **The Role of Innovation in E-Entrepreneurship**

The e-commerce industry is a hypercompetitive environment. This hypercompetitive environment is characterized by rapid changes in technology, relative ease of entry and exit, ambiguous and uncertain consumer demands, short-term competitive advantage and blurry industry boundary. These competitive conditions fuel a demand for innovation and speed while digital networks offer both speed and an opportunity for innovation.

In the absence of unique or new bundles of resources, the internet-based firms cannot mitigate their liability of newness and smallness. Whereas the liability of newness concerns the extra commitments (to product, market and technological development) a newly internet-based firm must make to compete against older firms already operating in the market, the liability of smallness involves the extra costs an internet-based firm must incur due to lack of scale and resources. To survive and grow in the highly competitive Internet business environment, these firms have to search beyond the resources-based competitive advantages. Possessing, deploying and upgrading capabilities is a primary driver of success in the Internet space and an important predictor of sustainable competitive position. Thus the dynamic capability perspective has vital implications for e-entrepreneurs.

### **A Dynamic Capability Model of Innovation for E-Entrepreneurship**

In the theory of RBV, organizations are viewed as "bundles of resources," which are defined as both tangible and intangible assets that are tied to the firm in a relatively permanent fashion (Caves, 1980; Wernerfelt, 1984). These resources confer competitive advantages in and of themselves (e.g., Barney, 1991; Hall, 1992). According to Barney, "firm resources include all assets, capabilities, organizational processes, firm attributes, information, knowledge, etc. controlled by a firm that enable the firm to conceive of and implement strategies that improve its efficiency and effectiveness" (1991: 101). Resources are categorized into several specific typologies, including human, physical, capital and technological (Grant, 1991). According to this perspective, sustainable competitive advantage exists when the resources possess value, uniqueness, nonsubstitutability and inimitability (Barney, 1991; Wernerfelt, 1984). As a result,

performance differences across firms are due to differences arising from valuable, rent-generating, firm specific resources and capabilities.

However, accumulating valuable resources is not enough to support a sustainable competitive advantage (Teece, Pisano & Shuen, 1997), especially for the internet-based firms. The ever-changing competitive Internet environments render seemingly sustainable competitive advantage obsolete. Instead, competitive advantages arise from a firm's capability to constantly redeploy, reconfigure, rejuvenate and innovate its capabilities in responding to the changing environmental conditions, which is what Teece and Pisano (1994) called dynamic capabilities. Teece & Pisano (1994: 541) propose dynamic capability theory as the "subset of the competences/capabilities which allow the firm to create new products and processes and respond to changing market circumstance." As a result, competitive advantages rest on distinctive processes, shaped by the firm's asset positions and the evolutionary paths followed. Dynamic capability requires the capacity to extract economic benefits from current resources and capabilities and to develop new capabilities.

Consistent with the dynamic capability perspective, e-commerce can be considered to be a dynamic capability (Zhu & Kraemer, 2002). Internet-based organizations continually reconfigure their internal and external resources and capabilities to employ digital networks to exploit business opportunities through continuous innovation. We contend internet-related firms have three distinctive but closely connected organizational capabilities – capability possession, capability integration and capability innovation.

*Capability Possession.* Capability possession concerns with a firm's established distinctive capabilities that are firm specific and can generate economic returns and a competitive advantage. Verona (1999) classified these capabilities into functional capabilities, such as information technology, strategic planning, strategic alliance to name just a few. This classification is also consistent with the first type of organizational routine argued by Zollo and Winter (2002), which they refer as to involving "the execution of known procedures for the purpose of generating current revenue and profits" (Zollo and Winter, 2002: p. 241).

*Capability Integration.* Capability integration concerns with a firm's capability in scanning external environment and recognizing business opportunities, with which organizations align their capabilities. It is consistent with Zollo and Winter (2002)'s second type of organizational routine. Routines of second type are traditionally identified as search routines in evolutionary economics (Nelson and Winter, 1982). Verona (1999) further defined these capabilities as internal integrative capabilities and external integrative capabilities. External integrative capabilities are associated with the dimensions of managerial processes, structures, information and managerial systems, and networks, through which external information and knowledge can be identified and imported across organizational boundaries. These external integrative capabilities are especially mission critical, given the pace of change in the internet-related businesses in terms of technology and competition. Once required informational, technological and

market knowledge has been acquired, internal integrative capabilities organize its use and recognize potential business opportunities and subsequently align and reconfigure organizational capabilities to exploit these opportunities.

*Capability Innovation.* Capability innovation is defined as the firm's ability to upgrade and create new capabilities. The success of an internet-based firm depends not merely on possessing and integrative capabilities but also on learning and acquiring new knowledge and capabilities. An innovative capability is defined as the ability to continuously transform recognized opportunity into new products and processes. The ultimate purpose of organizational capabilities is to innovate toward the creation of customer value in the forms of new services and new products. Figure 2 depicts the relationships among the three distinctive capabilities.

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Insert Figure 2 about Here  
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The possession of technological, informational, and strategic planning capabilities by an internet-based firm would affect not only its external integrative capabilities, but also its internal integrative capabilities – to combine organizational capabilities with desirable and feasible business opportunities. An opportunity is more than an idea. Deciding whether an idea is an opportunity or not involves judgments made under conditions of uncertainty and complexity (Das & Teng, 1997). These judgments mainly concerns with perceived risks and returns. The possession of organizational capabilities in internet-related business would most likely mitigate the perceived risks, while increasing the perceived potential returns at the same time. As a result, organizations are more likely to commit themselves to explore these business opportunities. Based on these discussions, we argue:

*H2: Capability possession of an internet-based firm is positively related to its internal integrative capabilities.*

### **Capability Possession and Capability Innovation**

A firm's possession of capabilities in technology, alliance, strategic planning and human resource would have a direct impact on its innovative capabilities. Specifically, technological capabilities are an important determinant of a firm's innovative capabilities. For example, in their empirical research of firm competence in pharmaceutical industry, Henderson and Cockburn (1994) report a positive link between R&D capabilities and the productivity of new drug development. In a similar vein, Pisano's (1996) study of pharmaceutical and biotechnology firms also reports a positive relationship between the lead time of new molecular development projects and the manufacturing capability. In the internet business, the dominant business configuration is a network, web or hub connected via information technology. Suppliers, customers, complementors, and alliance partners engage in "coopetition" as they collaborate via alliance and compete via coalitions (Brandenburger and Stuart, 1996; Afuah, 2000).

Competitive advantages for these internet-based firms may rest on tacit, inimitable collaborative relationships with various players within the network. These network of relationships provide a critical source of innovations (Ahujah, 1996). Based on the foregoing arguments, we suggest:

*H3: Capability possession of an internet-based firm is positively related to its capability innovation.*

### **Capability Integration and Capability Innovation**

External integrative capabilities and internal integrative capabilities are not mutually exclusive. Instead, they are closely connected. Specifically, external integrative capabilities refer to a firm's capability to identify and acquire externally generated knowledge that is critical to its operation (Zahra & George, 2002). Acquisition of external knowledge reflects the identification function, which represents the 'generator' of intelligence for the organization. External environmental signals are identified, and information on those signals is gathered and transmitted across the organizational boundary.

The more external knowledge and information that can be collected over a given period, the better the external integrative capabilities work. Subsequently, the internet-based firms avail with a wider range of ideas, among which lead to more business opportunities. In a similar vein, limited external integrative capabilities may constrain an organization's internal integrative capabilities as well. Given these discussions, we suggest:

*H4: External integrative capabilities of an internet-based firm are positively related to its internal integrative capabilities.*

External integrative capabilities also represent a construct that refers to "active listening." Information and knowledge can be obtained from a wide variety of sources, using a variety of media. The generation of external information should not be the monopoly of any one department but rather an organization-wide activity. Additionally, firms need to scan frequently and broadly. Although there is some indication that the most important areas of knowledge come from competitors and customers, the organization uses many more than the usual data collection sources from competitors and customers. The more information the organization gathers through the search process, the more options there are for identifying changes in the competitive and market environment, and therefore, the better chance of a firm to reconfigure or upgrade its capabilities to external demands.

*H5: External integrative capabilities of an internet-based firm are positively related to its capability innovation.*

The recognition of business opportunities would drive internet-based firms to re-examine their organizational capabilities and to re-deploy relevant knowledge and

technology possessed internally into new technologies and processes designed to meet the organization's specific, emerging needs. This is an internally opportunity-driven process that aids in the extension of existing competitive advantages and the creation of new and more effective and efficient process and services. Based on these rationales, we hypothesize:

*H6: Internal integrative capabilities of an internet-based firm are positively related to its capability innovation.*

## **RESEARCH METHOD**

### **Sampling Procedures**

Participants were one hundred twenty entrepreneurs of e-commerce organizations whose business activities encompass the Internet. The entrepreneurs and their respective firms were randomly sampled by the Internet sector of the CorpTech<sup>®</sup> Company Profiles Database. The majority of the entrepreneurs were male (92 percent), with over 19 years of business experience and 15 years of industry experience. All information was gathered from the entrepreneurs over a three-week period, utilizing a new methodology for data collection: on-line survey completion. E-mails were sent to the entrepreneur of the e-commerce organization, asking for their participation in the study. Within the text of the email was a hyperlink that would direct them to our on-line questionnaire. The entrepreneurs were told that we were conducting research to better understand top managerial roles and practices in Internet-based organizations.

### **Measures**

*Capability Possession.* To assess the entrepreneurial firm's functional capabilities, we used the Hartman, Sifonis, and Kador's (2000) Internet Readiness Measure. Entrepreneurs indicated how much they agree or disagree with the statements on a five-point Likert scale (1 = 'strongly disagree'; 5 = 'strongly agree'). Cronbach's alpha of this scale was .85.

*External Integrative Capabilities.* To measure external integrative capabilities, we adapted four items from Hills et al. (1997) scale on opportunity identification/recognition. Entrepreneurs used a five-point Likert scale (1=Not a source; 5=Significant source). Cronbach's alpha of this scale was .90.

*Internal Integrative Capabilities.* To measure internal integrative capabilities, we adapted four items from Simon, Pelled, & Smith's (1999) scale. These items assessed how top management teams recognizes new ideas or opportunities. Internal consistency (Cronbach's alpha) of this scale was .78.

*Innovative Capabilities.* In order to measure the types of innovative managerial practices implemented in our sample of e-commerce firms, we again used items from Hartman, Sifonis, and Kador's (2000) Internet Readiness Measure. Entrepreneurs

indicated how much they agree or disagree with the statements on a five-point Likert scale (1 = 'strongly disagree'; 5 = 'strongly agree'). Cronbach's alpha of this scale was .87.

### **Control Variables**

We chose four control variables that can have an influence on an entrepreneurial firm's innovation capabilities: business strategy, type of business (business to business vs. business to consumer model), diversity on top management team, and the proactivity of the entrepreneur.

### **Statistical Models**

Zero-order correlations as well as the mediated regression approach recommended by Baron and Kenny (1986) was used to test our hypotheses and proposed model. In the mediational approach, three separate regression equations are estimated. First, the mediators (external and internal integrative capabilities) are regressed on the independent variable (capability possession). Second, the dependent variable (capability innovation) is regressed on the independent variable. In the last equation, the dependent variable is regressed simultaneously on both the independent and mediational variable. Mediation is indicated when these conditions are met: the independent variable must affect the mediator in the first equation; the independent variable must affect the dependent variable in the second equation; the mediator must affect the dependent variable in the third equation; and lastly, assuming that all of these conditions are in the proper direction, the effect of the independent variable on the dependent variable must be less in the third equation than in the second equation. Full or perfect mediation is supported when the independent variable has no significant effect when the mediator is controlled, while partial mediation is indicated if the effect of the independent variable is reduced in magnitude but still significant when the mediator is controlled (Baron and Kenny, 1986).

## **RESULTS**

The means, standard deviations, zero-order correlations and reliabilities for our constructs are reported in Table 1. The reliabilities of the measures used were all over the .70 minimum established by Nunnally (1978). In analyzing the relationships, we found support for each of our hypothesized relationships. More specifically, capability possession was positively related to both external (hypothesis 1) and internal integrative capabilities (hypothesis 2) as well as capability innovation (hypothesis 3). Support was also found for hypothesis 4 in that external integrative capabilities were related to internal integrative capabilities. Finally, external integrative capabilities and internal integrative capabilities were related to capability innovation (hypothesis 5 and 6, respectively).

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Insert Table 1 about Here  
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While our hypotheses were supported at a one-to-one relationship (zero-order correlations), we wanted to utilize the mediational approach to better understand and evaluate the dynamic capability model within the context of our entrepreneurial e-commerce firms. Table 2 displays the approach and results to test this more stringent innovation model by including our control variables, capability possession, and the dual mediators of external and internal integrative capabilities. Results revealed that capability innovation is fully mediated by an entrepreneurial firm's capability integration. (relationship between possession and innovation was no longer significant when accounting for external and internal integration). That is, capability integration serves as an important link between a firm's possession of technological, strategic, human resources, and strategic planning activities and its ability to innovate and bring new value to its product/service offerings.

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Insert Table 2 about Here  
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## **DISCUSSION & CONCLUSIONS**

The model tested in this study, based on responses from 120 entrepreneurs of e-commerce firms, disclosed that the building of technology infrastructure serves an important role as an antecedent to the development of innovations related to new product/service improvements in the firms sampled. This investigation may provide insight as to which factors are potentially more important in determining how e-entrepreneurships can implement e-commerce technologies successfully to achieve greater innovations.

Our findings suggest resources and capabilities are important, but only to a certain extent. Our sample of Internet-based firms demonstrates that resources and capabilities are dynamic as these firms must continually build, adapt and reconfigure the internal and external competence to be continuously innovative. They exemplify the characteristics of dynamic capabilities as they engage routines, prior and emergent knowledge, integrative and analytic processes to turn IT into customer value in the forms of innovative products and services.

Additionally, our findings provide additional insight into the innovation process of internet-based firms. Specifically, our results illuminate the fact that organizational integrative capabilities play a critical role in a firm's innovate capability. By contrast, functional capabilities play an indirect role in the innovation process, through a firm's integrative capabilities. The primary constraint preventing these firms from growing through innovation is not the lack of resources as suggested by the resource based theory, but the lack of organizational integrative capabilities – routines for integrating external knowledge and identifying business opportunities.



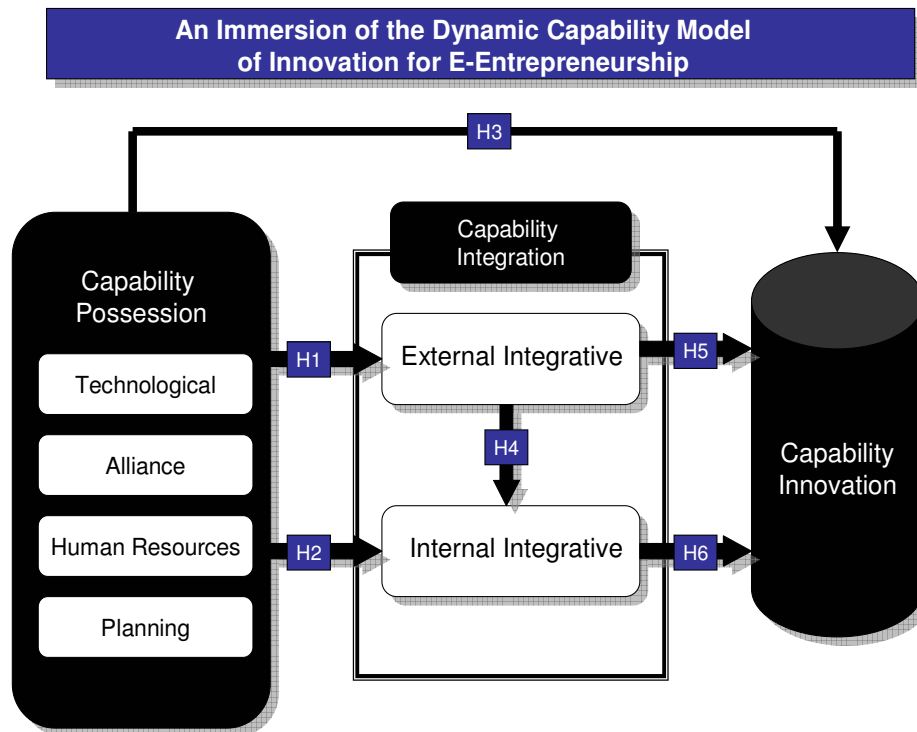
Our study highlights the importance of developing routines and capabilities in boundary spanning and opportunity recognition in the internet-related firms. Although the development of these integrative capabilities may incur additional bureaucratic costs, the gains from such routines would more than offset any adverse consequence of bureaucratization, as presumed by Stinchcombe (1965).

Within an entrepreneurial organization, the adoption of new technology to increase competitive advantage has been hindered by issues surrounding potential costs, risks of failure, and an inherent lack of innovative awareness (Maxwell & Westerfeld, 2002). By analyzing the benefits, as has been attempted in this study, many of these issues are outweighed by the diversity of opportunities, process innovations, firm effectiveness and growth. With the alignment of information and computer technology, knowledge, and resources, successful entrepreneurs can further seek out and act upon the demands of the market, differentiating themselves through customer management, relationship marketing, and community building. By exploring and incorporating new technology within their business models, entrepreneurs can leverage the information and experience they already have and deftly apply new intelligence and knowledge within the framework and structure of their firms.

## REFERENCE

References will be provided upon request.

**Figure 2**



**TABLE 1. DESCRIPTIVE STATISTICS AND CORRELATIONS**

|                                   | Mean  | SD    | 1     | 2     | 3     | 4     | 5     | 6     | 7     | 8     |
|-----------------------------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| Business Strategy                 | 3.12  | 1.25  | (---) |       |       |       |       |       |       |       |
| Type of Business                  | 29.61 | 30.43 | .13   | (---) |       |       |       |       |       |       |
| Diversity on Management Team      | 3.80  | 1.93  | -.21  | -.33  | (---) |       |       |       |       |       |
| Proactivity of Entrepreneur       | 4.37  | 0.82  | .15   | .04   | .10   | (.91) |       |       |       |       |
| Capability Possession             | 3.59  | 0.72  | .58   | .13   | -.13  | .20   | (.85) |       |       |       |
| External Integrative Capabilities | 4.53  | 0.89  | .09   | .00   | -.13  | .02   | .25   | (.90) |       |       |
| Internal Integrative Capabilities | 4.05  | 0.76  | .22   | .12   | -.05  | .43   | .41   | .32   | (.78) |       |
| Product/Service Innovations       | 4.06  | 0.90  | .59   | .17   | -.04  | .03   | .71   | .32   | .28   | (.87) |

Note:  $r > .20$  is significant at .05 level.

**TABLE 2 MEDIATED REGRESSION ANALYSIS**

| Equation                 | Summary   | Dependent Variable<br>Product/Service Innovations ( $\beta$ ) |
|--------------------------|---|---|
| <b>Control Variables</b> | Business Strategy   | .66   |
|                          | Type of Business  | .04   |
|                          | Diversity on Management Team                              | .11   |
|                          | Proactivity of Entrepreneur                               | .07   |
| <b>(1)</b>               | Capability Possession→External Integrative Capabilities   | .25*  |
|                          | Capability Possession→Internal Integrative Capabilities   | .41*  |
| <b>(2) and (3)</b>       | Capability Possession→ Capability Innovation              | .19   |
|                          | External Integrative Capabilities → Capability Innovation | .56**   |
|                          | Internal Integrative Capabilities → Capability Innovation | .25*  |
| <b>R<sup>2</sup></b>     |   | .88   |
| <b>F</b>                 |   | 8.62**  |

Note: ( $\beta$ ) = Standardized Beta Weight; The R<sup>2</sup> and F value results are for the last equation in the test for mediation. \*\* $p < .01$  \* $p < .05$

**THE INFLUENCE OF FAMILY BUSINESS SIZE ON  
MANAGEMENT ACTIVITIES, STYLES AND CHARACTERISTICS:  
AN INTERNATIONAL ANALYSIS**

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**ABSTRACT**

An analysis of an international sample of micro, small, medium and large family businesses found both similarities and differences between these categories with regard to a variety of management activities, styles and characteristics. Given the very limited prior research findings and theory on family firm size, the value of these findings is not that they provide definite conclusions about the nature of family business, but rather that they lay some groundwork for further research in this area, with the objective of answering these questions: Is size a significant factor with regard to family business? Should size be an analytical tool used by family business managers, researchers and/or consultants?

**INTRODUCTION**

Family businesses are a central component of the world's economies. While in most countries exact figures are difficult to obtain, it is estimated that 80% of American businesses are family-owned (Carsrud, 1994; Kets de Vries, 1993), that these businesses contribute 40% to 60% of the Gross National Product (Gomez-Mejia, Nunez-Nickel & Gutierrez, 2002; McCann, Leon-Guerro & Haley, 1997), and that 35% of *Fortune 500* businesses are family owned (Carsrud, 1994). In many other countries, such percentages are comparable (European Group, 2004). Although family business is important, the majority of studies have been qualitative rather than quantitative (Dyer & Sánchez, 1998; Litz, 1997), and there is a need for more empirical statistical analyses.

Furthermore, most family business studies have focused on family firms in the United States and sometimes Canada, with only an occasional study directed at family businesses in other countries. Only very recently have a few researchers postulated that family businesses in other countries may be different from those in North America (Morck & Yeung, 2003; Hoy, 2003).

Within this body of family business literature, there have been some attempts to categorize such firms, so as to develop typologies. Do different types or groups of family firms exhibit significantly different characteristics and behave differently? Can such a categorization lead to meaningful implications with regard to family firm management, research and assistance? One area of recent analysis has been with regard to possible *stages* of family firm growth. Work by Gersick, Davis, Hampton & Lansberg (1997) and others has led to a proposed model of such stages, each with different family firm characteristics and implications for the management of such firms.

Another recent family business categorization has been a focus on *generations* by Sonfield & Lussier (in press). This research compared first, second and third-generation family firms in light of various researchers' earlier investigations and, in contrast to these earlier studies, found few differences in managerial characteristics and activities.

The objective of this current study was to investigate, at an international level, another possibly meaningful family business typology: that of company size as measured by the number of the firm's employees. As family businesses grow in terms of number of employees, do managerial activities, styles and characteristics change? While *stages* may be a difficult measure for family firm owners, advisors and researchers to use, and *generations* may be an easier way to categorize such firms, the *number of employees* is certainly a still simpler measure. If it may have value as an analytical tool for evaluating companies, then this possibility should be explored.

## LITERATURE REVIEW

Searches of the family business literature find little prior investigation of issues of firm size, as measured by number of employees or any other measure. Even a broader search of the literature in business and management in general generates only modest results. Various researchers have attempted to find relationships between firm size (as measured by the number of employees in the firm) and that firm's characteristics, behavior and performance. For example, Watson (1996) investigated whether firm size related to failure, Ettlie and Rubenstein (1987) examined the relationship of firm size to product innovation, Goetz, Morrow and McElroy (1991) and Brush and Chaganti (1999) explored the relationship of size to management styles and effectiveness, Edmunds (1979) studied size effect on management competence, and Bates (1989) firm size and its effect on business failure. All of these studies were preliminary investigations, and the total set of quite mixed results underline the complexity of this basic issue. While a company's number of employees may influence managerial and firm activity and performance, considerably more research is needed before firm conclusions and meaningful implications can be reached, and theories can be generated.

Thus, given this lack of *size-related* research, theory, and established findings in family business, the hypotheses used for this current study derive from prior studies of *generational* issues in family business, an area where a moderate number of findings can be found. And if family firms generally grow with succeeding generations, then *generations* can be considered a reasonable surrogate for *number of employees* for the purposes of hypotheses generation for this study.

## HYPOTHESES

The eleven hypotheses used for this study are based on Sonfield and Lussier (2002) hypotheses, findings and propositions developed by earlier researchers who investigated similarities and differences between family firms. Because there are minimal and mixed prior findings with regard to firm size as measured by number of employees, the null hypothesis is used throughout.

H1: Larger family businesses are neither more nor less likely than smaller family businesses to include non-family members within top management.

H2: Larger family businesses are neither more nor less likely than smaller family businesses to have women family members working in the firm.

H3: Larger family businesses are neither more nor less likely than smaller family businesses to use a “team-management” style of management.

H4: Larger family businesses are neither more nor less likely than smaller family businesses to have conflict and disagreement between family members.

H5: Larger family businesses are neither more nor less likely than smaller family businesses to have formulated specific succession plans.

H6: Larger family businesses are neither more nor less likely than smaller family businesses to use outside consultants, advisors and professional services.

H7: Larger family businesses are neither more nor less likely than smaller family businesses to spend time engaged in strategic management activities.

H8: Larger family businesses are neither more nor less likely than smaller family businesses to use sophisticated methods of financial management.

H9: Larger family businesses are neither more nor less likely than smaller family businesses to be influenced by the original business objectives and methods of the founder.

H10: Larger family businesses are neither more nor less likely than smaller family businesses to have considered “going public.”

H11: Larger family businesses are neither more nor less likely than smaller family businesses to use equity financing rather than debt financing.

## METHODS

### Sample

Four countries were chosen to provide a broad geographic scope to the study, and to furthermore include countries with different sized populations, different cultures, different economic characteristics and histories, and different *GEM* rates of entrepreneurial activity (Croatia = 3.6, France = 3.2, India = 17.9 and U.S.A. = 10.5). The following country information may be of value.

*Croatia.* In 1991, the Republic of Croatia declared its independence from Yugoslavia, and is today a parliamentary democracy with a population of about 4.4 million, about 57 percent of which is urban. Gross domestic product was estimated to be \$24.9 billion in 2000. Of a total 148,000 business enterprises in Croatia, about 90,000 are one-person operations and another 54,000 are small (annual sales of 2 million U.S. dollars or less) (World Almanac 2003). Family-controlled businesses in Croatia have a long history in the country, prior to the institution of a

socialist Yugoslavia following World War II. Today, most family firms are single-generation small businesses, oriented toward autonomy, self-employment and stability. Only since the 1991 independence have growth-oriented family-controlled businesses become a significant factor in the economy (Denona and Karaman-Aksentijevic 1995; Galetic 2002).

*France.* France has a population of about 60 million people. Seventy-five percent of the population live in urban areas. In 2000, the gross domestic product was estimated at \$1.448 trillion (World Almanac 2003). Family-owned and controlled businesses in France, called “patrimonial” businesses, play a major role in the economy: 98 percent of companies with less than 100 employees, 75 percent of those with 100 to 3000 employees, and 20 percent of those with over 3000 employees (Gattaz 2003; Lyagoubi 2002; Mahérault 1999).

*India.* Home to one of the oldest civilizations in the world, Britain relinquished control of the Indian subcontinent following World War II, and the Republic of India was established in 1950. India has a population of over one billion people and had an estimated gross domestic product of \$2.2 trillion in 2000 (World Almanac 2003). The economy consists of a large state sector with a number of very large state enterprises, a relatively small number of multinational companies, and a large private sector. The private sector, with few exceptions, is controlled by families who may or may not hold large shareholdings in their companies. Thus, most of the large Indian companies, though they may be publicly traded, are controlled by families and their management succession is generally maintained within the family. Members of their boards of directors also hold their positions at the pleasure of the controlling family (Centre for Monitoring Indian Economy 2004; Manicuttu 2000).

### **Survey Instrument Distribution and Responses**

In the United States, survey instruments were randomly mailed or hand-delivered to a variety of New York and Massachusetts companies, which had been identified as family businesses. A net distribution of 550 surveys yielded 159 usable returned, a 28.9% return rate.

In Croatia, a sample of family businesses was developed by contacting the clients of Entrepreneurship Centers in four geographically diverse cities: Osijek, Pula, Split, and Varazdin. Seventy businesses were contacted by telephone, and a written survey was then sent to them. Fifty usable responses were received for a response rate of 71.4%

In France, a sample of family businesses was identified from a prior study's database, and 800 companies were sent a survey via mail. A total of 116 usable responses were received with four other respondents replying that they were not a family business. Thus the response rate was 14.5%.

In India, from that country's primary business data base (maintained by the Center for Monitoring the Indian Economy [CMIE]), 312 companies representing a range of sizes and business sectors were selected for a survey mailing. Follow-up mailings and telephone calls were made to all non-respondents. Forty usable responses were received and another 17 respondents stated that they were not family companies, thus providing a net response rate of 13.6%.

Thus, in the four countries combined, a total net distribution of 1715 survey instrument resulted in a usable return of 365 surveys, for a return rate of 21.3%.

Identifying family firms from various listings is consistent with that of other family business researchers, who have been constrained by the lack of national databases of family firms (Chua, Chrisman and Sharma 1999; Teal, Upton and Seaman 2003). This is an acceptable sample size and response rate for family business, as it has been reported that 62 percent of prior family business studies included no sample at all, or a sample with less than 100 family businesses, and 66 percent of these were convenience samples (Bird, Welsch, Astrachan and Pistrui 2002). In the top three small business or entrepreneurship-oriented journals (*Entrepreneurship Theory and Practice*, *Journal of Business Venturing*, and *Journal of Small Business Management*) around one-third of the articles had a response rate of less than 25 percent (Dennis 2003).

The survey instrument provided a variety of descriptive information about each respondent family business, including the number of employees. While there are no universally accepted employee number breakpoints for company size (and the U.S. Small Business Administration [2004] uses different breakpoints for different industries), the European Community has developed some guidelines (European Union, 2004). The respondent firms were categorized into these four EU categories:

| <u>Enterprise Category</u> | <u>Number of Employees</u> | <u>Sample (N = 365)</u> |
|----------------------------|----------------------------|-------------------------|
| Large                      | ≥ 250 (250 +)              | n = 69 / 19%            |
| Medium                     | < 250 (50-149)             | n = 97 / 27%            |
| Small                      | < 50 (10-49)               | n = 120 / 32%           |
| Micro                      | < 10 (0-9)                 | n = 79 / 22 %           |

## **Measurement**

The independent variable was size with four levels, as shown above. The dependent variables to test Hypotheses 1-11 were as follows: (1) the percentage of family to non-family managers. (2) The percentage of male and female family members involved in the operation of the firm. Hypotheses 3-10 were Likert interval scales of: “Describes our firm” 7 to 1 “Does not describe our firm.” (3) full family involvement in decisions, (4) level of family conflict, (5) formulation of succession plans, (6) use of outside advisors, (7) long-range planning, (8) sophisticated financial management tools, (9) influence of founder, and (10) going public. (11) The use of debt or equity financing was a nominal measure of one or the other. Descriptive statistical data included number of years the firm was in business, the number of employees, industry (product or service), number of generations, and form of ownership.

## **Statistical Analysis**

Hypotheses 1-10 compared the dependent variables by size using one-way ANOVA. Hypothesis 11, having nominal measured variables, compared debt to equity by size using chi-square.

## RESULTS

See Table 1 for a summary of descriptive statistics.

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[table 1 about here](#)

See Table 2 for a summary of hypotheses statistics testing. Of the eleven hypotheses, three were accepted and eight were rejected by the statistical analysis. There were no significant differences between the size categories of family businesses with regard to 1) the number of women family members working in the firm, 2) the use of team-management style, and 3) the formulation of specific succession plans. There were statistically significant differences, with a clear pattern from smaller to larger firms as follows: 1) larger firms were more likely to use non-family members within top management and 2) larger firms were more likely to use sophisticated methods of financial management. Furthermore, there were also significant differences, but *without* a clear pattern from smaller to larger firms, for the following: 1) having conflict between family members, 2) the use of outside consultants, advisors and professional services, 3) the time spent in strategic management activity, 4) the degree of influence by the original business objectives and methods of the founder, 5) consideration of going public, and 6) the use of debt versus equity financing.

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[table 2 about here](#)

## VALUE OF FINDINGS

Given the very limited prior research findings on family firm size, the value of these findings is not that they provide definite conclusions about the nature of family business, but rather that they lay some groundwork for further research and theory development in this area. Is size a significant factor with regard to family business? Should size be an analytical tool used by family business managers, researchers and/or consultants? Clearly, considerably more family business studies must be conducted before answers to these questions can be suggested.

## CONCLUSIONS

The findings of this study indicate that firm size may be a relevant factor in the analysis of family businesses. A limitation of this study is the variation between the four country samples, both in sample size and the distribution of the company sizes within each country, based on the histories and positions of family businesses within each country's economy. To strengthen our understanding of the relevance and importance of family business size, further studies should attempt to increase sample sizes, obtain more even firm size distributions within samples, and to obtain data from additional countries so as to reduce the impact of varying economic and family business characteristics from country to country.

## REFERENCES

A list of 34 references is available from the first author



Table 1  
Descriptive Statistics by Size of Business (number of employees)

| Variable                    | Micro (0-9)<br>n = 79 / 22% | Small (10-49)<br>n = 120 / 32% | Med (50-249)<br>n = 97 / 27% | Large (≥ 250)<br>n = 69 / 19% | Total<br>(N = 365)     |
|-----------------------------|-----------------------------|--------------------------------|------------------------------|-------------------------------|------------------------|
| Generation (n/ %)           |                             |                                |                              |                               |                        |
| 1 <sup>st</sup>             | 34 / 43%                    | 39 / 32%                       | 28 / 29%                     | 14 / 20% <sup>1</sup>         | 115 / 32%              |
| 2 <sup>nd</sup>             | 29 / 37%                    | 50 / 42%                       | 43 / 44%                     | 27 / 39%                      | 149 / 40%              |
| 3 <sup>rd</sup>             | 16 / 20% <sup>1</sup>       | 31 / 26%                       | 26 / 27%                     | 28 / 41%                      | 101 / 28%              |
| Years in business<br>(mean) | 24.84 <sup>2</sup>          | 35.37 <sup>2</sup>             | 45.44                        | 45.20                         | 37.62                  |
| Industry ( n / %)           |                             |                                |                              |                               |                        |
| Product                     | 22 / 28%                    | 58 / 48%                       | 48 / 49%                     | 39 / 57%                      | 167 / 46%              |
| Service                     | 57 / 72% <sup>3</sup>       | 62 / 52%                       | 49 / 51%                     | 30 / 43%                      | 198 / 54%              |
| Ownership (n/ %)            |                             |                                |                              |                               |                        |
| Corporation                 | 31 / 39%                    | 71 / 59%                       | 79 / 81%                     | 67 / 97%                      | 248 / 68% <sup>4</sup> |
| Partnership                 | 11 / 14%                    | 19 / 16%                       | 9 / 9%                       | 0 / 0%                        | 39 / 11%               |
| Sole proprietorship         | 37 / 47%                    | 30 / 25%                       | 9 / 9%                       | 2 / 3%                        | 78 / 21%               |
| Country ( n / %)            |                             |                                |                              |                               |                        |
| USA                         | 44 / 56%                    | 57 / 48%                       | 34 / 35%                     | 24 / 35%                      | 159 / 43% <sup>5</sup> |
| France                      | 5 / 6%                      | 46 / 38% <sup>5</sup>          | 57 / 59%                     | 8 / 12%                       | 116 / 32% <sup>5</sup> |
| Croatia                     | 30 / 38% <sup>5</sup>       | 17 / 14%                       | 3 / 3%                       | 0 / 0%                        | 50 / 14%               |
| India                       | 0 / 0%                      | 0 / 0%                         | 3 / 3%                       | 37 / 53% <sup>5</sup>         | 40 / 11%               |

<sup>1</sup> Micro businesses have significantly less 3<sup>rd</sup> generation firms, and large firms have significantly less 1<sup>st</sup> generation businesses (p = .044).

<sup>2</sup> Micro and small firms have been in business for significantly less years than medium and large businesses (p = .000).

<sup>3</sup> Significantly more micro firms offer a service (p = .003).

<sup>4</sup> There are significantly more corporations, and the percentage increases with size, as in the business population.

<sup>5</sup> There are significantly more firms from the USA and France (p = .000). As in the business population, in the USA there are more smaller firms than larger firms, and Croatia has more micro and small firms. The France participants have more small and medium size firms. India participants have more large firms.

Table 2

Hypotheses One-Way ANOVA Comparison by Size (N = 365)

| Hypotheses  | Micro<br>(0-9)<br>n = 79 | Small<br>(10-49)<br>n = 120 | Medium<br>(50-249)<br>n = 97 | Larger<br>(250+)<br>n = 69 | p-<br>value             |
|---|--------------------------|-----------------------------|------------------------------|----------------------------|-------------------------|
| 1. Use of non-family members within top mgt (% non-family)                              | 6.07                     | 23.05                       | 44.38                        | 66.51                      | <b>.000</b>             |
| 2. Women family members working in firm (% of women)                                    | 36.16                    | 34.48                       | 21.37                        | 27.85                      | .178                    |
| 3. Use of team-management style (7-1 <sup>1</sup> )                                     | 4.68                     | 4.64                        | 4.18                         | 4.17                       | .267                    |
| 4. Having conflict between family members (7-1)   | 2.86                     | 2.90                        | 2.67                         | 2.10                       | <b>.041</b>             |
| 5. Formulation of specific succession plans (7-1)                                       | 3.32                     | 3.50                        | 3.24                         | 3.72                       | .600                    |
| 6. Use of outside consultants, advisors, and professional services (7-1)                | 3.90                     | 4.49                        | 5.27                         | 4.75                       | <b>.000</b>             |
| 7. Time spent in strategic mgt activity (7-1)   | 3.14                     | 3.04                        | 3.14                         | 3.78                       | <b>.036</b>             |
| 8. Use of sophisticated methods of financial mgt (7-1)                                  | 2.91                     | 3.53                        | 4.15                         | 5.48                       | <b>.000</b>             |
| 9. Degree of influence by original business objectives and methods of the founder (7-1) | 4.97                     | 4.16                        | 3.85                         | 4.52                       | <b>.003</b>             |
| 10. Consideration of going public (7-1)   | 1.68                     | 1.44                        | 1.39                         | 4.25                       | <b>.000</b>             |
| 11. Use of debt financing rather than equity (proportion debt/equity)                   | 39 / 40<br>49/51%        | 80 / 39<br>67/33%           | 76 /18<br>81/19%             | 49 / 19<br>72/28%          | <b>.000<sup>2</sup></b> |

<sup>1</sup> Likert scales—Mean of Describes our firm 7 6 5 4 3 2 1 Does not describe our firm<sup>2</sup> Chi-square, not F value.

# **FIRST-GENERATION, SECOND-GENERATION AND THIRD-GENERATION FAMILY BUSINESS: A MANOVA COMPARISON**

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## **ABSTRACT**

This study compared first-generation, second-generation and third-generation family firms in terms of a variety of family business management activities, styles and characteristics. Only two of eleven hypotheses were accepted. As supported by the literature, subsequent-generations are more likely than first-generation firms to formulate specific succession plans, and top management styles and decisions in subsequent-generation family firms are no less likely than in first-generation family firms to be influenced by the original business objectives and methods of the founder. Thus, contrary to much of the current literature, there are few significant differences. However, the eleven variables in combination do provide an overall multivariate analysis of variance (MANOVA) model that does find differences between generations.

## **INTRODUCTION**

The objective of this study was to examine First-Generation Family Firms (1GFFs), Second-Generation Family Firms (2GFFs) and Third-Generation Family Firms (3GFFs) in a multi-factor and multi-dimensional analysis, building upon the more limited-focused hypotheses, propositions and findings of previous researchers, and also upon an earlier study (Sonfield & Lussier, 2002). Sonfield and Lussier used a smaller and less-evenly distributed sample, only 13 1GFF, and a univariate one-way ANOVA statistical analysis. The findings of this study should expand our understanding of possible similarities and differences between first-generation and subsequent-generation family businesses. This in turn might enable family firm owner-managers to better understand and administer their businesses, might allow researchers to better focus their future investigations into generational categories as separate entities, and also might strengthen the effectiveness of advisors, consultants, and others who assist family businesses by allowing them to better differentiate between their 1GFF, 2GFF and 3GFF clients.

The existing literature occasionally compares first-generation versus subsequent generation family firms, but very rarely differentiates between second, third or further generations. This study extends this limited theoretical analysis further. If a 2GFF differs from a 1GFF, then does a 3GFF differ from a 2GFF in the same manner and to a further degree?

## BACKGROUND AND HYPOTHESES

Dyer (1988) found that 80% of 1GFFs had a “paternalistic” management culture and style, but that in succeeding generations more than two-thirds of these firms adapted a “professional” style of management. “Paternalistic” management was characterized by hierarchical relationships, top management control of power and authority, close supervision, and distrust of outsiders. “Professional” management involves the inclusion, and sometimes the predominance, of non-family managers in the firm.

McConaughy and Phillips (1999), studying large publicly owned founding-family-controlled companies, concluded that descendent-controlled firms were more professionally run than were founder-controlled firms. These researchers postulated that first-generation family managers are entrepreneurs with the special technical or business backgrounds necessary for the creation of the business, but the founder’s descendents face different challenges—to maintain and enhance the business—and these tasks may be better performed in a more professional manner, often by non-family members. Both Dyer (1988) and McConaughy and Phillips (1999) found an earlier basis in Schein (1983), who also suggested that subsequent generations in family firms tend to utilize more professional forms of management. These findings lead to:

*Hypothesis 1. Subsequent-Generation Family Firms are more likely than First-Generation Family Firms to include non-family members within top management.*

(For this and the following hypotheses, this phrasing means that 3GFFs are more likely than 2GFFs, and 2GFFs are more likely than 1GFFs.)

Studying gender issues in family firms, Nelton (1998) stated that daughters and wives are rising to leadership positions in family firms more frequently than in the past, and that the occurrence of daughters taking over businesses in traditionally male-dominated industries is increasing rapidly. Cole (1997) found the number of women in family businesses increasing, but did not focus on generational differences. More generally, U.S. Census Bureau data showed women-owned firms growing more rapidly than those owned by men (Office of Advocacy, 2001). Thus:

*Hypothesis 2. Subsequent-Generation Family Firms are more likely than First-Generation Family Firms to have women family members working in the firm.*

Another aspect of family business behavior is the distribution of decision-making authority in the firm. Dyer (1988) found decision-making to be more centralized in first-generation family firms than in subsequent-generation family firms. Aronoff (1998) developed this suggestion further and postulated that subsequent-generation family firms are more likely to engage in team management, with parents, children and siblings in the firm all having equality and participative involvement in important decision-making, even if one family member is still the nominal leader of the business. Aronoff furthermore reported that 42% of family businesses are considering co-presidents for the next generation. This leads to:

*Hypothesis 3. Subsequent-Generation Family Firms are more likely than First-Generation Family Firms to use a “team-management” style of management.*

Interpersonal dynamics, including conflict and disagreement among family members, has been a major focus of family firm research. Conflict can exist in first-generation family firms, when siblings, spouses or other relatives participate in management and/or ownership, and conflict can also arise between members of different generations in subsequent-generation family firms. Beckhard and Dyer (1983) found that conflict among family members increases with the number of generations involved in the firm. Conversely, Davis and Harveston (1999, 2001) concluded that family member conflict increased only moderately as firms moved into the second-generation stage, but there was a more sizable increase from second to third-generation. This leads to:

*Hypothesis 4. Subsequent-Generation Family Firms are more likely than First-Generation Family Firms to have conflict and disagreement between family member managers.*

A major focus of the literature on family business has been succession. The primary issues here involve the difficulties founders have in “letting go” and passing on the reins of control and authority, the lack of preparation for leadership next-generation family members often receive, and thus the need for, and importance of, succession planning (Davis, 1983; Handler, 1994; Upton & Heck, 1997). Dyer (1998) investigated “culture and continuity” in family firms, and the need for firm founders to understand the effects of a firm’s culture, and that culture can either constrain or facilitate successful family succession. Fiegener and Prince (1994) compared successor planning and development in family and non-family firms, and found that family firms favor more personal relationship-oriented forms of successor development, while non-family firms utilize more formal and task-oriented methods. Building upon these and other studies of succession in family firms, Stavrou (1998) developed a conceptual model to explain how next-generation family members are chosen for successor management positions. This model involves four factors which define the context for succession: *family, business, personal* and *market*.

While these and other studies have dealt with various aspects of succession, none have specifically investigated succession planning and practices in first-generation versus subsequent-generation family firms. Still, given that the importance of succession has been well established and publicized, and that family firms often experience the trials of succession as they move from one generation to the next, it would be expected that subsequent-generation family firms are more likely to recognize the importance of succession than are first-generation family firms and respond accordingly. Thus:

*Hypothesis 5. Subsequent-Generation Family Firms are more likely than First-Generation Family Firms to have formulated specific succession plans.*

Several observers of family firms have postulated that, as these firms age and/or move into subsequent-generation family management and ownership, they also progress from

one style of management to another. Informal, subjective and paternalistic styles of leadership become more formal, objective and “professional” (Aronoff, 1998; Cole & Wolken, 1995; Coleman & Carsky, 1999; Dyer, 1988; Filbeck & Lee, 2000; McConaughy & Phillips, 1999; Miller, McLeod & Oh, 2001; Schein, 1983). “Professional” management may involve the following: (a) the use of outside consultants, advisors and professional services, (b) more time engaged in *strategic* management activities, and (c) the use of more sophisticated financial management tools. These conclusions lead to several hypotheses:

*Hypothesis 6. Subsequent-Generation Family Firms are more likely than First-Generation Family Firms to use outside consultants, advisors and professional services.*

*Hypothesis 7. Subsequent-Generation Family Firms spend more time engaging in strategic management activities than First-Generation Family Firms.*

*Hypothesis 8. Subsequent-Generation Family Firms are more likely than First-Generation Family Firms to use sophisticated methods of financial management.*

Another issue of interest in the investigation of family business is “generational shadow” (Davis & Harveston, 1999). In a multi-generation family firm a generational shadow, shed by the founder, may be cast over the organization and the critical processes within it. In such a situation, “succession” is considered incomplete, may constrain successors, and may have dysfunctional effects on the performance of the firm. Yet this “shadow” may also have positive impact, by providing a clear set of direction and standards for subsequent firm managers. Kelly et al. (2000) similarly proposed that a family firm founder’s “legacy centrality” will influence the strategic behavior of succeeding generations’ family member managers, with both positive and negative impact. Davis and Harveston (1999) also investigated generational shadow, but reached mixed conclusions regarding its impacts. Thus management in both first-generation family firms and subsequent-generation family firms should be influenced by the objectives and methods of the founder:

*Hypothesis 9. Top management styles and decisions in Subsequent-Generation Family Firms are no less likely than in First-Generation Family Firms to be influenced by the original business objectives and methods of the founder.*

Family firms need not always be privately owned. As they grow and/or as they move into subsequent generational involvement, opportunities and needs for “going public” may arise. The family may not be able, or may not choose, to provide sufficient management or financial resources for growth, and outsider ownership can resolve this situation. And even publicly owned companies can continue as “family businesses,” if management or financial control is maintained by the family. McConaughy (1994) found that 20% of the *Business Week 1000* firms are family-controlled. Thus:

*Hypothesis 10. Subsequent-Generation Family Firms are more likely than First-Generation Family Firms to have considered “going public.”*

Following from the preceding discussion, it is correspondingly more likely for subsequent-generation family firms to use equity financing rather than debt financing. Cole and Wolken (1995) and Coleman and Carsky (1999) found that older and larger family firms use more equity financing and less debt financing than younger and smaller family firms. This leads to:

*Hypothesis 11. Subsequent-Generation Family Firms are more likely than First-Generation Family Firms to use equity financing rather than debt financing.*

Note that ten of the hypotheses predict differences, and only Hypothesis #9 predicts no differences. Also, new to this follow-up study, with the use of multivariate analysis of variance (MANOVA):

*Hypothesis 12. Together the 11 dependent variables provide a MANOVA model that finds significant differences between generations of family firms.*

## **METHODS**

As stated, this paper is a follow-up study to the Sonfield and Lussier (2002) survey research study. Differences in the methodology between the two studies are discussed.

### **Sample**

Survey instruments were randomly mailed or hand-delivered to a variety of New York and Massachusetts companies which had been identified as family businesses. A net distribution of 550 surveys yielded 159 usable returned, a 29% return rate. To improve the earlier study (Sonfield & Lussier, 2002), the sample size was increased from 109 in that study to 159 in this study, with the majority of the additional family firms being first generation, which increased from 13 to 50, increasing reliability and validity of this current study.

### **Variables Measured**

The independent variable was the number of generations involved in the operations of the family business. The nominal measure was one, two or three or more generations.

From Sonfield and Lussier (2002), the dependent variables to test Hypotheses 1-11 were as follows. (1) The percentage non-family managers. (2) The percentage of female family members involved in the operation of the firm. Hypotheses 3-10 were 7-point Likert interval scales of: “describes our firm” to “does not describe our firm”: (3) degree of all family members involved in decision-making, (4) level of family conflict, (5) formulation of succession plans, (6) use of outside advisors, (7) amount of long-range/strategic thinking, (8) use of sophisticated financial management tools, (9) influence of founder, and (10) consideration of going public. (11) The use of debt or equity financing was a nominal measure of one or the other. Descriptive statistical data included number of

years the firm was in business, the number of employees, industry (product or service), and form of ownership.

## **Analysis**

The earlier study used univariate statistical testing, one-way ANOVA. This current study uses the strong multivariate test multivariate analysis of variance (MANOVA). Hypotheses 1-12 were tested by using MANOVA, which provides a multivariate test of the 11 dependent variables together as a model by generation (H12). It also provides tests of between-variable effects to test H 1-11. Thus, MANOVA is similar to one-way ANOVA in that it tests each variable for significant differences between generations; however, it is a stronger test as each individual test also takes into consideration the other test for interaction effects.

## **RESULTS**

Of the sample of 159, the number of first generation firms was 50 (31%), second generation 60 (38%), and three or more 49 (31%). The mean number of years the sample family firms were in business was 39 (1GFFs = 13, 2GFFs = 34, 3GFFs = 67). As can be expected, the more generations, the longer the firm has been in business. The mean number of employees was 195 (1GFFs = 51, 2GFFs = 228, 3GFFs = 310), with a s.d. of 662 and range from 1 to 6,454. As in the population, more businesses were in the service section 117 (74%), [1GFFs = 78%, 2GFFs = 71%, 3GFFs = 76%] with 42 (26%) offering products. More firm ownership was corporation 118 (74%), followed by sole proprietorship 24 (16%), and partnership 17 (11%).

### **Hypotheses Testing 1-11**

See Table 1 for hypotheses 1-11, two can be accepted. There was a significant difference in (H5) the formulation of specific succession plans ( $p = .000$ ). The 1<sup>st</sup> generation firms do less succession planning than the 2<sup>nd</sup> and 3<sup>rd</sup> generation ( $m = 1.96, 3.80, 3.16$ ). Also, as hypothesized, there was no difference among generations regarding the (H9) influence of the founder of the firm ( $m = 5.12, 5.35, 4.59$ ;  $p = .139$ ).

[table 1 about here](#)

Thus, seven hypotheses can be rejected because there were no significant differences among generations: (H1) the percentage of non-family managers, (H3) degree of family involvement in decision-making, (H4) presence of conflict, (H6) use of outside advisors, (H7) use of strategic planning, (H8) use of sophisticated financial management tools, and (H10) consideration of going public.

Two other hypotheses are also rejected because there were significant differences that were *not* predicted by the hypotheses: (H2) There was a difference in the percentage of female family members involved in the operation of the firm ( $p = .035$ ). First-generation firms had a higher percentage of females than 2<sup>nd</sup> and 3<sup>rd</sup> generations (38%, 26%, 26%).



(H11) There was a difference in the use of debt to equity financing ( $p = .000$ ). The 1st generation firms had the highest use of equity with 61% to 39% debt. 2nd generation firms had 88% debt and 12% equity. 3rd generation firms had 67% debt and 33% equity. There was also a significant difference between the 2nd and 3rd generation debt to equity ( $p = .014$ ) financing.

### **Hypotheses 12 Testing**

The MANOVA multivariate tests (Pillai's Trace, Wilks' Lambda, Hotelling's Trace, and Roy's Largest Root) indicated that the 11 dependent variables together form a model that has significant differences between generations ( $p = .000$ ), which supports the hypothesis (H12). However, there is a limitation to this finding. As with regression, if you include enough variables, with a large sample size, there is a good chance that the model will be significant. Only 3 of the 11 variables (27%) are significantly different between generations. The model also has poor explanatory power, as the largest adjusted R square for the 11 variables is only .131. So the model may be significant, but it may not be very meaningful.

## **IMPLICATIONS AND CONCLUSIONS**

The issue of possible generational differences among family businesses, and this study of that issue, are important because family business owner-managers and both those who research and those who assist family firms need to know whether it is of value and perhaps necessary to differentiate between generational categories within the total population of such firms. Are there significant differences which should be studied more fully, and would these differences in turn mean that different forms of management and of assistance would be most effective for first-generation versus subsequent-generation family firms?

Clearly, much of the existing literature regarding possible generational differences among family firms is not supported by this current research study. In most respects, 1GFFs, 2GFFs and 3GFFs share the same management activities, styles and characteristics. Most prior studies' examinations of generational issues were only a small or tangential part of a larger focus on other or broader family business issues. Thus, the hypotheses formulated for this study were based on limited research conclusions. Even though this current study provides a stronger testing of these issues than earlier studies, these current findings still indicate a need for more focused and more extensive analysis of generational similarities and differences among family firms.

## **REFERENCES**

Sonfield, M. & Lussier, R. (2002). First-Generation and Subsequent-Generation Family Firms: A Comparison. *Proceedings of the Small Business Institute Directors Association National Conference*, February, pp. 153-161.

Due to space limitations, the other 41 references available from the first author

Table 1  
MANOVA Test Between Variables Effects Comparison by Generation (N = 159)

| Hypotheses   | 1GFF<br>(n=50) | 2GFF<br>(n=60) | 3GFF<br>(n=49) | Adj<br>R <sup>2</sup> | p-<br>value |
|--|----------------|----------------|----------------|-----------------------|-------------|
| 1. Use of non-family members within top mgt (mean % non-family)                        | 28             | 30             | 36             | -.002                 | .434        |
| 2. Women family members working in firm (mean % of women)                              | 38             | 26             | 26             | .030                  | <b>.035</b> |
| 3. Use of team-management style (mean 7-1 <sup>1</sup> )                               | 3.66           | 4.33           | 3.71           | .005                  | .241        |
| 4. Having conflict between family members (mean 7-1)                                   | 2.40           | 2.65           | 2.22           | -.003                 | .467        |
| 5. Formulation of specific succession plans (mean 7-1)                                 | 1.96           | 3.80           | 3.16           | .100                  | <b>.000</b> |
| 6. Use of outside consultants, advisors, and professional services (mean 7-1)          | 3.54           | 4.38           | 4.53           | .022                  | .064        |
| 7. Time spent in strategic mgt activity (7-1)  | 3.04           | 3.25           | 3.20           | -.010                 | .794        |
| 8. Use of sophisticated methods of financial mgt (7-1)                                 | 3.06           | 3.77           | 3.16           | .011                  | .162        |
| 9. Degree of influence by original business objective and methods of the founder (7-1) | 5.12           | 5.35           | 4.59           | .013                  | .139        |
| 10. Consideration of going public (mean 7-1)   | 1.42           | 1.45           | 1.22           | -.001                 | .402        |
| 11. Use of equity financing rather than debt (proportion equity/debt)                  | 61/39          | 12/88          | 33/67          | .131                  | <b>.000</b> |

<sup>1</sup> Likert scales—Mean of Describes our firm 7 6 5 4 3 2 1 Does not describe our firm

**SESSION: E-BUSINESS, INFORMATION SYSTEMS, & TECHNOLOGY ISSUES**

**ENTREPRENEURIAL ASSESSMENT OF TECHNOLOGY COMMERCIALIZATION  
AND NEW VENTURE FORMATION USING A DECISION MATRIX TO DIRECT  
COMMERCIALIZATION STRATEGIES**

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**ABSTRACT**

An integrated, inter-disciplinary graduate course entitled *Strategic Market Assessments for New Technologies* has been described previously. Working in inter-disciplinary teams (business, engineering, legal, science/medicine), graduate students develop: 1) evaluations of the strengths and weaknesses of the technologies, 2) competitive analyses of products and/or services currently in the marketplace, and 3) strategies for further development and commercialization of the technologies under evaluation.

Technology and market assessment tools were developed and utilized to assist in the technology evaluation and in the market analysis. There remained a difficulty in the development of appropriate strategies for commercialization and scoring schema and decision matrices were developed. These matrices were instituted in spring 2004 with significant success. Subsequently, the matrices were used to retrospectively evaluate the 20 projects completed during 1999-2003 to assess these projects in a similar manner and to validate the utility of the matrices. Use of the tools and matrices aided the development of strategic alternatives by identification and

categorization of areas of needed focus and strength. The use of the matrices, with the assessment tools, resulted in appropriate strategies for commercialization. The commercialization matrices were demonstrated, in a small retrospective evaluation, to have usefulness in the evaluation of technologies for commercialization and development of potential new ventures. More evaluation of the assessment tools is necessary, however, before final definitive conclusions can be drawn and recommendations made. The tools and matrices are unable to quantitate the commitment, hard work, drive, and tenacity of the entrepreneur so vital to the success of technology commercialization and new venture formation.

## INTRODUCTION

Technology transfer and commercialization is generally defined as a process designed to apply and share scientific information available to other organizations. The historical paradigm for technology commercialization has typically been for an idea or question to be investigated and answered in the laboratory by the scientist; translation of the laboratory results/output or process to a scalable, repetitive, reproducible level by the engineer; followed by the creation of an appropriate venture for the marketing and sales of the technology/product through the expertise of the business professional. To expand and paraphrase an old adage: “Science creates ideas, engineering creates products, and...*business creates companies and sales.*” This interdisciplinary schema, when successful, results in wealth creation for all stakeholders and for society. In the case of a university technology transfer program, the objective is to make university research available to private industry, including start-up companies, venture capitalists, and state and local governments. (Snyder, 2003)

Entrepreneurship results in the creation of economic value by utilization of research, technical information, and knowledge in inter-disciplinary projects and ventures to commercialize unique and innovative technologies and products. Entrepreneurs have been shown to be characterized by innovative behavior and to employ strategic management practices; the main goals being profit and growth. (Sexton, 1984) Opportunity assessment is the initial step in successful entrepreneurship. In technology ventures, knowledge and information regarding the specific technology are implicit in the opportunity assessment and usually not a significant issue for the entrepreneur. However, knowledge, and preferably a deep understanding of potentially competitive technologies, are also vital and may not be apparent to the investigator/entrepreneur, or even to the technology transfer professional. Shane has shown that knowledge of markets and ways to serve markets and customer’s needs influence opportunity discovery. (Wright, 2004; Shane, 2000) This market-related information and knowledge may be lacking in the academic investigator/entrepreneur, and even in the technology transfer professional, especially with regards to specific technologies and markets. It can be extremely difficult, even for experienced professionals, to successfully identify those technologies/products which will be successfully commercialized, especially early in the research or developmental processes, due to uncertainty and risks that are difficult, if not impossible, to quantify and measure. As noted by Wright, et. al., “there is an imperative to deal with the uncertainty surrounding the technology in its primitive state” (Wright, 2004), and “the uncertainty arises...due to a lack of information and the lack of an obvious market...” (Miller, 1984)

Unsuccessful commercialization can result from technologies that are premature, dysfunctional, too expensive, do not meet customer’s requirements, or from markets where there is poor

demand, excessive competition, or lack of adequate financial return. Therefore, it becomes imperative that any technology assessment include detailed market assessment and analysis. Additional in-depth assessment is often necessary to determine whether a successful business venture can then be created around a novel technology or product. Unsuccessful transfer and/or commercialization can be costly for all stakeholders; therefore, it is critical the technology transfer and commercialization processes be efficient, effective, and optimal. The Kauffman Foundation Report identified that there was no comprehensive source of professional development and training for technology transfer and commercialization, and recommended “support for the next generation of technology transfer leaders”. (Snyder, 2003) The graduate educational process can be used to address this apparent deficiency, and has been a driving impetus for the development of the course which is the basis of this study.

To assist in the resolution of these issues, an integrated, semester-long (16 weeks), graduate course entitled *Strategic Market Assessments for New Technologies (SMA)* was developed and instituted and has been previously described<sup>7</sup>. Working in inter-disciplinary (business, engineering, science/medicine) teams, graduate students develop: 1) evaluations of the strengths of intellectual property portfolios of USF investigators, 2) competitive analyses of products and/or services currently in the marketplace and 3) strategic alternatives for commercializing the technologies. The teams work in conjunction with the University investigators and under the guidance of an inter-disciplinary faculty (business, engineering, science/medicine) that has experience and expertise as academicians, practitioners, and entrepreneurs within their fields of expertise. The projects were obtained following discussions with the University of South Florida Research Foundation, the USF Division of Patents and Licensing, and senior administration and faculty. These projects were selected as “cutting edge”, high profile, and with significant potential for technologies appropriate for transfer and ultimate commercialization.

To assist in the intellectual property and technology evaluation, and in the competitive market analysis, technology and market assessment tools were developed and utilized. There remained, however, a difficulty in the instructional process regarding development of appropriate strategies for commercialization. Therefore, scoring schema and decision matrices were developed to help alleviate “the absence of information that creates decision uncertainty and decision complexity” (Wright, 2004; Busenitz, 1997) for students. The use of these matrices was instituted in the spring 2004 with significant success from the standpoints of all stakeholders. Subsequently, the matrices were used to retrospectively evaluate the projects completed, and new ventures formed, during 1999-2003 in order to assess these projects in a similar manner and to attempt to validate the strategy matrices and their utility. The ultimate goal of the development of these tools and matrices was to standardize and streamline the processes of opportunity recognition, technology and market assessment, and strategy formation for appropriate technology transfer and commercialization, in addition to transfer of this knowledge and these techniques to graduate students for use in their subsequent careers.

## **METHODS AND MATERIALS**

The strategic decision matrices were developed in the Spring semester 2004. The matrices were presented to the students for use during the semester, and were used to assist in the strategy development for the 2003-2004 *SMA* projects. The matrix scores used in the current study for the year 2004 were the scores developed by the student teams, which had been reviewed during

course meetings. The 20 projects during 1999-2003 were evaluated independently and blindly. The scores of each evaluator for each project were tabulated and averaged to determine an average technology and market assessment score for each project. The technology and market scores were summed to determine recommendations regarding commercialization strategy and compared to the outcome regarding technology commercialization and/or new venture formation.

The project scores were tabulated at the decision “breakpoints” to determine the predictive ability of the individual technology and market assessment tools:

|        |  |
|--------|--|
| <40    | (Very Weak—Abandon/Further R&D),           |
| 40-54  | (Weak—Further R&D/Build Value),            |
| 55-69  | (Moderate—Build Value/License/New Venture) |
| 70-100 | (Strong—Joint Venture/New Venture)         |

The technology and market scores were totaled and tested against the combined total decision “breakpoints” for predictive ability related to successful new venture formation.

For the combined score, the designated breakpoints, and concomitant recommendations were:

|         |  |
|---------|--|
| <80     | (Very Weak—Abandon/Further R&D),                     |
| 80-109  | (Weak—Further R&D/Build Value),                      |
| 110-139 | (Moderate—Build Value/License/New Venture Formation) |
| 140-200 | (Strong—Joint Venture/New Venture Formation)         |

The potential recommendations from the matrices were: 1) abandon, 2) build value with further research and development (R&D), 3) license the technology, 4) joint venture, and 5) new venture formation, and were compared to the plans for the technology as determined by the USF Division of Patents and Licensing (DPL), the research investigator, and/or whether there was formation of a new venture.

## **RESULTS**

Of the 20 projects retrospectively reviewed, 16 had enough data to determine technology and market assessment scores using the matrices developed in 2004. The projects without adequate data were removed from further evaluation (one project removed was an internal, related project and new venture formation was not an option). With the 6 projects from 2003-2004, there were 22 total projects to evaluate the scoring matrices. From these 22 projects, there were 19 potential new ventures (3 projects were internal, related projects from previously formed new ventures where new venture formation was not an option and were not included in the analysis regarding new venture formation, but were included in the assessment of the matrices).

Based solely on the technology assessment score, three projects would have been recommended to be abandoned (very weak), while only one was felt strong enough to proceed with recommendation for early new venture formation. Eight were in the weak category, and ten were in the moderate category. These eighteen would have been given a recommendation to build value through additional research and development, or to consider licensure where the additional R&D could have been performed by the licensee. Based solely on the market assessment score, only one project was felt to have an inadequate market present or that could be developed (very weak). Again, only one project was felt to have strong potential markets. Five were in the weak category and fifteen in the moderate category. These twenty would have been

recommended to further define their potential markets or focus in a different area in order to build value for the project. The utility of the combined total score is demonstrated by the decrease in very weak projects to only two, but conversely, there were no longer any strong projects, since each project felt to be strong in either the technology or market area was significantly weaker in the other area. Again, most projects were in the weak or moderate categories.

Over the five years, 26 projects were evaluated, and four were deleted from the analysis due to a lack of adequate data (one of which was a second project for the same investigator). Of the remaining 22 projects, there were 19 potential new ventures (3 investigators had two different, but related, projects evaluated), and thirteen firms were formed (4 technologies were recommended for licensure, the investigator preferred to proceed with further R&D after evaluation in two separate projects, and 1 technology ultimately failed during further development. Despite recommendations to build value through additional R&D, thirteen investigators proceeded to form new ventures. Of these thirteen new ventures, twelve are still in existence or were acquired or merged—all outcomes that would be considered successful. The firm no longer in existence decided to develop its technology within an academic/government consortium. Of note, four new ventures were also formed from the four projects deleted from the analysis due to a lack of adequate data.

## DISCUSSION

This is a primarily a retrospective analysis with attempted validation of a newly developed analytic tool. The fact that this analysis includes only 26 projects, four of which were excluded from the analysis due to a lack of data, and is done with only three reviewers could raise debate about the relevance of the results of the study. However, because of: 1) the unique nature of the analytic tools and the analysis, 2) to hopefully entice and encourage other programs to assess the tools/matrices and their utility, and 3) to open the discussion and possibility of development of appropriate quantitative methodology for this issue within academic and applied forums, it was felt appropriate to present this data and study at this time.

One major difficulty in the evaluation of new technologies/products and markets is that *any evaluation is only a snapshot in time*, and the results can be quite variable depending on the corporate, economic, financial, and competitive conditions at the time of the evaluation. At any given point, a technology or product may receive a poor evaluation because it needs further research, further development, or more time for a market to develop or become recognized. This is particularly true for new, innovative, technologies such as were being evaluated in this course. Powell and Moris<sup>9</sup> have studied these issues and demonstrated that there are different timelines for commercialization across different technologies, which supports the likely variability in any specific temporal technology/market evaluation. An evaluation, however, may provide the investigator/entrepreneur direction and focus both in technology assessment and development, and in market assessment and determination, even if the evaluation results in a relatively “weak” assessment or recommendation, and may also provide support for the investigator/entrepreneur’s commitment to the project.

The technology assessment is straight forward and reasonably quantitative, consisting of a tabulation of the investigator’s publications, patent disclosures, issued patents, patent position

within the field (i.e., competitive patents), and grant support (government, industry, or both). The major “subjective” area of this assessment is the team assessment of the investigator/entrepreneur with regards to business acumen and interest in starting a new venture. This is a major issue for technology transfer and commercialization, and even more so for joint ventures or new venture formation as discussed succinctly by Wright, et. al. (Wright, 2004; Wright, 2004). Many of the projects received “weak” to “moderate” scores and recommendations at the time of the assessment of the technology. It would appear that this level of scoring in the technology assessment was due to a number of factors, most of which have to do with the early stage of development of the technology. All of the investigators were well recognized in their field of expertise with numerous publications, which would give a high score in this category. However, the number of patents disclosed and/or issued tended to be low (with resultant low scores) which would be expected with early stage technologies. Further, grant support (particularly SBIR/STTR) tended to be low and result in low scores; again to be expected with new and developing technologies that had not yet earned academic respect or industry interest. The achievement of higher scores would be expected after further development, which may well require significant commitment of time, effort, resources, and money. The issue may then be a “chicken/egg” situation. Unless the technology has extra-ordinarily high scores (i.e., 70+), significant commitment (additional research and/or grant support, “bootstrap finance, etc.) may be required by the investigator/entrepreneur to move forward; with the full recognition that there may be significant risk to further development of the technology.

Optimal scores in the marketing assessment are to be found with technologies that are focused on potentially large, well-defined markets, with the expectation of significant growth. This was not the case with all technologies being assessed, and this alone would skew the market scores to the lower end. The number of competitors can be important, but often for conflicting reasons. If technology licensure is planned, a large number of competitors (or potential licensees) may be useful. A large number of competitors, each with small market share, may also allow more easy entry into a market. However, if a new venture is planned, a small number of competitors may be preferable, unless there are one or two very dominant competitors. These contradictory characteristics are often present in other categories of the market assessment. It becomes rapidly apparent that the market assessment is much more subjective, requires more experience, requires more definition of reference points, expectations, and goals, and could potentially be open to more manipulation.

Use of the total scores (technology plus market) resulted in better analysis of the overall technology commercialization potential. This demonstrates that it is vitally important to assess both technology and markets to optimize commercialization potential. In fact, it is imperative to evaluate any potential new technology/product within the context of the market—it is impossible to assess a technology except as to how it will compete within the marketplace. The difficulty is in identification of the appropriate market or potential market—this is particularly true for potential “life/world-changing” technologies. But, it must be remembered that significant possibilities and returns exist even in relatively small niche markets if the technology is dominant, can be protected for a significant period of time, or develops significant market “pull”.

The likely recommendations in most of these projects based on the tools and matrices as developed would have been to build value or consider licensure of the technology and delay any



new venture formation, if a new venture would ever be formed at all. It is, however, difficult to be totally sure of the expected recommendations since the reviewers were looking only at documents and were not able to address the investigator/entrepreneur at the time of the analysis. A further difficulty is that the course and required documentation have evolved over the five year period. It was very apparent to the reviewers that the documentation was much better and present in significantly greater detail in the later years. This also made the evaluation of the later projects significantly easier and probably more consistent and representative. As noted above, these types of assessments are very time-dependent and dependent on many and varied external factors at the time in question. It is impossible to re-create these factors in a retrospective analysis. This is critically important in the assessment of new venture formation since the most critical determinant in any new venture is the management team.

The relatively low scores and weak recommendations are, however, primarily a function of the early stage of development of the technology and the markets, and may also account for the significant clustering of the results in the “weak” and “moderate” categories. This outcome, however, does identify the need for further development of the assessment matrices for better differentiation within the weak and moderate categories. Detailed assessment of the individual categories within the assessment matrices demonstrated a trend to a mean and median score of three—both in the retrospective portion of the study, and in the prospective portion completed by the student teams. This resulted in clustering of the scores in the mid-range (weak and moderate), and obviously contributed to the difficulty in differentiation of the projects. There may be explanations for this tendency, including:

- a difficulty in assessing the early stage of the projects,
- a scoring system without enough options for differentiation,
- a need for further differentiation factors/categories,
- a need for longer term follow-up to identify the appropriate differentiation factors or categories.

The first, easiest modification would be to adjust the scoring option scale from 1-5 to 1-10. This should expand the scoring and allow some further differentiation early on. We plan to make this modification immediately. On-going analysis and follow-up of the data regarding additional factors continues.

These tools and matrices represent an attempt to quantitate and objectify what are often qualitative assessments and subjective decisions. These efforts are still preliminary and will require further development of the tools and matrices, a larger sample of technologies and markets, and more time to evaluate the full result of their use. *In toto*, it would appear that these tools and assessment matrices are useful first steps. They provide a rough quantitative assessment of a technology and potential markets (even very early technologies), they are easily taught and understood, and generally provide consistent results between observers. An area, in which the tools and matrices are unquestionably deficient, and where they may well remain deficient, are measurement of the drive, commitment, and tenacity of the entrepreneur. This is obvious since, despite recommendations to the contrary, at least 13 investigators, and likely all 17, proceeded to form new ventures and did whatever was necessary to succeed. It is these qualities, in conjunction with viable technologies and sufficient markets (or adaptation of one to the other), that result in successful entrepreneurial ventures. Identification and determination of the correct combination and mix of all these factors remain the ultimate challenge.

This project is an attempt to begin the collection of standardized data on technology transfer and commercialization at USF as has been recommended by multiple authors. (Sexton, 1984; Morgan, 2001) The data is being entered into a computerized database where it will be readily available for retrieval and analysis. It is anticipated that the prospective collection, analysis, and use of this type of data and information will be of great use to the USF administration, faculty, and students. This is an on-going project at the USF Center for Entrepreneurship, and we would welcome utilization and assessment of our tools and matrices by other groups.

## SUMMARY

Decision matrices for the development of strategies for the assessment and commercialization of technologies have been developed and utilized in an inter-disciplinary graduate class focused on the strategic assessment of technologies at the University of South Florida. The results of the use of these matrices have been reviewed and analyzed. The use of the commercialization matrices, in conjunction with technology and market assessment tools, has resulted in appropriate conclusions and recommendations in the assessment of the technologies and the markets, in addition to appropriate strategies for commercialization. However, the matrices need additional development to better differentiate those technologies likely to become successful new ventures.

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# ENTREPRENEURS' STORYTELLING: PRELIMINARY EVIDENCE OF ENTREPRENEURS' USE OF ORAL NARRATIVE

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## ABSTRACT

Do entrepreneurs use storytelling to exchange important information? This study reports the analysis of oral histories of 25 entrepreneurs and describes the ways in which entrepreneurs use storytelling to exchange information. The study found evidence that entrepreneurs use storytelling to exchange important information including the processes of: organizing, opportunity identification, sales and financing. Entrepreneurs may find that development of specific skills for the use of storytelling could lead to improved performance in each of the functional areas. Entrepreneurship scholars may find the ability of entrepreneurs to tell stories provides a unique means for differentiating between entrepreneurs and non-entrepreneurs.

## INTRODUCTION

The popular press is full of stories successful entrepreneurs. The field of business management has a long history of utilizing storytelling in the form of case studies as a pedagogic tool (Alvarez & Merchan, 1992, p.29) and more recently has begun to utilize case studies in research (Chetty, 1996; Eisenhardt, 1989, p.534; Kanter, 1983). However, research that investigates storytelling as a practice of entrepreneurs is relatively rare in the field of entrepreneurship.

Storytelling or, more formally, oral narrative is defined as the verbal presentation of a series of events meaningfully connected in a temporal and causal way (Onega Jaén & García Landa, 1996, p.3). The collection and analysis of the stories that entrepreneurs tell allows researchers to view the phenomenon of entrepreneurship through the subject's eyes (emic point of view), rather than from the more limited viewpoint of an outsider (etic point of view) (Hansen & Kahnweiler, 1993, p.1401).

This study reports the collection and analysis of oral histories of self-identified entrepreneurs and describes new understanding of the way in which entrepreneurs use storytelling to exchange information. The specific research question of this study is: "Do entrepreneurs use storytelling to exchange important information?"

## DATA COLLECTION

Approximately 22 hours of interviews with 25 self-identified entrepreneurs were recorded in the course of this research project. Each interview consisted of an entrepreneur recounting his or her life story. The interviews were collected in 2002 throughout the southwest of Canada and the

northwest of the United States, an area chosen because it provided a relatively homogenous cultural heritage. The entrepreneurs who agreed to be a part of this study were from a wide variety of industries: clothing, communications, consulting, health care, hospitality, manufacturing, retail, software development, trading and yachting. They ranged in age from 27 years to 76 years. Thirteen of the entrepreneurs were American, eight were Canadian and four were immigrants to Canada from other countries. Male entrepreneurs made up 68% of the population of this study. This approximates the finding of the Global Entrepreneurship Monitor study, which found males made up 62% of the total number of entrepreneurs in the US and 67% of the total entrepreneurs in Canada (Reynolds, Hay, & Camp, 1999, p.24).

### Data Quality

Data quality is usually measured in terms of *validity* and *reliability*. Validity is defined as measurement of the accuracy of information and its generalizability (Creswell, 1994, p.158). In qualitative research, the construct of validity is generalized to truthfulness of investigation (Kvale, 1995, p.25). Reliability has been defined as a measurement of the likelihood of similar conditions giving rise to similar observations (Aunger, 1995, p.99). In qualitative research, the construct of reliability is generalized to craftsmanship on the part of the researcher (Mays & Pope, 1995, p.110).

Validity can be broken down into two constructs: *internal validity*, which concerns the accuracy of information and *external validity*, which concerns the generalizability of findings. The construct of internal validity in positivist science corresponds to veracity or the degree of correspondence with objective (Kvale, 1995, p.23). Postmodern philosophy of science disputes the notion of objective reality (Feyerabend, 1975, pp.81-92) and substitutes “spirit of truth” (Ricoeur, 1965, pp.189-190) as the measurement of veracity. In this study, veracity has been tested by comparing the events described in the actuality for conformity with printed records (Allen & Montell, 1981, p.85). The construct of external validity in positivist science corresponds to generalizability and is generally treated as a sampling issue in interpretive inquiry (Zikmund, 1994, p.259).

This study utilized a process of *theoretical sampling* (Glaser & Strauss, 1967, p.45) in the determination of the number and types of candidates to be interviewed. Simply stated, theoretical sampling means that the ethnographer chooses the next people to interview when he or she feels the need for data to compare to the data already collected (Agar, 1980, p.124). Barney Glaser and Anselm Strauss refer to this point as *theoretical saturation* (Glaser & Strauss, 1967, p.61). Overall theoretical saturation was tested by comparing the data collected to a typology of eight entrepreneurial archetypes described by William Gartner (Gartner, 1982).

### ANALYSIS OF DATA

The specific research question, which the study investigates, is: “Do entrepreneurs use storytelling to exchange important information?” Statements of entrepreneurs describing their use of narrative were collected from the entrepreneurs’ recorded life stories. Table 1 classifies these statements into a typology based on the ways that the entrepreneurs of this study described their use of storytelling.

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Table 1 about here

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It is interesting to note that the female entrepreneurs of this study reported using storytelling as a tool for organizing and as a sales tool more frequently than male entrepreneurs. However, the male entrepreneurs reported using storytelling as a tool for opportunity identification more frequently than the female entrepreneurs.

#### Storytelling as a Tool for Organizing

Entrepreneurs in this study referenced storytelling 19 times as a tool used for organizing. Management researchers Mills, Boylstein and Lorean have suggested that storytelling can be seen as “explanatory mythmaking or conceptual construction that interpret and frame organizational situations” (Mills, Boylstein, & Lorean, 2001, p.118). The entrepreneur, Tom Keffer provided an example of how he used storytelling to create an organizational myth:

I wrote a company history up. And one of the anecdotes I gave in that is how when you were trapped at the phone all day long you couldn't go anywhere. This was before cell phones. So even something simple like taking a shower was a problem. And more than once the phone would ring when I was in the shower. I would take the phone in with me and when it would ring, and I would shut the water off and wait a few seconds for the gurgling noise to stop; pick up the phone and as calmly as I could, I would say: “Rogue Wave Software.” (Keffer & McKenzie, 2002, 14:45-15:16)

This particular myth frames the importance of customer service at Rogue Wave Software. To Keffer, customer service is so important that he would allow a customer to interrupt his bathing. Entrepreneurs in this study used storytelling in organizing in a wide variety of ways: to share best practices amongst organization members, as a way of documenting organizational structure, to learn business practices in a family setting, as a way of articulating the entrepreneur’s vision to organization members, to describe a business model and as a way of explaining complex relationships within the organization. In all of these cases, narrative appeared to have been used as a vehicle for the exchange of complex and rich information.

Organization theorist Ellen O’Connor views organizational decision making as the convergence of oral narratives claiming that the narrative’s power comes from its ability to simultaneously render information and the meaning of that information (O'Connor, 1997, p.309). Jan Kelly found that stories were used in high-tech firms to address equality, security and control (Kelly, 1985, p.57). David Boje has observed that storytelling in organizations has two intertwined components, stories as texts and stories as performance (Boje, 1991, pp.123-124). The majority of references that the entrepreneurs in this study made to storytelling used as a way of organizing referred to stories as text. This would explain the logic of Keffer’s writing down his narrative of the history of Rogue Wave. By solidifying the story, he hoped to create a stable, predictable organizational culture.

#### Storytelling Used to Identify and Communicate Opportunities

The entrepreneurs in this study reported 16 instances of the use of storytelling for opportunity

identification. The entrepreneur, Peter Newman provided an account of how he used storytelling to identify the opportunity associated with the founding of Progressive Plastics:

We were running a campsite, which was a learning experience. We were running a campsite and we were running this fabricating shop in Prince George and doing all the estimating and everything else and Brad was looking after the shop. And, in the meantime, one of our plastics suppliers, one of the guys I knew there well. Him and I went for a beer one night and he was complaining about this company. And I said 'well why don't we start up our own plastics company?' So we started up a plastics...an industrial plastics supply company which he ran, and I was the joint partner with him. (Newman & McKenzie, 2002, 30:06-30:39)

Throughout the interviews of this study, it was common for entrepreneurs to place their visions of opportunities into the context of a performance narrative. Often the product or market or combination of product and market that formed the basis of the opportunity did not exist at the time the entrepreneur envisioned the opportunity.

Not only did the entrepreneurs in this study use storytelling to uncover opportunities, but they also tended to use versions of the narratives they had created to convey the opportunity to others. This is a clear example of storytelling as performance. The entrepreneur, Nathan Rothman was explicit in describing the importance he placed on exchanging information about new business ideas with other people when he said, "I'm a big advocate about talking to people about your business idea and getting other ideas from people" (Rothman & McKenzie, 2002, 25:33-25:38). The entrepreneur, Tim Vasko's description of his identification of the opportunity in investment banking provided a simpler example of how a narrative can contain the interplay of characters, needs and desires and time:

I've always been interested in the stock market. It's always fascinated me as a kid and everything. So I got my license to sell mutual funds and...I made one sale. And so I was basically as salesman and I made one sale for...and the guy who sponsored me...the sale I made was a \$30,000 bond fund. And so I was expecting to get, the commission was four percent, so I was expecting to get \$1,200 or something less, maybe \$1,000. And I got a cheque for \$600. And I called the guy who had sponsored me to get my license and he goes, "Well half of it is mine". And I said, "You mean, I went out, I found the person, you don't give me an office, you don't give me anything, you don't pay any of my bills, you don't pay for my gas and you're going to keep 50% of my money." And he said, "Yeah, that's the way it works." And I said, "Not for me it doesn't." And so I decided that...I said, "Well, I'll just go and start my own company." And the guy said. "Good luck." (Vasko & McKenzie, 2002, 07:05-09:08)

Contained within this brief oral narrative are a host of details about the operation of the marketplace in 1983, the prevailing attitudes of competitors, and the intentions of the storyteller. These details would be difficult to portray so concisely through a medium other than storytelling.

## Storytelling as a Sales Tool

The ability of narrative to carry richness of detail suggests that it is well suited to use as a sales tool. The life stories collected in this study make 12 references to storytelling being used as a tool to exchange information in the process of sales or marketing. Nathan Rothman tells this story about how he used oral narrative to sell a number of sailboats before he had built even one:

So I went out and actually pre-sold a couple of boats...And I showed the boat to Bill Black and I said, "Bill, you know, here's the design and thousand bucks holds you a spot in line." And I had another friend, at the time Stan Dabney. Stan and Sylvia Dabney, who are still in the boat business...Stan Dabney ran a printing company, later became our sales manager. But ran a printing company, but he was a good friend of mine. And I said, "Stanley, before I can go to Bill Black, I need to have somebody on the list, you know I need to have sold a boat to somebody else. So put your name on the list. You bought hull number three and we'll go to Bill and we'll go to other people and we'll tell them look three are sold already you'd better get on the line you better get on the list, or you know you're not going to get one, you know." And so we went to Bill, and Bill Black wrote a cheque for a thousand bucks. And we went to a fellow by the name of Sever Murphy who ran the Indoor Sun Shop, which was a florist and plant shop in the University District. And he wanted one, and we put him on the list, and we got a thousand bucks from him so we sold four or five boats. (Rothman & McKenzie, 2002, 23:53-25:14)

Rothman's narrative builds tension within the prospective purchaser's mind that replaces their concern over not being able to see a boat with a new concern that the boats might all be gone by the time they actually get to see one. This tension could not have been built with facts and figures, since no boats actually existed nor had any actually had been sold. This tension could not have been created using print media, since the delay caused by writing a report, delivering it and then waiting for it to be read takes too much time for the deft interplay between the characters that Rothman was manipulating. Rothman's use of narrative in sales took advantage of the difficulty the purchaser had in searching for accurate information. Clifford Geertz described the process of information search in the primarily oral bazaar economy as being "laborious, uncertain, complex and irregular" (Geertz, 1992, p.227). Marc Weinstein's account of the used book trade in Gardena, California reveals similar characteristics in a North American setting (Weinstein, 1999, pp.9-15). Rothman's clients were intent upon the purchase of a safe, reliable, fast and stylish sailboat, characteristics that were not necessarily mutually compatible. Rothman's narrative, like the bazaaris multidimensional bargaining, allowed each client to feel he was getting the best deal possible.

## Storytelling Used in Financing Ventures

The entrepreneurs in this study referenced storytelling eight times as a tool used for financing their ventures. Ellen O'Connor has described the use of narrative by entrepreneurs seeking venture capital financing as the creation of generic stories (O'Connor, 2002, p.45). Generic stories tend to be easy to tell and make intuitive sense with prospective investors. Tom Keffer described his experience touring the US to meet with investment professionals prior to Rogue

Wave Software's Initial Public Offering (IPO) in these words.

It's the road show that's got this mythic vision. But I don't know, I found the road show kind of boring. Because you have this presentation that you fix up and tune so that it's just...Oh...perfect. And you go out on the road and I gave that damn presentation 65 times in a row over two weeks. That's pretty dull, I'll tell you. It's not exciting or anything like that. It's just dull. (Keffer & McKenzie, 2002, 24:48-25:30)

Keffer offered the only example of this level of financing sophistication amongst the entrepreneurs interviewed in this study. However, other entrepreneurs used less heavily scripted narratives for the same purpose. We have already seen how Rothman pre-sold boats (Rothman & McKenzie, 2002, 23:53-25:14) so he could attract investors to Valiant (Rothman & McKenzie, 2002, 22:28-23:02).

### Other Uses of Storytelling by Entrepreneurs

The entrepreneurs in this study have also referenced storytelling three times as a form of recreational socializing. However, there is no evidence within any of these references differentiating them from the normal use of storytelling by non-entrepreneurs in recreational socializing.

## IMPLICATIONS

This study has provided preliminary evidence that entrepreneurs use storytelling to exchange important information. This evidence suggests an important role for future study of the stories that entrepreneurs tell. Further empirical investigation of the use of storytelling by entrepreneurs could provide evidence, useful both to entrepreneurs and to entrepreneurship scholars.

Entrepreneurs are likely to gain confidence from the realization that their storytelling ability is vital to their profession. The development of specific skills for the use of storytelling for organizing, opportunity identification, sales and financing could lead to improved performance in each of these functional areas. Entrepreneurship educators could integrate storytelling into their curriculum both as a way of passing along the heuristics of entrepreneurial expertise and as an entrepreneurial skill.

Entrepreneurship scholars may find the ability of entrepreneurs to tell stories provides a means for differentiating between entrepreneurs and non-entrepreneurs. Media scholars such as Marshall McLuhan (McLuhan, 1964) and Walter Ong (Ong, 1977) have differentiated between oral cultures and literate cultures. It is possible that an individual's ability to communicate using storytelling is related to his or her ability to identify opportunities, to create organizations and to make sales; all key entrepreneurial activities. McLuhan describes oral communication as a cool medium because the listener must fill much of the information passed in oral communication. On the other hand, he describes print as a hot medium because the author impacts one single sense of the reader with densely packed information (McLuhan, 1964, p.36). While all of the entrepreneurs examined in this study were extremely proficient in oral narrative, only 7 of the 25 entrepreneurs of this study appeared to have the same proficiency in written narrative.



## CONCLUSIONS

This study has found evidence that entrepreneurs use storytelling to exchange important information. All the entrepreneurs whose life stories were collected in this study made some use of storytelling to exchange important information. The analysis of the 25 oral histories contained in this study has found that the entrepreneurs interviewed used storytelling both as a text and as a performance as suggested by Boje (Boje, 1991). Storytelling was used in the identification of opportunities, in the development of new organizations, in the arrangement of financing and in the process of making sales.

The evidence of entrepreneurs using storytelling to exchange important information presented in this study is preliminary in nature. It must be noted that the unstructured interview process used in the study limits the ability to generalize this finding to larger populations. Participants were asked to tell their life stories and questions were intended only to add clarification or to enhance the conversation that the memoirist had initiated. None of the participants were specifically asked if they used storytelling to exchange important information or what kind of information they exchanged using storytelling. Further research into the use of storytelling by entrepreneurs will be required to substantiate our understanding of the links between storytelling and the creative processes of organizing, opportunity identification, sales and financing.

## FIGURES AND TABLES

Table 1  
Classification of Entrepreneurs' Use of Storytelling

| Use of Storytelling        | Frequency | Male | Female |
|----------------------------|-----------|------|--------|
| Organizing                 | 19        | 29%  | 40%    |
| Opportunity Identification | 16        | 32%  | 20%    |
| Sales                      | 12        | 18%  | 25%    |
| Financing                  | 8         | 13%  | 15%    |
| Other                      | 3         | 8%   | 0%     |

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DIXON'S FAMOUS CHILI  
A WOMAN-OWNED, FOURTH GENERATION, FAMILY BUSINESS CASE STUDY

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Abstract

Dixon's Famous Chili is the oldest, continuously operating, family owned restaurant in Kansas City, Missouri. From the early 1900's, women have played pivotal roles. The societal pressures and life events that impacted these women and their families are presented to exemplify the struggles women have faced when operating a small business. The case begins and ends in the present day with the current owner facing divorce, raising three school aged children, and having no means of support except the failing family restaurant.

The teaching note uses current research on both woman-owned and family-owned small businesses to present a real world context for theory and model application. The teaching note also offers various combinations of theory, models and discussion points to bring the theoretical into a real world context. Practitioners and students enjoy seeing the relevancy of their studies and in turn, the impact of entrepreneurial decisions.

Case studies in both a woman-owned and family business context are increasing, but are still rare. The examples set by the three generations of women in the Dixon's Famous Chili case study are powerful, not only for aspiring women entrepreneurs, but for men as well to understand the dynamics of marriage, family and partnership.

The women, men and families in the Dixon's Famous Chili case faced real world situations that can be seen and understood with the use of entrepreneurial and small business theory providing students a bridge between their course work and their future.

Introduction

Kansas City, Missouri's oldest family owned restaurant was going to close; it was inevitable. The new owner was a freshly divorced, single mother with three school age children and no business experience. Her only asset was a business that was pest infested, in debt and without suppliers. The third generation to own Dixon's Famous Chili was doomed to be the last. As the owner looked at the young faces of the fourth generation, she realized she would pass nothing of the family legacy down to them except memories. Was there any way to save her self, her family and her family legacy?

Founding History

Vergne Dixon started selling chili out of a cart in the early 1900's in downtown Kansas City, Missouri. The business and recipe were little more than a hobby and a passing curiosity for both owner and client. The uniqueness, however, soon settled into a regular money making business and a permanent location was soon a goal. By 1919, Dixon's Chili was located in a permanent building in downtown Kansas City. Interestingly, all the waiters were male due to a unique hiring system; Vergne hired recently paroled convicts and the homeless as labor, paying them in food. And so another unique feature of Dixon's came to be. The men were so moved by Uncle Vergne's support that many worked for decades after Uncle Vergne's death in 1963, with the last parolee retiring from Dixon's in the early 1980s.

During the lunch hour, the busiest time for Dixon's, Aunt Lela took all the cash home. As Vergne's wife, she quickly assumed the multi-role responsibilities of bookkeeper, accountant, and homemaker. Still, the family missed the freedom of the old cart. Realizing that the hot and humid Missouri summer months had a direct impact on chili sales, the Dixon's decided to close for the summer, and if the result was an extended summer vacation for the family as well, all the better. This tradition held until 1970 and the addition of air conditioning.

For the first 50 years, the menu never changed, including Uncle Vergne's rule of no ketchup. In fact, while customers would sneak in ketchup, Uncle Vergne would fine them 10 cents if he caught anyone using ketchup on his unique chili. To this day, while ketchup is on the menu, the price is still 10 cents in honor of Uncle Vergne. The chili powder was so unique and sought after that the chili powder is patented and Dixon's chili recipe has remained unchanged since the early 1900's.

Through two world wars and a great depression, Dixon's Chili managed to survive. Thriving was a different question, but the family was able to make a decent living through good times and bad and no one complained or sought to change the business. That was until 1952, when President Truman came in for lunch. President Truman, being from the Kansas City area, had always liked Dixon's Chili and was a frequent customer. But when you are President of the world's most powerful country and have just won a contentious election, the American press follows you everywhere. Such was the case when Life magazine published a photo of President Truman enjoying a bizarre looking concoction that no one would ever mistake for chili anywhere else in the country. You see, Dixon's chili is not served in a bowl, but on a plate. The meat, juices and all the fixings are served and billed separately (remember the ketchup, as well as onions, cheese, sour cream and so on). The photo put Dixon's on the tourist map of where to eat in Kansas City and business began a steady growth. As a result, the "Famous" was added to the restaurant name. As a side note, what the Life photo did not show was the owner going across the street to get President Truman a beer. Dixon's had never applied for a liquor license and President Truman preferred beer with his chili. Dixon's Famous Chili hand delivered a bowl of chili every year to President Truman for his birthday and received a hand written thank you note every year as well.

### The Second Generation

In 1961, Uncle Vergne and Aunt Lela retired without having had children. Their sole extended family member was Aunt Lela's sister, Edith and her son, Leonard. Leonard's wife was Virginia, who had a particularly close relationship to both Uncle Vergne and Aunt Lela, who regarded Virginia as the daughter they never had. Wanting to keep the business in the family, Uncle Vergne decided to sell the restaurant at a dramatically reduced price of \$10,000 to Leonard. But Uncle Vergne had one condition; that Aunt Lela be paid a stipend of \$500 per month for the rest of her life after his death. Uncle Vergne died in 1963, while Aunt Lela lived on another 15 years, always receiving her \$500 monthly Dixon's stipend.

Leonard did not sit still on the original Dixon's, as he felt Uncle Vergne had been doing. Leonard expanded to nearly a dozen different locations; two in Kansas, one in Minnesota and the rest in Missouri. All these sites Leonard kept in the hands of family and friends. In 1970, Leonard formed a corporation, selling shares only to family and friends. That same year, Leonard closed the original location, placing the headquarters in the second oldest restaurant located in Independence, the first major suburb of Kansas City, directly east of the city.

Unfortunately, while Leonard was good at initially spreading the wealth among family and friends, he was not a good manager of these same family and friends. Nor were these new

owners and operators selected on the basis of their business skills, restaurant knowledge or customer service skills. The only qualification required to operate a Dixon's was your personal relationship to Leonard.

Yet, the Dixon's name and originality carried the budding chain for years, as well as Leonard's contagious enthusiasm for customer service and the value of the Dixon's Famous Chili name. Today, people still reflect back on Leonard's smile requirement of all his employees and how their faces ached at the end of the day from always smiling. Leonard believed in knowing customers on a first-name basis and training the staff on all the possible combinations of Dixon ingredients. However, despite Leonard's obvious enthusiasm, he could not be in all dozen stores at once and the long term prospects for Dixon's remained in question. The sudden death of Leonard in 1973 at the age of 52 put the future of Dixon's in even greater doubt.

### The Third Generation

Virginia, Leonard's wife, inherited the Dixon's Famous Chili business and immediately appointed her son Vince to run it. Vince opened several more stores taking Dixon's to 16 total locations, which did not change until the mid 1980s. But the same issues facing his father quickly faced Vince as well; lack of central control and inexperienced manager/owners. Vince had all he could handle battling the continual deterioration of Dixon's hard-won quality, service and reputation. The 16 store expansion was in danger if imploding from within.

Virginia and Leonard's other child, Terri, worked the restaurant after school, weekends and summers to earn some spending money, but was not involved nor interested in any aspect of Dixon's. Terri's goal, after meeting and marrying her husband Steve, was to be a full time mother to her three children. Steve had other ideas.

### The Third Generation Part 2

By 1982, after a decade of Vince's control, Steve envisioned greater things for Dixon's. While profits were fine for a family lifestyle business, no one was getting rich. Steve, involved as a manager for the chain under Vince, was chafing at the family control and their supposed lack of vision. Steve believed he could expand Dixon's and make the restaurant work as a regional, if not national, franchise, with professional managers and even greater cash flows and profits. However, standing in his way was his mother-in-law, the sole owner. As luck, or unluck, depending on your perspective, would have it, Virginia developed a drinking problem. Steve saw an opportunity to gain influence over Virginia and began a campaign to discredit her son, Vince. And he was good at it. One day mom walked in, fired her own son by simply saying, "You're out!", and put Steve in charge. Terri was now married to the president of Dixon's Famous Chili and the sister of the former president.

What was going through Terri's mind? She had been raised by Leonard and Virginia to be a wife and mother, with her parents never voicing a strong opinion that she continue her education after high school or learn the family business. The assumption must have been that Terri, like Aunt Lela, Edith and Virginia, would simply work tirelessly behind the scenes on the home front in support of the family business. In all honesty, Terri stated, she was simply ignorant of the business side of Dixon's and only cognizant of the family side. Terri's goal in life at that time, she stated, was to stay home and raise her children.

In regards to family relationships, even there Terri was not really involved if Dixon's was involved. The family was very adept at keeping family and business separate. As far as her

mother working with her brother or her husband, or Steve working with Vince; Terri, by her own admission, was just thinking about her children. And the others were comfortable with that role.

Terri's life would only be comfortable for three short years. By 1985, Dixon's was imploding and was down to two franchises and the original in Independence. Steve's grand design was fatally flawed, and just how flawed would soon become apparent. In 1985, at the age of 30, with three children ages 4, 6, and 8 and a mother who was dying, Terri (for reasons not related to Dixon's, of course) filed for divorce. However, during this process, Virginia dies, leaving Dixon's to Terri and Steve. The family's way of life in Dixon's and Terri's marriage were now both falling apart and her mother was gone.

### The Third Generation Part 3

Terri's demand in the divorce was twofold; first, that she get her children and second, her family legacy, Dixon's Famous Chili. Terri really can not quite explain why this sudden need to possess Dixon's, except that she was staring at three children under 10, she felt strongly that Dixon's should stay in the family as a legacy of her father, and Dixon's was the only way she knew to support her family. Steve drove a hard bargain; Terri gave up her home, financial support and the two franchises to keep her children and Dixon's Famous Chili.

Literally, Steve walked out of Dixon's one day and Terri walked in the next. Yet Terri knew nothing of the restaurant business or even business in general, management or accounting. Vince, her brother, did come back to help some, mostly over the phone, as Terri worked her way through the office. The few things Terri did bring to Dixon's she learned from her dad; customer service and Dixon's quality. Leonard always set as a goal for the wait staff to learn ten new customer names each week. To this day, returning customers that used to ask Leonard about Terri now ask Terri about her children.

And what Terri inherited from her divorce was not a successful business, not even one in good operation. The business was rundown and dirty, bills and taxes were all unpaid, the air conditioning was broken and the whole building was infested with bugs. Suppliers had written off Dixon's and were on a cash-only basis. Yet Terri would not let Dixon's go. She started cleaning, she started organizing bills, and she began working with suppliers, creating those relationships all over again. Terri began by working deals where she could, since she had no cash, but she paid on time and added extra to make up for any debt. Eventually she won them all over. The bottom line for Terri, and she communicated this to anyone who would listen, was that Dixon's was her family business and she and her children were the family.

Key to Dixon's continued survival was Sunday beer sales. At that time, there were no Sunday retail liquor sales so on Sunday's, Dixon's would line up coolers in the front window and sell beer at a 60% profit, making \$3000 per Sunday. Again, however, Terri's continued bad luck would plague her. In 1985, the year of Terri's divorce and her mother's death, the state of Missouri passed a law that all business taxes must be paid and verified to keep a liquor license. Since Steve had not been paying Missouri business taxes, Dixon's lost their license for 1985. Terri fought all year to regain the Dixon liquor license, going to the state capital city of Jefferson City to continually monitor and get the taxes caught up and paid.

In addition to the three hour one way drive to Jefferson City, Terri concentrated on cleaning and maintenance, learning as she went. A key success factor here was her landlady, a widow who admired Terri and enjoyed Terri's three kids. Terri had no choice, but to always have the children with her at Dixon's. The landlady decided to keep the Dixon's rent the same, \$1300 per month, while Terri owned the business. So, from 1985 until the landlady's death in

2001, the rent never changed. Upon the landlady's death, she and Terri had an agreement that Terri could buy the building at fair market value and that is exactly what Terri did.

Interestingly enough, when Terri looks back on these days, she felt like no major mistakes were made; she felt like she and Dixon's were always moving forward. Admittedly, the progress may not have been dramatic at times, but Terri never felt like she was moving backwards. Throughout this time, she also felt the presence of her father beside her, encouraging her, and that what she was doing was best for her family. Dixon employees, for the most part, were behind her. Given the length of employment for many of the Dixon employees, many had known Terri since she was a child. Working on a new relationship of employer/employee was interesting, Terri said, for both sides, but Terri never felt any hostility. More curiosity from the employees than anything as everyone was anxious to see how Dixon's would turn out, so the employees gave Terri the benefit of the doubt and stayed out of her way. In return, Terri has rewarded them with continued employment.

With Dixon's Famous Chili still open for business, Terri just started working, kids in tow, while living out of a duplex. Not making money really, just treading water financially, the entire family usually ate two out of three meals a day at Dixon's. By the 4<sup>th</sup> grade, the kids were busing tables and dishwashing. Moving forward, never moving back, paid off for within five years, Terri and kids were living in a wealthy subdivision in the suburbs and lunch receipts had grown from \$300 per day to over \$3000 today.

#### The Fourth Generation

Today, Terri's oldest daughter is an elementary teacher and has never regarded Dixon's as anything but a way to pay for college and launch her own career. A happy member of the extended Dixon's family, Terri's eldest is happy to watch her younger siblings carry the full time Dixon's legacy. Julie, the second child, also never expressed any long-term interest in working at Dixon's. She too worked Dixon's all her teen years and through her bachelor's degree from Northwest Missouri State University. Stephen, the youngest and only son, has always expressed a very strong interest in carrying on the family business. But he was soon to be joined by another.

When Julie was a senior at Northwest, Terri called and told Julie that she needed some time off; some time away from Dixon's. Terri asked Julie to find a new grad from Northwest, someone the family could trust, to operate the business under Terri. Even with her network of eager young grads at Northwest, Julie was unable to find someone she felt Terri would approve of, train and work with. So Julie came home and did the job herself, while looking for a full time job in the greater Kansas City area. Realizing she enjoyed Dixon's, Julie asked Terri/mom if she could apply for the new manager job. Terri trained Julie for a month and then took some time off. Interestingly, three employees that had been at Dixon's for over 20 years were not interested in the manager position.

In September, 2003 Dixon's crossed a milestone with the opening of their 2<sup>nd</sup> location in Lee's Summit, Missouri, the fastest growing Kansas City suburb on the Missouri side. Terri's goal is for this newest operation to be run exclusively by Stephen while Julie maintains control of the Independence location.

Julie has already started making changes to the Dixon's traditional menu. Since tamales have always been the most popular option with Dixon's Famous Chili, adding tacos was an easy transition given that most of the chili fixings can also be used on tacos. Julie started all you can

eat Taco Tuesday's in the winter and all you can eat taco summers, with sales dramatically increasing for the summer months when traditionally sales were nearly cut in half.

Yet, Terri has kept control of all bookkeeping and banking relationships. She taught her self all financial aspects of running a business with no one to ask and no one to help. Her ex-husband had destroyed all these relationships and her brother preferred to keep his distance. While she involved both children in the finances, Terri maintains strict control and plans on maintaining control for the foreseeable future.

Long term, Terri and children would like to return Dixon's to franchising. In their favor is a relatively simple menu and the prep is also easy to master. Currently, Stephen, a recent business graduate from Missouri Western State College, will be responsible for exploring franchising. Terri emphasized the word, "exploring". She has had many offers by potential franchisees, but she has been frustrated by the complexity of franchising. Terri maintains that franchising is a goal, but is simply not in process right now. For Terri, franchising is "scary and expensive" which seems to reflect her past history with Dixon's and franchising. So wisely, Terri is waiting for the kids to come on board, learn the business and then when the family, i.e. Terri, is comfortable with expanding, she will consider the options.

One issue facing the Independence location is Julie's desire for a family of her own and her plan on only working part time once she has children. This will be a staffing issue that so far has been tabled until children are expected.

In regards to her extended family, Terri has always stressed family comes first; friends come and go. Terri did eventually remarry and her second husband gutted and rebuilt the Lee's Summit Dixon's location. Granted, like all families, Terri's has their moments of disagreement, but with Dixon's Famous Chili, the sole owner, Terri, has the final word. Both Julie and Stephen are Vice Presidents in the Dixon's corporation, but they have no voting shares.

In family matters, discussions are held and Terri does not have absolute power like she did when the children were young and she was single. Vince, her brother and previous owner, has never left the family, but he has moved on from Dixon's and is successful in the insurance industry. Terri's second husband will soon be joining Vince in his business, leaving Terri and her children in sole control of Dixon's. Now that the Lee's Summit location is up and running with newly graduated Stephen in control, Terri is concerned with business communication; she wants a formalized way of getting together instead of simply over the phone or dinner at home. And with the growth of the business, she stresses that she wants Dixon business talk to stay at Dixon's and dinner at home to be over other family life events.

Terri's exit strategy is to sell Dixon's Famous Chili to the children and go on a monthly stipend just like Aunt Lela.

## DIXON'S FAMOUS CHILI TEACHING NOTE

### Family Business Structure

Family businesses move through five stages (Gallo, 2002) which are presented and discussed.

### Family Business Structure Discussion Part 2

Building upon the issue of generational time, the influence of the founder, while powerful and oftentimes ongoing (Kelly et al, 2000) will be reinterpreted and adjusted by succeeding generations.



### Reputation

Even worse than a newly founded business (discussion could start here with the “liability of newness” as first presented by Stinchcombe in 1965), Dixon’s Famous Chili under Terri’s new ownership found itself not only facing reputation building, but starting with a negative reputation from both suppliers, customers and government. In contrast, a positive reputation is seen as proof of a firm’s overall success with all the above as well as other stakeholders (Goldberg et al, 2003). The cost of supplies, terms of contracts, ease of operating within a regulatory environment, attractiveness to customers and investors, and the ability to attract talented personnel are all indicative of a firm’s reputation (Goldberg et al, 2003).

### Succession

The majority of family owned firms do not survive intact through the second generation; only 30% survive the second generation while only 15% of family owned firms survive the third generation (Beckhard and Dyer, 1983; Ward, 1987; Kellermanns and Eddleston, 2004). Opening the succession section are Green’s (2002) five factors of survival.

### Succession Planning

A united family, one that successfully deals with conflict, is taught and learned by succeeding generations. The key process uniting all this is education of the young (Gallo, 2002). However, it is important to keep in mind when considering the low successful succession rate of family firms, that families are complex social units with their own histories and conflicts, conflicts that are usually far more intense and long lasting than conflict found in non-family businesses (Kellermanns and Eddleston, 2004). Succession is further complicated by the transfer of daily management of the firm and ownership of the firm. These can be mutually exclusive and take place at different times with different family members setting up potential conflict (Birley 2002).

### A Succession Model

The model presented in the full teaching note is based upon a literature search of over 40 articles and 7 books over the last 30 years regarding family business succession (Breton-Miller et al, 2002). Developing a family business succession model, which Le Breton-Miller et al (2004) detail nicely, is excellent reading for aspiring scholars of entrepreneurship.

### Family Businesses Part 1

Family businesses play a prominent economic role in virtually all economies worldwide and have a significant impact on the North American economies of Canada, Mexico and the U.S. (Kelly et al, 2000). However, literature and research on family owned businesses, and family woman owned businesses in particular, has been dramatically lacking relative to their overall economic impact (Birley, 2001; Kelly et al, 2002). Birley (2002) offers an interesting classification system that should stir class discussion.

### Family Business Part 2

In a continuation of the above, a resource-based view of entrepreneurship and the exclusive characteristics of family-owned firms (Sirmon and Hitt, 2003) is presented.

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## **SUCCESS FACTORS AMONG PHILIPPINE ENTREPRENEURS<sup>1</sup>**

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<sup>1</sup> Original paper submitted to the Annual Conference of the United State Association of Small Business and Entrepreneurship (2005), Indian Wells, California.

## **ABSTRACT**

The challenges that have been brought about by competitive and highly integrated markets, economic downturn, terrorism, and internal political strife in the Philippines pose difficulties and risks to entrepreneurs in the centrally located city of Cebu. Still, amid these threats, the local entrepreneurs have managed to survive. A survey of 113 entrepreneurs from Cebu, Philippines bears out the fact that hard work, the desire for financial independence and willingness to take risks, among others, have contributed to their success. Since the typical Philippine entrepreneur is traditionally unwilling to compromise family ties for business success, the entrepreneurs pursue a strategically thin line that delineates entrepreneurial success and family harmony as an adaptation mechanism to a global environment.

## **INTRODUCTION**

Lack of adequate entrepreneurship is often cited as a serious bottleneck in the development efforts of developing countries. Many developing countries have come to the realization that entrepreneurship is the engine for economic prosperity and started to formulate series of policies to stimulate entrepreneurship development. In an earlier study, McClelland (1961) observed a correlation between desire for achievement and motivation across different cultures. Subsequently, many entrepreneurship-related studies in a developing country context have been devoted to topics such as: who are these entrepreneurs, what motivates them and how business is created, to name just a few.

This paper explores some of the major issues faced by Philippine entrepreneurs. Filipinos are enterprising individuals who have been engaged in business and commerce for many centuries. Americans have taught the Filipinos to ask two critical questions: “does it work?” and “what has he done?” (Andres and Andres, 2001: 13). Jimenez (2002) underscored the importance of innovation and entrepreneurship among Philippine business practitioners. Philippine entrepreneurs who have a steady income stream, continue to explore ways to augment their income. It is not uncommon to see entrepreneurs owning more than two ventures in the Philippines. They are manifesting the Filipino’s quest to improve their standard of living. There are bigger dreams that they want to fulfill and seek to uncover ways to earn more and improve their lot through the establishment of a business (Sanchez, 2000: 15). An increase of status is also desired. Recognition and contribution are two main goals of entrepreneurs. The average Filipino worker would like to be known as a “businessman ” (Damaso, 1982: 103). As of 2000, there were 820,960 registered business establishments in the Philippines (National Statistics Office, 2004). Many entrepreneurs have been drawn by the income and the independence offered by self-employment.

Jimenez (2002) reported an international entrepreneurship research study conducted by Accenture entailing in-depth interviews with 900 board level executives in 22 countries. The 2001 Accenture study noted that characteristics relating to entrepreneurial behavior are rather universal, except for certain differences in cultures and environments prevailing around the world. Though the study included respondents from several international locations, the Philippines was not included. This study seeks to uncover potentially distinct attributes of Philippine entrepreneurs.

As the Philippine business environment becomes more globally integrated, and collaborative engagements with Philippine entrepreneurs loom, an understanding of the entrepreneurial mindsets of individuals in this emerging nation becomes highly relevant. Paje (2002) noted that in developing countries such as the Philippines, there are limited job opportunities in the formal sector of the society, as a result unemployment rates tend to be high in the countryside and migration of people to the urban centers ensue. As absorption of the new entrants is limited, these segment of the society are forced to engage in entrepreneurial activities due to the lack of other options. Morato (2004) pointed out that 91% of the registered enterprises in the Philippines are considered as micro enterprises (informal businesses with very few employees), 8% are described as small (less than 20 employees), while only about 1% are medium (20-99 employees) and large (100 or more employees). This suggests that home-based, family owned ventures abound in this emerging nation of 80 million.

In the context of international entrepreneurship, critical questions need to be asked to better understand this environment. This paper focuses on these questions: What are the attitudes of the Philippine entrepreneurs toward self-employment? What are the reasons for the residents' selection of business over other activities? What is the likelihood of the entrepreneurs' involvement in business in the next two years? What are the Philippine entrepreneurs' attitudes and beliefs regarding business?

### **PHILIPPINE ENTREPRENEURS**

The Philippine entrepreneur's motivation to engage in business is anchored on an aspiration not only for oneself but for the family as well. Value is placed on extended families over that of individuals. Thus, Philippine entrepreneurs want to prosper for the sake of the family. This concept is strengthened by the belief that the only source of emotional, economic, and moral support is the family (Andres, and Andres, 2001: 6).

In a study on entrepreneurship in 23 countries including the Philippines, Benz & Frey (2003) concluded that individuals engaged in self-employment tend to have greater work satisfaction than employees as a result of the freedom and independence they enjoy. Individuals are pulled toward entrepreneurship by the prospect of profit, independence, and a satisfying way of life (Longenecker, Moore and Petty, 1997: 6). Hamilton (2000) pointed out that entrepreneurs are at times willing to earn lower wages as long as they are engaged in self-employment. Since entrepreneurial activities entail a level of risk, in investing resources entrepreneurs directly assume financial risk. In leaving secure jobs, they risk their careers. The stress and time required in starting and running a business may place their families at risk.

There exist entrepreneurial attributes within the Philippine culture. In a cross-cultural study, Hofstede (1991) indicated that the Philippine culture has high power distance, high masculinity, low uncertainty avoidance. These attributes are identified by McGrath et al (1992) as traits typically present among entrepreneurs across international venues. In Hofstede's study, however, Filipinos scored low on individualism. High individualism typically characterizes entrepreneurs (McGrath et al, 1992). This collectivist or group-oriented behavior can temper entrepreneurial tendencies.

Yet, the expectation of achievement attracts the enterprising individual. Achievement is a self-administered reward derived from reaching a challenging goal

(Gibson, Ivancevich, and Donnelly, 1997: 182). Some authors view entrepreneurship as a matter of attitude. The right attitude converts one's quickened heart rate and night sweats into kind of excitement that leads to a successful business (Wolter, 2002: 63).

### **Sampling**

The respondents of this study were 113 randomly selected entrepreneurs in six major business locations in Cebu, Philippines. The entrepreneurs were asked to complete the Entrepreneurial Profile Questionnaire, which was used as a data collection instrument in this study. The Entrepreneurial Profile Questionnaire collected data on the demographic and business profile of the Philippine entrepreneurs. Data regarding the entrepreneurs' attitudes toward business risks incurred in establishing a business, their reasons for engaging in business, their future business plans, the consequences business engagement on their lives, personal beliefs and attitudes toward business, and the problems faced in conjunction with their business ventures.

There was no need for the researcher to translate the questionnaire into the local dialect. English is used as the language of instruction and business communication in the Philippines. For this reason, there was a low possibility of ambiguities or fallacies of intention in the treatment of the data.

Based on the authors' knowledge, this is the first study that delves into the entrepreneurial psyche of the Philippine entrepreneur. The area of study, Cebu is the second largest city in the Philippines, and has posted the largest economic growth in the country (Cebu Investment Promotions Center, 2004). The city has a population in excess of 1.5 million, urbanized, and has over 10,000 enterprises in operation (Department of Trade and Industry-Cebu, 2004).

The study was conducted in coordination with the Cebu Chamber of Commerce Inc. and a local company, Synergy Tech International. One thousand questionnaires were opportunistically distributed in business clusters in the districts of Mandaue, Lapu-lapu, and the Metropolitan Cebu area. Usable completed questionnaires constituted 11.3% of all forms distributed. The sample, comprising 113 entrepreneurs, were engaged in trading, professional services, food service, money lending, and poultry farming.

### **Survey Instrument and Data Collection**

The Entrepreneurial Profile Questionnaire (EPQ) was utilized as a data collection instrument. The EPQ was designed to survey the effect of individual, societal and environmental factors on entrepreneurship by collecting a combination of demographic information and extensive detail related to characteristics and orientations. A five-point Likert scale ranging from "strongly agree" (5) to "strongly disagree" (1) was provided next to each statement. The EPQ was successfully piloted and validated through a series of studies in Romania, Turkey, Russia, Poland, the Czech Republic, Hungary, Lithuania, Estonia, Germany, Venezuela as well as South Africa, Mexico and United States (Gundry & Welsch, 2001). The previous studies suggest that the measured dimensions determine entrepreneurial intensity and are reasonably reliable (Welsch, 1998).

Data on the respondents of the study are presented below.

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Tables 1, 2, 3, 4 about here

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## RESULTS

### Attitudes Toward Business

The Philippine entrepreneurs' attitudes toward business can be traced to their cultural orientation. This orientation governs their lives in both the personal and professional level. An important theme in the life of the typical Filipino is the love for study and hard work in order to meet ordinary material needs without borrowing (Lynch, 1992: 18). Filipinos in rural locations migrate to larger cities in order to attain economic security. Andres (1999: 8) highlights the culture's craving for importance, love, respect, recognition, dignity, and financial security. In addition, Philippine entrepreneurs prefer that they own their business rather than pursue a promising career (Table 5). Filipinos tend to believe that employment limits one's income potential. With entrepreneurship, income opportunity may increase according to the level of effort exerted in order to improve the financial situation. Consequently, there is a belief that there is no limit to the length of time maximum effort is placed to establish their business. Everything is being done in order to succeed in business, and they are willing to make significant personal sacrifices to achieve success. As a result, business becomes the central activity in their lives. Filipinos with entrepreneurial acumen believe that they should be in business for the welfare of the community. Nagai (2004) alludes to the fact that ideology of modernization has been internalized in the Philippines, and led to the transformation of the country's social vision. It is not surprising that Filipino businessmen group themselves into "chambers of commerce" in order to engage in socio-civic activities. This situation is evident among entrepreneurs in Cebu.

Financial independence and achievement are important to the Filipino entrepreneur. In explaining the mechanism of enterprise creation, Camposano (1992: 9) expounded that people generally initiate ventures or create enterprises because of dissatisfaction with the status quo, desire for achievement, independence and autonomy, and the need to augment income. Other reasons are boredom, job lay-offs, individual employment, increase in family need, such as when the children of a moderate-income family need to go to college, or when a parent dies, leaving the spouse with no choice but support the family (Camposano, 1993: 9).

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Table 5 about here

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Some entrepreneurs begin as employees, but work long enough for them to gain specialized knowledge and establish their own business. While employed, they develop new visions, which lead not only to the identification of emerging entrepreneurial opportunities but also to the creation of holistic plan entailing an economic and financial direction geared towards releasing themselves from dependency.

### **Risks and Opportunities**

Going into business independently may incur risks, but these risks are deemed reasonable by the Philippine entrepreneurs, as a wider breadth of opportunities would likely arise (Table 6).

According to Jimenez (2002), while it may be safe to wait out for a more favorable economic climate in the Philippines, individuals and firms that dare take the risk during challenging times are often the ones that manage to survive.

In addition, a combination of non-desirable business responsibilities needs to be performed by entrepreneurs. These tasks contribute to tension since these activities may be unstructured. There is no structured guidance for engaging in one's own independent business enterprise, and encouragement is often given sparingly (Wolter, 2002: 64). For this reason, new entrepreneurs may experience adjustment problems and coping pains.

Other risks such as losing one's position with friends, the prospect of failure, and the ire of the family does not appear to be a major hurdle. The Philippine family is so closely knit that the ideals of family solidarity are frequently upheld. When a Filipino, particularly one from Cebu, is in trouble, he would likely have his family to support him. As a form of security system, the Filipino has developed the extended family system, since he cannot turn to the state for protection (Andres, 1999: 7). His relatives by consanguinity and ceremony forms with him a relationship in which the parties involved take turns in being a benefactor and beneficiary in a value known as reciprocity (Hollnsteiner, 1992: 22). Thus, though the risks attendant to entrepreneurship exist, it is not considered a major obstacle to the Filipino. Instead, opportunities in enterprise development are positively perceived as an opportunity to achieve social and economic improvement, leading to a peaceful coexistence with his family.

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Table 6 about here  
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### **Reasons for Engaging in Business**

Among 38 reasons to choose from, the Philippine entrepreneurs cited 19 reasons for engaging in business (Table 7).

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Table 7 about here  
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### **Projected Business Activities**

There were eleven (11) indicators that denoted the Philippine entrepreneurs' ambitions to perform activities for expanding their business interests in the future (Table 8). They aspired to conduct research, add new products or services, acquire new equipment, expand distribution channels and upgrade their computer systems. Expansion of the enterprise was an aspiration, since they aimed to sell to a new market. Thus, they planned to add specialized employees, and projected that they could afford to hire consultants, since professional advice was deemed necessary. The redesign of layout and computerization of current operations were other aspirations indicated.

The Philippine entrepreneurs seek not only to diversify their products and services, but concentrate on a broad range of related products (Poblador, 1998: 32). While this attitude may be largely anchored on culture, the present business environment



also pushes entrepreneurs towards aggressive diversification. For instance, Jimenez (2002) quotes William Torres, President of Mosaic Communications Inc, as stating that the Internet service industry is challenged to offer more value-added services in response to growing competitive pressures from telecom firms expanding into data services.

Talisayon (2002) points to the fact that new business models and business paradigms occurring in the Philippines are testing who among the current entrepreneurs will excel, merely survive, or fall by the sidelines.

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Table 8 about here  
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Many of the entrepreneurs do not have grandiose plans for the future, but believe in taking small but steady steps that will eventually lead to “big rewards”. Gradual, steady, and minor successes with slow but sure activities ensure the growth of the business (Farber, 2003: 48). This attitude highlights the Filipino’s perseverance and sense of sacrifice. Eventually, after the Philippine entrepreneur undertakes concrete measures towards business improvement, a new focus towards an even bigger goal is developed. There exist an inherent desire to build and create something larger than oneself or the business. Particularly in the Philippines where people suffer from poverty and unemployment, entrepreneurs recognize their vital role in keeping the national economic situation viable by providing jobs and creating wealth (Camposano, 1993: 18).

### **Benefits Derived from Entrepreneurship**

Six significant benefits derived from entrepreneurship were cited by the respondents (Table 9). These benefits consisted of the improvement of the standard of living, enjoyment of life, fulfillment of personal goals, creation of jobs, and provision for financial security.

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Table 9 about here  
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Entrepreneurship is a source of residual income in the Philippines (Go, 2002: 28). A high income leads to other benefits that the Filipino yearns for. The benefits are varied for Philippine entrepreneurs, especially in Cebu, a location identified as the melting pot of residents outside the National Capital Region (vicinity of the country’s capital - Manila). Improvement of standard of living, the benefit of a vacation, and the fulfillment of worthwhile goals, such as a good education for children are deemed important. The Filipino’s optimistic fatalism, often referred to as the “come what may ” attitude provides the courage to go into untried fields that appear promising. (Andres, 1999: 5).

Lagua (1999) cites that SME’s in the Philippines contribute to the economy as a result of the following : (1) generation of employment and income growth; (2) stimulation of entrepreneurship and innovation; (3) expansion and diversification of markets; (4) urban-rural dispersion and community stability; (5) increase in savings rate and investment base; (6) alleviation of threats for survival of the poor; and (7) promotion of pluralist society.

### **Difficulties Encountered in the Business Start-Up Stage**

A number of difficulties originating from various factors confronted Philippine entrepreneurs in the business start-up stage (Table 10).

The first two difficulties were financial in nature. One pertained to obtaining a loan as an entry-level financial requirement. Another referred to the cost of securing rental spaces. Because of a law stipulating a ten percent increase in rental yearly, security of tenure might be difficult for entrepreneurs with low start-up capital.

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Table 10 about here  
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Financial security is compounded due to the fact that heightened global integration has resulted to the cost of imported goods being cheaper than several local commodities. In the Philippines, liberalization of imports could not lower the prices of local commodities (Hamlin, 2002: 25). Other challenges identified are high construction costs, lack of employees trained in marketing, lack of sources of technical assistance, anti-market attitude and behavior, lack of clear regulations, inherent difficulties in the business start-up process, lack of legal services, lack of international trading information, unreliable suppliers, and lack of market information.

Paje (2002) observed that while the number of entrepreneurial activities abound, failures take place as a result of (1) deficiency in skills and certain management competencies on the part of the entrepreneur, (2) limitations in resources to acquire valuable technology and knowledge, and (3) lack of the proper integration of know-how into the organization.

Additionally, family pressures could increase problems as the demand for the entrepreneur's time from family members gets added into the equation.

Lagua (1999) pointed out that the SME sector serves as a critical link bridging potential incongruous strategies existing between growth and equity. It is therefore important for the government and private sectors to pursue complementary measures in order to further economic progress. Ferreira (2003) suggests that the Philippine government can play a proactive role in the development of entrepreneurs and enterprises through the implementation of three initiatives : (1) create an environment that facilitates opportunity-seeking, (2) establish transparent and egalitarian parameters that simplifies opportunity-screening, and (3) develop open and accessible structures that encourages opportunity-seizing. The government has an important supporting role to play in the creation of entrepreneur-friendly environment.

Despite facing prospects of imbalance and incompatibilities between the society and individuals, Philippine entrepreneurs remain steadfast in their business, perennially on a quest to ride the wave of globalization and staying on course towards small but notable business success.

## **CONCLUSION AND DISCUSSION**

Many entrepreneurs believe that business in the Philippines is largely influenced by culture and the values that the people uphold. Spanish and American influences may have helped shape the Filipinos' attitudes towards entrepreneurship, since the country has been a colony of Spain for over 300 years and that of the US for about 50 years. However, the characteristically Filipino concept that economic and social mobility is an

integral part of life has spurred the entrepreneurial fire of the residents. Furthermore, the traditional Filipino belief that one needs to be able to fully finance their children's education and continually look after the welfare of the family, has been a driving force towards the appreciation of profit and financial stability brought about by entrepreneurship.

This analysis is based on conclusions derived from the respondent survey conducted in 2003. As business and economic environments are in constant flux, it is possible that certain aspects of the society's structure have changed. With regard to the individual structure, it is important to note that though the Philippine entrepreneurs may have shared views and insights, individuals vary in the extent of their beliefs. The combination of entrepreneurial attitudes possessed by an individual does not necessarily reflect that of the culture he or she is associated with.

Nevertheless, it is interesting to note that in the Philippine environment entrepreneurs have learned to manage and nurture positive entrepreneurial beliefs despite an unfavorable business and economic environment. In the course of globalization, entrepreneurs worldwide are faced with several options when responding to emerging opportunities and threats. Philippine entrepreneurs have chosen to move along and capitalize on whatever niche they can find. In facing the daunting challenges that prevail in an emerging environment, they have chosen to continually draw upon a reservoir of self-motivational factors as an inspiration for business success.

Based on the 2001 Accenture international entrepreneurship study, Jimenez (2002) highlights key recommendations for entrepreneurial organizations across borders : (1) Clarify strategy and purpose in the entire organization, (2) Be big, yet small – act within a global paradigm yet remain nimble, flexible, and quick to respond to arising opportunities and challenges, (3) Cultivate entrepreneurial attitude and behavior – through the communication and positive reinforcement that entrepreneurship is valued, (4) Encourage diversity of structure and thinking – by being open and flexible to the changing dynamics of the global economy, and (5) Make the best use of knowledge – by digging deep into organizational structures, technological frameworks, and stakeholder alliances to fully capitalize on intellectual assets.

A globalized environment paves the way for greater cross-cultural business interactions. As international enterprises explore opportunities for expanding their markets or building new competitive advantages in foreign shores, it is relevant to understand the entrepreneurial mindsets of potential business partners, suppliers, customers, and employees. An understanding of entrepreneurial predispositions, opens the gateway to the formulation and implementation of more effective business policies, systems and structures, developmental strategies, alliance models, and modes of organizational development. It opens new doors towards the spreading out and the creation of unified culture on international entrepreneurship. Furthermore, an assessment of the compatibility of entrepreneurial attitudes between the home country and that of a new market, or one market with another, helps in the identification of potential areas of business conflict or synergy creation.

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**Table 1**  
**Classification of Respondents According to Gender**  
**(N = 113)**

| <b>Gender</b> | <b>F</b> | <b>%</b> |
|---------------|----------|----------|
| Male          | 67       | 59.29    |
| Female        | 46       | 40.71    |
| Total         | 113      | 100.00   |

**Table 2**  
**Classification of Respondents According to Educational Level**  
**(N = 113)**

| <b>Educational Level</b> | <b>F</b> | <b>%</b> |
|--------------------------|----------|----------|
| Grammar School           | 4        | 3.54     |
| High School              | 8        | 7.08     |
| College                  | 83       | 73.45    |
| Graduate School          | 18       | 15.93    |
| Total                    | 113      | 100.00   |

**Table 3**  
**Classification of Respondents According to Age**  
**(N = 113)**

| <b>Age Range</b> | <b>F</b> | <b>%</b> |
|------------------|----------|----------|
| Below 25 years   | 49       | 35.40    |
| 26-30 years      | 9        | 7.96     |
| 31-35 years      | 25       | 22.13    |
| 36-40 years      | 26       | 23.01    |
| 41-45 years      | 4        | 3.54     |
| Over 45          | 9        | 7.96     |
| Total            | 113      | 100.00   |

**Table 4**  
**Classification of Respondents According to Type of Business**  
**(N = 113)**

| <b>Type of Business</b>           | <b>F</b> | <b>%</b> |
|-----------------------------------|----------|----------|
| Service organization              | 4        | 3.54     |
| Retail (including restaurants)    | 59       | 52.21    |
| Finance/Insurance/Real Estate     | 3        | 2.65     |
| Transportation                    | 5        | 4.42     |
| Professional Services             | 1        | 0.88     |
| Distribution/Wholesale            | 15       | 13.27    |
| Manufacturing                     | 11       | 9.74     |
| Construction                      | 6        | 5.32     |
| Others (ie, agriculture, poultry) | 9        | 7.96     |

|                   |     |        |
|-------------------|-----|--------|
| farming, fishing) |     |        |
| Total             | 113 | 100.00 |

**Table 5**  
**Philippine Entrepreneurs' Attitudes Toward Business**

| <b>Attitude Indicators</b>  | <b>Mean</b> |
|---|-------------|
| I would rather own my own business than pursue another promising career.                              | 4.18        |
| There is no limit as to how long I would give a maximum effort to establish my business.              | 4.14        |
| I will do whatever it takes to make my business a success.  | 4.10        |
| I would be willing to make significant personal sacrifices in order to stay in business.              | 4.03        |
| My business is the most important activity in my life.  | 3.80        |
| I would like to make a significant contribution to the community by developing a successful business. | 3.58        |
| I would rather own my own business than a higher salary employed by someone else.                     | 3.53        |
| I would go to work somewhere else only long enough to make another attempt to establish my own firm.  | 3.53        |
| Owning my own business is more important than spending more time with my family.                      | 3.02        |
| My personal philosophy is to do "whatever it takes" to establish my own business.                     | 3.27        |
| I plan to eventually sell my business.  | 1.50        |

**Table 6**  
**Risks Incurred and Opportunities Gained by Philippine Entrepreneurs When Establishing a Business**

| <b>Risk Indicators</b>   | <b>Mean</b> |
|--|-------------|
| Attending to a variety of undesirable responsibilities in a business | 3.94        |
| Quality time with my children  | 2.64        |
| My position in the eyes of my friends                                | 2.61        |
| Willingness to take on additional debt                               | 2.61        |
| Risk of total failure in the business                                | 2.19        |
| Giving up my friends   | 2.03        |
| Sixty hours of work per week   | 1.96        |
| Incurring the wrath of my family                                     | 1.73        |
| Loss of significant recreation time                                  | 1.71        |
| Mortgaging my house  | 1.67        |
| Loss of time in another profession                                   | 1.57        |
| Borrowing my assets  | 1.50        |
| Conflict with the family   | 1.39        |
| Lost time with the family  | 1.38        |

|   |      |
|---|------|
| Use of all my savings                                       | 1.26 |
| Break of my marriage  | 1.03 |
| <b>Opportunity Indicators</b>                               |      |
| Sending my children to a better college/school              | 4.22 |
| Acquiring additional skills at significant personal expense | 3.89 |
| Watching my favorite TV program                             | 3.73 |
| Willing to take on any task in my business                  | 3.41 |
| Attending my favorite sporting event                        | 3.38 |

**Table 7**  
**Philippine Entrepreneurs' Reasons for Engaging in Business**

| <b>Reasons</b>   | <b>Mean</b> |
|--|-------------|
| To be able to develop an idea for a product or a business                                    | 4.26        |
| To fulfill a desire to have high earnings  | 4.24        |
| To keep learning   | 4.17        |
| To take advantage of an opportunity that appeared  | 4.13        |
| To be my own boss; to work for myself  | 4.08        |
| To fulfill the need for more money to survive  | 4.06        |
| To achieve a personal sense of accomplishment  | 4.02        |
| To increase the status and prestige of the family  | 3.99        |
| To make a direct contribution to the success of a family                                     | 3.99        |
| To have considerable freedom to adopt my own approach to work                                | 3.92        |
| To give myself, my spouse and children security  | 3.91        |
| To have fun  | 3.88        |
| To achieve something and get recognition for it  | 3.86        |
| To be challenged by the problems and opportunities of starting a business and making it grow | 3.84        |
| To become part of a network of entrepreneurs   | 3.82        |
| To have greater flexibility in my personal and family life                                   | 3.82        |
| To refrain from working for an unreasonable boss   | 3.78        |
| To achieve a higher position for myself in society   | 3.57        |
| To have influence in my community  | 3.42        |
| To be respected by friends   | 3.38        |
| To be able to work with people I choose  | 3.33        |
| To have the opportunity to lead rather than be led by others                                 | 3.32        |
| To control my own time   | 3.31        |
| To follow the example of a person I admire   | 3.25        |
| To have an element of variety and adventure in my work                                       | 3.12        |
| To make better use of my training or skills  | 3.11        |
| To be innovative and be in the forefront of technological development                        | 3.00        |
| To be able to work with people I like  | 2.87        |
| To make use of a time in my life when business made sense                                    | 2.74        |
| To contribute to the welfare of the community I live in                                      | 2.26        |
| To have access to fringe benefits  | 2.18        |
| To contribute to the welfare of my ethnic group  | 2.11        |
| To contribute to the welfare of my relatives   | 2.03        |



|  |      |
|--|------|
| To work in a desirable location for me and my family | 1.73 |
| To continue a family tradition                       | 1.50 |
| To compensate for my frustration in my previous job  | 1.31 |
| To escape from unsafe working conditions             | 1.25 |
| To perform the only thing I could do                 | 1.17 |

**Table 8**  
**Philippine Entrepreneurs' Projected Business Activities**

| <b>Projected Activities</b>                 | <b>Mean</b> |
|---|-------------|
| Researching on new markets                  | 4.03        |
| Adding a new product or service             | 4.01        |
| Acquiring new equipment                     | 3.99        |
| Expanding distribution channels             | 3.81        |
| Upgrading computer systems                  | 3.80        |
| Selling to a new market                     | 3.78        |
| Adding specialized employees                | 3.67        |
| Seeking professional advice                 | 3.57        |
| Redesigning layout                          | 3.44        |
| Computerizing current operations            | 3.43        |
| Seeking additional financing                | 3.41        |
| Adding operating space                      | 3.30        |
| Redesigning operating methods               | 3.18        |
| Expanding current facilities                | 3.13        |
| Replacing present equipment                 | 3.11        |
| Offsite training for employees              | 3.04        |
| Expanding advertisement and promotion       | 2.54        |
| Expanding the scope of operating activities | 2.38        |

**Table 9**  
**Benefits Derived from Entrepreneurship Identified by Philippine Entrepreneurs**

| <b>Benefits</b>                                    | <b>Mean</b> |
|--|-------------|
| Improvement of standard of living                  | 3.95        |
| Enjoyment of life                                  | 3.88        |
| Fulfillment of personal goals                      | 3.78        |
| Creation of jobs                                   | 3.65        |
| Provision for financial security                   | 3.54        |
| Provision of sufficient income                     | 3.40        |
| Provision for the family of an opportunity to work | 3.15        |
| Reinforcement of the feelings of autonomy, freedom | 3.03        |
| Creation of the means to express myself            | 2.83        |
| Creation of an opportunity to serve the community  | 2.40        |
| Reduction of personal stress                       | 2.36        |

**Table 10**  
**Difficulties Met by Philippine Entrepreneurs in the Start-Up Stage**

| <b>Difficulties</b>   | <b>Mean</b> |
|---|-------------|
| Obtaining a loan  | 4.08        |
| Entry level financial requirements                            | 4.07        |
| Number of competitors   | 4.00        |
| Finding a good location                                       | 3.96        |
| Lack of security  | 3.96        |
| Construction costs  | 3.93        |
| Lack of employees trained in marketing                        | 3.91        |
| Lack of sources of technical assistance                       | 3.87        |
| Anti-market attitudes and behavior                            | 3.83        |
| Lack of clear regulations                                     | 3.81        |
| Beating the entire risk of start-up                           | 3.80        |
| Lack of legal services  | 3.79        |
| Lack of international trading information                     | 3.78        |
| Unreliable suppliers  | 3.77        |
| Fatigue from long hours                                       | 3.75        |
| Being taken seriously by family members                       | 3.74        |
| Lack of market information                                    | 3.73        |
| Bureaucratic red tape   | 3.65        |
| Lack of guidance and counsel                                  | 3.64        |
| Lack of managerial service                                    | 3.61        |
| Scheduling business and family activities                     | 3.56        |
| Lack of distribution channels                                 | 3.48        |
| Lack of access to capital                                     | 3.42        |
| Narrow attitude toward my ethnic groups in business           | 3.41        |
| Lack of entrepreneurial understanding                         | 3.40        |
| Negative attitude toward profit-making                        | 3.38        |
| Extension of credit from suppliers                            | 3.21        |
| Corruption  | 3.17        |
| Lack of employees trained I financial affairs                 | 3.16        |
| Lack of family encouragement                                  | 2.90        |
| Storage / warehouses  | 2.89        |
| Finding enough time to spend with children                    | 2.67        |
| Lack of knowledge of relevant information sources             | 2.50        |
| Government assistance agencies                                | 2.49        |
| Lack of confidence from customers because of my ethnic origin | 2.41        |
| Discriminating practices against my ethnic group              | 1.83        |
| Among women:  |             |
| Narrow attitude toward women in business                      |             |
| Discriminating practices against women                        |             |
| Lack of confidence in women among the customers               |             |

# **STATE-LEVEL ENTREPRENEURSHIP POLICY AND TERTIARY ENTREPRENEURSHIP EDUCATION: A STUDY OF BENCHMARKS AND TRENDS IN NORTH DAKOTA**

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## **ABSTRACT**

Recently the National Governor's Association endorsed policies promoting entrepreneurship as a key vehicle for state-level economic development. One of the policy planks calls for offering entrepreneurship programs at tertiary institutions of higher education. Five years ago, a similar policy was developed and adopted by North Dakota's University System. This study examines the background of these policies and reports entrepreneurship education benchmarks and trends in North Dakota's institutions of higher education.

## **INTRODUCTION**

The Global Entrepreneurship Monitor (1999) attributes almost 70 percent of economic growth to entrepreneurship. Now economic development agencies and government policy makers are embracing entrepreneurship as a key driver of economic growth that must be nurtured.

Some of the endorsement that entrepreneurship has received from policy makers stems from the costs and rising expectations associated with incentive-based economic development schemes. At the state and local level, economic development initiatives often focus on the provision of costly incentives for business relocation and business retention. In addition, it is now expected that states will provide work force training and skills improvement, infrastructure investment, and favorable regulatory and tax environments (National Governor's Association, 2004).

Another set of problems comes with the sorts of businesses attracted by incentives and the industry clusters that develop. Paying incentives to low-wage, low-economic multiplier, and low-skills businesses may create entire industry clusters of such businesses. While jobs are created, the sort of jobs created is unsatisfactory to build future prospects and prosperity (Huenneke, 2004).

With assistance from the Ewing Marion Kauffman Foundation, the National Governor's Association (NGA) recently published *A Governor's Guide to Strengthening State Entrepreneurship Policy* (2004). According to the guide the following five state-level policy initiatives are essential to influence a more positive entrepreneurship environment.

- 1) Integrate Entrepreneurship into State Economic Development Efforts
- 2) States should use the education system to nurture and encourage future entrepreneurs
  - a. Build entrepreneurial readiness through the State's K-12 schools
  - b. Offer entrepreneurship education at public universities
  - c. Support faculty entrepreneurship in the University System
- 3) Incubate Entrepreneurial Companies
- 4) Invest in Diverse Sources of Risk Capital for the State's Entrepreneurs and Growth Companies
- 5) "Get Out of the Way" through Regulatory Reforms and Streamlining

## **PURPOSE**

The purpose of this paper is to inventory (or benchmark) academic entrepreneurship programs in one US state and determine program trends. Thus, the following paper looks at North Dakota and its efforts to nurture entrepreneurship through its tertiary educational system.

First, a profile of the state and its economic performance is built. Second, a review of the North Dakota University System and other colleges and universities is made. Third, a review of the North Dakota Roundtable Report, a policy document that mandates offering entrepreneurship education at public universities, is examined. Fourth, benchmark and trend data for tertiary entrepreneurship education in North Dakota are developed. Fifth, findings and recommendations for future research are offered.

## **North Dakota Population, Economic Health, and Entrepreneurial Standing**

North Dakota is a large state with less than 640,000 people. The state's population is both declining and aging. These two factors will have a significant impact on the state's university system and its future economic growth prospects. In regard to traditional college students entering college upon completion of their high school degrees the picture is bleak. From a recent high of 8,800 annual high school graduates, the number of annual high school graduates will decline to approximately 7,800 over the next decade (North Dakota University System, 2000).

In broad terms the state is struggling economically. Except for Nebraskans, North Dakotans have the highest rate of multiple job holding, 10.3 percent and 9.2 percent respectively. Nationally only 5.3 percent of employees held multiple jobs (North Dakota State Data Center, 2004). North Dakota's 2002 per capita income ranks 37<sup>th</sup> and is just \$26,567 as compared to the 2002 US per capita income of \$30,832 (North Dakota State Data Center, 2003b). Government, services, and retail trade are the biggest income generators for North Dakota and together comprise 48 percent of North Dakota's total 2002 personal income (North Dakota State Data Center, 2003b). North Dakota's 2001 gross state product is \$19.0 billion or just 0.2 percent of the US total (North Dakota State Data Center, 2003a).

According to a study by Goetz and Freshwater (2001), North Dakota soundly lacks an entrepreneurial climate. In relation to the other US states, North Dakota ranks 45<sup>th</sup> in entrepreneurial activity, 46<sup>th</sup> in entrepreneurship, 25<sup>th</sup> in ideas and innovation, 39<sup>th</sup> in human capital, and 47<sup>th</sup> in financial capital.

### **Tertiary Educational Institutions in North Dakota**

Given its small population, North Dakota hosts a large number of colleges and universities. These include the publicly supported North Dakota University System (NDUS) colleges and universities, private universities, and tribal colleges. In total the NDUS is composed of 11 units—two Ph.D. granting institutions, one master's degree granting institution, three bachelor's degree granting institutions, and five associate and trade/technical degree granting institutions. In addition, two private schools, one granting master's degrees, the other granting bachelor degrees compete for students from the general population. Five tribal colleges serve the state's Native American population.

As a unified system, the NDUS came into existence in 1990. The total 2003 enrollment of the NDUS is 41,620. Total enrollment has trended upward--34,293 in 1999, 35,093 in 2000, 37,596 in 2001, and 39,614 in 2002. The following is a brief profile of each NDUS unit as described in the 3<sup>rd</sup> Annual Accountability Measures Report (2003).

Bismarck State College (BSC) is located in Bismarck, ND. Bismarck is the state's second largest city. BSC is a comprehensive community college. Its enrollment is 3,430.

Dickinson State University (DSU) is located in Dickinson, ND. It offers certificates, associate degrees, and bachelor's degrees. Its enrollment is 2,461.

Lake Region State College (LRSC) is a two-year comprehensive community college. LRSC is located at Devil's Lake, ND and has an enrollment of 1,473.

Mayville State University (MaSU) is located in Mayville, ND. It offers certificates, associate degrees, and bachelor degrees. Its enrollment is 817.

Minot State University (MiSU) is a comprehensive mid-sized university offering bachelor's degrees, master's degrees, and education specialist degrees. It is located in Minot, ND, the state's fourth largest city. It has an enrollment of 3,825.

Minot State University-Bottineau Campus (MiSU-B) is located in Bottineau, ND. It offers diploma, certificate, and associate degree programs. Its enrollment is 620.

North Dakota State College of Science (NDSCS) has an enrollment of 2,468. It is located in Wahpeton, ND. It offers diploma, certificate, and associate degree programs.

North Dakota State University (NDSU) is the state's land grant institution and one of the state's two flagship institutions. It offers certificates, bachelors, master's, and doctoral degrees. It is located in Fargo, ND, the state's largest city. Its enrollment is 11,623.

University of North Dakota (UND) is the largest and oldest university in the state and offers certificates, bachelor's, master's, and doctoral degrees. Its enrollment is 13,034. UND is located in Grand Forks, ND, the state's third largest city.

Valley City State University (VSCU) is located in Valley City, ND. Its enrollment is 998 and it offers certificates, and associate and bachelor's degrees.

Williston State College has an enrollment of 871 and is located in extreme northwestern North Dakota in Williston, ND. It offers diploma, certificate, and associate degree programs.

While North Dakota's private and tribal colleges and universities are not governed by the NDUS, they are nonetheless affected by its policies. North Dakota's private higher educational institutions are in direct competition with NDUS schools and imitate successful public institutional ventures. In addition to other aims, the tribal colleges feed students into the NDUS system. Recognizing this role, some North Dakota tribal colleges have attempted to harmonize their systems with those of the NDUS.

### **The Roundtable Report**

In 1999 the North Dakota Legislative Assembly passed a resolution calling for the study of the state's university system. The study would address how the North Dakota University System could meeting the state's needs in the next century, the funding methodology needed to meet these expectations and needs, and an accountability/reporting system (North Dakota University System, 2000).

An interim committee of 61 (21 legislators and 40 business, education, and government representatives) formed the "Roundtable" to assess the state's future and the role of the NDUS in this future. The Roundtable concluded that unless concerted action is taken North Dakota will 1) suffer further population losses, especially among the most productive segment--young adults 2) fall further behind the rest of the country in income and quality of life measures, and 3) be unable compete in the new information-based economy (North Dakota University System, 2000).

The Roundtable Committee made six key recommendations or cornerstones upon which to build a university system. The following are the policy cornerstones as reported in *A North Dakota University System for the 21<sup>st</sup> Century* (2000, p. 7). (Detailed verbiage is included for those cornerstones that directly or peripherally address entrepreneurship in the NDUS setting.)

Cornerstone 1: Economic Development Connection--Direct connection and contributions of the University System to the economic growth and social vitality of North Dakota.

Cornerstone 2: Educational Excellence-High quality education and skill development opportunities which prepare students to be personally and professionally successful, readily able to advance and change careers, be life-long learners, good citizens, leaders, and knowledgeable contributing members of an increasingly global and multi-cultural society.

Cornerstone 3: Flexible and Responsive System-A University System environment, which is responsive to the needs of its various clients and is flexible, empowering, competitive, entrepreneurial, and rewarding.

Cornerstone 4: Accessible System

Cornerstone 5: Funding and Reward-A system of funding, resource allocation, and rewards which assures quality and is linked to the expressed high priority needs and expectations of the University System-assures achievement of the expectations envisioned.

Cornerstone 6: Sustaining the Vision

### **Description of Cornerstone One**

Cornerstone One, the Economic Development Connection, subdivided the responsibilities of the NDUS into three roles—workforce training, encouraging entrepreneurship, and the use of colleges and universities as direct sources of economic development. Workforce training is a well-established university role and fits with pre-conceived notions of economic development. Encouraging entrepreneurship was further subdivided into three parts: 1) Offering college educational programs that will provide “individuals who are so inclined with the knowledge, skills, and experiences necessary for them to become successful entrepreneurs,” 2) Provide assistance and advice to entrepreneurs, 3) Create “Occasions for the entrepreneurial ideas and the financing (venture capital) to come together” (North Dakota University System, 2000, p. 14). The third role, using university and college intellectual capital to spin off and engage in entrepreneurial activities, is identified as one of the more difficult roles to establish and enable. This will require significant changes to NDUS oversight and management routines.

The Roundtable Report (North Dakota University System, 2000) mandates that all units offer educational programs on the topic of entrepreneurship. Two benefits of this policy are stressed. First, it gives North Dakota the ability to grow its own new companies. Second, it exposes and mentors students in entrepreneurship, thus broadening their horizons.

The Roundtable Report then sets out accountability measures. In the case of encouraging entrepreneurship the measure is the “Level and trends in enrollment in entrepreneurship courses and the number of graduates of any future entrepreneurship programs” (North Dakota University System, 2000, p. 67).

In short, the Roundtable Report and the National Governor’s Association stance on policies to promote entrepreneurship are in close coincidence. But, how well have North Dakota’s tertiary educational institutions responded to policy directed entrepreneurship education provision?

## **METHODOLOGY**

The following is a description of the methodology used to benchmark and assess trend data for entrepreneurship education at all tertiary educational institutions in North Dakota.

First, a baseline assessment was done by reviewing the 2001, 2002, and 2003 NDUS Accountability Reports. These annual reports were mandated by the Roundtable. Second, an assay of entrepreneurship programs was collected through Internet searches and catalogs/materials published by North Dakota University System (NDUS), individual NDUS educational units, and non-NDUS educational institutions. Third, a telephone survey of knowledgeable informants (e.g., Deans, Chairs, Directors, etc.) was conducted to determine the veracity of collected materials, future intentions in regard to entrepreneurship education, and drivers of any initiatives/interest in entrepreneurship.

For the purposes of this study North Dakota tertiary educational institutions are classified as four-year public, four-year private, two-year public, and two-year tribal institutions. In addition to entrepreneurship, the search terms included small business and innovation courses and programs.

Total program offerings were assessed. That is, academic programs, academic courses, seminars and institutes, business development outreach, and student development opportunities such as entrepreneurship clubs, competitions, and internship offerings were checked.

## **RESULTS**

In general, the idea to power North Dakota's economic development engine through entrepreneurship education and growing businesses is laudable. The actual results are sobering for their modesty. Moreover, given the mandate that all NDUS units will embrace and offer entrepreneurship education the response is extremely weak.

The publication, A North Dakota University System for the 21<sup>st</sup> Century: The Report of the Roundtable for the North Dakota Legislative Council Interim Committee on Higher Education, (2000) set accountability measures and related data reports and so no actual measures were collected or reported. The 2001 report (Creating a University System for the 21<sup>st</sup> Century: 1<sup>st</sup> Annual Accountability Measures Report) reported only workforce training related measures for Cornerstone 1: Economic Development Connection. No data about entrepreneurship education or university business spin-offs were included. The 2<sup>nd</sup> Annual Accountability Measures Report (2002) reported on the number of businesses using NDUS workforce training services, their level of satisfaction with the training, and the level of research expenditures. Again no data were reported about entrepreneurship programs or courses. The most recent report (2003, p. iii), the 3<sup>rd</sup> Annual Accountability Measures Report stated, "NDUS institutions offered 45 entrepreneurship courses, two entrepreneurship programs and one option within a program. In the past year 862 students enrolled in entrepreneurship courses, and six students graduated from entrepreneurship programs. An additional 425 participants attended three non-credit seminars that had an entrepreneurship focus."

The direct review of Internet, catalog, and published sources undertaken by this study presented an even more modest picture. Our findings indicate that a total of 30 regularly listed entrepreneurship courses are offered by NDUS units. (Perhaps the 45 entrepreneurship courses reported in the 3<sup>rd</sup> Annual Accountability Report include special topics offerings or multiple class sections of regularly listed courses.) Of the eleven NDUS units only two, UND at the



bachelor-degree level and WSC at the associate-degree level, offer a meaningful array and depth of entrepreneurship coursework. Only one unit, UND, offers entrepreneurship options for business and non-business majors. Three NDUS units appear to offer no regularly scheduled entrepreneurship courses at all.

Budding entrepreneurs have few avenues to experience entrepreneurship outside of the classroom. Conferences/seminars with entrepreneurship topics were available at two institutions. One business plan competition was available to MiSU students and one North Dakota-wide business plan competition was available to any tertiary educational institution that was willing to field a team. University-integrated business-help agencies appear to be limited to UND and DSU. The possibility for internships was available at most units. However, clubs for young entrepreneurs were not active at most NDUS units.

Concerning private tertiary institutions, one (University of Mary) offered a regularly scheduled entrepreneurship course and the other (Jamestown College) only offered entrepreneurship as a special topic. Concerning tribal colleges, one (Sitting Bull College) offered both an associate degree and a certificate in Arts/Crafts Entrepreneurship. This certificate and degree were supported by just two entrepreneurship courses—BAD 220 Entrepreneurship and BAD 216 Small Business Management. Another tribal college (Fort Berthold Community College) offers an Entrepreneurship Management Certificate and a Entrepreneurship Marketing Certificate both of which include one entrepreneurship course—BADM 216 Writing a Business Plan. Fort Berthold Community College hosts a chapter of AIBL (American Indian Business Leaders).

Telephone interviews with knowledgeable informants at the various institutions highlighted the role of academic entrepreneurs. Only two higher education units have permanently institutionalized meaningful academic entrepreneurship programs. These are UND and WSC. UND's program includes a BBA in Entrepreneurship. The effort to launch this program was led by an academic champion who rallied others to the cause. In the case of WSC, a grant powered the necessary skills development, course offerings, and ultimately institutionalization. Given that grant production can be considered the output of academic entrepreneurship highlights the importance of academic entrepreneurs.

### **RESPONDING TO “SO WHAT”**

Providing entrepreneurship education at the university level is a critical component to power any state's economic development. In the most recent annual report available only two percent of North Dakota University System students received any entrepreneurship education. Despite a mandate to provide access to entrepreneurship education, too few students are being educated.

Since the mandate to deliver entrepreneurship education is an unfunded mandate, the work of academic entrepreneurs who secure resources, adherents, and build programs is essential. The two comprehensive NDUS entrepreneurship programs are the result of academic entrepreneurship. Certainly creating academic environments that foster academic entrepreneurship is necessary if meaningful entrepreneurship education is to take root.

## CONCLUSIONS AND FUTURE DIRECTION

Can an entrepreneurial climate be built in a state in which entrepreneurship has not yet taken root? Certainly policy decisions that demand tertiary entrepreneurship courses and programs at all NDUS units are a start. Monitoring the output of the NDUS units is a start. However, as an unfunded mandate, meaningful progress depends on two things. The first is internal reallocation of funds and top management support. The second is academic entrepreneurship, that is, academicians who act entrepreneurially to win resources, support, and build programs.

Finally, policy attention needs to be focused on the internal operations of NDUS units. How can the academic units be made friendly for academic entrepreneurs? What disincentives, leadership routines, and organizational impediments retard academic entrepreneurship with the NDUS?

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# **WHAT EXACTLY DO I HAVE IN COMMON WITH AN ENTREPRENEURIAL MANAGER? UNDERGRADUATE PERCEPTIONS OF POTENTIAL BOSSES BASED ON STATEMENTS OF PHILOSOPHY**

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## **Abstract**

Over the years a large body of literature has developed regarding cultural difference using Hofstede's cultural dimensions. In the course of studies regarding this literature attention has been placed on the differences between management and employees from a management perspective, yet little attention has been focused in the opposite direction. This study uses an in-basket laboratory experiment to determine if US students would prefer to work for a boss who shared cultural traits. The literature, methods and findings are followed by a discussion of the results and implications for entrepreneurs.

## **Introduction**

Buntzman and Parker (2004) recently applied the Hofstede value system to an analysis of MBA student perceptions of CEO effectiveness and found evidence in a pilot study that their perceptions of CEO effectiveness might in fact be related to their internationally diverse cultural backgrounds. This study is in some ways a follow-on study. It examines the preferences of undergraduate students to possibly work for individuals whose philosophies reflect various cultural backgrounds typical of the USA and certain European, Latin American and Asian regions.

Currently a wealth of literature exists on the impact of culture on business operations particularly in the area of employer/employee relations. Much of this literature is useful in examining the role that cultural differences plays in the understanding of how business works. Culture though extends farther than just an individual's background; one must also consider the culture of business to which a new graduate will be entering upon completion of a degree program or an experienced worker might enter upon changing jobs. "Corporate culture is comprised of philosophy and mission, manner of internal communications and hiring practices. From the

outside such things as dress code, flexibility of work schedules and level of volunteerism often form a company's public profile" (Pfister 1999).

This attitude is particularly true in American culture. As one U.S. CEO stated: "I think the most important thing you can have is pride in how you dress, in how you act...when you have facilities that are clean and painted, people take pride in that, and you end up with a better safety record, a better environmental record" (Pfister 1999). The philosophy of the CEO was reflected in how the employees reacted to it. One employee indicated that as a result of the CEO's attitude the company had become "extremely image conscious" and failure to adhere to norms would result in co-workers quietly pointing out violations (Pfister 1999).

The American value system as pointed out in a number of studies is not universally accepted. In an application of the Hofstede values (collectivism vs. individualism, high vs. low uncertainty avoidance, high vs. low power distance, masculine vs. feminine and dynamic vs. Confucian) Gouttefarde (1996) observed the interaction between Americans and French working in French companies. The comparison was justified given the cultural differences between the two nations. The French are high on the power distance scale whereas Americans rate low. The French and Americans also are at odds on uncertainty avoidance. Many of the respondents in the Gouttefarde study expressed frustration at their cultural counterparts. The Americans were seen as brash and too individualistic. The French were seen as micromanagers who stifled the creativity of American employees and were mired in bureaucracy. French bosses were seen as aloof from subordinates whereas the feeling was among French subordinates that the American supervisors got too close.

In other international studies (e.g. MacMahon 1996 and Channon & Dakin 1995) the importance of cultural understanding and identity was seen as a key to business success. In terms of hiring practices by small business owners in Ireland one entrepreneur stated: "I think that in a small company you have to be careful in selecting your workforce anyway – you try to make sure that people will fit in with your way of thinking, your way of doing things and the other employees" (MacMahon 1996). In the emerging markets of Central and Eastern Europe after the fall of communism, over 70% of companies surveyed for a study in hiring practices were aiming for "99-100 per cent local staffing in the long term, as most felt local staff would have a better understanding of the local market" (Channon and Dakin 1995).

It must be noted that the individual countries of the European Union (when examined apart from the EU) are considerably more homogeneous than the United States. In a 1998 study Chatman et al, investigated the impact of demographic characteristics on work processes and outcomes. Their findings indicated that the "salience of demographic attributes as social categories was higher in heterogeneous than homogeneous organizations" (Chatman et al 1998) once gender was excluded from the measurements. They also determined that "the salience of organizational attributes was higher in collectivistic than individualistic organizational cultures" (Chatman et al 1998).

But what are companies doing to foster the culture that will best suit their entrepreneurial objectives? Herb Kelleher, former CEO of Southwest Airlines is credited with establishing a culture that carefully "protects and nurtures its employees" (Fryer 2004). Other firms offer

employees access to top executives and perks such as African safaris and other exotic trips. Such actions are significant in that “employee morale and performance improvement are top management concerns” (McMaster 2003). Problems begin to arise when bosses begin to label subordinates as weak performers. According to Jean-Francois Manzoni, a management scholar at a leading French business school: “employee performance tends to adjust up or down according to such expectations” (Mount 2002). The emphasis on cultural understanding was succinctly framed in a recent editorial in the *Dallas Morning News*: “A company is only as good as its employees. That employer-employee relationship is being tested as never before, making it more difficult for companies to get workers to agree with their leaders on the same business goals. Successful businesses will understand the trends that are undermining workplace morale and will respond accordingly” (March 15, 2004).

Given that discussions have been raised on employer responsibilities in cultural awareness as seen above, what can be investigated about the expectations or desires of subordinates coming into a new work situation? Do workers desire to be employed by someone who has a similar background and values to them? In the United States, is cultural similarity a factor in determining whether or not a person would base a decision on job acceptance based upon the perceived opinions and judgments of similarity with the boss?

### **Research Questions**

In order to investigate the whether or not cultural similarities are desirable between employees and employers, we posed the following research questions based on the above:

R1 - Do US undergraduate students prefer a boss whose values are consistent with the US "archetype" that was identified by Hofstede?

R2- Do US business students prefer an entrepreneurial-type boss or one who is more conservative?

R3 - Is the type of business, its size and environment, a factor in determining whether an entrepreneurial or conservative boss would be preferred?

### **Method**

#### **Sample.**

The sample consisted of 100 undergraduate students enrolled in several sections of the authors' required business courses. Participation was voluntary and extra credit was provided.

#### **Instruments.**

We devised an in basket-like laboratory experiment for this study. Written instructions asked respondents to assume the role of a relatively new employee who has been appointed as a member of a 360° style selection committee seeking a replacement for a “very senior management position” for either a large multinational corporation or a small local business in the

service sector. After reading brief statements of philosophy attributed to each candidate in turn, subjects were asked to rate them as good for the organization, whether they would enjoy working for the person, whether the person would be a good role model for them, whether this person should receive priority in being given a personal interview, and the excellence of each candidate's philosophy. Each item was evaluated on a seven point Likert-type scale anchored by "Disagree" (1) and "Agree" (7).

Additionally, we collected data on how the candidates were perceived with respect to the Hofstede dimensions masculinity/femininity, low/high uncertainty avoidance, individualism/collectivism, and high/low power distance on seven point Likert-type scales. The scales asked subjects to rate candidate in terms of: hard driving or easygoing (to represent Hofstede's masculinity/achieving orientation); concern for subordinates, to represent collectivism, or out for himself, to represent individualism; entrepreneurial, representing low uncertainty avoidance, or cautious, representing high uncertainty avoidance; and elitist, representing high power distance, or democratic, representing low power distance.

Four candidates were presented for evaluation. Alex's statement of philosophy was designed to have him perceived as masculine, individualistic, with low power distance (LPD) and low uncertainty avoiding. According to Hofstede (1980) this is a typical value structure in the USA. Bobby was portrayed as masculine, LPD, collectivistic, and high uncertainty avoiding, typical of value systems in Japan and other parts of Asia and Latin America Hofstede (1980).

Charlie's philosophy was intended to present him as feminine, HPD, individualistic, and high uncertainty avoiding. This value system is consistent with Western European countries such as France and some Asian states Hofstede (1980). Finally Del's philosophy was intended to portray his/her value system as masculine, individualistic, HPD, and high uncertainty avoiding, typical of countries such as Belgium and Italy Hofstede (1980).

Independent variables were subject gender, business type (MNC v. Small Business) and type of value system. We used analysis of variance and stepwise multiple regression to analyze our data.

## **Results**

As stated above, Masculinity/Femininity was measured with the anchors "hard driving" (M) and "easy going" (F); Individualism/Collectivism was measured with the anchors "out for himself" and "concerned for subordinates." Low/High UA was measured with the anchors "entrepreneurial" and "cautious" and High/Low Power distance used the anchors "elitist" and "democratic" (Please see Table 1 below.)

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Table 1 about here

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As is shown in Table 1, Alex is perceived as Masculine (mean <4.0) and significantly more masculine than Bobby. Del is most masculine. Alex is perceived as more individualistic (>4.0), and more so than the collectivist Bobby. He is perceived as a low uncertainty avoider (entrepreneurial) (<4.0) and low PD (democratic) (>4.00). With two exceptions, the "applicants"

were perceived as expected. The exceptions were that Bobby was perceived as Feminine and Charlie was perceived as masculine. Overall, subjects perceived the candidates as would be expected based on their "statements of philosophies."

There were no gender differences in how men and women perceived the candidates. There were no business-type differences in how subjects perceive the candidates suitability for the position. Means for the dependent variables based on type of business tended to be close to the neutral midpoint value of 4 on the seven point Likert – type scales.

The candidates' value systems do appear to have influenced subjects' perceptions and recommendations. We expected that Alex would be rated more favorably because his/her value profile was intended to be similar to that for the USA, and the vast majority of the subjects were also from the US. In performing tests of differences in perceptions, we took the mean value of the rating for the dependent variable for Alex (representing the US value structure) as the test value against whether the others were compared. Results for these comparisons are discussed below.

Would this person be good for the organization? Using t-tests, Charlie (Feminine, High Power Distance, Individualistic, High Uncertainty Avoidance) had a rating of 4.52 (s.d. 1.22) versus 5.09 (s.d. 1.09) for Alex,  $T=-4.65$ ,  $p<.000$ . Thus Charlie was seen as somewhat neutral for the organization compared to Alex.

Would the subject enjoy working for this person? Bobby (B) received the highest rating, 5.12 (s.d. 1.23). This was significantly higher than the ratings for Alex (A). Del (D) had a significantly lower rating and Charlie's (C) low rating approached significance.

Would this person be a good role model? None of the candidates stood out in this regard with mean ratings close to the midpoint of 4.00, but C was significantly lower than A (3.99, s.d. 1.31, vs. 4.28, s.d. 1.48) and  $t=-2.22$ ,  $p<.03$ .

Should preference be given to this person to be offered an interview? No candidate stood out here either. There were no significant differences between A and the other candidates.

Does this applicant have a good overall philosophy? B was rated marginally higher than A,  $T>1.81$ ,  $p<.074$ . C was not significantly different and D was significantly lower ( $t=-2.29$ ,  $p<.024$ ).

Finally, we wondered whether perceptions of an applicant's strengths (would he/she be good for the organization, would enjoy working with others, would be a good role model, has a good overall?) would be predictors of an offer for interviews. We used stepwise multiple regression to explore this issue. For candidates A, B, and C only "excellent philosophy" entered the equation, but for D "a good role model" added explanatory power. Adjusted R-squares ranged from about .26 to about .49

## **Discussion**

We thought that US students would prefer a candidate, one for whom they might actually work according to our scenarios, who matched the value profile of U.S. culture as determined by Hofstede. This was not the case. In fact, using the mean for Alex as the reference point our subjects did not demonstrate a statistically significant preference for any of the candidates be offered an interview before the others.

The regression equations in which the candidates' philosophy was shown to be associated with making an offering all provide food for thought. These are no doubt many factors which bear on an individual's preferences in choosing to join an organization on the one hand, or whom to recruit to it on the other. Our results indicate that consideration of a candidate's philosophy (values) may be a major influence on those decisions. Often the emphasis in making such decisions is placed on using "hard" data such as income or profits or some other measure of achievement. In this experiment, however, we depicted the candidates as equally able and so there was not tangle data on which to base a decision. Another possibility would be to determine preference based on self-interest, but here self-interest concerns such as "would enjoy working with the person," or "would be a good role model," did not enter into the regression equations for three of the four candidates. In fact, for three of the four candidates nothing entered into the regression equation but philosophy. Only in the case of D was "would be a good role model" a predictor with a beta of .37. Perhaps this association is related to the fact that on average our subjects did not think D would be as good a role model as the other candidates.

### **Directions for future research.**

More work needs to be done, with a cross-cultural study and with other types of samples, to determine the impact of senior management characteristics on the preferences of subordinates. In-situ survey research may be most appropriate for such a follow-up study. More research into the impact of organizational philosophies, degree of entrepreneurial culture and the like is warranted.

### **Implications for Practice.**

In the real world, it is the subordinate who is most often the one under consideration to be hired and so is the one to be offered an interview, contrary to the scenario in this study. But the hiring process is a two way street since the subordinate has an opportunity to accept or reject an offer. Organizations that want to attract the best candidates cannot ignore this part of the process and should be aware of the things that make them attractive to potential employees. That is where this study makes a small contribution. "Soft" issues such as leader philosophy, organizational culture and so on should not be ignored if organizations wish to attract the best candidates

### **Limitations of the study.**

As this was a laboratory study with a student population from a limited geographic area it would be unwise to generalize at this time. More research is needed to clarify relationships and to validate the generalizability of the results.

## **Conclusion**



From this study it appears that a “similarity to me” syndrome does not apply to the sample population making these evaluations (assuming that the students sample does itself match the US value archetype). It is striking that a candidate’s overall philosophy is important as a determinant of offers (as indicated by the regression equations). This is a positive sign inasmuch as business schools of late seek to emphasize the importance of values in the workplace. But business schools also have emphasized the importance of an entrepreneurial culture, networking and mentoring and these do not seem to have been influential in preferences since an entrepreneurial orientation, role modeling potential and enjoying working with an individual were, for the most part, inconsequential considerations.

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**Table 1. Perceptions of Candidates**

| <i><b>Lower Vals.</b></i> | <i><b>Alex</b></i> | <i><b>Bobby</b></i> | <i><b>Charlie</b></i> | <i><b>Del</b></i> |
|---------------------------|--------------------|---------------------|-----------------------|-------------------|
| <i>Masc.</i>              | <u>3.67</u>        | <u>4.80*</u>        | <u>3.66</u>           | <u>3.27*</u>      |
| <i>Collec.</i>            | <u>4.27</u>        | <u>3.03*</u>        | <u>4.70*</u>          | <u>5.08*</u>      |
| <i>Low UA</i>             | <u>3.36</u>        | <u>4.99*</u>        | <u>3.88*</u>          | <u>3.91*</u>      |
| <i>High PD</i>            | <u>4.35</u>        | <u>4.84*</u>        | <u>3.77*</u>          | <u>3.78*</u>      |

\* =  $p < .05$

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# WHAT HAPPENS TO NASCENT ENTREPRENEURS? AN ECONOMETRIC ANALYSIS OF THE PSED

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## ABSTRACT

This paper follows the progress of American nascent entrepreneurs - identified in the initial interview of the Panel Study of Entrepreneurial Dynamics (PSED) - over each of the next two years of the panel. A novel theoretical and econometric model is used to reveal which personal and economic characteristics are associated with venture start-up - and which are associated with remaining a nascent entrepreneur, or giving up entirely. We discuss the implications of our results for lenders, business start-up support agencies, and policy-makers.

## EXECUTIVE SUMMARY

At least three groups of stakeholders want to know what happens to nascent entrepreneurs (NEs): policy-makers, lenders, and business start-up support agencies. In this paper, we put ourselves in the position of these stakeholders by predicting what NEs will be doing in one and two years' time – whether continuing as a NE; starting up a new venture; or giving up altogether. Our objective is to advise stakeholders about the factors they should look for when deciding whether and how to offer support to a NE, as well as the effects of such support on NEs' behaviour.

To this end, we estimate a novel model of entrepreneurial choice econometrically using PSED data, and find that:

- Nascent entrepreneurs who go on to start a venture are more likely to be in high-tech, to own their home, receive external finance, and have self-employed parents.
- Nascent entrepreneurs who take longer to launch their ventures are wealthier and provide more self-finance on average, and are more likely to be non-white and to envisage operating a solo home-based or non-high-tech start-up.
- Nascent entrepreneurs who give up altogether are more likely to have attractive “outside” options in the home and in paid employment. Nascent entrepreneurs who have attended business assistance programs are significantly *less* likely to give up in the long run.

We draw several policy implications from these results. First, lenders might consider adding to their loan screening criteria parental self-employment experience, having friends or kin in business, several specific venture characteristics, and NEs' domestic circumstances. Second, our results give some novel support to current US Federal policies of targeting loan assistance

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programs on ethnic minority starts. Third, benefits from business assistance programs only begin to emerge after two years, suggesting that policy-makers should not expect them to yield immediate payoffs.

## EMPIRICAL APPROACH

Consider a set of variables  $Y_i$  which affect the probability that nascent entrepreneur  $i$  chooses one of the following outcomes:

$$Z_i = \begin{cases} 0 & \text{if } i \text{ remains a NE} \\ 1 & \text{if } i \text{ starts the firm} \\ 2 & \text{if } i \text{ gives up / quits} \end{cases} \quad (1)$$

We use a multinomial logit framework to forecast the probability that  $i$  ends up in destination  $Z_i = j$ :

$$\Pr[Z_i = j] = \frac{\exp(Y_i^T \gamma_j)}{\sum_{m=0}^2 \exp(Y_i^T \gamma_m)} \quad j = 0,1,2 \quad (2)$$

In practice, rather than interpreting the coefficients  $\gamma_j$ , it is often easier to interpret the *marginal effects* of the independent variables on the probability of observing a particular destination. These are given by  $\delta_j = \Pr[Z_i = j] \times (\gamma_j - \bar{\gamma})$ , where  $\bar{\gamma}$  is the mean vector computed across all status groups.

We will use (2) to estimate the determinants of NE outcomes  $Z_i$  as described by (1) based on data from each of Waves 1 and 2 of the PSED – where data for the explanatory variables  $Y_i$  are taken from the “Screening interview” (12 months before the Wave 1 interview). Therefore the explanatory variables  $Y_i$  will be truly exogenous to the NE outcomes.

## DATA

The PSED is a representative sample of American adults first interviewed in 1998-99, and then re-interviewed in subsequent 12 monthly intervals. To give some idea about the diversity of NEs’ destinations, and hence the value of being able to predict future destinations based on observable initial characteristics, consider Table 1. This shows the destinations after 1 and 2 years of the PSED’s mixed gender sample of NEs that are used in this article. What is striking is the diversity of destinations among the NEs in the sample, with continuation in NE being the modal category in both years. Our challenge is to explain the factors underlying this diversity.

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Table 1 about here

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## VARIABLES USED IN THE ECONOMETRIC ANALYSIS

We identified several variables from the PSED data set that are likely to affect NEs' choices about whether to continue, launch, or quit. For convenience, they are grouped into the following categories:

- Value of a non-entrepreneurship “outside option”
- Financial circumstances
- Process activities
- Human and social capital
- Control variables

Based on a model which appears in a longer version of this paper, the predicted effects of each variable on NE outcomes are summarised in Table 2.

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Table 2 about here

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In addition, we also included several control variables to capture other manifestations of NE heterogeneity. These relate to the nature of the market, legal and organisational form of the start-up, and family structure. The effects of these variables appear in Table 3.

## RESULTS

Table 3 presents estimates of the determinants of NE destinations, both 12 months and 24 months after the initial interviews. The results indicate reasonably good predictive power, especially for the 24-month case. For brevity and clarity, Table 3 presents estimates of the marginal effects  $\delta_j$  that are statistically significant in at least one destination and time period. Several other variables from the PSED were also included in the econometric analysis, but failed to reach conventional levels of significance. Some of these are listed at the end of Table 3.

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Table 3 about here

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According to Table 3, those NEs who go on to start a venture are significantly more likely to have established credit with suppliers; to own their home; to have received external finance; to be involved in a high-tech start-up; and to have self-employed parents. The first of these three variables - which relate to resources - are important for facilitating start-up within the first year of nascent entrepreneurship. In contrast, the last two variables - which relate to the innate characteristics of the venture and the NE - appear to have a longer-term (2-year) impact on organisational emergence.

NEs who continue to wait before launching do so for a mixture of reasons. Waiting appears to be beneficial for non-white NEs who might have to prepare for entry more thoroughly in the face of discrimination. This might be deemed a negative reason for waiting. Positive reasons for waiting are associated with the luxury of being able to plan start-ups in a more leisurely way, as tends to be the case for retirees; NEs with greater income, wealth, and money invested; and for NEs contemplating a home-based start-up. NEs planning sole start-ups are not under pressure from business partners and so also have the luxury of waiting. Benefits of waiting include greater chances of eventual business success, which rational forward-looking agents should take into account when making their choices. Of course, it is also possible that some of the “waiters” might be lethargic dreamers whose declared intentions of eventually running a business are never really very likely to amount to anything.

Interestingly, the benefits of business assistance programs are more evident in the longer term (2 years after the initial interview) than the shorter term (one year). These programs appear to encourage waiting and deter quits from nascent entrepreneurship. In view of the well-documented evidence of over-optimism among entrepreneurs and high exit rates among new entrants (de Meza and Southey, 1996), these programs might be providing a valuable service, by encouraging greater caution about starting up without deterring NEs from entrepreneurship altogether.

Not surprisingly, individuals who are further into the process of launching the venture, for example having hired workers and established credit with suppliers - are significantly less likely to remain a NE – especially after 2 years – and significantly more likely to start-up. (For similar findings, see Carter *et al*, 1996; Delmar and Shane, 2004; and Kessler and Frank, 2004). Interestingly, although founders who are further into the process are significantly less likely to quit after one year, they are significantly more likely to do so after 2 years. This might be because those who are further into the entrepreneurial process are among the first to encounter insuperable difficulties that lead to quits.

Other factors also affect NEs’ decision to give up. Having attractive options outside entrepreneurship (which are associated with higher levels of education and raising young children) appear to be important, implying a strong voluntary component in quit decisions. In contrast, social capital is associated with lower quit rates. There is also some evidence that NEs who intend to enter markets characterised by strong price competition are less likely to quit, with the opposite being the case for markets characterised by non-price competition. The reasons for this are not entirely clear. A possible explanation is that NEs who intend to introduce a radical innovation (e.g., a novel durable good) for which price competition is unimportant, face greater risks and difficulties, and soon come to realise the limitations of their vision.

### **“SO WHAT?” - POLICY IMPLICATIONS**

These results carry several implications for stakeholders. First, they show that lenders play a key role in facilitating start-ups among nascent entrepreneurs, with receipt of external funds being a significant factor in helping to turn nascent into actual entrepreneurs, and reducing quits from nascent entrepreneurship. This contrasts with the effects of self-finance, which do not tie nascent entrepreneurs into a tight timetable for start-up, and so are associated with delay.

Our findings identify several variables that lenders might usefully incorporate into their loan screening models to improve their lending decisions. As well as relying on “traditional” indicators such as home ownership and education, lenders might also take into account parental self-employment experience; having friends or kin in business; characteristics of the venture (in particular, whether home-based or tech-based); and whether the NE is retired, married, a homemaker, or raises young children. Interestingly, our results suggest that education is associated with *quitting* nascent entrepreneurship, rather than continuing with it. Our theoretical model (outlined in a longer version of this article) can explain this in terms of more attractive outside opportunities in paid employment being available to the better educated.

Second, the evidence that non-whites remain NEs for longer than whites is consistent with the notion that they face different constraints, which necessitates a longer period of waiting before launch. If this reflects discrimination in the capital markets, then current US Federal policy seems justified in targeting assistance to ethnic minorities in the form of special loan guarantee programs. This point is strengthened by our additional finding that non-whites are significantly more likely to eventually start a business (i.e., after 2 years). Clearly, however, more research is needed to dig deeper into the ethnic dimension of NE entry decisions.

Third, our results indicate that existing business assistance programs appear to promote continuation in nascent entrepreneurship, and deter quits. It is notable that these effects are significant after two years, but not after one. This suggests that assistance programs need time to bear fruit. While we uncovered no direct evidence that these programs have significantly increased the number of business starts, that does not imply that the programs are ineffective. Indeed, it is quite possible that greater long-term benefits will accrue by encouraging NEs to delay and improve their business ideas than by urging them to launch precipitately.

We believe the robustness of our findings is enhanced by the exogeneity of the explanatory variables used in our multinomial logit analysis. We deliberately used initial pre-determined variables, rather than current-dated variables, for two reasons. First, only the former are observed by lenders and business advisors when they offer finance or advice. Since we want to offer them practically useful advice we must condition on the kind of data that they can gather themselves. Second, current-dated variables might suffer from the serious drawback of being endogenous, i.e., jointly determined with NEs’ destinations. For example, current wealth, income, and process activities might all be *determined by* NEs’ choices  $Z_i$ , rather than determining these choices. If so, causality is unclear, and one would also be unable to obtain unbiased results from standard statistical procedures (Greene, 2003).

## CONCLUSION

This paper used several waves of the rich PSED longitudinal data set in an attempt to understand what happens to nascent entrepreneurs in America. We first proposed a theoretical model capable of generating testable predictions. We then estimated the model using three waves of PSED data: an initial interview and two subsequent follow-up interviews at twelve-monthly intervals. We identified several key factors which can help predict which nascent entrepreneurs launch their ventures, which remain nascent entrepreneurs, and which give up altogether. We

went on to discuss the implications of our results for three types of stakeholder: lenders, business start-up support agencies, and policy-makers.

We would like to add a final thought for scholars in the nascent entrepreneurship field. Our analysis suggests that future researchers should utilise state-of-the art multinomial logit estimators (rather than the nearly ubiquitous binary logit), and truly exogenous explanatory variables that stakeholders can measure and use. We believe that these are valuable ways of helping stakeholders improve the design of their programs, in order to turn today's nascent entrepreneurs into the active entrepreneurs of the future.

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**Table 1**  
**Destinations of nascent entrepreneurs in the PSED**

|               | <b>12 months after the first<br/>Interview</b> | <b>24 months after the first<br/>Interview</b> |
|---------------|--|--|
| Still nascent | 160<br>(46.8%)                                 | 75<br>(46.3%)                                  |
| Operating     | 112<br>(32.7%)                                 | 40<br>(24.7%)                                  |
| Gave up       | 70<br>(20.5%)                                  | 47<br>(29.0%)                                  |
| <i>Total</i>  | 342<br>(100 %)                                 | 162<br>(100 %)                                 |

Notes:

Numbers of cases appear as the first cell entries, with sample percentages in parentheses underneath.



**Table 2**  
**Predicted effects of explanatory variables on nascent entrepreneurs' outcomes**

|                             | Outcome            |                                 |              |
|-----------------------------|--------------------|---------------------------------|--------------|
|                             | Still nascent: Z=0 | Start up: Z=1                   | Gave up: Z=2 |
| Wealth                      | +                  | –                               | –            |
| Household income            | +                  | –                               | –            |
| Money invested              | +                  | –                               | –            |
| Retired                     | +                  | –                               | –            |
| Home-based venture          | +                  | –                               | –            |
| Household head              | –                  | +                               | +            |
| Children under 6            | –                  | +                               | +            |
| Non-white                   | +                  | [– in short run; + in long run] |              |
| Saving money                | –                  | +                               | –            |
| Received funds              | –                  | +                               | –            |
| Owens own house             | –                  | +                               | –            |
| Hired workers               | –                  | +                               | ?            |
| Credit with suppliers       | –                  | +                               | ?            |
| Post-high school degree     | –                  | –                               | +            |
| College degree              | –                  | –                               | +            |
| Business assistance program | +                  | +                               | –            |
| Self-employed parent        | –                  | +                               | –            |
| Kin own businesses          | –                  | +                               | –            |
| Friends own businesses      | –                  | +                               | –            |

**Table 3**  
**Determinants of destinations of nascent entrepreneurs: significant marginal effects**

| Explanatory variables | 12 months after interview |                      |         | 24 months after interview |                      |         |
|-----------------------|---------------------------|----------------------|---------|---------------------------|----------------------|---------|
|                       | Still nascent             | Start-up             | Gave up | Still nascent             | Start-up             | Gave up |
| Log-likelihood        |                           | -300.974             |         |                           | -110.574             |         |
| $\chi^2(96)$          |                           | 169.049 <sup>a</sup> |         |                           | 154.593 <sup>a</sup> |         |
| Pseudo-R <sup>2</sup> |                           | 0.163                |         |                           | 0.360                |         |
| Actual frequency      | 160                       | 112                  | 70      | 75                        | 40                   | 47      |
| Predicted frequency   | 119                       | 65                   | 32      | 59                        | 27                   | 32      |

(continued on next page)

|                                   |                     |                     |                     |                     |                     |                     |
|-----------------------------------|---------------------|---------------------|---------------------|---------------------|---------------------|---------------------|
| Constant                          | -0.443              | -0.110              | 0.552 <sup>b</sup>  | 0.777               | -0.994 <sup>b</sup> | 0.218               |
| <u>Value of an outside option</u> |                     |                     |                     |                     |                     |                     |
| Wealth (\$)                       | 0.001 <sup>a</sup>  | -0.001 <sup>b</sup> | -0.001              | 0.001               | -0.001              | -0.001              |
| Household income (logs)           | 0.003 <sup>a</sup>  | -0.020 <sup>c</sup> | -0.013              | 0.037 <sup>c</sup>  | 0.025               | 0.013               |
| Money invested                    | 0.059 <sup>a</sup>  | -0.017              | -0.043 <sup>a</sup> |                     |                     |                     |
| Retired                           | 0.383 <sup>b</sup>  | 0.006               | -0.388 <sup>b</sup> | -0.147              | -0.335 <sup>c</sup> | 0.481 <sup>b</sup>  |
| Home-based venture                |                     |                     |                     | 0.281 <sup>b</sup>  | -0.111 <sup>c</sup> | -0.171              |
| Household Head                    | -0.279 <sup>c</sup> | 0.193               | 0.087               |                     |                     |                     |
| No. Children under 6              |                     |                     |                     | -0.139              | -0.059              | 0.198 <sup>b</sup>  |
| Non-white                         | 0.183 <sup>a</sup>  | -0.113              | -0.071              | -0.062              | 0.219 <sup>b</sup>  | -0.157              |
| <u>Financial circumstances</u>    |                     |                     |                     |                     |                     |                     |
| Saving money                      |                     |                     |                     | -0.308 <sup>c</sup> | 0.099               | 0.210               |
| Received funds                    | -0.107              | 0.188 <sup>b</sup>  | -0.081              | 0.153               | 0.099               | -0.252 <sup>c</sup> |
| Owens own house                   | -0.075              | 0.136 <sup>c</sup>  | -0.062              |                     |                     |                     |
| <u>Process</u>                    |                     |                     |                     |                     |                     |                     |
| Hired workers                     | 0.041               | 0.135               | -0.175 <sup>b</sup> | -0.430 <sup>c</sup> | 0.125               | 0.305               |
| Credit with suppliers             | -0.172 <sup>b</sup> | 0.211 <sup>a</sup>  | -0.040              | -0.261 <sup>c</sup> | -0.008              | 0.268 <sup>b</sup>  |
| <u>Human and social capital</u>   |                     |                     |                     |                     |                     |                     |
| Post-HS degree                    |                     |                     |                     | -0.298              | -0.071              | 0.368 <sup>b</sup>  |
| College degree                    |                     |                     |                     | -0.198              | -0.172 <sup>c</sup> | 0.369 <sup>b</sup>  |
| Business assistance program       |                     |                     |                     | 0.336 <sup>c</sup>  | 0.027               | -0.362 <sup>b</sup> |
| Self-employed parent              |                     |                     |                     | -0.016              | 0.142 <sup>b</sup>  | -0.127              |
| Kin own businesses                | -0.131 <sup>c</sup> | 0.098               | 0.033               | 0.135               | -0.249 <sup>b</sup> | 0.115               |
| Friends own businesses            | 0.065               | 0.080               | -0.145 <sup>b</sup> |                     |                     |                     |
| <u>Control variables</u>          |                     |                     |                     |                     |                     |                     |
| Price important                   | 0.158 <sup>b</sup>  | -0.030              | -0.128 <sup>b</sup> |                     |                     |                     |
| Price not important               | -0.173              | -0.045              | 0.218 <sup>b</sup>  | -0.232 <sup>c</sup> | -0.001              | 0.232 <sup>c</sup>  |
| Durable good                      | -0.315              | -0.044              | 0.359 <sup>c</sup>  |                     |                     |                     |
| Competition moderate              | -0.082              | -0.035              | 0.117 <sup>c</sup>  |                     |                     |                     |
| High-tech                         |                     |                     |                     | -0.210              | 0.158 <sup>b</sup>  | 0.052               |
| Sole start-up                     |                     |                     |                     | 0.504 <sup>a</sup>  | -0.182 <sup>c</sup> | -0.323 <sup>c</sup> |
| Partnership start-up              |                     |                     |                     | 0.350               | -0.260 <sup>b</sup> | -0.090              |
| Other owners                      | -0.177              | -0.071              | 0.248 <sup>a</sup>  | -0.350              | -0.040              | 0.389 <sup>c</sup>  |
| Household size                    |                     |                     |                     | 0.120               | 0.055               | -0.174 <sup>c</sup> |
| Married                           | 0.194 <sup>b</sup>  | -0.183 <sup>b</sup> | -0.011              |                     |                     |                     |
| Homemaker                         | 0.097               | 0.022               | -0.118 <sup>b</sup> | -0.181              | -0.016              | 0.196 <sup>c</sup>  |

Notes:

Entries are marginal effects. Missing values denote insignificance in the given specification. Superscripts a, b, and c indicate statistical significance at 1%, 5%, and 10%, respectively, based on robust estimated standard errors. All columns include industry and regional dummies (not reported). Insignificant variables include age, experience, gender, older children, if unemployed.

## LIABILITY ISSUES FROM A CHANGING SMALL FIRM LABOR FORCE

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### *I. Introduction:*

This paper investigates how the changing small-business labor force will create numerous and expensive liability issues for small-business owners in the future.

Many of the laws and regulations governing the U.S. labor market are the product of an earlier era—when workers tended to remain with one employer for longer periods of time.<sup>1 2</sup> Many of these regulations have been modified many times in attempts to make them applicable to 21<sup>st</sup> century employees who will change jobs frequently.

Small employers often do not know how to interpret increasing costly and complex regulations that affect employee health care, pensions and related benefits, workplace safety and security, and to an increasing degree, privacy. The result of this confusion is that one in four privately held companies has been sued by an employee or former employee in the last few years.<sup>3</sup> About a quarter of the lawsuits involved employee benefits.

In an effort to obtain better protection, more small-business owners now rely upon consultants for advice on how to cope with electronic privacy and even terrorism. After health insurance, the “Cost and Availability of Liability Insurance” was the second highest ranked problem by small-business owners in a recent NFIB Research Foundation survey.<sup>4</sup>

Why are additional regulations important? The answer is that small employers need protection from lawsuits that arise from misinterpreting one or more of the newer, more complex labor regulations. One way to obtain this protection is to purchase an increasingly expensive employer liability insurance policy.

As the baby boom generation begins to retire, there will be major demographic shifts in the workforce. The slowdown in the growth of the labor force will result in hiring

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<sup>1</sup> “Job tenure declines among men.” U.S. Bureau of Labor Statistics, *Monthly Labor Review*.” October 6, 1998. Available at [www.bls.gov/opub/ted/1998/oct/wk1/art02.htm](http://www.bls.gov/opub/ted/1998/oct/wk1/art02.htm)

<sup>2</sup> Lynn A. Karoly and Constantijn, W.A. Panis, “The 21<sup>st</sup> Century at Work: Forces Shaping the Future Workforce and Workplace in the United States.” Prepared for the U.S. Department of Labor by the Rand Corporation under contract 0—8330-3492-8, 2004.

<sup>3</sup> “The Chubb 2004 Private Company Risk Survey.” Quoted in *Liability and Insurance Week*, 19 (22), May 31, 2004.

<sup>4</sup> Bruce D. Phillips, *Small Business Problems and Priorities*, (NFIB Research Foundation, Washington, D.C., 2004).

different kinds of workers to prevent labor shortages.<sup>5</sup> These future small-firm employees are likely to be older, more likely to be recent immigrants, and perhaps more likely to be persons with disabilities if labor markets become tight as they did in 1999 and 2000 (part II below).

The changing mix of employees will increase liability insurance costs. Small-firm owners may be more likely to be sued over the unintended interpretations of many labor-related regulations: overtime rules, age discrimination in employment regulations, workers compensation issues, unemployment insurance issues and disagreements over some provision of employee benefits.<sup>6</sup>

A brief overview of the changing composition of employees in small firms is found in section II. Some of the options for small-business owners to avoid potential labor shortages that may also minimize employer liability are discussed in Section III. Employment liability issues based upon federal regulations are discussed in section IV. Liability issues that are more likely to be state-based are summarized in Section V; policy implications and the “so what” issue are found in section VI.

## *II. The New Employees in Small Firms*

Many labor force entrants will consist of both entry-level immigrants and more experienced employees/managers who return to the work force from retirement. It is also unclear whether the skills of recent immigrants—especially Hispanic and Asian workers—will match the skills needed by small-business owners. The current supply of immigrants has been sufficient in most areas to fill semi-skilled jobs in industries like food services and construction; that will probably continue. But problems may arise where better language skills and higher educational attainment are required, especially in office-type occupations, and in health, business, and professional services.<sup>7</sup> The slowdown in labor force growth may push wages higher in particular industries. Rural areas may also be adversely impacted by fewer available workers, especially in manufacturing sectors.

## *III. How Can Small-Business Owners Fill Future Job Vacancies?*

There are a number of steps that small-business owners can take to minimize potential lawsuits associated with older workers, more immigrants, and complex labor regulations. They may or may not minimize potential labor shortages.

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<sup>5</sup> See, for example, Michael W. Horrigan, “Employment Projections to 2012: Concepts and Context.” *Monthly Labor Review*, February, 2004. Available at [www.bls.gov](http://www.bls.gov).

<sup>6</sup> The Chubb Insurance survey indicated that 50 percent of private employers believe a lawsuit filed with the Equal employment Opportunity Commission is likely.

<sup>7</sup> Bruce D. Phillips, “The Future Small Firm Workforce.” *Business Economics*, forthcoming, October, 2004.

The following are ways employers can help resolve labor shortages and their implications for owner liability:

1. Creating incentives to postpone the retirement of *existing* workers through flexible working arrangements - may increase potential liability due to contractual/communications issues and off-site workplaces.
2. Increasing hours of existing workers - may increase potential liability due to misinterpretation of amended overtime (FLSA) rules;
3. Increasing the use of legal immigrant - may increase potential liability due to security, documentation issues;
4. Increasing the employment of persons with disabilities - may increase liability due to employment disability regulations (e.g. ADA).

The following steps may cause declines in potential labor shortages and in potential employer liability problems:

1. Increasing the use of self-employed contractors/consultants, both full-time and part-time - will result in a decline in employer liability since contractors are not employees.
2. Enticing retirees back into the labor force - may decrease potential liability if retirees already have pensions and/or health insurance from previous jobs;
3. Using additional unpaid family members - decrease in potential liability;
4. Leaving vacant jobs open will reduce employer liability.<sup>8</sup>

#### *IV. Employer Liability Issues: Federal Issues*

Little has been written about how hiring older workers, employees with disabilities, and immigrants may increase additional small owner liability. This is more likely if the small employer has no written personnel manual, or listed set of employment practices. The list below, while incomplete, is based upon current Federal laws and regulations that may increase in importance with a more diverse employment mix:

1. *Disability Issues*: if a potentially productive employee is partially disabled, what kinds of additional accommodations are small-business owners willing to make under the Americans With Disabilities Act (ADA) to hire such persons?<sup>9</sup> Are there additional liabilities if persons with disabilities telecommute?
2. *Family and Medical Leave Act (FMLA) Issues*: if an older worker requires extended sick leave, will the employee be retained if the small firm is not subject to FMLA rules?<sup>10</sup> Owners of very small firms might be especially disadvantaged

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<sup>8</sup> William J. Dennis, Jr., ed. "The Changing Search for Employees." NFIB National Small Business Poll. 1 (1), 2001.

<sup>9</sup> An employer may not have to provide "reasonable accommodations" if they can establish "undue hardship" i.e., that it would be unduly expensive, disruptive, or adversely affect the business." For further information see, "Federal Employment Law Handbook," NFIB Legal Foundation, Washington, D.C. , 2004.

<sup>10</sup> A recent NFIB National Small Business Poll on Family Leave suggests that many small owners follow the rules of the FMLA Act, although they are technically not covered by the Act because they have fewer

- if a key worker is disabled for an extended period. How might intermittent absences be accommodated and recorded?
3. *Age Discrimination in Employment (ADEA) Issues:* are age discrimination suits more likely if a small firm increases its proportion of older workers? Will terminating such employees be more problematic?
  4. *General Benefit Issues:* If the typical small firm workforce has a growing proportion of older employees, will an employer feel obligated to offer a 401(k) plan or other pension related benefit to remain competitive? Will there be increased pressure to offer a health plan if a worker - more likely to be female - is less than 65 years old and without health insurance?<sup>11</sup>
  5. *OSHA Issues:* Will older employees be more likely to push for ergonomics rules?<sup>12</sup> Will this vary by industry and/or firm size? Will OSHA compliance change with an aging workforce?
  6. *Immigration Issues:* Due to terrorism, will small-business owners be more subject to government scrutiny if their future usage of immigrants rises? What kinds of additional paperwork costs will be imposed upon these business owners?
  7. *Privacy Issues:* How can small employers guarantee the privacy of all employees, especially the medical records of older workers and new immigrants? What costs may be involved in computerizing new and existing records? Revealing either too much information, or the wrong information may increase the probability of a lawsuit. How much testing (for drugs, violence, background credit checks, etc) will employers be permitted or required to perform in the future?
  8. *Employer Defamation Issues:* How will the dissemination of prior employee job ratings affect liability in the future?

This list is not exhaustive, and it is not mutually exclusive. But it is offered as a partial list of potential employer problems in hiring older workers, immigrants and workers without health insurance.

AARP reports that lawsuits filed against employers over the Age Discrimination in Employment Act (ADEA) have recently begun to increase. As Rix (2004) indicates, it is

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than 50 employees. See NFIB National Small Business Poll, "Family and Medical Leave." (NFIB Research Foundation, Washington, D.C., 4 (2), 2004).

<sup>11</sup> Because a greater proportion of females work part-time, they are less likely to have health insurance. In addition, females move in and out of the labor force more often than males due to child rearing and divorce.

<sup>12</sup> Sara Rix, "Aging and Work--A View From the United States," AARP Public Policy Institute Paper #2004-02, February, 2004, page 15. AARP, "Staying Ahead of the Curve 2003: The AARP Work and Career Study," (Washington, D.C., AARP, 2003).

possible that such lawsuits vary directly with the state of the economy: age-based lawsuits against employers are more likely when labor markets are slack, or the economy is growing below trend.

Lawsuits over age discrimination already occur in small firms. For example, a 72 year-old cab driver was recently fired when his employer learned that its liability insurance carrier would not insure drivers over 70. But the problem was with the insurance company, not the small employer. The fired cab driver sued the cab company.<sup>13</sup> Fortunately, the cab company was able to obtain a waiver from its insurance company, and rehired the driver. It is increasingly likely that small employers will find themselves in such absurd situations in the future. They become the defendant in an age discrimination lawsuit through no fault of their own.

### *Family and Medical Leave/ Employment of Persons With Disabilities*

Most small employers currently accommodate sick leave requests as needed, and most employees are paid for small amounts of time away from the job.<sup>14</sup> But an older workforce with employees who need periodic time off for medical treatments may become problematic when an employee is terminated for cause. Lawsuits due to the lack of formal personnel manuals or miscommunications are always possible and do occur with increasing frequency.<sup>15</sup>

About half the states have either proposed paid leave laws in some form, or made FMLA regulations applicable to employers with fewer than 50 employees in specific circumstances (see section V below). These mandates take the decisions away from small employers who almost always “do the right thing” even when it is not legally required.

About 35 percent of persons with some disability are employed at least part-time, up recently but below the peak participation rates of about 40 percent reached in the early 1990’s.<sup>16</sup> Might employment contracts with “do not sue” clauses be useful in the future? The courts have gone both ways on whether a worker can be made to waive his or her “right to sue” an employer when that employer is making a job offer, whether the worker

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<sup>13</sup> “Insurance Policy Shows Evidence of Age Bias But Not Employer’s Intent, Ninth Circuit Says.” Bureau of National Affairs, Daily Labor Bulletin, June 15, 2004, Page A-5.

<sup>14</sup> William J. Dennis, Jr. ed. “Family and Medical Leave.” NFIB National Small Business Poll, op. cit.

<sup>15</sup> Many analysts and publications stress the need for an employee personnel manual that specifically lists employee and employer obligations under various federal laws. It is part of an overall program to manage risk. See, for example, Karen Breckenridge, “Using Employee Risk Management To Reduce Workers Comp Claims.” North Bay Business Review, June 9, 2004. Available at [www.futurerehab.com](http://www.futurerehab.com). About 20 percent of employer lawsuits that reached the Supreme Court in 2004 were over employment related issues.

<sup>16</sup> “Disability Statistics: Online Source for U.S. Disability Statistics.” Available at [www.ilr.cornell.edu/ped/Disability Statistics/statistics.cfm](http://www.ilr.cornell.edu/ped/Disability%20Statistics/statistics.cfm). See also the 2004 Harris National Survey on the Employment of Persons With Disabilities. Available at [www.nod.org/content.cfm?id=1537](http://www.nod.org/content.cfm?id=1537). The trends from the Harris survey and the CPS data do not agree, and neither are readily available by firm size.

is disabled or not.<sup>17</sup>

Additional work is needed before we can make unqualified judgments about the additional assets and liabilities that older workers, immigrants and persons with disabilities bring to smaller employers. The issues above give small employers reasons to think carefully (or seek outside advice) before filling jobs. Decisions should be made carefully based upon the tightness of the labor market in specific industries and in specific places. The wrong decisions may be very costly and significantly increase the probability of a lawsuit.

#### V. *Employer Liability: State Issues*

Many liability issues concern programs jointly administered by federal and state government agencies. These include OSHA issues and environmental regulations. In some cases, it is simply a bureaucratic difference over which level of government administers the program. (Some state employees, for example, act on behalf of the federal OSHA). Other programs, such as Workers' Compensation (WC) and Unemployment Insurance (UI) tend to be state specific and have state based rates.<sup>18</sup> Other issues, such as Family and Medical Leave and tort claims, also tend to be state specific. While some of the liability areas listed below are arguable as "state-specific" issues, they have been included to illustrate the large range of employer liability issues.

1. *Workers Compensation Issues:* Will a larger proportion of older workers influence small employers' workers' compensation issues? Are on-the-job injuries more likely, even in service/retail sectors? Will a larger proportion of older workers cause higher WC premiums?
2. *Unemployment Insurance Issues:* Will older employees be less likely to remain with a single employer? What might happen to an employers' "experience rating" if older employees are terminated for cause more often? Will the qualifications for benefits change to accommodate older workers who are only employed part-time?
3. *State OSHA Issues (Asbestos, Silica Issues, etc.):* If older workers and/or immigrants who have partial disabilities are hired by small employers, how will it be made clear to insurers that the small employer will not have liability for the employees pre-condition? This could be difficult if the older employee

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<sup>17</sup> Vikram David Amar, "A Crucial Contract Issue May Go All the Way to the Supreme Court: Are Agreements to Arbitrate Enforceable, Or Do Parties Still Retain the Right to Sue?" The New York Times, Friday, Feb 21, 2003. Available at <http://writ.news.findlaw.com/amar/2003030221.html> and [www.cgood.org](http://www.cgood.org).

<sup>18</sup> See, for example, NFIB Research Foundation and National Foundation for Unemployment Compensation and Workers Compensation, "Legislative Guide to Workers' Compensation Insurance Reform in the States." NFIB Research Foundation, Washington, D.C., June, 2004.



works in the same industry (e.g. mining or construction) where they had worked before. Will states enact or expand separate ergonomics laws?

4. *Automobile/Accident/Traffic Issues:* Many small employers use automobiles as part of their daily business activities. A recent NFIB National Small Business Poll indicated that traffic accidents are a major concern of small-business owners.<sup>19</sup> With both more older drivers and new (immigrant) drivers, how might these affect the automobile liability insurance premiums of employers? Small employers may well restrict the driving of older workers if necessary.
5. *Environmental Liability Issues:* Will older workers who work for small employers at Superfund sites blame a small employer for any liability if they get sick at either the worksite or at home? State Toxic Release Inventory (TRI) lists and Community Right to Know Laws all have very high paperwork costs and potential high liability costs if a suit is filed.
6. *Personal Injury Law (Non-Vehicle Related):* An NFIB survey indicated that 46 percent of actual lawsuits were related to personal injuries.<sup>20</sup> Will an older workforce increase the likelihood of personal injury lawsuits that occur away from the business owners' premises?
7. *Employee Time-Off Issues:* About half the states have some minor form of unpaid leave in place, and many others are debating similar issues.
8. *Tort Claims (Negligent Hiring, etc.):* Many employers no longer provide employee evaluations for fear of being sued. The result is that good employees suffer because they cannot receive favorable referrals, and poor performers are advantaged.

The summaries below do not lead to any definitive conclusions. Rather, they are presented as a series of examples of issues in which NFIB state positions have met with varying amounts of success. Some have implications for areas such as WC, UI, Family Leave, and Tort Claims that may be impacted by using older workers and a larger proportion of immigrants. But because the examples are not based upon a survey, but rather what is available, no conclusion is possible. Despite the fact that this section looks "where the light is good," it does provide some idea of the likely wide variance in outcomes, based upon the particular politics of each state.

#### *What Are The Likely Actions of State Regulators?*

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<sup>19</sup> William J. Dennis, Jr. ed. "Workplace Safety." NFIB National Small Business Poll, 2 (1), (NFIB Research Foundation, Washington, D.C., April, 2002).

<sup>20</sup> David Stephenson, "Small Business and the Civil Justice System." NFIB Education Foundation, mimeo, 2000.

### *A. Workers' Compensation (WC)*

Studies in Washington, California and Wisconsin have shown that older workers generally have fewer workplace injuries, probably because of maturity and experience. However, when older workers are injured, they do take longer to heal, driving up medical costs and wage losses. The most expensive WC claim can be for permanent disability,<sup>21</sup> although states like Wisconsin are trying to end permanent disability from WC claims by introducing part-time work for disabled workers.<sup>22</sup>

#### *Idaho*

In Idaho, the “no fault” or “exclusive remedy” system of WC has been preserved in which an employee cannot sue an employer when the injured party immediately receives appropriate medical attention. And employers that provide Long Term Care Insurance can deduct it from their business income taxes.<sup>23</sup> These are particularly useful regulations for an older workforce, and may even help attract some older employees.

On the negative side, the “exclusive remedy” doctrine has been recently eroded in many states.<sup>24</sup> Third parties have frequently tried to prove that employers did little to prevent serious injuries through “willful misconduct” or “intentional injury.” Some agreements have been eroded in favor of recoveries for “pain and suffering” awards in WC cases.

### *B. Unemployment Insurance (UI) Issues*

As older workers become more commonplace in smaller firms, what if any, changes might states make to UI eligibility and/or benefit, requirements? For example, could the standard 20 weeks of paid employment needed to be eligible for UI be reduced, or alternately, could the number of hours be reduced?

These issues have already been discussed for part-time workers in many cases, but not for older workers. If requirements to receive benefits are made more liberal for older employees, small firms with higher turnover rates will be at a competitive disadvantage.

In the case of older workers who have had more than one employer, there is some question as to whether the employer who terminated the worker should be liable, or whether several employers should share disproportionately in their accounts being

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<sup>21</sup> Jeff Biddle, Leslie T. Boden and Robert Reville, “Older Workers Face More Serious Consequences From Workplace Injuries.” National Academy of Social Insurance, December 2003.

<sup>22</sup> “Permanent Part-Time Position Reasonable For Disabled Worker, Wisconsin Court Finds.” Bureau of National Affairs, Daily Labor Bulletin, July 8, 2004, Page A-9.

<sup>23</sup> National Federation of Independent Business, “Idaho State Report,” June-July, 2004. Available at [www.nfib.com/ID](http://www.nfib.com/ID).

<sup>24</sup> “Legislative Guide to Workers Compensation Insurance Reform in the States,” op. cit., pages 10-11.

charged. The recent NFIB/UC study suggests that “benefits should be charged in proportion to base period wages.”<sup>25</sup> Therefore, if a worker was employed part of the time for a large firm during the base period, the large firm would also contribute to the employees UI payment, even if that firm was not the last employer of the worker.

### *C. Tort Reform*

The American Tort Reform Association’s (ATRA) “Tort Reform Record” keeps a scorecard on the progress of tort reform in each of the states. During the most recent 2004 legislative session, the most bills were introduced in the areas of “Joint and Several Liability Reform” and “Reform of the Collateral Source Rule.”<sup>26</sup>

If “joint and several liability” is reformed, damages could not be collected from multiple defendants. Thirty-nine states have some modifications of these rules.

Thirty-five percent of medical malpractice claimants receive compensation from other sources—such as WC funds. Twenty-three states have enacted legislation that would disallow collateral source payments in medical malpractice cases, or at least allow the existence of those payments to be introduced as evidence.<sup>27</sup> It is not known how much this will lower settlements, especially in WC based cases, among older workers and immigrants. But this and similar tort reforms in areas such as punitive damages and non-economic damage caps can only help lower the cost of liability insurance.

### *Effects of Higher Employer Liability Premiums*

To protect themselves from lawsuits, small-business owners increasingly purchase a variety of expensive liability insurance policies. These liabilities cover premises liability, employment liability, environmental liability, and professional liability, among other categories. In a 1995 NFIB survey, a theoretical doubling of liability insurance premiums was estimated to have the following effects on small-business owners’ operating policies:

- a) raise selling prices-33 percent;
- b) reduce insurance coverage-16 percent
- c) reduce owner earnings-12 percent;
- d) reduce employment-7percent;
- e) change insurance carriers-6 percent;
- f) freeze employee wages/benefits-3 percent.

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<sup>25</sup> “Legislative Guide to Unemployment Insurance Reform, op cit.

<sup>26</sup> American Tort Reform Association, “Tort Reform Record,” July 13, 2004. Available on the net at [www.atra.org](http://www.atra.org) .

<sup>27</sup> Ibid.

The survey was taken in 1995, a relatively good year for the economy.<sup>28</sup> The mean increase in employer liability premiums between 1995 and 2004 has been significant, but direct premium comparisons are not relevant because liability policies today cover a broader array of areas than policies written a decade ago.<sup>29</sup> With slack economic conditions during 2001-2003, it is likely that the ability to pass on increased insurance costs from employers to customers was severely limited, compared to results reported in 1995.

## VI. *Summary and Conclusion: The “So What” Issue*

This short essay has tried to relate how the changing workforce in small firms may increase owner liability premiums in the future. Much of this is not predictable, but speculative, dependent upon two sets of forces: precisely who will be working in small firms, and the areas that will be further regulated by federal and state governments.

A few things are known. Workers in smaller firms are getting older, just as they are in the general workforce. And owners of small businesses may or may not increase their use of immigrants and disabled workers. Much depends on labor demand and potential labor shortages. The state of the labor market is also likely to determine what additional benefits, if any, small employers offer their employees. Some benefits, like telecommuting, may be relatively costless but increase potential owner liability. Others, like matching 401(k) accounts, or offering health benefits to part-time employees may be much more costly but have few implications for additional employer liability.

Associations like NFIB attempt to use both the federal and state legislative processes to minimize future liability for small-business owners, and hold down and even reduce costs where feasible. There have been both successes and failures. That is not likely to be altered. However, the changing workforce of small firms is likely to make the task of making a profit more difficult in the future.

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<sup>28</sup> NFIB Education Foundation “Small Business—Plaintiff or Defendant.” (Washington, D.C., NFIB Education Foundation, October, 1995). Quoted in David Stephenson’s, “Small Business and the Civil Justice System.” (NFIB Education Foundation, Washington, D.C., 2000).

<sup>29</sup> The issue is complex. Many liability insurers write policies that exclude areas (such as environmental liability) that they did not several years ago. Therefore it is very difficult to compare the cost of a similar policy over time.

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## THE FUTURE SMALL BUSINESS WORKFORCE

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### *I. Introduction:*

During the next decade, there will be major demographic shifts in the workforce as the baby boom generation begins to retire. The rate of growth of the labor force will decline, and the supply of labor for small firm owners will be smaller and more diverse. The labor force will grow about 1.1 percent a year from 2002-2012, compared with rates in excess of 2.0 percent annually during the 1970-1995 period.<sup>1</sup> Future employees are likely to be either under 30 years old or over 50 years old. This is the case because workers 30-44 years old are expected to shrink by over three million by 2010.<sup>2</sup> What does this mean for owners of small firms looking for either entry- level or more experienced workers?

Much has been written about the changing labor force. Many new labor force entrants are also likely to be immigrants or the offspring of recently arrived immigrants, particularly Asian and Hispanic workers.<sup>3</sup> Because the growth of the labor force has slowed, a rapid increase in the demand for labor may mean a return to labor shortages unless there is a significant increase in employed immigrants.<sup>4</sup>

The purpose of this paper is to explore how small firm owners will avoid potential labor shortages during the next decade. How will small firm owners adapt to the changing pool of available workers? Four potential scenarios are explored below:

1. Increases in the labor force participation rate (LFPR) of the baby boom generation will increase labor supply. Increases are being driven by insufficient saving. The lack of retiree health benefits and pensions will cause workers to postpone retirement, but move to small employers because of increased flexibility.
2. Spot shortages will occur in rapidly growing sectors—especially in labor-intensive construction and in manufacturing sub-sectors now dominated by

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<sup>1</sup> Michael W. Horrigan, "Employment Projections to 2012: Concepts and Context," *Monthly Labor Review* February, 2004. Available online at [www.bls.gov](http://www.bls.gov).

<sup>2</sup> Justin A. Heet, "Beyond Workforce 2020: The Coming (and Present) International Market for Labor." Hudson Institute White Paper, October 2003. Available at <http://www.hudson.org>. Fifty-six percent of workers are 40 or over today, compared with 38 percent in 1977.

<sup>3</sup> It is also likely that some of these immigrants will also form small businesses.

<sup>4</sup> There were approximately 7 million legal immigrants in the United States between 1991 and 1998, according to the Census Bureau. Approximately the same level of immigration is assumed for the projection period.



small businesses. It may be especially difficult to find unskilled workers in some industries and in some rural areas.

3. **Future immigration—at about the current rate –will continue during the next ten years. Many of these immigrants will be employed in small firms, but mismatches are likely between the skills required for various jobs, and the education and skills of immigrants.**
4. **Small business owners may use more semi-retired self-employed persons or leased employees to avoid paying additional costly benefits, especially if the older workers are already qualified for Medicare.**

## *II. Potential Labor Shortages Will Vary By Industry*

The Bureau of Labor Statistics (BLS) is projecting overall productivity (output per hour) to increase about 2.1 percent annually from 2002-2012, slower than the 1995-2001 rate of 2.3 percent, but above the 1.5 percent rate of 1990-1995.<sup>5</sup> For small business owners, it means that additional workers may be required to produce the same amount of output in the future.<sup>6</sup>

BLS forecasts that between 2002 and 2012, 96 percent of job growth is expected in service producing sectors. There are four major sectors that are expected to account for about two-thirds of this growth:

**Retail trade: Employment growth of 9.6 percent**

**Professional, scientific, technical and business services: Growth of 22.5 percent**

**Education and health services: Growth of 23.8 percent**

**Leisure and hospitality services: Growth of 9.9 percent<sup>7</sup>**

These four sectors contain a mix of small and large firms, but small businesses dominate many of the sub-industries within the large categories. Most of these sectors are labor intensive.

Small owners are also very important employers in manufacturing sectors. Small business owners contributed over two-thirds of the jobs in specialized manufacturing in 2001,<sup>8</sup> and about half the jobs in metalworking machinery. The jobs in these sectors tend to be more physically demanding, and workers tend to retire earlier from them. Selected manufacturing sectors are areas of potential labor

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<sup>5</sup> “Employment Projections to 2012,” op. cit, charts 1 and 2.

<sup>6</sup> However, productivity is notoriously difficult to predict, and may or may not be a significant determinant of labor demand.

<sup>7</sup> “Employment Projections to 2012,” op. cit.

<sup>8</sup> Specialized manufacturing includes medical and dental equipment, jewelry and silverware, sporting goods, toys and musical instruments, among others. It is new NAICS industry number 339.

shortages.<sup>9</sup> Some of these jobs are likely to remain in or near rural areas from which workers have been leaving.<sup>10</sup>

### *III. Baby Boomers Will Not Retire On Time-The Supply Side*

By 2010, the number of 55-64 year olds will grow by more than 11 million, an increase of 46 percent over their number in 2000. The labor force participation rates (LFPR) of those aged 55 years and over (in 1990) rose about three percentage points between 1990 and 2000, from 56 percent to 59 percent. As shown in Table 1, virtually all of this increase was accounted for by women aged 55+, whose LFPR rose by 7 percentage points.<sup>11</sup>

In table 1, there are large *increases* forecast in LFPR of both men and women 55 years and older. Second, by 2012, almost a third of men (29.1 percent) and almost 20 percent of women 65-74 will be in the labor force. Almost 8 percent of men over 75 years old will also be participating in the labor force by 2012.

Table 1 below tells us nothing about worker supply (e.g. whether workers will be available full-time or part-time). Nor does it tell us how many additional workers will match the needs of small business employers on a part-time vs. full-time basis.<sup>12</sup> While some service jobs can be filled on a part-time basis, this is less likely in traditional manufacturing and in some manufacturing related service sectors like computer or engineering services where close collaboration is needed.

How many additional workers do the increased LFPR in table 1 imply? About 1.94 million additional workers 55 years and over will be available in 2012 by postponing retirement. About two thirds of these will be men. About 200K additional workers will be 75 years and over in 2012. Viewed from another perspective, almost 60 percent of the increase in the labor force between 2002 and 2012 will be comprised of workers 55 years and over who do not retire.<sup>13</sup>

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<sup>9</sup> Many of these manufacturing sectors also require experienced workers, rather than apprentices. About 90 percent of the jobs in manufacturing tend to be full-time, and may not be replaceable by part-time older workers.

<sup>10</sup> See, for example, Mark Drabentstott, "A New Era for Rural Policy." Economic Review, Federal Reserve Bank of Kansas City, 88(4), 2003, pp. 81-95. The author asks whether new entrepreneurs can be drawn to rural America to continue to start new firms.

<sup>11</sup> Ibid, table 6.

<sup>12</sup> We are assuming that the current full-time schedules and part-time schedules of workers in firms reflect employer needs. Whether they will match worker needs/desires in the future is not clear.

<sup>13</sup> Mitra Toosi, "Labor Force Projections to 2012: The Graying of the U.S. Workforce." Monthly Labor Review, February, 2004, Table 5.

**TABLE 1-Current and Projected Labor Force Participation Rates of Workers, 55 Years and Over: 1982-2012**

| <i>Group</i>                    | <i>1982</i> | <i>1992</i> | <i>2002</i> | <i>2012</i> | <i>Change, 2002-2012</i> |
|---------------------------------|-------------|-------------|-------------|-------------|--------------------------|
| <b>All Workers, 55 and Over</b> | 31.9        | 29.7        | 34.5        | 39.7        | 5.2                      |
| 55-64                           | 55.1        | 56.2        | 61.9        | 65.1        | 3.2                      |
| 65-74                           | 16.2        | 16.3        | 20.4        | 23.6        | 3.2                      |
| 75+                             | 4.9         | 4.5         | 5.1         | 5.7         | 0.6                      |
|                                 |             |             |             |             |                          |
| <b>Men, 55 and Over</b>         | 43.8        | 38.4        | 42.0        | 45.8        | 3.8                      |
| 55-64                           | 70.2        | 67.0        | 69.2        | 69.9        | 0.7                      |
| 65-74                           | 22.5        | 21.1        | 25.5        | 29.1        | 3.6                      |
| 75+                             | 8.5         | 7.3         | 7.6         | 8.2         | 0.6                      |
|                                 |             |             |             |             |                          |
| <b>Women, 55 and Over</b>       | 22.7        | 22.8        | 28.5        | 34.5        | 6.0                      |
| 55-64                           | 41.8        | 46.5        | 55.2        | 60.6        | 5.4                      |
| 65-74                           | 11.3        | 12.5        | 16.1        | 18.9        | 2.8                      |
| 75+                             | 2.8         | 2.8         | 3.5         | 4.1         | 0.6                      |
|                                 |             |             |             |             |                          |

Source: Mitra Toossi, “Labor Force Projections to 2012: the Graying of the U.S. Workforce”, Monthly Labor Review, February, 2004, derived from table 3.

These additional workers will partially offset the projected loss of 2.5 million workers aged 35-44 between 2002 and 2012. How do the workers who will be available by postponing retirement compare to the needs of small business owners?

As the February 2004 Monthly Labor Review articles imply, small firm owners can do any of the following to *increase* future labor supply:

1. Create incentives to postpone retirement of *existing* workers; this could include, for example, telecommuting from remote locations.
2. Increase hours or overtime hours of *existing* workers;
3. Shift *existing* older full-time workers to *part-time* status; and/or hire additional part-time workers to fill the vacant hours;
4. Increase the use of legal immigrants;
5. Increase the employment of previously unemployed persons with disabilities;
6. Increase the use of self-employed contractors/consultants, both full-time and part-time as appropriate;
7. Entice retirees back into the labor force.
8. Use additional unpaid family members.

In addition, many small business owners have coped with past labor shortages by simply increasing their own hours of work, or by letting jobs go vacant.<sup>14</sup>

<sup>14</sup> William J. Dennis, Jr., ed. “The Changing Search for Employees.” NFIB National Small Business Poll. (I) 1, 2001.

**The recent recession told us that increasing productivity, increasing overtime hours, hiring temporary workers and letting jobs go vacant were steps to avoid hiring additional workers.<sup>15</sup>**

#### ***Retirement Income Needs of Baby Boomers***

**More workers will need to keep working past retirement for financial reasons, including rising health care costs. The Congressional Budget Office (CBO) recently took a comprehensive look at the preparation of the baby boom generation for retirement..<sup>16</sup> The CBO conclusion, much like that of a 2002 study from the Center For Retirement at Boston College, was that many older workers *considering* retirement have changed their plans. (These new plans are reflected in the higher projected LFPR's of older workers from the Bureau of Labor Statistics.)<sup>17</sup> Based upon additional studies using various datasets from the Census Bureau and the University of Michigan, the CBO study team concluded that additional retirement assets or additional years of work are required for workers over the age of 62."<sup>18</sup>**

#### ***Estimating Business Formation by Baby Boomer Consultants***

**Recent AARP surveys report that 17 percent of baby-boomers expect “to go into business for themselves” (e.g. transition into self-employment) when they retire.<sup>19</sup> It is unknown what percentage will represent self-employed independent contractors, but surveys suggest it is likely to be in the 15-20 percent range.<sup>20</sup> While contractors (or self-employed persons) may be available to small business owners, it is not known whether matches will occur between the hours, places and industries of the self-employed compared to what small business owners will need.<sup>21</sup>**

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<sup>15</sup> Written communications by William Dunkelberg of Temple University and Chief Economist, NFIB. See also the recent issues of NFIB's "Small Business Economic Trends" on the Web at [www.nfibresearch.com](http://www.nfibresearch.com)

<sup>16</sup> "Baby Boomers Retirement Prospects: An Overview.." (Congressional Budget Office, November 2003).

<sup>17</sup> Andrew D. Eschtruth and Jonathan Gemus, "Are Older Workers Responding to the Bear Market?" Center for Retirement Research at Boston College, September, 2002, no. 5.

<sup>18</sup> CBO Retirement Study, op. cit.

<sup>19</sup> "The Policy Book: AARP Public Policies 2003." (American Association of Retired Persons, Chapter 4, Employment, pages 4-28. According to 2002 CPS data, about 16.4 percent of workers aged 50 and over were self-employed. The 17 percent figure approximately represents "transitioners" into self-employment, as well as the long-term self-employed. It is not clear whether these percentages are additive.

<sup>20</sup> See North Carolina study referenced in footnote 18.

<sup>21</sup> Consultants are likely to be of two types: highly educated persons with advanced degrees, and experienced blue collar workers who have worked in the construction, wholesale trade and retail trade sectors.

#### *IV Will Small Firms Hire Larger Numbers of Older Workers?*

Table 2 provides data on the current distribution of workers by firm size and age, as of 2002:

**TABLE 2-Distribution of Workers, 55 Years and Over, By Firm Size: 2002**

| Age of Workers         | Less than 55    | 55-64          | 65-74          | 75+          |
|------------------------|-----------------|----------------|----------------|--------------|
| <b>Firm Size:</b>      |                 |                |                |              |
| <b>Under 10</b>        | <b>83.3</b>     | <b>11.1</b>    | <b>4.4</b>     | <b>1.2</b>   |
| <b>(Number in 000)</b> | <b>(14,628)</b> | <b>(1,945)</b> | <b>(775)</b>   | <b>(218)</b> |
|                        |                 |                |                |              |
| <b>10-24</b>           | <b>86.2</b>     | <b>9.9</b>     | <b>3.1</b>     | <b>0.8</b>   |
|                        | <b>(11,035)</b> | <b>(1,260)</b> | <b>(392)</b>   | <b>(104)</b> |
|                        |                 |                |                |              |
| <b>25-99</b>           | <b>86.1</b>     | <b>10.6</b>    | <b>2.8</b>     | <b>0.5</b>   |
|                        | <b>(15,189)</b> | <b>(1,869)</b> | <b>(495)</b>   | <b>(85)</b>  |
|                        |                 |                |                |              |
| <b>100+</b>            | <b>86.7</b>     | <b>10.9</b>    | <b>2.0</b>     | <b>0.4</b>   |
|                        | <b>(55,526)</b> | <b>(6,967)</b> | <b>(1,301)</b> | <b>(264)</b> |

Source: Current Population Survey (CPS), Bureau of the Census. Source: Prepared for the NFIB Research Foundation by the Employee Benefit Research Institute under contract. Data are from the March, 2003 survey.

From table 2, we observe that there is little variation in the age distribution of employees by firm size. Small business owners with fewer than 10 employees and larger businesses with more than 100 employees employ the largest absolute numbers of workers aged 65 and over.

If future labor force increases will be among men older than 65, and among women 55 years and over, it is useful to know if small firms already employ similar workers.

Table 3 below presents an indirect answer to the question above by examining the percentage of workers employed part-time by major industry in 2002.<sup>22</sup> Two definitions of part-time employment are used: less than 20 hours per week, and less than 35 hours per week. Using the more inclusive definition of less than 35 hours per week, about 20 percent of the non-farm employed worked such a schedule in 2002. However 26-27 percent worked such a schedule in the growing retail trade and service sectors. Clearly younger workers make up the difference. Note that the percentage of part-time employment in manufacturing is also very small.

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<sup>22</sup> The preferred cross tabulation of worker age by industry by firm size is not available.

**TABLE 3-Distribution of Non-farm Full-Time Workers vs. Part-Time Workers By Major Industry: 2002**

| <i>Sector</i>                         | <i>Full-Time</i> | <i>Part-Time<br/>(&lt;35hrs/wk)</i> | <i>Full-Time</i> | <i>Part-Time<br/>(&lt;20hrs/wk)</i> |
|---------------------------------------|------------------|-------------------------------------|------------------|-------------------------------------|
| Ag, Ag Services                       | 82.0             | 18.0                                | 92.8             | 7.2                                 |
| Mining                                | 96.3             | 3.7                                 | 99.3             | 0.7                                 |
| Construction                          | 91.0             | 9.0                                 | 98.2             | 1.8                                 |
| Manufacturing                         | 95.0             | 5.0                                 | 98.9             | 1.1                                 |
| Wholesale,<br>Retail<br>Trade         | 73.8             | 26.2                                | 91.7             | 8.3                                 |
| Transportation,<br>Utilities          | 89.3             | 10.7                                | 97.8             | 2.2                                 |
| Communications                        | 87.3             | 12.7                                | 95.6             | 4.4                                 |
| Finance,<br>Insurance, Real<br>Estate | 87.0             | 13.0                                | 96.7             | 3.3                                 |
| Services                              | 72.4             | 27.6                                | 90.7             | 9.3                                 |
| All Sectors                           | 80.0             | 20.0                                | 93.6             | 6.4                                 |

Source: Tables prepared for the NFIB Research Foundation by the Employee Benefit Research Institute, under contract, from the March, 2003 CPS.

#### *Part-Time Workers By Age Group*

Examining the full-time/part-time distribution of workers by *age group* is another method of analyzing whether the *available* workers will match the *hours required* by *small business owners*. How do the percentages of part-time workers by industry sector compare with the percentages by age group? An answer is in table 4 below.

On a percentage basis, the youngest and oldest age groups comprise the bulk of the part-time workforce. Although about 20 percent of employed women 25-54 work part-time, it is likely that the largest number of future part-time workers needed by small business owners in the retail and service industries are likely to come from two age groups: 16-24 year olds of both genders and females, 55 years and over. On an absolute basis, (not shown in table 4), the actual *number* of part-time workers in the 16-24 age group is about 4 times that in the 55+ group.

**TABLE 4-Percentage of Non-Farm Workers By Age Group Working Part-Time: 2002**

|             | Working <20 Hours per Week |      |        |  | Working 21-35 Hours Per Week |      |        |
|-------------|----------------------------|------|--------|--|------------------------------|------|--------|
|             | Total                      | Male | Female |  | Total                        | Male | Female |
| All Workers | 6.6                        | 4.0  | 9.5    |  | 19.8                         | 12.7 | 27.6   |
| 16-24       | 17.7                       | 14.4 | 21.1   |  | 46.1                         | 40.2 | 52.5   |

|       |      |     |      |  |      |      |      |
|-------|------|-----|------|--|------|------|------|
| 25-44 | 3.6  | 1.1 | 6.5  |  | 13.2 | 5.6  | 21.9 |
| 45-54 | 3.1  | 1.0 | 5.3  |  | 11.7 | 4.7  | 19.3 |
| 55-64 | 5.8  | 3.2 | 8.6  |  | 17.3 | 10.7 | 24.9 |
| 65+   | 21.4 | 1.7 | 27.0 |  | 48.3 | 42.7 | 55.5 |

**Source:** Prepared by the Employee Benefit Research Institute for the NFIB Research Foundation, under contract from March, 2003 CPS Data.

Only the youngest (16-24) and oldest (55+) age groups contribute large numbers working less than 20 hours per week. What is somewhat surprising from table 4 is that a much larger percentage of females 25-54 years old currently work more than 20 hours per week; the proportion of women 55-64 working more than 20 hours per week is almost three times larger than the group working less than 20 hours per week. This probably reflects a combination of business owner requirements (e.g. demand) and worker availability (e.g. supply).

While about five percent of all workers were aged 65 years and over in 2002, about 25-27 percent of employees in trade and services were working part-time (e.g. 21-35 hours per week).<sup>23</sup> While many of these part-time workers are young workers aged 16-24, a growing proportion are also older workers aged 65 years and over, based upon recent increases in LFPR. If potential labor shortages are to be averted, these percentages will have to increase because of the projected slowdown in labor force growth.

If very young workers and older workers are more readily available to small business owners in the future, how likely are owners to hire older workers not yet qualified for Medicare, especially if they cannot afford to pay benefits?<sup>24</sup>

There are also a number of potential conflicts inherent in small firm owners' hiring of older employees and consultants. These include 1) mismatches between available employee hours and those desired by owners, 2) benefit demands by employees versus what employers can afford to pay, 3) location of the business vs. location of employees, and 4) skill mismatches between employees and owner needs.

## ***VI. Will Immigration Eliminate Labor Shortages in Small Firms?***

It is likely that future immigration will partially alleviate labor shortages in small businesses. The main determinants are the level of economic growth (e.g. higher growth implies the need for more workers), new business formation, the possibility of substituting capital for labor, and skill mismatches. The BLS assumes

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<sup>23</sup> Compare Tables 3 and 4 above.

<sup>24</sup> There is some limited evidence that small employers introduced health plans about 13 percent of the time because some employees or their dependents needed the coverage. See, William J. Dennis, Jr. ed. NFIB National Small Business Poll, "Health Insurance." Question 13(f), page 10., 3(4), 2003.

a future level of immigration similar to that of the 1990's, about a million legal immigrants annually, with some variation around that figure.

Small firm owners currently employ immigrants who are U.S. citizens as well as non-citizens. They are already a significant part of the small firm workforce. As shown in Table 5 below, about 17 percent of workers in small firms are immigrants who are citizens and non-citizens—almost 1 out of 5 employees. (In the smallest firms with fewer than 25 employees, about 13 percent of the workforce are also immigrants who are non-citizens).<sup>25</sup>

Small firm owners are more intensive users of immigrants than larger firms. Of the approximate 17.3 million employed immigrants in 2002, about 66 percent worked in the small firm sector (firms with fewer than 500 employees). In raw numbers, about 3.3 million or about 20 percent of employed immigrants worked in firms with fewer than 10 employees.<sup>26</sup>

**TABLE 5-Distribution of Citizens and Non-Citizens By Firm Size, Private Sector: 2002 (Data in 000)**

| Firm Size:<br>(No. Of Employees) | Total<br>(in 000) | Native-Born<br>Citizens | Immigrants-<br>Citizens | Immigrants-<br>Non-Citizens | Pct. Of Size Class |      |      |
|----------------------------------|-------------------|-------------------------|-------------------------|-----------------------------|--------------------|------|------|
|                                  |                   |                         |                         |                             |                    |      |      |
| Total, All<br>Sizes              | 114,756           | 97,410                  | 6,155                   | 11, 191                     | 84.9%              | 5.4% | 9.8% |
| <10                              | 18,180            | 14,795                  | 1,039                   | 2,347                       | 81.4               | 5.7  | 12.9 |
| 10-24                            | 13,263            | 10,963                  | 619                     | 1,681                       | 82.7               | 4.7  | 12.7 |
| 25-99                            | 18,060            | 15,076                  | 909                     | 2,075                       | 83.5               | 5.0  | 11.5 |
| 100-499                          | 17,555            | 14,820                  | 1,022                   | 1,713                       | 84.4               | 5.8  | 9.8  |
| 500+                             | 47,697            | 41,756                  | 2,566                   | 3,375                       | 87.5               | 5.4  | 7.1  |

Note: percentages may not add to totals due to rounding errors.

While small firm owners more intensive use of immigrants is well documented, the more interesting question is whether this utilization will increase in the future. Many immigrants and self-employed persons initially take unskilled or semi-skilled jobs (and then move up fairly quickly); small firm owners will generally increase their utilization of them if the jobs and industries that are predicted to grow match the skill levels of these immigrants.

<sup>25</sup> There is a large body of literature that shows that small firm owners historically provide immigrants, youth and women with their first job opportunities. For a summary see [www.sba.gov/advo/stats](http://www.sba.gov/advo/stats). Click on "Outside Research." See in particular, John Sibley Butler and Patricia Greene. "Don't Call Me Small: The Contribution of Ethnic Enterprises to the Economic and Social Well-Being of America." In Zoltan J. Acs. Ed. *Are Small Firms Important: Their Role and Impact* (Kluwer, Boston, 1999), Chapter 8, pp. 129-147.

<sup>26</sup> By comparison, about 15.2 percent of small firms were minority –owned firms in 1997, the latest Census data available on this subject. They were owned by African-Americans, Hispanics, Asians, American Indians or Alaska Natives/Pacific Islanders. A definitive percentage of the self-employed who are immigrants is not available, but if the sum of Asian and Hispanic business owners are a proxy, it may be close to 10 percent of all business owners as of 1997.



Table 6 below compares the utilization of immigrants in selected labor-intensive occupations during 2000-2002 with the use of immigrants in other occupations that are projected to be rapidly growing from 2002-2012, based upon BLS projections. The second column in Table 6 gives each occupation's percentage of total employment. The third column gives a similar distribution for recently arrived immigrants.<sup>27</sup>

In labor-intensive occupations like construction and food service, there are about twice the proportion of immigrants than of workers in the general labor force. For example, the small business dominated industry of food service and preparation employs about 8.6 percent of the labor force, but about 20.4 percent of recently arrived immigrants. Similar observations are true in construction and production.

**Table 6-Distribution of Recent Immigrants in Selected Labor Intensive Occupations vs. Distribution in Fast-Growing Occupations: 2000-2002**

| Occupation Type:                    | Pct. Of Total Employment | Pct. Total Employment Provided by Recent Immigrants (last 5 years) |
|-------------------------------------|--------------------------|--|
| <i>Labor Intensive Occupations:</i> |                          |  |
| Construction Trades                 | 5.6                      | 10.7   |
| Food Preparation and Serving        | 8.6                      | 20.4   |
| Production Occupations              | 7.8                      | 12.9   |
|                                     |                          |  |
| <i>Fast Growing Occupations:</i>    |                          |  |
| Healthcare Practitioners            | 4.5                      | 2.3  |
| Business and Financial Occupations  | 3.9                      | 1.7  |
| Management Occupations              | 10.6                     | 4.7  |
| Office and Administrative Support   | 14.7                     | 7.1  |
|                                     |                          |  |
| Totals, All listed Occupations      | 55.7                     | 59.8   |

Source: Derived from Michael W. Horrigan, *Employment Projections to 2012: Concepts and Context.* Monthly Labor Review, February, 2004. Table 8.

occupations. In each case, the percentage of immigrants in the occupation is disproportionately high.

Rapidly growing management occupations make up about 10.6 percent of employed persons, but only 4.7 percent of employed immigrants. The totals in both columns 2 and 3 account for about 55 percent-60 percent of total employment, and total employed immigrants, respectively.

Table 6 tells us that based upon this sample of occupations, immigrants make up a small share of employment in occupations that are growing rapidly, and are over-

<sup>27</sup> Immigrants arrived in the U.S. within the last 5 years, according to the BLS.

represented in occupations that are labor intensive. For judging potential labor shortages, are these labor-intensive occupations (top half of table 6) *also* growing very rapidly? That is where potential labor shortages may occur.

The answer is that labor shortages could occur in the food service and hospitality sectors. While many of these are part-time positions, and could also be performed by older workers, it is unclear whether they will take such jobs.<sup>28</sup> Office support positions may be more appealing to older workers, especially if some of the jobs can be done remotely.

## *VII. Summary Observations and Conclusions—The “So What” Issue*

Trying to understand the impact of the aging process upon small business owners involves positive influences, negative influences, and many that are still too difficult and complex to predict.

There will be many positive influences that will mitigate future labor problems for small business owners. The largest is probably the projected increase in labor force participation rates of males 65 years and over, and women, 55-64 years. The forces pushing these groups to remain in the labor force include stagnant pension coverage, insufficient retirement savings and escalating health costs that will occur with a longer life span. It is also possible for these same forces to influence males now 55-64 to remain in the labor force to increase retirement savings.

Assumed levels of immigration that do not vary much from those at present, and two very large sources of labor—(1) older workers and (2) immigrants—will be available. However, there does seem to be some disconnect between the present usage of immigrants, and industries and occupations (as in office employment and in health services) that are growing rapidly. It is unclear whether immigrants will have the skills needed for the more sophisticated full-time manufacturing jobs of the future, nor whether older workers are willing to take some of the less skilled jobs that will become available.

The predictable trends (continuing immigration and rising LFPR of older workers) may help small business owners in labor-intensive sectors. Older workers, some of whom will be employed part-time, will likely be available and desirable in sectors that require more experience and education. And there will also likely be a large pool of self-employed persons that will be composed of both highly educated persons and those with less education but considerable experience. Self-employed persons and outside consultants may also help business owners avoid the benefit problem.

Jobs may have to be restructured—where possible-- to match the available workers, and some compromises will inevitably occur. In the fast growing business services and health services sectors, it is possible that some jobs will be converted to a part-

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<sup>28</sup> Data by age of workers, occupation and firm size is not available.

time basis to avoid paying benefits. In non-retail industries, technology may also allow some jobs to be done outside the workplace.

Geographic mismatches between available workers and available job opportunities may still occur. Small firm owners in rural, non-retirement areas may still face labor shortages, and firms that need highly skilled workers may not find them available at a price that is affordable. On the other hand, there may be a glut of highly educated persons in urban areas that want to work part-time (at attractive salaries) in office environments with good benefits. Such positions may not be available either.

An older workforce also brings with it all kinds of challenging liability issues. Many small employers may find that older workers are the only qualified workers available, but will be well advised to seek counsel on potential lawsuits that may occur with such hires. It is possible that small firm owners will form alliances in the future to create an environment that minimizes the cost of insurance that will be needed to prepare for such eventualities.

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**NO FIRM SIZE IS TOO SMALL,  
BUT FIRM SIZE MATTERS:  
A NEW ANALYSIS OF MITTELSTAEDT, HARBEN, AND WARD**

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**ABSTRACT**

Mittelstaedt, et. al. [2003] wrote an intriguing article that purports to show a firm size of at least twenty employees is a necessary and sufficient condition for export activity. Since smaller percentages of micro firms (less than 20 employees) exported less than the average percentage of all firms in a given industry, the researchers concluded that 20 employees is a necessary condition of export success.

This paper shows that the prior conclusions are flawed in two ways:

1. The Chi-Square test examines whether a grouping of firms (micro, small, medium, large) yields a smaller proportion of exporters than would be expected. This paper shows that the statistically significant results indicate that micro firms do not export as much as the average firm, but the results do not indicate that micro firms do not export at all. Therefore, firm size is not a necessary and sufficient condition for export activity.
2. The conclusion that 20 employees is a necessary and sufficient condition for export activity is flawed because of the arbitrary selection of firm sizes examined. This paper shows that 100 employees or many other arbitrary partitions could have also been shown to be a necessary and sufficient condition for export activity because the chi-square test is a zero sum game and if some firms export more than average, some firms export less than average.

This paper concludes by arguing that policy makers should continue to support very small firms because large firms generally come from small firms. If small firms are not assisted, there may never be any large firms.

**INTRODUCTION:**

Mittelstaedt, Harben, and Ward (2003) argue that small firms with fewer than 20 employees appear to be too small to acquire the knowledge or experience necessary to engage in the

exporting process. Their conclusions contrast with the recent work of Wolff and Pett (2000) who argue that micro firms are capable of exporting. We concur with Woff and Pett (2000). The purpose of this paper is to provide a response to Mittelstaedt, Harben, and Ward (2003). We challenge the conclusions drawn by them in their article, "How Small is Too Small? Firm Size as a Barrier to Exporting from the United States," published in the *Journal of Small Business Management*. Our conclusions provide much more hope to researchers and public policy officials that are interested in the barriers that may raise the costs of foreign market entry by small firms.

In the next section, we provide a brief review of the literature on exporting by small firms with a particular emphasis on size as a barrier to exporting. Then, we discuss how we evaluated exporting using the same sample of firms previously analyzed by Mittelstaedt, Harben, and Ward (2003) and we explain how our findings and conclusions differ from Mittelstaedt, et. Al. (2003). In the final section, we discuss the implications of this research for researchers and public policy makers as well as directions for future research.

## **LITERATURE REVIEW:**

Research on small firms has emerged as one of the most topical debates in business schools, among business leaders, and by public policy administrators over the past quarter century (Wright, 1993; Autio, Sapienza, Almeida, 2000; Baird, Lyles, and Orris, 1994; Aitken, Hanson, and Harrison, 1997; and Oviatt and McDougall, 1995). Rather than attempt an exhaustive review of past research, this section will emphasize the more dominant research relevant to firm size as a determinant of exporting.

### **Firm Size**

Research in international business has been dominated by studies of the activities of large firms as they seek to pursue market development strategies in overseas markets. In contrast, the present study focuses on small businesses. As our understanding of international business has grown, researchers have included firm size as an explanatory factor. In general the results of these types of studies has found a positive relationship between firm size and internationalization. Baird, Lyles, and Orris (1994) found that international firms are larger and tend to be industrial firms rather than retail or service firms. A recent study by Dhanaraj and Beamish (2003) confirmed this finding using a resource-base theory of the firm (Penrose, 1959; Barney, 1991) in a sample of Canadian firms.

The most recent research to date also provides some contradictory evidence about the relationship between firm size and export activity. A study published in the *Journal of Small Business Management* (JSBM) by Wolff and Pett (2000) demonstrates that small firms are fully capable of exporting. Wolff and Pett conclude that small firms use a different decision process to export than do large firms. They argue that the resource-based view of the firm may serve as a useful explanation for the success of these small exporters. Very small firms in their study appeared to capitalize on unique resources that were independent of economies of scale or other cost efficiencies.



The work by Wolff and Pett (2000) is in sharp contrast to another JSBM article by Mittelstaedt, Harben, and Ward (2003). Using a sample of manufacturing firms in South Carolina, they found that micro firms, defined as companies with fewer than 20 employees, were far less likely to engage in exporting than small firms with between 20 and 500 employees ((Mittelstaedt, Harben, and Ward, 2003). Their research concluded that these firms simply do not have the resources (time, money, people) to engage in exporting. However, after reviewing their findings, we strongly question how they could have reached their conclusions. We believe that they misinterpreted their results. We believe that the authors did not demonstrate that firms with fewer than 20 employees were incapable of exporting, but merely that small firms were less likely to export than larger firms. In addition, we believe that using 20 employees as a breakpoint is not an absolute value, but rather an artifact of the Chi Square test. We demonstrate this argument in our analysis and discussion.

### **RESEARCH METHODOLOGY:**

Mittelstaedt, et. al., examined firms from the 2000-2001 South Carolina Industrial Directory to see if firm size serves as a necessary and sufficient condition for export success among small manufacturing firms. We use the same data to replicate the study and demonstrate the conclusions from the prior study cannot be supported. More current versions of the South Carolina Industrial Directory are available, but the 2000-2001 version is used to remain consistent with the prior study. Mittelstaedt, et. al sorted the South Carolina firms into three digit SIC codes and then partitioned them into four groups – micro (fewer than 20 employees), small (20-99 employees), medium (100 – 499 employees), and large (500+ employees). The study then counted firms that export and firms that do not export by SIC classification within each size group. Chi-square tests were performed on each SIC classification and 31 of 49 SIC classifications studied had statistically significant results. The meaning of the statistics will be discussed later in this section.

A very helpful example was given on pages 71-72 of the original paper. The example used was SIC code 355 (Special Industry Machinery and Equipment) which has a total of 120 firms and is partitioned into micro, small, medium, and large. The left hand side of Table 1 shows the number of firms that export and firms that do not export in each partition and also shows the calculation of the chi-square test. This example shows that 5.33 fewer micro firms export than would be expected. This example does not show that firms with fewer than 20 employees appear to be too small to export. The example does show that micro firms export, but a smaller percentage of these firms export than would be expected based upon the average of all firms in SIC code 355. This result is consistent with the graphs previously presented.

To further address the assertion that firms with fewer than 20 employees appear to be too small to export, we decided to partition the data in another way to see if there is a minimum firm size to effectively export. We arbitrarily partitioned the data from SIC code 355 into firms with fewer than 100 employees, firms with from 100-200 employees, firms with 200-500 employees, and firms with more than 500 employees. The results are reported on the right hand side of Table 1. This example shows that 4.40 fewer firms with less than 100 employees export than would be expected. The results of the Mittelstaedt, et. al. example on the left hand side of Table 1 and the arbitrary partition on the right hand side of Table 1 occur because of the nature of the

chi-square test and the nature of the data. The expected values in the table are calculated by assuming that the average of firms that export in SIC Code 355 will also be the average of firms that export in each partition. For example, 63.33% [76/120] of firms in this classification export. Therefore the chi-square calculation expects that 63.33% of firms will export in each partition. Thus, 63.33% of the 70 micro firms yields an expectation that 44.33 of these firms will export. Because the expectation is a simple allocation problem, the actual minus the expected values is a zero sum game. That is, the actual number of firms that export (and do not export) and minus the expected number of firms that export (and do not export) sum to zero across the columns and down the rows. Therefore, when firms in some categories export more than average (i.e., large firms), then it follows that firms in some other category have to export less than average (i.e., small firms). The graphs show that small firms export less, therefore any partition of smaller firms will show that smaller firms export less than larger firms. The analysis performed does not show that firms with fewer than 20 employees appear to be too small to export but rather shows that:

Insert Table 1 Here

1. Smaller firms export less AND
2. There is nothing interesting about a partition of 20 employees. Many partitions of employees (20 employees, 100 employee, etc.) yield the result that small firms export less.

These two issues are reinforced when the larger data set is examined [See Table 2]. The left hand side of Table 2 reports the results from Mittelstaedt, et. al. These result show that a smaller percentage of micro firms (less than 20 employees) export than one would expect from the average of all firms in each of the 31 SIC codes reported. The right hand side of Table 2 reports the results when the data is arbitrarily partitioned into firms with fewer than 100 employees, firms with from 100-200 employees, firms with 200-500 employees, and firms with more than 500 employees. The results from the arbitrary apportionment show that a smaller percentage of firms with less than 100 employees export than one would expect from the average of all firms in 27 of the 31 SIC codes reported. Using the same logic as Mittelstaedt, et. al., one could make a strong, but erroneous argument that firms must have at least 100 employees to effectively export.

Insert Table 2 Here

### **SUMMARY:**

This paper examines the results from a study by Mittelstaedt, et. al. (2003) that suggests that a firm size of at least 20 employees is a necessary and sufficient condition for export success among small manufacturing firms. This research shows that the prior research is flawed in two ways:

This paper shows that the prior conclusions are flawed in two ways:

1. The chi-square test examines whether a grouping of firms (micro, small, medium, large) yields a smaller proportion of exporters than would be expected. Our data indicate that micro firms do not export as much as the average firm. The results do not indicate that micro firms do not export at all. Therefore, firm size is not a necessary and sufficient condition for export activity, as concluded by Mittelstaedt and his colleagues.
2. The conclusion that 20 employees is a necessary and sufficient condition for export activity is flawed because of the arbitrary selection of firm sizes examined. This paper shows that 100 employees or many other arbitrary partitions could have also been shown to be a necessary condition for export activity because the chi-square test is a zero sum game and if some firms export more than average, some firms export less than average. Since Graphs 1 & 2 demonstrate that very small firms export less than average, many arbitrary partitions of small firms will show a consistent pattern of less than average exporting. Thus there is no minimum size necessary to engage in the exporting process. In fact, we remind the reader that among the sample firms, 44% of firms with 0 employees exported.

### **RESEARCH IMPLICATIONS:**

The analysis by Mittelstaedt, et. al. (2003) is clearly at odds with our findings. The analysis in this study supports the argument that small firms are fully capable of exporting, such as the recent study by Wolff and Pett (2000). We believe a more fertile ground for future research would be to accept the fact that small firms can and do export (Autio, et. al., 2000). Thus, researchers should try to identify the factors that lead to successful exporting among micro firms, firms with fewer than 20 employees, rather than to continue to pursue correlational studies of the relationship between firm size and export activity. Further research on export propensity is no longer a promising research agenda. Like Olson and Gough (2001), we believe that future studies should begin to pursue more research on the performance implications of exporting by very small firms.

### **POLICY IMPLICATIONS:**

Mittelstaedt, et. al. (2003) also made suggestions to policy makers based upon their conclusions about firm size and export activity. They said that policy makers should focus on fostering domestic growth strategies rather than exporting for micro firms because the micro firms are too small to effectively export. This research shows that this underlying premise is false.

Large firms start as small firms that grow over time. Rather than growing in a consistent and predictable fashion, small firms follow many different strategies toward growth. Export activity is also not neatly described in a simple 1-2-3 fashion. Early research accepted the stages model of internationalization (Johanson and Vahlne, 1977). It was argued that small firms gradually began exporting and escalated their efforts as they grew and gained experience. Bilkey and others essentially argued that exporting is a process of development. However, researchers have recently questioned this perspective. In their ground-breaking work, McDougall, Shane, and Oviatt (1994) and Oviatt and McDougall (1995) argue that some ventures are created with an intent to sell internationally. Autio, Sapienza, and Almeida (2000) call this the “born-global”

trend, whereby new ventures are launched with cross-border business activities in mind. predictable growth strategy described by the stages of internationalization model. Yet, if policymakers were to follow Mittelstaedt, et. al.'s advice, micro small firms would not be assisted with their exporting questions. We believe that if policy makers assist micro small firms with their exporting, these firms may grow to become large firms.

#### **END NOTES:**

1 We realize that other forms of market entry are available to small firms, but exporting remains the most attractive means of foreign market entry.

2

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Others available upon request.

**Table 1**  
**SIC Code 355, Special Industry Machinery and Equipment**

**Initial Partition Into 4 Sizes Of Firms**

| <b>Actual Values</b> | <b>&lt;20</b> | <b>20-99</b> | <b>100-499</b> | <b>500+</b> | <b>Total</b>  |
|----------------------|---------------|--------------|----------------|-------------|---------------|
| Export               | 39.00         | 25.00        | 10.00          | 2.00        | <b>76.00</b>  |
| Don't Expo           | 31.00         | 13.00        | 0.00           | 0.00        | <b>44.00</b>  |
| Total                | 70.00         | 38.00        | 10.00          | 2.00        | <b>120.00</b> |

**Expected Values**

|  |       |       |       | <b>Total</b>  |
|--|-------|-------|-------|---------------|
|  | 44.33 | 24.07 | 6.33  | 1.27          |
|  | 25.67 | 13.93 | 3.67  | 0.73          |
|  | 70.00 | 38.00 | 10.00 | 2.00          |
|  |       |       |       | <b>120.00</b> |

**Actual - Expected Values**

|  |       |       |       | <b>Total</b> |
|--|-------|-------|-------|--------------|
|  | -5.33 | 0.93  | 3.67  | 0.73         |
|  | 5.33  | -0.93 | -3.67 | -0.73        |
|  | 0.00  | 0.00  | 0.00  | 0.00         |
|  |       |       |       | <b>0.00</b>  |

**(A-E)2/E**

|  | <b>&lt;20</b> | <b>20-99</b> | <b>100-499</b> | <b>500+</b> | <b>Sum Sq Errors</b> |
|--|---------------|--------------|----------------|-------------|----------------------|
|  | 0.64          | 0.04         | 2.12           | 0.42        | <b>8.80</b>          |
|  | 1.11          | 0.06         | 3.67           | 0.73        | 3df                  |

p Value  
0.032131

**Another Arbitrary Partition Into 4 Sizes Of Firms**

|  | <b>&lt;100</b> | <b>100-200</b> | <b>200-500</b> | <b>500+</b> | <b>Total</b>  |
|--|----------------|----------------|----------------|-------------|---------------|
|  | 64.00          | 8.00           | 2.00           | 2.00        | <b>76.00</b>  |
|  | 44.00          | 0.00           | 0.00           | 0.00        | <b>44.00</b>  |
|  | 108.00         | 8.00           | 2.00           | 2.00        | <b>120.00</b> |

|  |        |      |      | <b>Total</b>  |
|--|--------|------|------|---------------|
|  | 68.40  | 5.07 | 1.27 | 1.27          |
|  | 39.60  | 2.93 | 0.73 | 0.73          |
|  | 108.00 | 8.00 | 2.00 | 2.00          |
|  |        |      |      | <b>116.00</b> |

|  |       |       |       | <b>Total</b> |
|--|-------|-------|-------|--------------|
|  | -4.40 | 2.93  | 0.73  | 0.73         |
|  | 4.40  | -2.93 | -0.73 | -0.73        |
|  | 0.00  | 0.00  | 0.00  | 0.00         |
|  |       |       |       | <b>0.00</b>  |

|  |      |      |      | <b>Sum Sq Errors</b> |
|--|------|------|------|----------------------|
|  | 0.28 | 1.70 | 0.42 | 0.42                 |
|  | 0.49 | 2.93 | 0.73 | 0.73                 |
|  |      |      |      | 3df                  |

p Value  
0.052184

**Table 2****Actual Number of Firms That Export Minus Expected Number of Firms That Export*****Mittelstaedt, et. al. Partition Into 4 Sizes Of Firms***

|      | (A-E)  | (A-E) | (A-E) | (A-E) |
|------|--------|-------|-------|-------|
| SIC  |        | 20-   | 100-  | 500+  |
| Code | <20    | 99    | 499   |       |
| 201  | -7.33  | -1.33 | 6.33  | 2.33  |
| 209  | -2.76  | 2.61  | 0.16  | 0.00  |
| 228  | -0.38  | 2.92  | -1.77 | -0.77 |
| 233  | -0.25  | -0.42 | -0.25 | 0.92  |
| 243  | -4.42  | 0.65  | 3.76  | 0.00  |
| 249  | -1.65  | -0.16 | 1.81  | 0.00  |
| 251  | -4.09  | -0.42 | 3.13  | 1.38  |
| 254  | -1.25  | -1.00 | 2.25  | 0.00  |
| 265  | -2.83  | 0.50  | 1.61  | 0.72  |
| 275  | -5.81  | 3.36  | 2.50  | -0.05 |
| 281  | -1.67  | -0.51 | 2.65  | -0.47 |
| 282  | -2.12  | -1.15 | 1.51  | 1.76  |
| 286  | -1.00  | -2.60 | 2.80  | 0.80  |
| 287  | -2.64  | 2.86  | -0.23 | 0.00  |
| 301  | -0.55  | -1.64 | -0.09 | 2.27  |
| 308  | -13.68 | 7.17  | 5.16  | 1.34  |
| 332  | -0.91  | -0.73 | 1.64  | 0.00  |
| 334  | -1.50  | 2.00  | -0.50 | 0.00  |
| 336  | -2.77  | 0.62  | 2.15  | 0.00  |
| 342  | -2.29  | -0.14 | 3.00  | -0.57 |
| 344  | -11.39 | -3.65 | 14.29 | 0.75  |
| 349  | -5.50  | 3.00  | 1.50  | 1.00  |
| 352  | -1.88  | 0.75  | 0.75  | 0.38  |
| 353  | -2.86  | 0.45  | 2.41  | 0.00  |
| 354  | -10.49 | 6.46  | 3.48  | 0.55  |
| 355  | -5.33  | 0.93  | 3.67  | 0.73  |
| 359  | -6.43  | -0.09 | 5.72  | 0.79  |
| 362  | -1.43  | -1.68 | 1.71  | 1.39  |
| 363  | -2.00  | 0.50  | 0.50  | 1.00  |
| 364  | -2.09  | 0.41  | 2.27  | -0.59 |
| 366  | -2.00  | 2.00  | 0.00  | 0.00  |

***Another Arbitrary Partition Into 4 Sizes Of Firms***

|  | (A-E)  | (A-E) | (A-E) | (A-E) |
|--|--------|-------|-------|-------|
|  |        | 20-   | 100-  | 500+  |
|  | <20    | 99    | 499   |       |
|  | -8.67  | 4.33  | 2.00  | 2.33  |
|  | -0.16  | 0.26  | -0.11 | 0.00  |
|  | 2.54   | 0.15  | -1.92 | -0.77 |
|  | -0.67  | -0.25 | 0.00  | 0.92  |
|  | -3.76  | 2.23  | 1.54  | 0.00  |
|  | -1.81  | 1.81  | 0.00  | 0.00  |
|  | -4.51  | 1.76  | 1.38  | 1.38  |
|  | -2.25  | 1.50  | 0.75  | 0.00  |
|  | -2.33  | 0.46  | 1.15  | 0.72  |
|  | -2.45  | 1.54  | 0.95  | -0.05 |
|  | -2.18  | 1.59  | 1.06  | -0.47 |
|  | -3.27  | 0.76  | 0.76  | 1.76  |
|  | -3.60  | 1.60  | 1.20  | 0.80  |
|  | 0.23   | -0.23 | 0.00  | 0.00  |
|  | -2.18  | 0.00  | -0.09 | 2.27  |
|  | -6.51  | 2.19  | 2.97  | 1.34  |
|  | -1.64  | 0.00  | 1.64  | 0.00  |
|  | 0.50   | -0.50 | 0.00  | 0.00  |
|  | -2.15  | 2.15  | 0.00  | 0.00  |
|  | -2.43  | 0.86  | 2.14  | -0.57 |
|  | -15.04 | 8.03  | 6.26  | 0.75  |
|  | -2.50  | 0.00  | 1.50  | 1.00  |
|  | -1.13  | 0.75  | 0.00  | 0.38  |
|  | -2.41  | 2.07  | 0.34  | 0.00  |
|  | -4.03  | 0.19  | 3.29  | 0.55  |
|  | -4.40  | 2.93  | 0.73  | 0.73  |
|  | -6.51  | 1.38  | 4.34  | 0.79  |
|  | -3.11  | 0.39  | 1.32  | 1.39  |
|  | -1.50  | 0.00  | 0.50  | 1.00  |
|  | -1.68  | 0.64  | 1.64  | -0.59 |
|  | 0.00   | 0.00  | 0.00  | 0.00  |

# **AN INTEGRATED PROGRAM FOR ENTREPRENEURSHIP CLASSES**

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## **Abstract**

A three -part experiential program consisting of an idea-generating activity-the “bugs”-, a networking activity- “Networking”- and a real-life start-up exercise-the “seed money”- was implemented in an undergraduate class of entrepreneurship during spring 2004. The objective of this program was shifting the “burden” of teaching from a conventional lecturing method to a series of hands-on assignments in which students had to generate business ideas, establish contacts with the local entrepreneurs, and actually start a business. These activities initially appeared as disconnected and unrelated efforts. However, as the class progressed, underlying relatedness of these exercises became more and more apparent.

Major outcomes of this program were: 1- After three rounds of sifting and refining, a long list of business ideas was compiled 2- A large number of local entrepreneurs- among whom many expressed their willingness to be guest speakers- established links with the students and the University. 3-Many students who had never experienced how a small proprietary business operates realized mechanics of starting and managing an enterprise.

## **INTRODUCTION**

The program is based on a simple logic: Adding entertainment to conventional teaching enhances learning. The program critically “engages” students in work and at the same time make them think that they are in a playing field. The theoretical basis of “engagement” (Pine and Gilmore, 1999) simply implies that education is absorption and active participation in an experience, as opposed to absorption and passive participation of the target, in our case, students. The process of “learning by doing” is actually conversion of the explicit knowledge (theory) that is transmittable in formal, systematic language into tacit knowledge (practice) that is personal, and context-specific. As stated by Nonaka and Takeuchi (1995), when experiences are internalized in the form of technical know-how, they become valuable assets.

The following section explains the theoretical background of the three ingredients of the program the bugs, networking, and the seed money.

1- The “Bugs” constitute the first component of the troika. Its purpose is to produce ideas with the potential of becoming new products and services.

The most successful products are response to problems or needs that someone has. Many entrepreneurs get ideas for new products from needs that they have themselves, or they identify when speaking with someone. For instance, Leo Gerstenzang invented the Q-tip in the 1920's. His wife had used a toothpick with cotton stuck on the end to clean their baby's ears, and Leo invented Q-tips to replace her "invention". Or Velcro was invented by George de Mestral-Swiss engineer- in 1948. While hiking, he had noticed that burdock seeds stuck to his clothing extraordinarily well. The seeds had extensions that attached themselves firmly to clothing. Mestral used this same model to develop Velcro.

Inventions do not go all the way from ideas to usage. They go through many phases of refining and filtering, and in a sort of "natural selection". Some ideas may work well in a laboratory experiment but not in the marketplace. Many good ideas and inventions fail to succeed, even after being financed, because companies don't have the well-rounded business knowledge to have all areas of their company on solid ground.

2. The second constituent of the program, networking, is in fact the other side of the invention – finding "bugs". While the latter is the saga of the "hero", the one who is able to solve problems, the former emphasizes on the power of networking. Here, the hero acts within and with the help of a network of friends, associates, and acquaintances. There is more to success than having a good idea and raising money. Marketing, advertising, accounting, taxes, and networking are just some of the other areas of knowledge necessary to maximize success. The advocates of this line of reasoning propose that the "networks" are the "most significant resource of the firm" (Johannisson, 1990, p. 41), and the contacts with the network are often a source of new venture ideas (Christensen and Peterson, 1990). Another research (Hills, et. al, 1997) indicates that network entrepreneurs recognize significantly more opportunities than "solo" entrepreneurs. In fact, in reference to the concept of "bounded rationality" (Simon, 1976), entrepreneurs can use their social networks to expand boundaries of rationality. By taking this approach, our proverbial hero turns into a creature of his environment and networks.

3-The seed money activity initiates from a fact that people have different approaches to learning. Students in a seminar might be all thumbs in a lab or studio; students rich in hands-on experience may not do so well with theory. Students need opportunities to show their talents and learn in ways that work for them. This hands-on activity provides an outlet for practical students and acts as an additional tool of leaning.

## **DESCRIPTION OF THE PROGRAM**

The program of integrated experiential exercises, discussed in this paper, was formed to engage students in learning and turn theories into practices. The three components of this experiment are a brainstorming track -"bugs", a networking track-"networking", and an actual business operations-"seed money".

In developing this program, three ideas merged: The idea of brain storming activity, creatively labeled "bugs" – things that aggravate you came from Marcie Sonneborn (Syracuse University). The networking idea flowed from David Newton (Westmont College, Santa Barbara, California).



Robert Peterson, from University of Portland, presented the third activity in a paper at USASBE 2004 in Dallas, Texas.

The author is not aware of execution of the first two works, but the seed money project had been practiced before. These activities were totally separate and unrelated works developed by different persons. The idea of integration and expansion, however, was developed later.

In this paper particulars of the program are presented so that repeat of the exercise becomes an easy task. It is evident that any reproduction of the experiment has to be modified to echo the local conditions and preferred objectives. For instance, universities have different calendars and the length of terms vary. Some schools, particularly those located in large urban areas, have access to more resources and entrepreneurs, which allows a slightly different approach. In instances, the instructor may desire to invite entrepreneurs as guest speakers to her or his class. Still, the class size may influence the arrangement of groups.

## ACTIVITIES

1- “What does bug you” Report: This is an individual work: For this assignment each student is asked to list 70 or more things that really annoys her/him. In this exercise students must reflect on their own life, their personal needs, activities in which they are involved, things they like to do, relationships that they have, things that they observe in their everyday world, and so forth. As such, they compose a laundry list of particular things that bug them.

This assignment is completed in four phases: In the first phase students are asked to come up with 70 “bugs”. In the second phase students are required to classify their bugs into various categories such as social, personal, environmental, and legal. Here they are told that the purpose is to find a reasonable solution that may lead to creating a certain product or service. In the third phase students need to filter their bugs and select the 10 best promising concepts for future business enterprises. The result of this phase is a table that specifies some key business concepts. The project is completed in the fourth phase and here we have a list of the 10 best bugs that reflects market deficiencies suggesting various business opportunities.

Table one demonstrates a sample of irritating things that students presented as “Bugs”. In the same table, we also note suggested solutions –a potential product- for them.

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Table 1 about here

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As the sample table demonstrates some of the suggested solutions are directed at immediate and local concerns. Others have been proposed to solve universal problems.

2- Networking Report: This is a group work: This assignment requires a group of students to progressively fill up a binder with specific information. The entries include business cards, clipped articles about intriguing entrepreneurs, telephone numbers for great referrals, web URLs or email addresses for related products or services, brochures picked up at trade fairs or exhibits, firm owners cited in various publications in the state and cold call referrals secured during the

semester. Students have to keep adding value to their binders. Which means that in each round, they must submit a progress report to the instructor and the class. They have to add more items to the folder (more business cards, more brochures, etc.), and have to have a follow-up with the business card owners. This implies that during the semester, students will increase their professional contacts, and thereby amplifies their awareness.

There are four rounds of this work: First, students are asked to collect business cards, brochures, newspaper clips, fliers, etc, from the local businesses. They can be from any type of business. In the second phase, in addition to adding more items collected in the previous phase, students are required to interview local entrepreneurs. Since this is a group project, students are expected to conduct at least ten interviews during this phase. In the third phase a table must be completed. Certain information about five of the entrepreneurs who have been interviewed are to be placed in part of this table. At last the previous phase has to be completed and the final project is to be submitted to the instructor for grading.

Despite the clear merits of experiential exercises, a textbook was used during the semester for two reasons: Not all students know or are able to remember business concepts previously learned in other classes. It happened quite a few times that nobody in the class could recall even the simplest business terms. Thus, the textbook could be used as a reference. Additionally, the textbook would exert discipline in the class. The experienced instructor is aware that certain topics and chapters in any textbook are more helpful than others, and those sections must be emphasized.

### **Week-by-week activities: Week One through Week Six**

First two weeks: A general discussion of entrepreneurial characteristics, as well as discussion of identifying opportunities and entry strategies. The assumption is that after covering these subjects, students are ready for completion of the first round of the “bugs” and “network”. In addition, instructors can assign other exercises to their students.

Third week through sixth week: Discussion of business valuation and buying an existing business, management teams, legal forms of organization, and intellectual property. Again, additional homework activities that are related to these topics may be assigned. Here students are prepared for the second round of both experiential exercises. A third exercise, the “seed money” project is to be initiated at this time. In other words, when the seed money project starts, the semester is about six weeks old.

3. Seed Money Project- For this two-month long activity, each student is given \$ 20.00 to start a service or produce a product. They knew that as long as the business was legal and ethical, its type did not matter. When the seed money was distributed the instructor and student- signed a contract. Students were free to form a partnership if their project required more money to start. If a partnership was formed a contract must be signed and kept in the portfolio.

The reason for the rather late start for this project was to pass the course withdrawal period. Also by this time students have become acquainted with the basic concepts of doing business and have had an opportunity to evaluate the pros and cons of selecting the test or seed money options.

The grades given to students are for the quality of the reports only. There is a chance that a certain enterprise loses its initial fund. This itself is an exercise in entrepreneurship and student's responsibility to face the risks of starting a business. The seed money would be collected regardless of the outcomes.

A big bonus can be awarded to each project where the owner(s) were able to entice local entrepreneurs to finance their expansion and growth. Bonus can be extra points or just certificates of appreciation awarded to the individual founders or their enterprises.

Each group has to prepare a collective resume for itself. The instructor forms these groups and they are composed of students with different overall grade averages (GPA). The importance of this collective resume is multi-fold. It enhances group cohesiveness. It reveals to them that no single individual has all the necessary talents and skills. In addition, the seed money project requires having the professional resume of the entrepreneur. Thus, if a partnership has been formed, the said resume would be a collective one. A part of network assignment, too, demands inclusion of a collective resume.

A short report about this project, as was implemented in the class, is presented below:  
Out of 28 students in this class, 22 decided to take the seed money path. The remaining 6 selected to take the tests. Five of these six were graduating seniors. Their final grades were about the same level of some other students who did not take the tests.

Each student received \$20.00. However, some of them formed companies. As the result, we ended up having 11 enterprises. Some students acted alone, but in one case, the "company" had 5 partners. The initial investment of \$440.00 generated net revenue of \$ 826.00. Considering the life span of this exercise (just two months), this return on investment (87.7%) is to be regarded as a huge success by a group of students who had very little or no business experience. Students paid a 10% "tax". Some "donated" extra funds. In total, \$88.90 was collected that was deposited in a special account for our CEO Club.

Types of the businesses that these students founded included: One-person enterprises: A car detailing, a car washing (at your residence), a web designing, a candy making, a jewelry making, a woodcutting, and a decorating business. Businesses that consisted of more than one investor: two T-shirt companies and one massaging enterprise (with one female and two male students). None of these enterprises lost any money. But, the majority of the students lost points due to bad preparation of their reports. In most cases, mistakes were more prominent on balance sheets and income statements.

### **Week-by-week activities: Week Seven through Week Fourteen**

Week seven through week ten: During this phase, the following topics are discussed: Contracts and leases, how to protect business interests, government regulations, and analyzing the market. After these discussions, students should turn in their third round of "bugs" and "network" assignments. They should also demonstrate substantially improved knowledge of market and

how to convert ideas into products. If a seed money project is assigned, its first report is due at this time.

Week eleven through week fourteen: In preparation for the fourth and last reports of the “bugs” and “network” assignments, students will have studied subjects such as pricing, market penetration, developing financial statements, and sources of capital. Since this is about the end of the semester, a final (in fact the second) report of seed money project is also due at this time. Similar to the preceding phases, the instructor may require students to complete other assignments. These homework assignments are the type that will further assist students to acquire knowledge about the complex task of business management.

## **CONCLUSION**

By following the step-by-step activities, the program achieved several objectives: We reviewed the most important subjects of how to manage an enterprise. We made the class an exciting place of learning and playing, and allowing students to actually implement a business concept. And at last, these exercises created opportunities for students to approach a network of experts, supporting group, and potential investors.

Buckingham and Coffman (1999) point out “through Gallup’s studies of great accountants, we have discovered that one of their most important talents is an innate love of precision.” As this experiment progressed, a fact started to reveal itself to both students and the author. We discovered that certain students while completing phases of activities were demonstrating very clear signs of having such entrepreneurial talents as courage, determination, and tolerance for ambiguity, and accepting risks without much anxiety. The three exercises demonstrated to students that when the subject of entrepreneurship is taken seriously, it is not a course for everybody. All participants in the class learned skills necessary to manage an enterprise. They also acquired awareness of rules of the game. One needs a kind of brain wiring to practice a meaningful profession. As we moved on, we discovered the less talented fellows. Some were missing the deadlines. Some were shy in interviewing the local entrepreneurs. Still others couldn’t identify “bugs”, those irritating life experiences, demonstrating their lack of recognizing opportunities. Almost the same individuals were expressing their inability to start a business-seed money activity- and were begging others to accept them as partners.

A direct result of this kind of experiential exercise is “discovering” talents. While it is much easier to teach skills (how-tos) and knowledge (awareness), it is far more crucial and difficult to find hidden talents, conducive to successful future business path. These exercises have the power of digging into the potential pool of human talents and expose the ones that are important in carrying out a business venture.

The author would like to hear from colleagues if they decided to implement this system of experiential exercises in their classes. This work has the potential of further refinement and improvement.

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Table 1. A Sample of Bugs and Suggested Solutions

| What does bug you  | Solution  |
|--|---|
| I frequently lose my keys  | Attaching a beeping device to the key chain to be activated when a button is pressed on the base  |
| I don't like to add liquid detergent any time that I load a washer | Developing an automatic dispenser that will release detergent from a large container inside the machine   |
| It is very hard to level pool tables                               | Developing an electronic device that is attached to a mechanical adjuster on each leg of the pool table. This device would adjust each leg automatically. |

**AN EXPLORATORY STUDY OF RETAIL SERVICE MANAGEMENT IN THE  
PHILIPPINES**

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# **AN EXPLORATORY STUDY OF RETAIL SERVICE MANAGEMENT IN THE PHILIPPINES**

## **ABSTRACT**

The Philippines has become an important source of global middle managers as its population has become more educated and bilingual. Along with China, the Philippines attracts international enterprises seeking to establish a presence in Asia. This exploratory study examines retail small/medium enterprises (SMEs) management and employee perceptions of customer service. The results suggest that managers and employees in the Philippines behave in similar ways to those in western countries, but there are differences, probably related to cultural characteristics. The Philippines is a culturally diverse country, with historical and cultural influences from China, Malaysia, Spain, Japan, and the United States. As the Philippine market becomes more ingrained in a globalized environment, the importance of service quality increases. Global retailers stand to benefit from this study through an enhanced understanding of the mindsets and attributes of managers, employees, and customers in this region of the world. The lessons learned can be valuable in the formulation of training, sales and marketing, business development, human resources management, and strategic planning. Implications for practice are discussed.

## **INTRODUCTION**

The Asian Crisis in 1997 awakened the global community to the fact that Asian economies are closely linked to international markets and that economic and business events that occur in Asia have a direct impact on Western economies. The growing number of emerging economies in the region has also attracted international entrepreneurs to the many business opportunities in this region. This study examines the nature of retail service quality in the Philippines and should help entrepreneurs better understand the Filipino perceptions of this important factor.

With a growing population of around 86 million, a growth rate of 2.36% between 1995-2000, and with close proximity to other Asian markets, the Philippines is strategically appealing (Philippine National Statistics Office, 2002). Purchasing power in the Philippines is generally low, but more than 2 million consumers earn over US\$1,250 per month. Other significant sources of disposable income are derived from an underground economy (30-40% of GDP) and from remittances from overseas Philippine workers amounting to more than US\$ 6 Billion in 2001 (UK Trade Invest, 2004).

Philippine consumers are familiar with many US products, films, music, and mass media advertising. Millions of Filipinos reside in the US and periodically travel back to the Philippines and 94% of Filipinos speak English (Philippine Franchise Association, 2004). Despite this, as the Philippines further industrializes, managers face the challenge of achieving modern results while maintaining their traditional values. Dealing with contrasts is an inherent part of the Philippine culture. As a predominantly coastal region beset with severe seasonal typhoons, Filipinos have developed a fatalistic attitude (known as “bahala na”), leaving their fate to God.

Sison (2003) points out that Filipinos have developed a knack for improvisation and a strong focus on the present.

Cultural dimensions revealed by Geert Hofstede (1991; 2004) also help us to understand Filipinos and their interactions with retailers. Hofstede's cultural values for the Philippines show relative high power distance index (PDI) and low individualism (IDV) measures. In addition, they have a relatively short-term orientation. These values suggest the Filipino culture could influence retailers in the following ways: High PDI – sales people should look for direction from sales managers and other management authorities; Low IDV suggests that sales employees require direction and are less likely to solve problems on their own; a Short Term-Orientation suggests that changes may be able to be instituted rapidly.

## **Retail Environment**

Retail trade in the Philippines has recently blossomed. The Philippine National Statistics Office (2004) counted 437,325 establishments engaged in wholesale and retail trade in 2000, with the industry employing over 1.7 million people. Retail sales in 2002 amounted to 1,692.3 billion pesos (approximately US\$30 billion), an 11.1% increase from 2001 (Euromonitor, 2004). Most retail stores in the Philippines are small, home-based, unregistered, and employ a staff of less than 10 people, with food retail outlets comprising about 65 percent of the total number of outlets. Thirty percent of the country's total retail sales are concentrated in metro Manila.

The Retail Trade Nationalization Act once confined retail trade to Philippine nationals. However, recently the Retail Trade Liberalization Act paved the way for increased retail competition, along with expansion and growth, innovation, introduction of new technologies, professional management, and diversification into new sectors (Patalinghug 2001). Trade liberalization has also increased opportunities for international retailers.

Retailing in the Philippines spans a gamut of venues including sari-sari stores (mom and pop stores), sidewalk vendors, wet and dry markets (produce and dry goods), groceries, supermarkets, hypermarkets, warehouse and discount clubs, large malls, mall stores and shops, and convenience stores (also known as c-stores) (Omana, 2003). However, the lifeblood of Philippine retailing is the huge network of small mom and pop stores known as sari-sari stores. Sari-sari variety stores make up 90% of the retail outlets. Sari-sari stores offer lower-income consumers easy accessibility and credit terms, as well as the opportunity to purchase in smaller portions in line with limited budgets. A modern version of the sari-sari store is the convenience store. It mixes the attributes of a traditional sari-sari store, with that of a supermarket, and offers a wider selection of product lines in a friendly, comfortable, and strategically located venue. Typically open 24 hours a day, 7 days a week, it caters to the fast-paced and changing life-styles of urban professionals. There are over 600 convenience stores in the Philippines (Omana, 2003).

The Philippine retail industry is fragmented, but as large international players enter the country, the industry will likely experience greater consolidation and should be prepared to respond and adapt to incoming paradigm shifts (Lugo, 2002). In fragmented Asian markets like the Philippines, Japan, and Korea, consumers tend to remain loyal to retail stores (Asia



News Network, 2002). In the Philippines, building customer loyalty is a sensible goal for retailers and the ability of a retailer to plan and implement customer retention measures determines future success or failure.

Patalinghug (2001) suggests that while retail saturation continues to grow in the Philippines, the industry continues to offer market opportunities for new entrants and for current players seeking to expand. Franchising is one of the fastest growing sectors in the economy. The growing demand for new products and services attest that there is plenty of room for new players and many opportunities for U.S. companies (U.S. Department of State, 2001).

## **Service Quality**

A number of studies examine retail service quality in the U.S., but we know less about it in developing countries. Previous research, though, generally supports a relationship between culture and service quality (Furrer, Liu & Sudharshan, 2000). Crotts and Erdmann (2000), for example, found that Hofstede's value dimensions relate to travel service satisfaction, suggesting culture relates to perceptions of service quality. In another study, consumers with high uncertainty avoidance values and short-term orientations tended to have higher expectations for service quality (Donthu and Yoo 1998).

Retailers in the Philippines find their market increasingly competitive, with foreign retailers attempting to move into the market in greater numbers (Baetiong and Flores 2002). Competing with global retailers will become increasingly difficult, unless local Filipino retailers can differentiate themselves in ways meaningful to their customers (Jabson 2004). This study takes an initial look at current service quality issues and relates them to various cultural and demographic dimensions.

## **Hypotheses**

We examine the relationships between service quality expectations, perceptions, and fatalism. Since this is an exploratory study with little theory to guide us, we justify our hypotheses with logical explanations. Shopping experience should have an effect on both expectations and perceptions of service quality. Experienced shoppers should be more likely to expect higher service quality and perceive that they get it. Some of this might be due to self-selection. Experienced shoppers know which stores consistently provide good service and are likely to frequent them more often than retailers who provide inconsistent or poor service quality. Our first two hypotheses reflect these assumptions.

H1: The greater the experience in shopping, the greater the expectations for service quality.

H2: The greater the experience in shopping, the greater the perceptions on service quality.

Most Asian cultures tend to be more fatalistic than North Americans and northern Europeans. In addition, religious values may add to the cultural values of fatalism. The Philippines is strongly Roman Catholic, with regional concentrations of Muslims, both groups tend to be fatalistic.

Previous studies showed fatalism inversely affected both expectations and perceptions of service quality (Raven and Welsh 2004), leading to the following hypotheses.

H3: The greater the fatalism, the less service quality expected.

H4: The greater the fatalism, the less perceived service quality.

In traditional societies, genders tend to play traditional public roles (Hofstede, 1991). Since the Philippines is a rapidly developing country, we expect that gender will still play a role in service quality. Raven and Welsh (2004) showed that males had higher expectations of service quality and females lower perceptions of service quality. Since that study occurred in a different culture, we have left the direction open.

H5: There will be a gender difference in expectations of service quality.

H6: There will be a gender difference in perceptions of service quality.

H7: There will be a gender difference in fatalism, with females tending to be more fatalistic than males.

## **METHODOLOGY**

### **The Sample**

Three employees of Synergy Tech International, a Philippine firm, surveyed retail employees in Cebu, under the direction and training of one of the authors. This resulted in a convenience sample of employees, who were first-line salespeople and their managers. There were 124 usable responses. The stores were located mostly in shopping centers (96%), but a few were on the street (.8%), and others were stand-alone stores (3.2%). Of the more than 100 stores sampled, most were small individually owned stores and a few were department stores. A wide variety of products were offered in the stores, including automotive parts, electronics, travel, banks, fashion clothing, sporting goods, food, books, and many other products and services.

**ServQual** The primary measure of interest was service quality, comparing expected service and perceived service outcomes. Validity and reliability of the ServQual scale has been well-supported (Parasuraman, Zeithaml, & Berry, 1986, 1988). The ServQual model measures the expected and perceived levels of service. The level of service is measured on five dimensions:

Tangibles – physical neat appearance of the facilities, personnel, etc.

Reliability – ability to perform service dependably and accurately

Responsiveness – willingness to help customers

Assurance – conveyance of knowledge, trust, and confidence

Empathy – caring, individualized attention

The ServQual instrument was previously used in cross-cultural and cross-industry studies with generally satisfactory results. Lam (1997) used the ServQual instrument in evaluating patient service quality in Hong Kong. A modified version of ServQual determined quality of service in marketing research agencies in the U.K, suggesting the instrument has practical applicability in cross-cultural contexts (Donnelly, Van'T Hull, & Will, 2000).

**Fatalism** Fatalism refers to the level of control people believe they have over outside events. High levels of fatalism suggest people believe they have little control over events affecting their lives. We used a scale developed by Farris and Glenn (1976) to tap this dimension. The questions asked respondents the extent to which they agreed with the following statements:

- Making plans only brings unhappiness because the plans are hard to fulfill.
- It doesn't make much difference if people elect one or another candidate, for nothing will change.
- With the way things are today, an intelligent person ought to think about the present, without worrying about what is going to happen tomorrow.
- The secret of happiness is not expecting too much out of life and being content with what comes your way.

Studies of fatalism have most often been reported in the sociology literature, where it has been linked to attributions of poverty and cross-cultural differences between Lebanese and Portuguese (Abouchedid & Nasser, 2002), among others. Fatalism was used with Hofstede's value dimensions to compare cultural values in Russia, Georgia, Kazakhstan, and Krygystan (Ardichvili, 2001) as well as in Kuwait and Lebanon (Raven & Welsh, 2004).

## **RESULTS AND DISCUSSION**

Due to the abbreviated version of this paper, the data and analyses are not reported, but are available from the contact author. Rather, we discuss the major findings of interest to USASBE members. Our results suggest that shopping experience influences service quality expectations and perceptions in the Philippines. Shoppers with more experience tend to expect higher service quality and perceive that they get it. This has implications for retailers in understanding and communicating what service quality entails and delivering it. Retailers delivering higher service quality than their competition should have more customers that are loyal. It also has implications for retail managers in making sure marketers understand service quality parameters of importance to customers and that training programs emphasize service quality deliverance.

Filipino respondents with lower fatalism scores had higher service quality expectations and perceptions than those with higher scores. The more fatalistic people expected and perceived that they received lower service quality. Fatalism may be an indicator variable for other changes going on slowly within a culture and deserves consideration in global retail strategies.

While the results comparing gender were inconclusive because of large differences in sample sizes – almost 77% of our respondents were females – gender does seem to influence both expectations and perceptions of service quality, with males usually expecting greater service quality and perceiving they got it. In our sample, males were slightly more fatalistic than females, but not significantly so.

Growing competition both domestically and internationally will likely stimulate higher qualities of retail customer service, innovation, technology integration, workforce efficiency, productivity enhancement, research, security control, and cost efficiencies in the Philippines. Performance benchmarks and service measurements need to align with the prevailing business landscape and be continually adjusted to changes in industry and consumer dynamics. A one-size-fits-all global

management approach could be a prelude business disaster. This study provides evidence on the value of training sales people and retail employees in the Philippines. Training can influence the customer orientation of sales people in improving responsiveness, reliability, and empathy, among other service dimensions when coupled with good management techniques.

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# THE IMPACTS OF ADOPTING LEAN PURCHASING AND SUPPLIER MANAGEMENT PRINCIPLES ON SMALL BUSINESSES PARTICIPATION IN FEDERAL PURCHASING

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## Abstract

The Small Business Act requires that small businesses be afforded the maximum practicable opportunity to participate in Federal contracts. Contracts for small businesses have been on the decline for several years. This research seeks to determine whether Lean Aerospace Initiatives (LAI) are acting as entry barriers to small businesses attempting to enter the federal market. Statistical analyses of a decision-making exercise identified specific LAI principles that are acting as market entry barriers for small businesses. This study found that two LAIs did serve to significantly restrict small business participation: target costing and supplier management of inventory.

## INTRODUCTION

Federal procurement agencies are directed by statute and regulation to maximize small business participation in their procurement activities. The same agencies strive to incorporate strategic purchasing initiatives to maximize the efficiency of their procurement processes and the effectiveness of the dollars they spend on behalf of the taxpayers. Unfortunately, small business goals are often in conflict with efforts to incorporate efficiencies and leverage procurement dollars. The research question of this paper is: Are Lean Purchasing and Supplier Management Principles acting as entry barriers to small manufacturing and parts supplier businesses attempting to enter the Federal market?

### Small Business

Federal spending of taxpayer dollars serves a key function – contributing to congressionally established socio-economic goals. One of these socio-economic goals results from the Small Business Act (Public Law 85-536) that provides small business concerns the maximum practicable opportunity to participate in Federal contracts and subcontracts.

In an effort to ensure that small businesses are provided the maximum practical opportunity to compete for federal contracts, the Small Business Administration sets a certain percentage of total contract award dollars to small businesses as target goals for Federal Departments and Agencies. For example in 2001, the Air Force had a goal of awarding 16.2 percent of its contract dollars to small businesses. The Air Force fell short of that goal and awarded only 13.8 percent to small business. From 1995 through 2001, the percentage of dollars being awarded to small businesses declined each year (AFMC/CD Memo, 3 Jul 02).

Miller (2002) identified Lean Purchasing and Supplier Management (Lean PSM) principles as being a common theme in the changing relationship between large business prime contractors and small business subcontractors.

A primary goal of the Lean Aerospace Initiative (LAI) is to add value by eliminating waste and inefficiency while improving quality and reducing costs (Cook and Graser, 2001). Eventually, the LAI became a joint effort between the Air Force, industry and MIT to determine whether or not lean principles could be successfully implemented within the defense aerospace industry.

## **LITERATURE REVIEW**

### **Lean Aerospace Initiative**

LAI's mission statement was "To enable fundamental change within industry and government operations that supports the continuing transformation of the US aerospace enterprise towards providing aerospace systems offering best life-cycle value" (*Proposal*, 1999:3).

In order for a company to truly become "lean", lean principles must be applied to the entire supply or value chain (Cook and Graser, 2001:88). It is estimated that purchased materials and parts make up between 50 to 70 percent of the cost of a typical military aircraft (Cook and Graser, 2001:87). The nine specific Lean PSM practices are: supplier qualification and certification, long-term relationships, communications with suppliers, electronic data interchange (EDI) with suppliers, continuous improvement *kaizen* events at suppliers, target costing, just-in-time (JIT) delivery, supplier management of inventory at customer, and supplier kitting (Cook and Graser, 2001:92-99). Lean PSM principles pertinent to this research follow.

A small business may not have either the monies to finance Lean PSM principles or the human capital necessary for implementation, training, and operations. Depending on the particular industry, small businesses are defined based upon either yearly gross revenues or the number of employees. The gross annual revenue limit can be as high as \$29 million and the maximum number of employees can be as high as 1,500. However, the most common numbers across all industries are a gross revenue limit of \$6 million or having 500 or fewer employees. (SBA Small, 2002) These are human and financial limitations large businesses are not encumbered with.

## **METHODOLOGY**

We selected Department of Defense (DoD) aerospace contracts and contractors to serve as proxies for our research. DoD represents 70% of all Federal contract dollars spent, and

aerospace contracts allow us to investigate the impact of Lean Aerospace Initiatives on small business. Because archival data was not available for this effort, a survey methodology was used.

## Survey Development

The decision making exercise was modeled after Stahl and Zimmerer (1984) and Karakaya and Stahl (1989), and created around a one-half replicate of a full factorial design with six independent variables, each of which had two treatment levels: “High” or “Low” and represented the level of implementation by incumbent subcontractors. The level of PSM factor implementation by the incumbent companies a market entrant is competing against creates the market entry barriers. Figure 1 is an example of the decision making exercise modeled after that of Stahl and Zimmerer (1984) and Karakaya and Stahl (1989). The finalized survey instrument is available from the authors.

During the exercise, please assume you are making the decision to enter or not enter the market as a subcontractor to a large aerospace firm. Each market condition specifies attributes the prime contractor is requiring in making its subcontract award decision. In each condition and decision, consider your company’s current capabilities, financial strength, and any costs necessary for you to implement the required attributes. With the level of the incumbent subcontractors’ implementation for these 6 attributes in mind, please indicate the chance you would decide to enter the market.

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Figure 1 about here

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The research question was studied by testing the following hypotheses:

**H1: EDI is acting as an entry barrier for small businesses attempting to enter the DoD aerospace parts manufacturing/supplier market.**

**H2: Target costing is acting as an entry barrier for small businesses attempting to enter the DoD aerospace parts manufacturing/supplier market.**

**H3: JIT is acting as an entry barrier for small businesses attempting to enter the DoD aerospace parts manufacturing/supplier market.**

**H4: The supplier’s management of inventory at the customer’s facility is acting as an entry barrier for small businesses attempting to enter the DoD aerospace parts manufacturing/supplier market.**

## Sample

The population for this study was all American small businesses that are currently in or considering entering the DoD aerospace manufacturing and parts supplier market. The complexity involved in compiling a comprehensive listing of this population, we utilized the Small Business Administration’s (SBA) Pro-Net Database was used as a sampling frame.



From the Pro-Net sampling frame, a database of small businesses was compiled using searches containing the keywords “aerospace” and “aircraft” within manufacturing and research and development business types.

591 companies received the E-mail surveys and 171 responses were received. The response rate was 28.93 percent. 69 survey responses were found to be unusable because they were incomplete. 102 usable surveys were collected and represent a usable response rate of 17.26 percent.

## **RESULTS AND ANALYSIS**

### **Regression Analysis**

A model consisting of the four main effects and the six possible two-way interactions was analyzed at the individual and group level. The two-way and higher interactions were analyzed to determine if their inclusion in the study was warranted. Using an alpha of .01, five of the two-way interactions, or .81 percent, were significant.

Standardized beta coefficients were computed to allow comparison of the beta coefficients. A negative significant factor would indicate that a high level of implementation by the incumbent subcontractors of the particular PSM factor was causing the decision makers’ probability of entering to decrease and therefore acting as a barrier to entry. The Lean PSM principles of target costing and supplier management of inventory at customer’s facility had significant negative standardized beta coefficients at  $\alpha = .05$  and were therefore acting as market entry deterrents in the sample. The PSM factors of just-in-time and electronic data interchange were not found to be significant predictors among the sample.

Table 1 shows the number of significant effects for each independent variable consistent with the hypotheses and the number of significant effects that were inconsistent with the hypotheses at the individual level.

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Table 1 about here

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The subjects’ judgments relating to TC and SMI were significantly influenced in the hypothesized direction. Out of the 102 subjects, 40 identified TC as a significant factor, and 29 (72.5 percent) subjects viewed a high level of TC implementation by incumbent subcontractors as being a market barrier to entry. A high level of TC implementation by the incumbents had a significant negative effect on the decision makers’ probability of entering the market. Out of the 102 subjects 53 identified SMI as a significant factor, an overwhelming 46 (86.8 percent) viewed a high level of SMI implementation by incumbent subcontractors as being a market barrier to entry. A high level of SMI implementation by the incumbents had a significant negative effect on the decision makers’ probability of entering the market.

The subjects’ judgments relating to EDI and JIT were not significantly influenced in either the hypothesized or other direction. Of the 102 subjects, 50 viewed the level of EDI implementation

by the incumbent subcontractors as being a significant factor. However, 26 (52 percent) viewed a high level of EDI implementation as having a negative effect on the decision makers' probability of entering the market and 24 (48 percent) viewed a high level of EDI implementation by the incumbents as having a positive effect on their probability of entering the market.

It appears that the sample is split into two groups – those that have EDI capabilities and those that do not. Of the 102 subjects, 33 viewed the level of JIT implementation by the incumbent subcontractors as being a significant factor. Of these 33, 19 (57.58 percent) viewed a high level of JIT implementation by the incumbent subcontractors as having a negative effect on the decision makers' probability of entering the market and 14 (42.42 percent) viewed a high level of JIT implementation by the incumbent subcontractors as having a positive effect on their probability of entering the market. Again, the sample appears to be somewhat split between those that have JIT capabilities and those that do not.

### **Repeated Measures ANOVA**

Repeated measures analysis of variance for the combined sample was computed. The marginal means for the treatment levels of each independent variable are shown in Table 2. For each independent variable, the directional impact on the dependent measure was as hypothesized – the Lean PSM factors are acting as entry barriers for market entrants. Thus, an independent variable with a HIGH level of implementation by incumbent subcontractors results in a lower probability of entering the market than do LOW levels of implementation.

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Table 2 about here

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The analysis of variance for the main effects shows that the Lean PSM principles of target costing and supplier management of inventory at customer's facility have a significant difference between their treatment level marginal means. Target costing and supplier management of inventory at the customer's facility have F-statistic values of 6.46968 and 40.44094. The marginal means amounts for TC and SMI are consistent with the hypothesized direction meaning that high levels of implementation of TC and SMI by incumbent subcontractors are acting as significant entry barriers at the overall level. The Lean PSM principles of electronic data interchange and just-in-time delivery do not have significant differences in their marginal mean levels and are therefore not acting as entry barriers.

### **Regression Compared to Repeated Measure ANOVA Results**

The results between the regression and repeated measures analysis of variance are consistent. Both identified a high level of TC and SMI implementation by the incumbent subcontractors as having a significant negative effect on the probability a decision maker would enter the market.

### **Hypotheses 1 Through 4 Test Results**

H1: EDI is acting as an entry barrier for small businesses attempting to enter the DoD aerospace parts manufacturing/supplier market.

**NOT SUPPORTED.** In using the regression and repeated measures analysis of variance, there is insufficient evidence to support the hypothesis that electronic data interchange is acting as a market entry barrier. Implementing an EDI system may require additional capital outlays or investments in a computer network, hardware, software, technical expertise and training.

H2: Target costing is acting as an entry barrier for small businesses attempting to enter the DoD aerospace parts manufacturing/supplier market.

**SUPPORTED.** In using the regression and repeated measures analysis of variance, there is sufficient evidence to support the hypothesis that target costing is acting as a market entry barrier. The data suggest that a high level of target costing implementation by incumbent subcontractors is acting as a market entry barrier. Because target costing requires a high degree of trust, information sharing, and joint problem solving (Monczka et al, 2002:445), incumbents may have a significant advantage in that they have these working relationships already established.

H3: JIT is acting as an entry barrier for small businesses attempting to enter the DoD aerospace parts manufacturing/supplier market.

**NOT SUPPORTED.** In using the regression and repeated measures analysis of variance, there is insufficient evidence to support the hypothesis that just-in-time delivery is acting as a market entry barrier. Implementing JIT may require additional capital outlays or investments in communication/computer equipment, skilled personnel, and training, as well as access to distribution channels.

H4: The supplier's management of inventory at the customer's facility is acting as an entry barrier for small businesses attempting to enter the DoD aerospace parts manufacturing/supplier market.

**SUPPORTED.** In using the regression and repeated measures analysis of variance, there is sufficient evidence to support the hypothesis that the supplier's management of inventory at the customer's facility is acting as a market entry barrier. It makes sense that managing a customer's inventory at their facility is acting as a market entry barrier. Managing a customer's inventory at their facility may involve requiring additional personnel resources, training, and communications systems to name a few. Incumbents may have a significant advantage in that they have these resources available and have already established working relationships with their customers.

## **CONCLUSIONS AND RECOMMENDATIONS**

This research effort yields evidence to support the hypotheses that target costing and supplier management of inventory at the customer's facility are acting as entry barriers for small businesses attempting to enter the DoD aerospace parts supplier/manufacturing market.

This research provides insight that may partially explain why small business participation and awards are on the decline. This understanding may assist SBA in making intelligent and

informed changes to its policy and procedures in order to help achieve its goals and more importantly increase the amount of small business participation. In addition to legislation that promotes small business concerns receiving the maximum practicable opportunity to participate, SBA may need to initiate actions to help new and emerging small businesses break through market entry barriers.

Small businesses within the aerospace industry will benefit from this study. Because specific market entry barriers to the aerospace industry have been identified, SBA should take action to provide training and to assist small businesses in breaking through the barriers and provide the small businesses the maximum practicable opportunities to compete.

Taxpayers also benefit from this study. Market entry barriers “discourage” new entrants into a market, thus providing an advantage to firms already within a market. The resulting lack of competition can result in higher prices that are paid with taxpayer funds out of dwindling Federal budgets. If it is found that market entry barriers do exist within the aerospace market, efforts can be taken to “level the playing field”, increase competition, expand the industrial base, and ultimately make more efficient use of dwindling funds.

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| <u>MARKET CONDITION #1</u>                                 |  |
|--|--|
| <u>Attribute Required by Prime Contractor</u>              | <u>Incumbents' Level of Implementation</u> |
| Electronic Data Interchange.....                           | HIGH                                       |
| Target Costing.....  | LOW  |
| Just-In-Time Delivery.....                                 | LOW  |
| Supplier Management of Inventory at Customer's Facility... | LOW  |

**Example Decision:** Please circle your probability of entering the example market condition.

(No Chance)   0%   10%   20%   30%   40%   50%   60%   70%   80%   90%   100% (Definite)

Figure 1 DoD Aerospace Manufacturing and Parts Supplier Market Entry Decision Making Exercise Example

| <u>Effect</u> | <u>Significant* Effects</u> | <u>Significant* Effects</u> | <u>Total</u> |
|---------------|-----------------------------|-----------------------------|--------------|
|               | <u>Consistent with</u>      | <u>Effects</u>              |              |
|               | <u>Hypotheses</u>           | <u>Inconsistent with</u>    |              |
|               | <u>Hypotheses</u>           | <u>Hypotheses</u>           |              |
| EDI           | 26                          | 24                          | 50           |
| <b>TC</b>     | <b>29</b>                   | 11                          | 40           |
| JIT           | 19                          | 14                          | 33           |
| <b>SMI</b>    | <b>46</b>                   | 7                           | 53           |

\*p<=.05

Table 1 Frequency of Significant Effects Consistent and Inconsistent with Research Hypotheses

|             | <u>Treatment Level</u> |              |
|-------------|------------------------|--------------|
|             | 1                      | 2            |
|             | <u>HIGH</u>            | <u>LOW</u>   |
| EDI         | 59.06                  | 59.13        |
| <b>TC*</b>  | <b>56.55</b>           | <b>60.96</b> |
| JIT         | 58.4                   | 59.11        |
| <b>SMI*</b> | <b>52.73</b>           | <b>64.78</b> |

Table 2 Marginal Means for Treatment Levels of Independent Variables

**HOW DOES A SMALL MEDIUM ENTERPRISE SUCCEED IN AN EMERGING  
ECONOMY?  
THE CASE OF ISKON INTERNET, CROATIA**

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**Abstract**

The country of Croatia has experienced a tremendous amount of social, political and economic change in the past 15 years. Transition from communism to a market economy has brought with it Western management thinking. The purpose of this study was to demonstrate a successful model of small business development in an emerging economy, such as Croatia. The case study method was used to illustrate the story of Iskon Internet, a viable and growing company that evolved and is competing with a government monopoly. Findings indicate education, perseverance as internal variables of success. Conclusions suggest external factors as being essential in the development of small business in a transitional economy.

## **INTRODUCTION**

The country of Croatia has experienced a tremendous amount of social, political and economic change in the past 15 years. Transition from communism to a market economy has brought with it Western management thinking (Revelas, 2003). However, while new systems evolve, old systems and mental models prevail and provide substantial barriers that limit economic growth. The purpose of this case study is to demonstrate a successful model of small business development in an emerging economy such as Croatia.

## **METHODOLOGY**

The case study method is a preferred strategy when attempting to address the 'how' or 'why' question. The focus, in this paper, is to study a phenomenon in a real life context. The essence of a case study, the central tendency of all case studies, is that it attempts to illuminate a decision or set of decisions: why they were implemented, and with what result (Schramm, 1971.) Similarly, case studies also focus on individuals, organizations, processes, programs, neighborhoods, and events (Yin, 2003). The most important component of our case analysis is to explain presumed causal links in real life interventions that are too complex for survey or experimental strategies. In other words, by telling the story, it illustrates the most effective method of reporting our results. For the purpose of this study, we will focus on an organization, Iskon Internet, Croatia, because we believe that this particular business best illustrates our topic and supports our inquiry. It is the belief of the researchers that this particular company illustrates a model of successful evolvement of a small medium enterprise in an emerging economy. Moreover, it addresses the issue of breaking down the perception that a monopoly can be challenged in transitional economies. As part of our inquiry, we used in-depth interviews as the primary method of collecting information. It is our rationale that this was the most effective way of data collection for this investigation. In depth interviews are qualitative in nature, that is, a technique that is not numerical in nature. The purpose of these interviews is to not prove hypotheses, but to probe an understanding of the phenomenon of interest (Trochim, 2001).

## **CROATIA**

Croatia is a mid-sized European state (slightly smaller than West Virginia, with 4.4 million inhabitants (The World Fact Book, 2004)... The country consists of two regions: continental Croatia in central Europe and coastal Croatia is located on the Adriatic Sea in the Mediterranean region. The earliest finding of the Croatian name as Horovathos, which can be traced on the stone inscriptions in Greek, dated from the second century and was found by the Black Sea. A majority of the then Croat tribes moved to the territories of present Croatia in the 7th century (Croatia in Europe, History, 2004). There they were in contact with the Romans and Romanized descendants of Illyrians, Celts and others. The oldest known governmental document was issued back in 852 in Latin script, in which the Croatian name was mentioned (dux Chroatorum). Beginning in 1102, the Croats shared together with the Hungarians a state under common Hungarian and Croatian kings. The kings were crowned twice: with both Hungarian and Croatian crowns (Croatia in Europe, History, 2004). Geographically and politically Croatia was, for centuries, standing on the crossroads of cultures and civilizations (east and west) being the longest barrier to Ottoman Empire penetration into western parts of Europe. Beginning in 1918 through 1929, Croatia was one state in a kingdom shared by Serbs, Croats and Slovenes. In 1929, the region was renamed Yugoslavia and existed as such until 1941. In II World War, the Croats fought the anti-fascists - Germans, Italians and domestic pro nazi regime. Out of that in 1945 a new socialist Yugoslavia (consisted of 6 republics and 2 autonomous provinces), a nonaligned state, evolved. It became increasingly evident that the joint state did not function properly. The

differences in core social values and economic output between republics within common state were major. The struggle for freedom and independence in Croatia began in early 1970s - which culminated in 1990 causing the fall of the communist regime in Croatia, leading to the first multiparty elections, and the proclamation of independence (June 25<sup>th</sup> 1991). In 1991 the Serbian separatists and the Yugoslav Army occupied almost one third of Croatia. After 4 years of UN inefficiency, where some 14,000 troops were deployed, endless negotiations, and further ethnic cleansing, Croatian military forces liberated occupied territories in 1995 by themselves (Croatia in Europe, War in Croatia, 2004). Therefore, Croatia is a land of a long history and tradition but newly independent country and a rapidly emerging Central European market. Since independence, Croatia has been engaged in the process of modifying its laws and practices. Croatia is also currently working toward membership in the European Union (EU) – scheduled to enter in next 3 to 5 years. In preparation for membership Croatia is harmonizing its legislation with the EU. On that path, Croatia faces many economic and social obstacles and changes: structural adjustment, privatization, financial sector reform and growth and competitiveness of domestic industry and exports. Croatia's economic teams developed and implemented a successful stabilization program, which has resulted in the lowest rate of inflation in the region (less than 4 percent), real GDP growth and exchange rate stability. The size of GDP is \$24.79 billion, purchasing power parity and GDP per capita is \$5,700 purchasing power parity (The World Fact Book, 2004).

### **THE CROATIAN MARKETPLACE**

Croatia is progressing through a considerable transformation in its economic and political landscape. The economic structure is moving quickly toward a dynamic, market-based system, and a Western-style infrastructure is being developed. Croatia also has a well-educated and skilled labor force, particularly in technical areas such as engineering. Before the dissolution of Yugoslavia, the Republic of Croatia, after Slovenia, was the most prosperous and industrialized area, with a per capita output one-third above the Yugoslav average (The World Fact Book, 2004). Although the economy is still developing, it has excellent potential with tourism as a main economic driver. However, massive structural unemployment remains a key negative factor, with the 2003 estimate for unemployment rate at 18.9% (The World Fact Book, 2004). In the past 4 years, the government's failure to press the economic reforms needed to spur growth is largely the result of politics and public resistance, particularly from trade unions. Opponents fear reforms would cut jobs, wages, and social benefits. The government has a heavy backlog of civil cases in its legal infrastructure. One of the main deterrents perceived for business development is the government itself - with inefficient and unresponsive public service (bureaucracy at all levels of state agencies and institutions). Even though the government is perceived generally as a barrier, the Croatian market is open to foreign investors. In terms of their rights and obligations, foreign investors are granted "national treatment" - this means that they are treated on an equal basis with domestic companies. Limits on national treatment exist in a few areas, such as arms manufacturing (Country Commercial Guide FY, 2004). Small and medium sized business has evolved as an important driving force in Croatia. As in other economies, it easily adapts to market demands and is less demanding on initial finance and input. Previously, rates of self-employment used to be low and concentrated on the agricultural, crafts, catering and trade sectors, as well as selected professions such as art. Since 1990 the self-employment rate has been rising constantly, often as response to unemployment. Presently, the small business sector is made of approx. 58,000 companies (compared to 35,000 in 1993). The share of total number of companies is 98% but they account for only 44% of the total number of employed persons in Croatia (about 435,000). The small business contribution in GDP is around 55% (Croatian Chamber of Economy, Small Business, 2004).



The number of new business start-ups in the past years well illustrates the existence of an entrepreneurial spirit in Croatia. However, the business environment and support systems (legal, tax, finance, knowledge and skills developments) to those entities was not up to the level where it needed to further new business development. Hence, to increase economic growth in this area, Croatia needs to improve its business infrastructure to assist in prevention of failures and aid growth of small and medium sized companies. Corruption in Croatia is one of the problems that small business can encounter when moving forward for development. The Croatian government has made modest efforts to eliminate corruption, particularly by establishing specialized anti-organized crime and anti-corruption units. However, bribery and corruption are still perceived to be widespread. The Berlin based Transparency International (TI), the international watchdog organization on corruption, has assessed the government's anti-corruption program positively, but still considers Croatia a corrupt country at all levels. TI's rating of public perception for Croatia improved from 74th (mid 90s) on its rank-ordered list of corrupt countries to 51<sup>st</sup> in 2000 and 47<sup>th</sup> out of 91 countries in 2001 (Transparency International, 2001). In terms of human capital, Croatian business people do have confidence in their abilities; however they lack managerial knowledge and skills. Croatia benefited from the previous "self-management" economic system by developing managers familiar with market principles. However, decision-making has tended to be centralized in structure, with the managing director or general manager having all the power. A newer and more innovative managerial class is emerging with extensive Western business knowledge and business behavior. Education (in management, innovation, human capital) and exposure to such principles is improving the overall business environment. Even though most Croatian executives know English and many young managers are fluent, and technology skills among major Croatian companies are extensive, much advancement is needed in education and training.

### **TELECOMMUNICATIONS AND INTERNET**

Croatia's telecom network is quite advanced both in terms of penetration and equipment, including optical cables (some 15,000 kilometers installed), digital equipment and mobile telephones. There are over 1.84 million installed fixed telephone lines and 100% percent of the transmission capacity is digitized (Basic Telecommunication Market Indicators, 2003). Croatian Telecom (HT), 51% owned by Deutsche Telecom (HT General and Financial Data, 2004) is the current and sole telecommunications operator in Croatia. HT had a monopoly in the field of fixed network voice telephony until the end of 2002. Realistically, it still does have the monopoly since there is no other operator to enter the market. The reason being the Telecommunications Act in Croatia allows HT to deny other operators access to its local loop until 2005. Beginning in 2005, HT will be required to allow access to its local loop to other operators under the conditions and modalities defined in EU guidelines. The government invited interested parties to express interest in the concession for the second fixed telecommunications network. Internet development has been slowed by high interconnection costs for Internet Service Providers (ISPs) and no transparent regulations, although some progress was made over the past few years (the entire list of legislation is available on line at [www.telekom.hr](http://www.telekom.hr) or [www.mppv.hr](http://www.mppv.hr)). Thanks to the financial backing of United States, German and Austrian investors, several ISPs (in our case study, Iskon is a brilliant example) managed to become competitive to HT's HTnet (an Internet provider). As of July 2003, there are ten commercial Internet service providers (ISPs) in Croatia. According to industry estimates, at the end of 2003, some one million citizens, or 23 percent (up from 18 percent in 2001) of total population has access to the Internet. However, the number of paying subscribers is much lower: 576,000 citizens and 30,000 businesses (out of which 1,100) access Internet via leased lines (Basic Telecommunication Market Indicators, 2003).

All ISPs in Croatia must use HT's infrastructure for customers to access the Internet. In 2002, ISP's competitive to HT's HTnet, attained or came close to break-even (Interview, CEO Iskon, 2004). ISPs must still rely heavily on their flexibility and innovation, since high HT interconnection costs and unfavorable terms in revenue structure (HT collects revenue for the last mile access to customers), as well as high licensing costs. However, because of Iskon, licensing costs have significantly dropped by their action on the government for better terms and increased fair regulation. Electronic commerce in Croatia is on the rise, with a surging number of Internet transactions registered by travel agencies, bookstores, and IT equipment distributors. Banking is still the leading sector for Internet transactions, as several banks offer online banking services to residential and business entities.

### **THE STORY OF ISKON INTERNET**

The story of Iskon Internet is unique in that its founder, Mr. Damir Sabol, demonstrates persistence in growing a business that was in its infancy. The Internet industry in 1993 was practically non-existent and the vision and dedication of its founder was instrumental in the growth and success of the company. We will discuss the many factors as to why the organization evolved into a viable and successful company.

#### **The Founder**

Mr. Damir Sabol, graduated at the Faculty of Electrical Engineering - University of Zagreb, Croatia in 1996. Simultaneously, he started to explore the Internet, recognizing the opportunity of learning something technologically new. This was a period of time in Croatia's history that was tumultuous, a time when the country was at war, striving for independence. Technologically, the country had not been exposed to the innovation and advantages of technology, in its broadest sense and was eager to move forward socially, politically and economically. In 1995, Mr. Sabol started his career as administrator in Zamir, an NGO, trying to reconnect cities (Zagreb, Belgrade, Sarajevo, etc.) and the entire region in a virtual network. The conflict of war was obvious, communication channels were being disrupted and technology was acting as a bridge to building relationships in the region. The war ended in the latter part of 1995 and Croatia was faced with building and designing its future.

Mr. Sabol's idea of introducing commercial Internet Service Provider (ISP) in Croatia was emerging gradually, as variables in the environment became slowly, but increasingly favorable. The war had concluded, the country was ready for change, something new to assist in building economic stability. In 1997, Mr. Sabol negotiated an agreement to maintain Zamir's technological infrastructure. In addition, the Soros foundation donated the necessary hardware to start and operate a small, single proprietary business. Iskon was conceived! The location of this start up was in the basement of a Zagrebanka business tower, approximately 30 square meters (180 square feet). The company was literally living in the dark, with no ventilation and natural light. The struggle of survival for this start-up would be difficult. Upon this turn of events in 1997, Iskon applied for a government license to operate such an open protocol service. At this particular point in time, the political, legal and business environment were not friendly for such an idea, as it was completely new to the market and also challenged the huge monopoly, HT – Croatian Telecommunication. In 1998, after 12 months of battling the powerful government bureaucracy, a license was issued and Iskon was able to conduct business with a "powerful" and "strong" connection of 5 (five) regular telephone lines for approximately \$12,000. By 1999, 15 leased line business customers were acquired, meaning they had permanent line lease with Iskon. Somehow the business was surviving, even though it was in a completely inadequate space (without natural light and ventilation, where the equipment was malfunctioning). Customers recognized the enthusiasm, dedication and commitment of three Iskon employees, the founder, a technician and the

founder's sister (the founder's sister is presently working on bringing the company in compliance with ISO 9000). In 1999, Iskon negotiated the first investments via foreign venture capital funds, while simultaneously government telecommunication inspectors investigated the company. Inspectors found Iskon was not using only 5 "mighty" lines but 30 and was very near in closing the operation down due to violations of regulation. However, just a few months before inspectors came to check whether Iskon is complying with all the rules and regulations, Mr. Sabol wrote a letter to authorities asking for multiplication and expansion of their capacity. The government agency did not respond. Since the government had not responded to Iskon's letter, inspectors allowed Iskon to operate without interruption. While the tension was building surrounding the government's unresponsiveness (approximately 45 days), investors were losing their patience and almost abandoned the project. Typical of most small business start-ups, Mr. Sabol's roles included, a delivery driver, director of public relations, sales manager, marketing manager, technology chief, and Chief Financial Officer (CFO). This was taking its toll on the founder and was also suppressing business growth. In a then strategic move, Mr. Sabol pondered the future of his company, in an industry that was faltering worldwide and made a critical decision to negotiate for further funding. In 2000, he was successful in a series of negotiations in securing further funding for the company. Initially, the first investor (ANI, Texas, USA) granted a \$300,000 loan (equity convertible) with another \$300,000 in equity to follow. Mr. Sabol used the investment for business development, increasing the number of employees to 60 in a few months. Iskon was now on the fast track and was growing very rapidly. During 2000, another investor approached Iskon and invested \$1.9 million, with third round of investment soon to follow. A total of \$4 million was invested in Iskon and the future looked bright for this fledging company. However, just as the global internet marketplace was on a down trend, retrospective in a surprise move, Dresdner Kleinwort Benson Private Equity entered the Iskon in 2001 with a \$6 million investment, just prior to the internet micro-bubble burst. With the input of new capital, Iskon continued to grow, peaking with 160 employees 80,000 customers in just 1 year. Iskon started to make the transition from a technology company to a service company. However, growth was difficult, as daily tasks became increasingly complex, and four years of double digit workdays, fatigue started to surface for the 31 year old founder. As he mentioned: ".... In those days I have learned a lot – about marketing, human resources, sales but above all, I explored my physical and mental limits". In 2001, with a strong customer base, superior customer service and enormous growth rate (another example of running against the trend that was happening globally), Iskon was spending money and operations looked bright. In reality, because of its Iskon's inefficiency (e.g. lack of middle management systems), the company started to decline. Mr. Sabol was losing control of the evolving variables of the business. Moreover, he was losing his aspiration of creativity and his vision of success. Recognizing the decline and challenges that Iskon was facing, he stepped down as CEO of Iskon. Upon this event, a new CFO, Mr. Ratko Pažur (KPMG employee), was brought in to bring fiscal control to the company. An important point to note is a cultural norm in Croatia. Unlike in the United States, failure in Croatian business culture is catastrophic. If a business executive is perceived to have failed, the person is marked as a "loser" or incompetent. Initiating and progressing to a new career are very difficult. This was an important event, because what has shaped Iskon is that its founder realized that it was time to step down as CEO and open the door to another individual who would elevate the company to the next level. Mr. Sabol moved to Supervisory Board and presently he focuses on strategic business issues in assisting the company in development and growth. As he states: "My wish was not to control the company but to build it." In 2002, Iskon implemented a strategy of consolidation, which consequently evolved the business in showing a profit in 2003. This part of the history of Iskon will be further explained in the next section.

## **The CEO**

Iskon grew dramatically in 2000, with the money flowing (\$5 million from ANI, Texas, USA and another \$6 million from Dresdner Kleinwort Benson Private Equity), from 10 employees to 180 in less than 12 months, sales were increasing, and the customer base was expanding. However, Mr. Sabol (the founder of Iskon) and investors sensed that something was wrong. They realized that company growth was progressing too fast, resulting in deficiencies of quality, hence, threatening sustainable growth. In order to insure the longevity of the company, a leadership change was essential. Externally, the Croatian Government and Deutsche Telecom owned HT (Croatian Telecom) was taking unfair advantage by using its political power to gain favorable business terms (e.g. rates of service, price) and its monopoly of infrastructure. In a major strategic move, Mr. Ratko Pazur, KPMG Croatia senior auditor, joined the company in 1<sup>st</sup> quarter of 2001 as Chief Financial Officer. Within a month of joining Iskon, he was appointed to CEO, being charged with implementing new operational strategy for the company. Mr. Pazur analyzed the company and concluded the following:

- Invoicing deficiency - too many customers were not being invoiced and payment terms were not being managed (e.g. accounts payable)
- An analysis of secondary companies in the business portfolio were analyzed, (portal, PC magazine, web design unit, programming) in some cases sold or consolidated. A strategic move to focus on core business was implemented (Internet Service Provider Solutions-ISP).
- Implementation of middle management systems (e.g. basic supervisory structure and accountability for real outcomes)
- New organizational structure, and compensation structure were essential to bring systematic change to the organization.
- The work force was energetic, loyal and enthusiastic but lacked business experience and skills (e.g. company protocol)
- A analysis of process management and a consolidation of staffing (e.g. termination of 40 employees)
- An analysis of the main monopoly; competitor HT was attempting to increase their hold on the Internet market and strategy was designed.
- Cost control was introduced at all levels of business, price competitiveness was essential to bring financial stability to the company.

The results of these initiatives were very positive, as Iskon now covers 60% of business IP, 35% of IP leased line connections market, 25% of market share with residential internet connection, and 50% of the Croatian online advertising market. With new service processes, such as high quality 24/7-customer support proved to be the right solution for many customers. In 2000, revenues were 919,453.00 EUR and by the end of 2003 it prospered to 7,605,568.00 EUR. Comparing to world marketplace, CEO Pazur found out that there was no real connection with events in Croatia; the ISP industry was suffering through dot.com demise globally, however in Croatia it was growing. He points out: “.... timing was crucial, we learned from the world’s mistakes”. This was a crucial external factor, as the global marketplace struggled with growth in the ISP industry, Croatia was ready for growth. In other words, timing was perfect for the development of this industry and consequently, Iskon Internet. According to Mr. Pazur, both residential and business markets will continue to grow in Croatia. At the moment, Iskon is positioned by strong leadership and market variables that would suggest a very bright future for the company. With a focus on customer satisfaction, quality services, investing in research and development, the imminent deregulation of telecommunications industry and strong company leadership; Iskon is strengthening its position to continue to be a major player in the ISP industry in Croatia.

## **LESSONS LEARNED FROM ISKON**

In conclusion, the Croatian marketplace is advancing rapidly and changes are generally positive in the economy. However, in advancing the economic condition of the country, the state will need to alter its position on new business and small business start-ups. Government regulations are not in favor of small business owners and thus far does not promote prosperity and growth. So far, the success of small businesses in Croatia has been the result of individual entrepreneur's hard work, sacrifice and personal connections.

There is a paradox that is evident: there has to be less government obstacles and less government involvement but only through government action. What we have found and are suggesting is to simplify business infrastructure, increase information awareness of small business programs, and improve educational and legal systems. Croatian entrepreneurship and business in general has been limited, where no significant additional development and growth will be possible without changes in the approach by with governmental agencies implement public policy and promote sound business practices.

In our study, we have mentioned the importance of education to the growth of economic conditions in Croatia. It was clear in Iskon's case that a well educated management team and workforce made a significant impact on the growth and success of the company. Even with 100+ employees, management practices used at Iskon are similar to many large and respected multinational companies. Iskon, while being at the right place at the right time, still had to overcome many barriers to growth. This case illustrates that while global market conditions may inhibit small business to enter the marketplace, many new opportunities exist in emerging economies that have been explored and implemented that can add tremendous value to the country. Hence, there can be greater growth and development in emerging economies. With Croatia joining the European Union, the business environment will bring significant challenges (e.g. tougher competition) but also considerable opportunities (e.g. new markets, new services, product demand and more effective business infrastructure). With emerging boundaries and free flow of goods and services, entrepreneurship in Croatia could evolve into a major economic strategy for business development and growth. Government, business and educational leaders will need to further understand the complexities of this as a potential strategy and work together to enhance small business development in Croatia.

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# ENTREPRENEURSHIP IS A GENERAL EDUCATION COURSE! THE WHY, HOW AND TRANSFERABILITY OF THE CONCEPT

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## Abstract

This paper describes a course entitled Entrepreneurship and Innovation (E&I) that appears to be the first to be given general education status as a social and behavioral science. The paper argues that the core concepts of entrepreneurial thinking are consistent with the goals of general education. Entrepreneurship adds a new dimension to general education by emphasizing integrative learning. This fills a gap defined by leaders who seek to reinvigorate general and education and thereby prepare students for leadership in the 21<sup>st</sup> Century. The discussion concludes with lessons that other colleges can use to incorporate an E&I course into their curriculum.

## **Why Should USASBE be interested in the Entrepreneurship & Innovation Course?**

The authors' university had a blank slate when designing its new entrepreneurship program in 2002. A key component of that new curriculum is an entrepreneurship course that will become part of the university's General Education model. Other universities have programs to link entrepreneurship with the liberal arts, but general education status for entrepreneurial courses is comparatively rare and groundbreaking. In the search for such models, it was found that there were no entrepreneurship courses listed as general education courses. The authors believe that the experience presented in this paper provides a model for faculty from other universities who may use these insights to lead similar efforts on their own campuses.

The authors' university wanted its entrepreneurship program (E-program) to be accessible to budding entrepreneurs within majors and disciplines outside the college of business. The decision to place the initial Entrepreneurship and Innovation Course (hereafter referred to as

E&I) under the university's General Education umbrella was based on a combination of pragmatism, sound pedagogy, and good politics. Career surveys say that the entrepreneurs of the future will include significant numbers of students from non-business disciplines. Self-employment figures now include one geoscientist in eight, thirteen percent of psychology graduates, up to forty percent of music majors, over fifty percent of all artists and related workers (Farr and Shankin, 2004), eleven percent of economists, and over thirty percent of writers and authors (BLS, 2004). The Kauffman Foundation's GEM study reported that individuals with a college degree are more likely to engage in entrepreneurial businesses that create new jobs. The study recommends that entrepreneurship training should be more fully integrated into the collegiate setting so that it is available across departments and to students of diverse disciplines. To this end, the study argues that it is important to educate students in entrepreneurship throughout a broad spectrum of fields and productive endeavors.

The university examined a variety of pedagogical options to develop the course design. The review of undergraduate E-program curricula at a range of institutions confirmed that a common outreach practice in established E-programs is to invite other majors to come *into the business school* to take the entrepreneurship course (E-course) along side business majors. Yet, as Carl J. Schramm notes [President and CEO, Kauffman Foundation], there are considerable barriers to accessibility for non-business majors who find that "the hardest place to take a course is often in the business school" (Flaherty, J., 2004). A related concern was the difficulty that majors outside the College of Business face in trying to fit an E-course into their over-prescribed requirements. Another emerging model is to offer special-purpose courses such as "Small Business and the Arts," taught to non-business majors. This effort, created through start-up grants from the Ewing Marion Kauffman Foundation, seeks to *transplant entrepreneurship courses from the business schools into other disciplines* and departments (Mangan, 2004). The authors' university, however, chose a different path in order to attract a heterogeneous mix of student majors. The result was an introductory course titled "Entrepreneurship and Innovation (E&I)" that was designed to satisfy the rubric of the university's General Education Model, as well as provide an inspirational foundation for business students who pursue a specialization in Entrepreneurship.

Designating an entrepreneurship course as "General Education" would have seemed heretical in the 1990's when the campus was concerned with "Liberalizing Professional Education." Business courses, even interdisciplinary ones, hazard rejection from General Education committees that consider them too applied, too specialized, or narrowly focused on occupational skills and techniques. However, there has been a change in climate as higher education associations, accrediting organizations, and other stakeholders nationwide have called for reform of general education and the liberal arts major. This paper elaborates on the claim that the E&I course belongs in General Education together with traditional arts and science courses. The E&I course design includes content and processes that are compatible with the General Education conceptual framework. The core concepts that comprise entrepreneurial thinking are intrinsically consistent with the purpose of general education. Moreover, the study of entrepreneurship adds an integrative dimension to the learning experience in order to prepare students for leadership in the 21<sup>st</sup> Century.



## What makes this Entrepreneurship and Innovation course distinctive?

In 2004, the College of Business introduced an undergraduate specialization in Entrepreneurship consisting of nine new courses. The launch pad for this specialization was a sophomore level ‘vestibule’ course titled “Entrepreneurship and Innovation (E&I).” The course introduces a new way of thinking – an opportunity and problem solving orientation – to the broadest possible audience. It is different from other business courses in that it avoids business planning and computer games, and instead uses a team-based learning process that models and stimulates entrepreneurial behaviors. The course reframes six traditional concerns of entrepreneurship:

- **Entrepreneurship Domain:** Evolve in small business, high technology - high innovation environments, corporate environments, social enterprises and international enterprises.
- **Entrepreneurial Thinking:** Emphasizes thinking about “Opportunity,” understanding and developing opportunities.
- **Problem Solving:** Offers an overview of strategic and scenario planning that introduces students to means of developing strategy, scenarios, tactics, tools, skills and requisite timing to execute plans.
- **Creativity:** Stresses the importance of creativity by validating the proposition that creativity can be learned and clarifies the underlying logic, specific knowledge, tools and skills for achieving creativity.
- **Opportunity Recognition:** Illustrates the importance of perception, including new ways of seeing and hearing in order to discover and create unique opportunities.
- **Entrepreneurial Careers:** Expands the student’s appreciation for the multiplicity of venues and circumstances to which the entrepreneurial process can be applied.

The student’s *initial encounter* with the discipline reveals the convergence of the generative creative process and the entrepreneur’s innovation response. It does so in the context of the student’s effort to plan his or her life work and future career. Students will be immersed in a learning experience that conveys unmistakably the essential character and multiple forms of entrepreneurial pursuits.

“Entrepreneurship and Innovation” was designed as an exciting and practical introduction to professional business credentials and knowledge, but also as a useful course for any student interested in building an enterprise, regardless of major. Prospective students include majors in Engineering, Health and Exercise Science, Computer Science and others that are planning careers in high technology/innovation organizations. Students who will become corporate “*intrapreneurs*” need exposure to the opportunity focus of such a course and the shift in problem solving strategy that begins with “Why Not?” instead of “Why?” Students in the arts, humanities, social, or political disciplines who aspire to become “social entrepreneurs” and lead non-profit enterprises will benefit. To these ends, the *core entrepreneurial outcomes* are to understand the essentials of entrepreneurship; to learn how to use the motivations, skills, and strategies of successful entrepreneurs; to develop decision-making knowledge and skills; to develop creativity and innovation knowledge and skills; and to learn opportunity recognition for new products, services, and customers.

Designers of the E&I course were clear that conventional didactic pedagogy was not likely to stimulate a wide range of students with dissimilar interests. Rather, the use of original and inventive learning exercises would be central to teaching methodology. Learning activities and resources draw upon authors specializing in creativity such as James Adams (*Conceptual Blockbusting*), Michael Gelb (*How to Think like Leonardo da Vinci*), Roger von Oech (*A Whack on the Side of the Head*) and of course, Edward de Bono (*Lateral Thinking*). This type of pedagogy relies upon changing the way students look at and approach problems. For example, one class will use de Bono's "Brain Sailing" process that aims to improve creative thinking skills through direct effort and change in focus. This technique is juxtaposed as an improvement on brainstorming, which originated in the advertising world. Another de Bono process, "Six Hats Thinking," engages the learner to differentiate among thinking modes and choose the methods that are best adapted to the opportunity at hand. Students can explore various ways to make time for creative thinking. They can discover ways to enlist others in a creative effort, learn how to stop those who are persistently negative and to encourage people to look at the benefits of an idea. The students can also learn how to express their intuition and gut feelings in a meeting.

These approaches lead the student to engage in *integrative thinking and learning*. As described by de Bono and scholars of learning theory, the ideal culmination of a general education is to acquire, through each discipline, a step in the process of making judgments and taking action. Each discipline emphasizes some, but not all of the following: generating data and information; understanding feelings, intuition, and emotion; making critical judgments; promoting optimism or framing the logical benefits of new ideas; stimulating creative effort in oneself and others; and developing process controls that assure the success of the plans. A central aim of the course is to teach not just *one* method of thinking, but to emphasize integrative *thinking* that brings together a variety of models. Students from various fields bring backgrounds that emphasize how professionals perform these entrepreneurial processes. They help one another to appreciate, as Kao, J. (1996) points out, that "Creative ideas spring from the abrasion of divergent inputs."

### **The Emergence of E&I as a General Education Course.**

During the curriculum review process, enthusiasm was expressed by faculty members and administrators for offering the E&I course to students from non-business disciplines. Engineering students were expected to participate as a result of early collaboration with that college's faculty on programs to address professional leadership in high tech / high innovation companies. The course designers also had hoped to draw a heterogeneous audience in order to form of multidisciplinary teams that would benefit from the diversity of inputs and approaches. The authors were pleasantly surprised to discover the campus-wide support to make the course a component within the university's "General Education Model."

As with any curricular innovation, it is crucial to have a congruence of institutional goals, structures, and resource allocation. The E&I course proposal has steadily gained support from the President, Provost, multiple Deans, department chairs, and faculty as a key value-adding element for students across the campus. The interdisciplinary design was chosen for its ability to address a number of internal and external opportunities and problems. The focus on creativity and innovation as generic processes appealed for its intrinsic value. The emphasis on development of critical thinking skills was needed for project-driven disciplines. The

multidisciplinary and collaborative learning approach is consistent with the expectation that students must prepare to work in the ever-changing social environment.

Chief among the extrinsic benefits was responsiveness to continually improve the metrics by which university and individual programs are measured. There is heightened concern about the time it takes to fulfill graduation requirements. Putting an entrepreneurship course in the general education distribution requirements adds flexibility. Another benefit may be an increase student retention and graduation rates across programs. Curricular flexibility would place more attention on satisfaction of persistence-related needs and student competencies. Even one course focusing on the application of entrepreneurial knowledge to liberal studies is a critical strategy to improve job placement rates after graduation, and to prepare students for a more self-directed career path.

### **Why Does The E&I Course Belong In The General Education Model?**

There are at least three secrets to making the case that entrepreneurship belongs in general education. The first is to focus on the universal and generic underpinnings of entrepreneurship and to avoid traditional business school biases toward the for-profit sector. The second key to success is to make an unambiguous case for the goodness of fit between the E&I course content and outcomes and the general education canon. A third factor is the use of the appropriate pedagogy and an appreciation for the learning theory that guides instructional techniques.

First, entrepreneurship can be generalized to a multiplicity of contexts, particularly as the E&I course is configured. The authors broadly defined their response to the question ‘What is Entrepreneurship?’ The course uses Venkataraman’s (2000) thesis that the central issue of Entrepreneurship is “how exactly opportunities are discovered or crystallized or created.” The E&I course adopts Timmons (1990) definition: “Entrepreneurship is creating and building something of value from practically nothing. ... Entrepreneurship is the process of creating or seizing an opportunity and pursuing it regardless of the resources currently controlled.”

Second, there has never been a better time for establishing entrepreneurship as general education. The Association of American Colleges and Universities (AACU), which represents traditional liberal arts institutions, has sponsored or facilitated discussions, research papers and initiatives on the state of general and liberal education. AACU’s meta-analysis of the issues identifies a widespread perception of the need for reform and revitalization of the components of the core curriculum. Higher education associations are mobilizing their memberships to revisit the meaning, relevancy and purpose of a liberal arts base in today’s society. Faculty and students criticize Liberal or General Studies models, taking aim at a number of common issues including:

- Fragmentation of the disciplines that comprise the traditional liberal arts core, each beset by over-specialization;
- Lack of explicit efforts to assure that the student arrives at some degree integration across the disparate disciplines (the ‘functional silos’ problem);
- A bias for teaching in ways that favor abstract and conceptual learning, thus making learning in the liberal arts less accessible for those whose preferred mode of learning is through application of principles and practice; and

- Lack of a shared vision about the benefits of conventional general education subjects among students, their families, the employer community, legislators and educators.

The AACU analyzed methodologies used by education associations, disciplinary associations, accrediting agencies, students, and colleges/universities to define the goals of a college education. Schneider and Shoenberg (undated) reported that there *is* a broad consensus on learning goals among campuses:

- Acquiring intellectual skills or capacities in writing and oral expression, quantitative and moral reasoning, technological literacy, second language, and negotiating difference;
- Understanding and using multiple modes of inquiry and approaches to knowledge;
- Developing societal, civic, and global knowledge;
- Gaining self-knowledge and grounded values; and
- Achieving concentration but also integration of learning between general studies and majors.

Most of these widely embraced goals can be incorporated in the Entrepreneurship and Innovation course through careful articulation of learning objectives, course content, and pedagogy. Among these important objectives, “Achieving concentration but also *integration of learning, including integrative learning, between general studies and majors*” is of special interest because it is the focus of heightened nation-wide attention and a search for new solutions.

“Integrative Learning: Opportunities to Connect” is a collaborative project of the Association of American Colleges and Universities and The Carnegie Foundation for the Advancement of Teaching. Huber and Hutchings (2004) define its aims to identify new ways for students to pull together the threads of knowledge in a way that relates insights and leads to formation of new results. One Carnegie Corporation survey (2000) pointed to promising sources of renewal and transformation. These included several specific tactics such as “Learning by Doing” through techniques, such as research projects, to integrate experience and application with academic work; “Interdisciplinary Approaches” bringing together scholars pursuing interdisciplinary fields of inquiry; and “Integration of the Liberal Arts and Professional Study.” The problems and opportunities defined by higher education authorities are the starting point for aligning an entrepreneurship course with general education. An array of integrative models also is being explored through the Consortium for Liberal Education and Entrepreneurship. This network of colleges and universities is dedicated to encouraging liberal arts and sciences institutions to infuse entrepreneurship into the framework of a liberal education and to facilitate collaborations that connect the arts and sciences with business, engineering, and other professional programs.

A third success factor in building a case for categorizing E&I as general education is a design that draws upon learning theory and data that supports claims that entrepreneurship contributes to learning outcomes. McElroy (2003) argues that it is important to distinguish between *creativity*, the process of generating ideas, and the notion of *innovation*, which is a process of sifting, refining and implementing ideas. Creativity draws upon divergent thinking for idea generation while innovation relies on convergent thinking and putting ideas into action. The higher education critique of general education noted a gap with respect to achieving integration of learning between general studies and majors. General Education courses typically stand as the introductory courses for liberal arts majors. As such they are understandably short on their ability

to assimilate ideas across disciplines and tie together learning that is multidisciplinary. Entrepreneurship and Innovation is inherently multidisciplinary and has the ultimate integration of concepts from divergent sources as its subject focus.

### **What can other campuses learn about incorporating the E&I course into their curriculum?**

Entrepreneurship curriculum has enormous potential to energize and revitalize a general education program. Just one entrepreneurship course emphasizing creativity and innovation can be a tool for integrating learning within general education and pulling together the various styles or modes of thinking learned in a range of subjects. It also can enhance student career prospects by introducing entrepreneurial alternatives. Students are increasingly choosing self-employment, business creation, and entrepreneurial careers within established organizations. This small innovation provides some advantage that may lead to improvements in retention, persistence and graduation rates.

Securing campus support for designating Entrepreneurship a general education course within the social and behavioral sciences bank of the model was not an overnight phenomenon. Several measures that the authors' university employed led to greater success. First, introduction of curriculum was preceded by judicious diplomacy and munificent efforts to create good will and a positive image for entrepreneurial courses and the Center for Innovation and Entrepreneurship. The *Chair of the Center for Innovation and Entrepreneurship* designed a series of initiatives to engage decision-makers in pivotal campus sectors to attract champions outside the College of Business. These initiatives are described in detail below.

A critical first step was to enlist the Provost, and Deans of Engineering, Education and Business to attend USASBE meetings. These individuals provided support at the administrative level to address concerns of colleagues and encourage investment in institutional resources for the entrepreneurship initiatives. Later, these champions were able to spread ideas for integrating entrepreneurship across disciplines to their own academic constituencies within and outside the university. They have become good partners in developing grant proposals and advancing pedagogical papers at national conferences.

Second, the Center for Innovation and Entrepreneurship sponsored an "Entrepreneurship Boot Camp for Liberal Arts Faculty" to address entrepreneurial projects pursued by faculty members. This three-day workshop provided both a graphic and experiential learning opportunity for faculty to familiarize themselves with the curricula. Moreover, it provided each with tools and learning to enhance their own projects and scholarships. Joint ventures with college faculty from other departments led to proposals to seek grant funding to establish programs built upon entrepreneurial goals.

Finally, when curricula were developed, the first proposals were created to provide an open door for all majors. Eliminating the criticism that excessive prerequisites, "majors only" and over use of "leveling requirements" would make it impossible for non-majors to enroll in courses or to complement their major with a minor track. Early establishment of curriculum proposals that remove barriers for non-business majors included a certificate program for engineering majors and a minor for majors in any discipline.

These measures, along with a grounded understanding of general education and liberal arts components, led to an unusual approach to linking entrepreneurship to general education. The quintessential management guru, Drucker (1985), predicted a future in which an Entrepreneurial Society was essential and inescapable in the 21<sup>st</sup> Century. He argued that leaders must remain flexible and self-renewing; pragmatic rather than dogmatic. In Drucker's world, Innovation and Entrepreneurship are essential to address the opportunities and needs emanating from all segments of society. The approach described in this paper is an important step toward sharing that message with the rest of the campus community and brightening the future for many students of various academic backgrounds.

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# **BOARD MEMBER SELECTION IN NEW TECHNOLOGY BUSINESSES:**

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## *Abstract*

*Recent events in the US have focused attention on the fiduciary responsibility of independent board members at a public or private company. This paper examines the process of selecting board members at a high tech start-up where issues of investment in innovation, conflict of interest, firm valuation, non-interference in direct management, exit strategy and accounting practices can be difficult for an entrepreneurial team to handle in a timely manner. Start-ups are in a unique position in that they have the opportunity to initiate a board composition that not only can serve them well in the first few years of business but can set the “tone” or “culture” for the expected levels of ethical behavior in the entrepreneurial team. After reviewing the functions of board members, a typology of candidates and general qualifications, suggestions are made to the start-up’s entrepreneurial team in the form of a checklist for dealing with several of these issues in board governance.*

## **CHANGING ROLE OF THE BOARD OF DIRECTORS**

Recent events in the US have focused attention on the fiduciary responsibility of board members in a company. Questionable tactics in financial reporting at *Enron*, lucrative executive compensation packages at *Tyco* and numerous reports of insider trading and conflict of interest have eroded the confidence in the methodology of board oversight. In the aftermath of recent corporate scandals, the spotlight has shown most brightly on whom shareholders considered the most impartial of board members and who was supposed to best represent their interests – the independent board member. The independence was derived from several attributes: not being part of management or related to any member of management; not having substantial financial investment in the company; not doing business with the company; and not being able to accrue great personal wealth from the company’s performance. Nevertheless, despite the disappointment and due to the urging of institutional investors, companies have moved towards having more and more independent directors. (Colman, 1994) However, there are mixed reviews as to the value of the independent directors on the board in relation to firm performance. (Lin, 1996) (Barnhart and Rosenstein, 1998) (Denis, 2001) The role the board plays in corporate governance is certainly becoming more pronounced and the board’s relationship with the CEO is also changing. (Pound, 1995)

Start-ups have the unique opportunity to begin corporate governance with principles that have become important to shareholders – transparency, communications, standard and widely accepted accounting rules, and the highest ethical standards. Although start-ups

begin their corporate life almost without exception as private companies, many choose to immediately follow SEC and NASDAQ rules about the role independent directors should play in corporate governance. In this way, the corporate governance transition in going from a private company to a public company would be smooth and with no need for major alteration. There are many books and articles outlining the responsibilities of a corporate board member, *The Corporate Director's Guidebook* (1994) being an example. However, few authors have addressed the methodology for the selection of board members, especially in start-ups, let alone high tech start-ups.

Due to the recent adverse stock market conditions and the “witch hunt” now underway in the US to ferret out unethical if not illegal behavior of company management and board members, it is timely for the entrepreneurial team (“ET”) to place more importance on board selection than ever before. Further, the selection process may become more laborious than before due to the disinterest being generated in potential board members as they see board membership as more “risky” than in the past. Director and Officer (“D&O”) insurance policies, once relatively common in public but rare in private companies, may become a requirement for a prospective board member of any stature, wealth and reputation to join a company board. Few public companies have braved not having D&O insurance in the past and fewer will dare continue not having such protection.

Another reason for developing a corporate governance plan at a start-up centers on its high risk of business failure in the early years. A strong board can assist in detecting and attending to signs of business ailments (Scherrer, 2003). Assembling the right board can also assist the high tech start-up in maintaining its focus on innovation and commercialization processes. (Perel, 2002) High tech start-ups have the added business hurdle to overcome of introducing a new technology to the market and achieving its acceptance within a window of opportunity dictated primarily by the level of investment and low competition.

## **FUNCTIONS OF A BOARD MEMBER**

The Sarbanes-Oxley Act of 2002 imposes requirements on board governance as an attempt to make more uniform board oversight of companies. Basic duties and responsibilities were initially outlined in the Model Business Corporation Act of 1978. (Model Act) However, over time five types of relationships have developed between the board and the company: (a) Legalistic; (b) Agency; (c) Strategy and policy; (d) Advisory; (e) Contributory. Four of these types are described in Ong and Lee (2000) as “theories” that researchers have used linearly and individually to describe the functioning of the board relative to the company. Little research has been done to model board influence on company performance using even two of the relationships at the same time let alone all five.

The five relationships or functions ascribed to board behavior in this paper are listed below in similar form to that of Table 1 in Ong and Lee (2000). We will briefly discuss the attributes of each relationship and the impact they may have in assembling a board for a high tech start-up.



**Legal.** The company board has powers and responsibilities endowed by its articles of incorporation, corporate bylaws, federal and state statutes, or regulations passed down from the SEC or stock exchanges.

**Agency.** The role of agency dates back to the expectation that owners and managers can have a divergence of interests. (Berle and Means, 1932) In this light the primary job of the board directors is to provide impartial and diligent oversight of a company's operation and management *in the interest of all shareholders*.

**Strategy and Policy.** As a result of performing its legal and oversight duties, the board exercises judgment in evaluating business plans, investment opportunities and organizational priorities. The process of evaluating and approving such major strategic options of the company empowers the board in establishing strategy for the company. (Zahra, 1990) Research has shown a positive correlation between board involvement in corporate strategy and firm performance. (Pearce and Zahra, 1991)

**Advisory.** Board members are expected to perform in an advisory role to company management. Large investors in a technology company, such as venture capitalists ("VC's"), at times insist on playing a major advisory role as board members, especially with youthful and inexperienced management teams. VC's can overplay this role to their detriment if they fail to gain the trust of the entrepreneurial team early in their association. (Besenitz, Moesel, Fiet and Barney, 1997)

**Contributory.** Board members do volunteer their services operationally in many ways with or without additional compensation under the conditions that the time to complete the service is not burdensome and that the service does not compromise their career or current position. This relationship is attributed to a "stewardship" function of a board member. (Davis, Schoorman and Donaldson, 1996)

## **TYPOLGY OF BOARD MEMBERS**

**Investor.** Anyone who has made a significant investment in the start-up frequently asks for a board seat principally for the sake of "protecting" their investment. Venture capitalists commonly ask for a restructuring of the board as they make an investment, assuring themselves of enough board seats to reflect the size of investment being made in the company. Depending on the limited partnership agreement governing the venture capital firm, it is often the case that the VC partner him/herself has to sit on the board associated with his/her "deal."

**Employee/Manager.** It is common for managers or other employees, especially founders, to request a board seat, frequently using the argument that they own considerable stock and they have a significant stake in board decisions. Entrepreneurs can find that the CEO's membership is adequate for representing the interests of the managers and other employees. Employees are obvious "insiders" who are biased in that they tend to protect their jobs with the company.

**Relevant Stakeholder.** Other stakeholders found on boards include customers, suppliers, legal counsel, spouses of the CEO or other board members and family members. Entrepreneurs are advised to avoid encouraging such candidates to join the board, principally for avoiding conflict of interest.

**The Independent Board Member.** Extensive research has been conducted analyzing company performance relative to board structure parameters such as number of insiders, number of independent members, board compensation, etc. The motivation for such research is obvious. It attempts to answer the question: “What kind of board is associated with acceptable company performance? The consensus from this research, despite a weak association, is to advocate for more independent board members (Barnhart and Rosenstein, 1998) (Denis, 2001).

### **GENERAL QUALIFICATIONS FOR INDEPENDENT BOARD MEMBERS**

More variables that are ascribed to a board member on an individual basis that certainly can influence company performance include (a) communications; (b) motivation; (c) operations experience; (d) teamwork; (e) time. These attributes are especially important for an entrepreneur to assess in a candidate for a board position.

**Communications.** One attribute that may portray the prospective board member’s true temperament is that board member’s ability to communicate. Witnessing the would-be board member’s oral presentations, especially in group meetings, and a review of some his/her writings on business subjects can give insight into the individual’s mode of thinking, reasoning and judgment.

**Motivation for Being an Independent Board Member.** What motivates a person to join a board as an independent director? Compensation in the form of bonuses and stock options can be a significant incentive. (Gutierrez, 2003) One model of human behavior poses three classes of variables in determining human behavior (Jain and Triandis, 1990). Social factors such as roles, norms, self concept and interpersonal agreements form one class of variables. Act satisfaction associated with pleasurable activities is another class. Finally, perceived consequences of performing the act is the third class.

**Operations Experience.** Just as it has been reported in the literature (Farris, 1982) that basic knowledge of the underlying technology area has been found to be useful in the success of a manager of knowledge workers in a technology area (resulting in more innovation), so it is likely that a board member can exercise his/her fiduciary responsibility in an improved manner if he/she is knowledgeable in the technology area of the start-up. There is certainly merit to having independent board members who have different backgrounds, such as legal, financial, technical, managerial and ethnicity.

**Teamwork.** It is imperative that the prospective board member demonstrate the ability to handle group dynamics in a professional manner. A tendency to dominate meetings, be vociferous or cantankerous can torpedo a board meeting.

**Time Requirements.** Serving on a board can consume considerable time so entrepreneurs should be aware of the contribution of possibly the most important asset a professional has – his/her time. Frequently, independent directors have a full time job at another company or organization and simply cannot afford more than that amount of time per month.

## **BEST PRACTICES IN BOARD GOVERNANCE**

Several best practices that are pertinent to high tech start-ups are the following. Several of these practices are listed in Sherwin (2003):

1. Majority of directors are independent.
2. The Chair and CEO are separated.
3. Audit committee is composed entirely of independent directors, whose backgrounds indicate a high degree of financial competence.
4. Board conducts annual performance review of management team.
5. Board has a CEO succession plan in place.
6. All committees chaired by independent directors.
7. Board membership exhibits diversity in experience, skills, backgrounds, gender and ethnicity.
8. Trust, communications and teamwork are nurtured in board activities.
9. Review of strategic plan and annual financial plan happens at every board meeting.
10. Board meetings are planned with published agenda one week in advance with targeted start and end times.

## **CHECKLIST FOR BOARD SELECTION AND CONCLUSIONS**

As a result of the prior discussion the following ten assessment steps in Table 1 form a guide for entrepreneurial teams in dealing with board member selection. The first seven steps assess the board member candidate's suitability for general board membership while Steps 8-10 specifically deal with the issue of the start-up's technology focus. There is much activity, perhaps even turmoil, in the initial period of starting up a company. Entrepreneurial teams are often eager to start the product or service development process once funding is secured. It is easy to put off board member selection or relegate it to the lead investor in the company. However, the ET may never be in such an advantageous position again to help select the best available group of people who will perform oversight of the company's management and make other valuable contributions.

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Table 1

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Usage of Table 1 by an ET in assessing a board member candidate can also be modified by assigning a "weight" to each attribute. For example, the absence of a board member on the current board that exhibits strength in Step 4 may lead the ET to assign a higher weight to Step 4 than to others. However, it is important that ET's understand that no

attribute can be ignored. Indeed, board candidates who rate poorly in Steps 3, 5 and 7 can cause trouble far in excess of their potential positive contributions.

In summary, the selection of board members for new technology businesses is an important step in laying the groundwork for a company's success. The process of selection should be seen by ET's as a rare opportunity to strengthen the people assets of the company. Choosing board members can very well rival the importance of choosing key operational team members.

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**Table 1**  
**Assessment Steps for Selecting an Independent Board Member**  
**in a High Tech Start-up**

| Step No. | Attribute                                     | Areas   | Comment   |
|----------|---|---|---|
| 1        | Business Experience                           | Marketing, Sales, Strategy  | These areas are probably most useful to a start-up  |
| 2        | Communication Skills                          | Active Listening and Succinct Verbalization                           | Individual must be able to “listen” to the E-team’s issues and not “overtalk.”            |
| 3        | Ethics & Background                           | Impeccable ethical background   | Avoid selection of anyone with questionable reputation.                                   |
| 4        | Ability to “Open Doors”                       | Relationship with Potential customers, suppliers, potential investors | This is valuable initial “capital” for the start-up.                                      |
| 5        | No Conflict of Interest                       | No significant interest in ownership or financial association         | Too much potential conflict will necessitate excusing the board member from deliberations |
| 6        | Time Availability                             | No more than 2 other board memberships                                | Regardless of other virtues, absences from deliberations does disservice to company       |
| 7        | Chemistry with Founders                       | More so than age difference, interpersonal skill is important         | Difficulty in relating to founding team is a “no-no.”                                     |
| 8        | Gen. Knowledge of Technology                  | Career in technology  | A degree in technology helps  |
| 9        | Specific Knowledge of Company’s Technology    | User, Developer, Researcher   | User is most needed for a start-up  |
| 10       | Operational Knowledge of Technology Companies | Executive of functional area  | Sales and Marketing of Technology products or services most helpful                       |

# **RESOURCE CONFIGURATION IN FAMILY FIRMS: LINKING RESOURCES, STRATEGIC PLANNING AND ENVIRONMENTAL DYNAMISM TO PERFORMANCE**

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## **ABSTRACT**

We apply the resource-based view (RBV) to the study of family firms by investigating how family specific (altruism) and firm specific (technology) resources contribute to performance. We then examine how the impact of these resources is moderated by strategic planning and environmental dynamism. Our findings suggest that family firms can benefit from emphasizing the positive aspects of kinship and from developing technological assets. In addition, we found a heightened importance of altruism in dynamic environments, and that strategic planning increased in importance for those family firms that lack technological resources.

## **INTRODUCTION**

Resource management is critical to managing a family firm and gaining a competitive advantage (Chrisman, Chua & Zahra, 2003). In particular, a family firm's culture can act as an important strategic resource that can lead to a distinct advantage (Zahra, Hayton & Salvato, 2004). While family firms are often criticized for failing to seek new ventures (Cabrera-Suarez, Saa-Perez & Almeida, 2001), being conservative and resisting change (Morris, 1998), those family firms that are innovative and possess technological resources may increase their distinctiveness. In addition, while many family firms are plagued by conflict that can devastate their performance, other family firms possess harmonious cultures that increase cooperation and commitment (Zahra et al., 2004). Indeed, effective relationships within a family firm can be a unique resource (Kellermanns & Eddleston, 2004). Therefore, due to the interaction between the family and the business, a family firm's competitive advantage may come from resources derived from the business's technological capabilities or resources derived from effective family relationships.

However, possessing resources may not be enough to achieve a competitive advantage. Strategic planning and the environment may affect the degree to which resources are able to contribute to performance. Family firms must manage their resources and plan for the future in order to succeed in today's competitive landscape (Sirmon & Hitt, 2003). Leveraging resources requires managers to participate in strategic planning aimed at creating a distinct advantage (McGrath & MacMillan, 2000). Furthermore, while resources are the essential building blocks of gaining a competitive advantage, they must be leveraged to effectively pursue environmental opportunities (Chrisma, et al., 2003). Certain resources may be essential in a dynamic environment if a firm is to perform well and protect its competitive advantage (Sirmon & Hitt, 2003). Family firms operating in dynamic environments need to manage their resources so as to exploit opportunities present in uncertain markets (Shane & Venkataraman, 2002). As such, in line with recent research on RBV, strategic planning and the environment must be considered in order to fully understand how a family firm's resources contribute to its performance (Sirmon & Hitt, 2003).

Our paper examines the affect of two distinct and potentially important resources on family firm performance. First, because it has been suggested that innovation may be an important resource that distinguishes family firms and contributes to their competitive advantage (Zahra et al., 2004)

we examine how technological resources impact a family firm's performance. Second, given that positive and effective family relationships have been argued to be an important source of competitive advantage that is unique to family firms (Kellermanns & Eddleston, 2004), we investigate how altruism contributes to family firm performance. In line with recent research on RBV (i.e. Cabrera-Suarez et al., 2001; Chrisman et al., 2003; Sirmon & Hitt, 2003), we also consider the role that strategic planning and environmental dynamism play in shaping how these distinct resources affect a family firm's performance.

### **THE RESOURCE-BASED VIEW OF THE FIRM**

According to RBV, firms can develop unique characteristics that allow them to gain a sustainable competitive advantage, thus positively affecting their performance. These firm-specific assets can be both tangible and intangible, but the key is that they are not available to all firms in the industry. Barney (1991) described four characteristics of these firm-specific assets: that they need to be valuable, rare, not easy to imitate, and non-substitutable. A further element of RBV is that resources alone do not confer a competitive advantage. Firms must also allocate these resources for strategic activities, deploy them effectively to obtain a sustainable competitive advantage and accomplish strategic objectives. Therefore, in order to succeed, firms must develop resources that cannot be easily imitated and are firm-specific, embedded in the organization and non-transferable. (Makadok, 2001).

#### **Technology as a Firm-Specific Resource**

Family firms are often criticized for failing to invest in new ventures (Cabrera-Suarez et al., 2001), avoiding risk and resisting change (Morris, 1998). Many family firms do not plan for the future or invest in technological capabilities. They become fixated on maintaining the status quo and fail to invest in technology thereby limiting their growth. In contrast, it has been argued that family firms need to innovate and pursue entrepreneurial activities in order to increase their distinctiveness and enhance their profitability (Zahra et al., 2004). By developing technology and continuously renewing that technology, a firm can create an important strategic resource that can lead to a sustainable competitive advantage, thereby enhancing its growth and profitability.

**Hypothesis 1:** Technological resources are positively related to family firm performance.

#### **The Family as a Resource**

While most research focuses on how family relationships can negatively impact firm performance (Kellermanns & Eddleston, 2004), recently it has been argued that "familiness" can be a source of competitive advantage for family firms (Sirmon & Hitt, 2003). In particular, altruism may explain why in some family firms members are able to successfully work together and run a business while in others, family members are laden with animosity that deteriorates performance (Kellermanns & Eddleston, 2004). As such, high levels of altruism within a family firm may constitute as an important source of competitive advantage. Altruistic family firm members can be seen as stewards rather than as agents of the firm. In line with stewardship theory (Davis, Schoorman & Donaldson, 1997), altruistic families are characterized as possessing collectivistic orientations that encourage family members to exercise self-restraint and to consider the effect of their actions on the firm (Kellermanns & Eddleston, 2004). Indeed, research suggests that the agency costs of family firms tend to be lower than the agency costs of non-family firms (Chrisman et al., 2004; Sirmon & Hitt, 2003).

**Hypothesis 2:** Altruism is positively related to family firm performance.



### **The Need for Strategic Planning**

While resources are important to a firm's performance, according to RBV, whether an organization gains a competitive advantage and the associated returns depends on the strategic planning used to leverage those resources (Chrisman et al., 2003; McGrath & MacMillan, 2000). Therefore, a family firm's level of strategic planning may impact the degree to which altruism and technological resources affect performance. Specifically, strategic planning may heighten the positive effects of technological resources on family firm performance because the long-term nature of family firms allows them to strategically plan the dedication of resources required for innovation and risk taking (Zahra et al., 2004). In addition, research suggests that for family firms to prosper from their innovative capacity they must invest in formal strategic processes (McCann, Leon-Guerrero & Haley, 2001).

Concerning altruism, to create a sustainable competitive advantage, "familiness" must be properly assessed and managed in a family business (Cabrera-Suarez, et al., 2001). When family firms place noneconomic goals, like avoiding family conflict or creating jobs for family members, ahead of economic considerations, performance can be compromised (Chrisman, et al., 2003). In addition, because family employees often work for a firm not because of their qualifications, but because of their family status (Schulze, Lubatikin & Dino, 2003), the discussion of each family member's abilities and how they can be efficiently and effectively deployed is of the utmost importance (Kellermanns & Eddleston, 2004). Employees of family businesses need to be motivated to participate in strategic planning and implement strategies if the firm is to benefit from its resources (Sirmon & Hitt, 2003). As such, greater strategic planning may amplify the positive effects of altruism on family firm performance.

**Hypothesis 3:** Strategic planning moderates the relationship between (a) technological resources and (b) altruism and family firm performance. Specifically, higher levels of strategic planning enhance the positive relationship between (a) technological resources and (b) altruism.

### **Environmental Dynamism: The Impact of a Turbulent Environment**

Environmental dynamism may affect the extent to which resources contribute to a firm's performance. Specifically, family firms operating in dynamic environments may need greater resources in order to exploit opportunities present in uncertain markets (Shane & Venkataraman, 2002). Concerning technological resources, venturing activities and innovation may be particularly important to surviving in a highly dynamic environment (Sirmon & Hitt, 2003). A turbulent environment, with fast-changing unpredictable markets, is complex, threatening and risky. There is less time to react, resource needs can change quickly, and technologies underlying products can become suddenly obsolete. Entrepreneurial behavior may fit well within such dynamic environments, particularly in technology intensive industries (Zahra & Bogner, 1999).

Furthermore, in uncertain, dynamic environments, a stewardship philosophy toward management, which encourages a collectivistic, trustworthy and pro-organizational culture, is argued to be most effective (Davis et al., 1997). Family firms that encourage cooperation and collaboration may be best able to respond to environmental changes (Zahra, et al., 2004). This is because in order to prosper in an uncertain and turbulent environment, trust and shared responsibility is essential (Davis et al., 1997). This leads to the following hypothesis:

**Hypothesis 4:** Environmental dynamism moderates the relationship between (a) technological resources and (b) altruism and family firm performance. Specifically, higher degrees of environmental dynamism enhance the positive relationship between (a) technological resources and (b) altruism.

## METHOD

**Sample.** Data for the study were collected using a questionnaire survey. A mailing list of 232 family businesses was obtained from the family business centers at two universities. We sought multiple respondents from each family firm because consensus among several stakeholders in the family firm would aid in the representativeness of our results to family businesses. There were 126 questionnaires returned, resulting in 74 family firms and a 32% response rate. The employment size for non-family employees of these firms ranged from 2 to 545 with an average size of 97 and a median of 44.

**Measures.** All constructs were measured on a 7-point Likert scale anchored by “strongly disagree” to “strongly agree”, unless otherwise noted in the subsequent section. Alphas ranged from .83 to .90. We measured altruism among family members by adapting four items from a scale developed by Becker and Vance (1993). In order to assess the level of technological resources within a family firm, we used three items modified from scales developed by Miller & Barbosa (1983) and Zahra (1996). We measured strategic planning in family firms by modifying three items from a scale by Gould (1979). Environmental dynamism was captured by utilizing four scale items used by Zahra (1996). Performance was assessed with eight questions regarding growth, returns and profitability. In addition, we controlled for firm size.

## RESULTS

The hypotheses proposed in the research model were tested using multiple regression analysis. Results are presented in Table 1. In model one, the control for size was entered, however, it was not significantly related to performance. To test Hypotheses 1 and 2, we entered both independent variables in the second model. A significant change in  $R^2$  was observed ( $\Delta R^2 = .20$ ,  $p < .001$ ) and technological resources ( $\beta = 0.25$ ,  $p < .05$ ) and altruism ( $\beta = 0.34$ ,  $p < .01$ ) were found to have a significant positive impact on performance, supporting Hypotheses 1 and 2.

In order to test the suggested moderation effects, we first entered the moderators independently in Model 3 and then entered the four interaction terms in Model 4. A significant change in  $R^2$  was produced ( $\Delta R^2 = .12$ ,  $p < .05$ ). Hypothesis 3 was partly supported; whereas strategic planning did not affect the relationship between altruism and performance, a significant interaction was observed between strategic planning and technological resources ( $\beta = 0.45$ ,  $p < .01$ ). Hypothesis 4 was also partly supported; whereas environmental dynamism did not moderate the relationship between technological resources and performance, a significant interaction was observed between environmental dynamism and altruism ( $\beta = 0.22$ ,  $p < .05$ ). To facilitate interpretation, the two significant interactions were plotted in Figure 2 and Figure 3. The interaction between strategic planning and technological resources in Figure 2 shows that when there is little strategic planning, technological resources become increasingly important to family firm performance. However, when there is much strategic planning, the level of technological resources has no significant impact on family firm performance. The second significant interaction effect between environmental dynamism and altruism is displayed in Figure 3. The interaction shows that in

stable environments, altruism has little effect on performance. However, when the environment is dynamic, a higher level of altruism is associated with stronger family firm performance.

## **DISCUSSION AND IMPLICATIONS FOR FUTURE RESEARCH**

Our study contributes to the family firm literature in many ways. Kellermanns and Eddleston (2004) argued an indirect positive performance effect of altruism in family firms, however other research portrayed altruism as detrimental to family firms (Schulze, et al., 2003). Our study is the first empirical investigation that begins to resolve these opposing arguments. Whereas altruism might lead to non-zero agency costs in family firms (Schulze et al., 2003), our study suggests that these costs are still lower than in non-family firms. This notion is further supported by our results that showed the enhanced importance of altruism in dynamic environments. In these environments high agency costs seem even more detrimental than in stable environments. Thus, our study shows that if altruism is present and fostered in family firms, it can be a powerful resource, which can lead to a competitive advantage that is not replicable in other firms.

We further demonstrated the importance of technological resources and strategic planning in family firms. Whereas superior strategic planning can offset the negative performance consequences of impoverished technological firms, our study supports the importance of strong technological resources for all family firms. These findings are significant given that family firms are often criticized for failing to seek new ventures or to be innovative (Cabrera-Suarez et al., 2001). Our study demonstrates that family firms that invest in technological resources will have a stronger performance. However, we also see that for those firms with little technological resources, strategic planning may be able to compensate and help these firms to succeed. Given these findings, future researchers should further investigate how family firms can improve their technological resources and also, how family firms that may not have technological capabilities may use strategic planning to compensate and contribute to their performance.

Another avenue for future studies should be aimed at unraveling our complex findings regarding environmental dynamism. While altruism was found to be a positive resource in dynamic environments, technological resources did not have a significant effect. Perhaps technological resources were not significant because in highly dynamic environments, competitive advantages are short-lived, and even new competencies produce only temporary advantages. It appears that higher levels of technological resources in neither dynamic nor stable environments ensure a long-term advantage. In contrast, today's competitive landscape requires the integration of specialized knowledge. Altruism may foster knowledge exchange and learning within a family firm which may help them succeed in dynamic environments.

Importantly, this study showed that the performance of family firms cannot be fully understood without taking into account the psychodynamic effects of family relationships. Thus, our study shows a specific family resource, altruism, that helps family firms to succeed. As such, this study demonstrates that family relationships and interactions are significantly tied to a family firm's performance. This suggests that the family can be a source of competitive advantage for a family firm. Our findings also suggest from the resource-based perspective that the inclusion of other "familiness" variables may provide fruitful avenues for future studies that are aimed at helping family firms understand the unique resource that effective family relationships can provide.

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**Table 1: Hierarchical Regression Analysis<sup>a</sup>**  
**Dependent Variable: Organizational Performance**

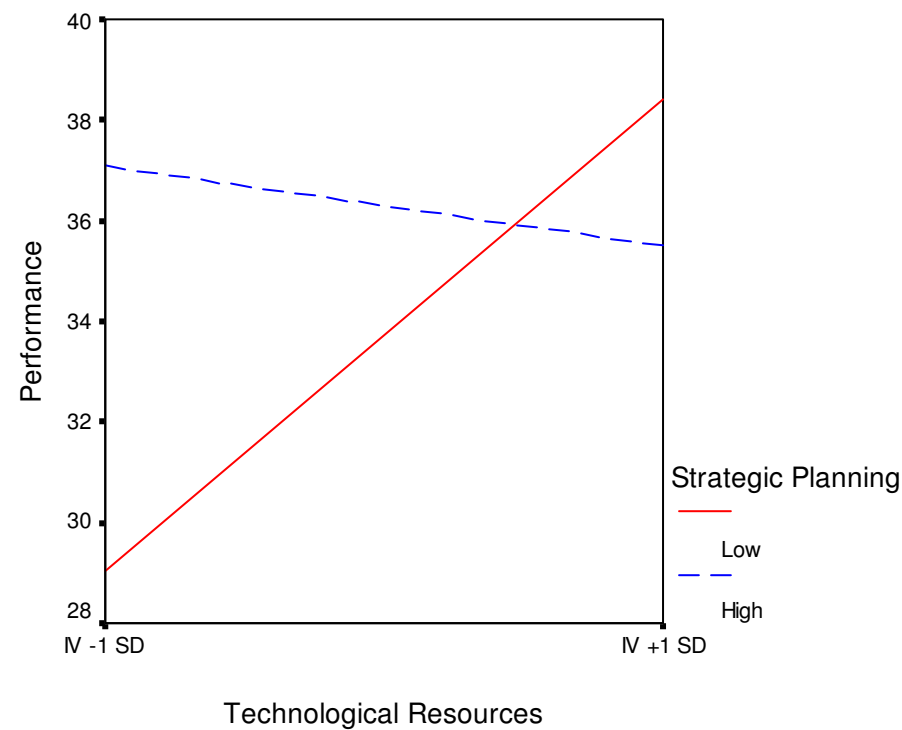
|  | Model 1 | Model 2 | Model 3          | Model 4          |
|--|---------|---------|------------------|------------------|
| <b>Step 1: Controls</b>                      |         |         |                  |                  |
| Firm Size (Employees) <sup>1</sup>           | -.04    | -.06    | -.05             | -.01             |
| <b>Step 2: Main Effects</b>                  |         |         |                  |                  |
| Altruism                                     |         | .34**   | .27*             | .15              |
| Technological Resources                      |         | .25*    | .25*             | .30**            |
| <b>Step 3: Moderators</b>                    |         |         |                  |                  |
| Strategic Planning                           |         |         | .21 <sup>†</sup> | .20 <sup>†</sup> |
| Environmental Dynamism                       |         |         | .02              | -.08             |
| <b>Step 4: Interaction Effects</b>           |         |         |                  |                  |
| Strategic Planning * Altruism                |         |         |                  | .09              |
| Strategic Planning * Technological Resources |         |         |                  | -.45**           |
| Environmental Dynamism * Altruism            |         |         |                  | .22*             |
| Environmental Dynamism * Tech Resources      |         |         |                  | .20              |
| Change in R <sup>2</sup>                     | .00     | .20***  | .04              | .12*             |
| R <sup>2</sup>                               | .00     | .20     | .25              | .36              |
| Adjusted R <sup>2</sup>                      | -.01    | .17     | .19              | .28              |
| F  | .11     | 5.96*** | 4.42**           | 4.07***          |

<sup>a</sup> Regression coefficients are reported as betas.

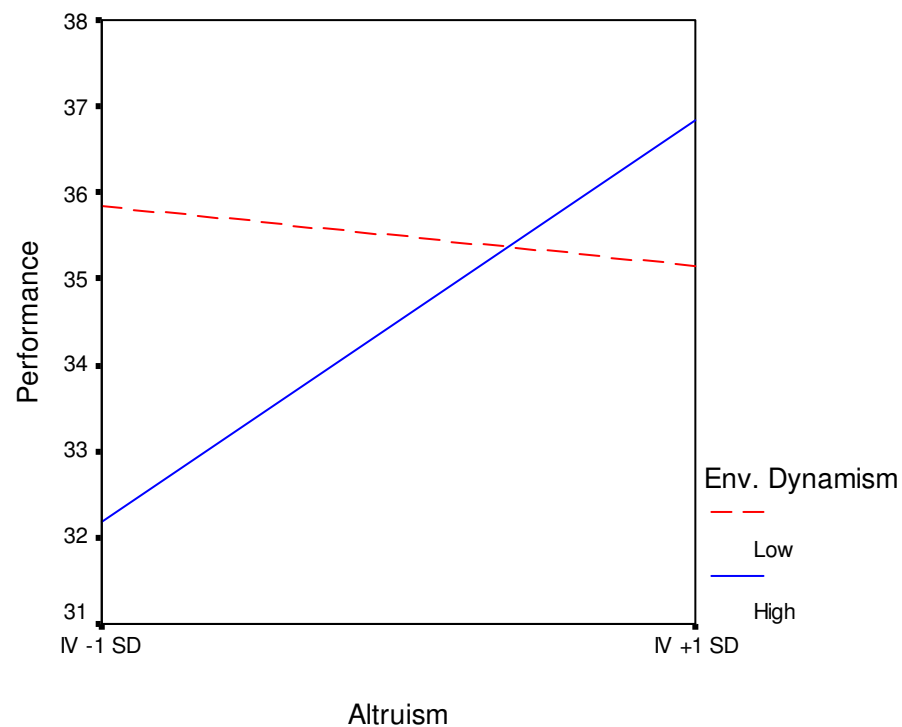
<sup>1</sup> logarithmized

N = 74, <sup>†</sup> p <.10; \* p <.05; \*\* p <.01; \*\*\* p <.001.

**Figure 2: Interaction: Strategic Planning and Technological Resources**



**Figure 3: Interaction: Environmental Dynamism and Altruism**



## **SMALL BUSINESS AND COMMUNITY BANKS**

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### **Abstract**

Using survey data from a sample of U.S. small businesses collected in 1987, 1995 and 2001, this paper addresses the question of whether small firms obtain better banking outcomes from community banks. Over the entire period, we find that small firms using community banks experience higher quality service are less likely to have experienced increases in the number of services with fees or fees per unit of service, and experienced improved credit availability. The results for loan terms were mixed, with no differences detected for rates charged or compensating balances required, but a significantly higher incidence of collateral requirements and lower incidence of loan fees. These results also suggest that small firms with limited operating histories or those with limited financial data that is used in typical credit scoring models have a better chance of success for a loan approval at a community bank.

## **SMALL BUSINESS AND COMMUNITY BANKS**

### **INTRODUCTION**

Do community financial institutions (“CFIs”) provide small firms with better banking outcomes, such as service quality, credit availability and loan terms?<sup>1</sup> This question is important to small businesses because of their heavy reliance on banks for their external financing (Berger and Udell, 1998) as well as important for macroeconomic policy given the importance of small business in the job generation process. Community banks, with their flatter organization structures are better suited to produce soft information such as information about the owner’s character, relationship with suppliers or ability to manage through a business cycle (Berger and Udell, 2002, Stein, 2002). This information should benefit small, small, information-opaque firms that may not have a track record of hard information required of many large banks that rely on financial ratios or credit scoring to make lending decisions. Indeed, the preponderance of the empirical evidence shows that community banks enhance credit availability for small firms (e.g., Berger et al, 2004). Yet, there is scant evidence regarding whether community banks provide improved loan terms or improved service.

In this paper we use survey responses from a representative set of U.S. small businesses in 1987, 1995 and 2001 to determine whether small firm owners have a better banking experience at community banks. These data provide detailed firm-level information on owner assessments of service quality that include accessibility of the loan officer, quality of service, capability of staff, staff turnover, and the overall ease of doing business. The survey provides information on the outcome of the most recent loan attempt and an assessment of any unmet borrowing needs in the past few years. If owners were successful on the most recent attempt, they reported both the rate and non-rate terms of the loan. Using the size of their current bank as the key independent variable, we are able to investigate the association between choice of bank size and measures of service quality, credit availability, and loan terms.

This paper adds to the literature on understanding of how locally-owned banks can benefit small firms compared to large banks. Other papers have examined the effect of bank size on small firm credit availability and attributes of a banking relationship that are important to small firms (e.g., Berger et al, 2004, Cole et al, 2004, and Scott, 2004). While these papers provide important results, they do not address the association between bank size and service quality or bank size and loan terms. Perhaps more importantly, none of the extant empirical work examines whether smaller banks have been able to consistently deliver these benefits to small firms over a period (1987-2001) when dramatic consolidation took place in the U.S. banking system.

### **DATA DESCRIPTION AND ANALYSIS**

The data in this study come from the Credit, Banks and Small Business (CBSB) survey conducted by the National Federation of Independent Business through surveys of

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<sup>1</sup> Gramm-Leach-Bliley (CFI, 12 USC 1422(13)) defines community banks by asset size. This definition is a legal, not an economic one, and CFIs could be defined by market size, deposit base, or customer base. However, defining CFI by asset size is most frequently used for research and policy purposes.



random samples of its 600,000 members in 1987, 1995, and 2001. The response rates have varied over time: 26 percent in 1987, 20 percent in 1995, and 18 percent in 2001.<sup>2</sup> Although self-reported, there is no reason to believe that there is any systematic self-reporting bias in the reports in the banking outcomes. The data are similar to that gathered by the Board of Governors of the Federal Reserve System in their Survey of Small Business Finance through a telephone survey of small firms drawn from the Dun and Bradstreet files.

Table I about here

Key demographic statistics are presented in Table I for each survey. The definition of the variables used in the analysis and key summary statistics are shown in Table II for all firms that reported a commercial bank as their primary institutions. A CFI, or community financial institution, is defined as a bank with assets under \$1,000 million and LFIs (large financial institutions) are banks with assets over \$1,000 million. The number of observations in Table II is restricted to those owners that reported the size of their bank or the name of the bank, permitting an assignment of the asset size of the bank.

Table II about here

A comparison of the small firm characteristics and their banking outcomes between CFIs and LFIs is shown in Table III. Service quality is assessed by ratings four characteristics: accessibility of the account manager, overall quality of service, capability of staff and staff turnover. These ratings are based on the owner's assessment of the change in the characteristic at their principal bank in the last three years and are coded as a '1' if better, '0' if no change, and '-1' if worse. With the exception of overall service quality in 1987 small firms rated CFI performance significantly higher than LFIs. The ratings on accessibility of account manager and staff capability have shown little change since 1987, but the quality of service and staff turnover have shown a marked decline between 1995 and 2001. An overall CFI service quality index, based on the sum of the four service characteristic ratings, is also higher for CFIs, but the mean value of the index declined significantly between 1987 and 2001.

Owners doing business at CFIs are significantly less likely to be denied in their last loan application in all of the surveys and for those approved, their loan size received is significantly lower – which may be due to smaller firms self-selecting smaller banks. However, there are no significant differences between CFIs and LFIs for those owners reporting unmet borrowing needs over the past three years.

The average loan rate for all loans is systematically higher at CFIs, but the difference from large bank rates is not significant. The evidence on non-rate terms is mixed, with a significantly higher incidence of collateral requirements only in 2001, but a significantly lower incidence of required business checking accounts as a condition of their most recent loan in 1995 and 2001. Loan size is also significantly lower, either because of the

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<sup>2</sup> A similar decline in the response rate has been experienced with the Board of Governor's Survey of Small Business Finance.

smaller size of firms using community banks or binding lending limitations because of less capital (e.g., loan-to-one borrower limits).

Table III about here

Table III also suggests that owners at CFIs have a different demographic profile than those at LFIs. Owners currently doing business at CFIs are younger and smaller (in terms of employment and sales), which suggests a more risky profile that may be reflected in the higher average loan rates. Owners at CFIs also tend to be organized more frequently as proprietorships and less likely as corporations, an outcome that is likely correlated with size. Owners banking at CFIs are significantly less likely to be located in urban areas (Metropolitan Statistical Areas or “MSA”), in markets with greater employment and higher deposit concentration ratios.

### **MULTIVARIATE RESULTS**

Multivariate analysis was used to confirm the relationships identified in Table III for both non-loan term (service quality index, change in fees and credit availability) and loan-term (rate, collateral, loan size, and compensating balances). The key feature of the multivariate analysis is the use of instrumental variables for bank size to avoid complications arising from the possibility that improved outcomes at CFIs are attributable to the characteristics of the small firm that cause it to choose the CFI, not the bank size itself. These instruments include population, region, MSA, and deposit concentration.

In addition, a simultaneous equation model is used to estimate the loan term equations because these terms are jointly determined by the bank. A full set of control variables is included in the analysis such as firm size, years in business, form of business, and industry classification. Additional control variables are included in the loan term equations to control for the yield curve, the overall level of rates, default risk premiums, maturity and loan type.

The multivariate results (not reported here but available from the authors) confirm most of the results in Table III. Owners banking at community banks consistently report higher service quality, a lower incidence of services with new fees or higher fees on existing services, and a lower chance of being turned down on their most recent loan request. Loan terms were not affected by the choice of a CFI with the exception of a consistently higher incidence of collateral at CFIs.

### **CONCLUSIONS**

Do small banks provide better banking outcomes for small firms? After controlling for the endogeneity between firm size and the selection of the bank, the results in this paper confirm the Berger et al (2004) results that credit availability improves for small firms at CFIs. In addition, owners at CFIs experience better service and lower incidence of fee increases, with mixed results for loan terms. Despite the consolidation of the banking industry and the concomitant reduction in the number of community banks, these results suggest that owners of small firms receive better banking outcomes at CFIs – an

advantage that has persisted over 14 years from 1987 through 2001. These results also suggest that owners who lack the hard operating numbers that are used in credit scoring models used by many large banks are likely to have a better chance of success in obtaining a loan at a community bank.

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**TABLE I. Distribution of NFIB survey respondent demographic characteristics**

The frequency distributions for selected firm characteristics from the 1987, 1995, and 2001 National Federation of Independent Business (NFIB) Credit, Banks and Small Business Survey.

| <b><u>Form of Business</u></b>        | <b><u>1987</u></b> | <b><u>1995</u></b> | <b><u>2001</u></b> |
|---------------------------------------|--------------------|--------------------|--------------------|
| Proprietorship                        | 35                 | 31                 | 26                 |
| Partnership                           | 8                  | 6                  | 8                  |
| Corporation                           | 57                 | 42                 | 40                 |
| S-Corporation                         |                    | 21                 | 24                 |
| No answer                             | 1                  | 1                  | 2                  |
|                                       | 100                | 100                | 100                |
| <b>Full Time Equivalent Employees</b> |                    |                    |                    |
| One                                   | 8                  | 6                  | 7                  |
| 2-4                                   | 24                 | 23                 | 29                 |
| 5-9                                   | 30                 | 30                 | 25                 |
| 10-19                                 | 19                 | 20                 | 17                 |
| 20-49                                 | 13                 | 14                 | 12                 |
| 50-99                                 | 4                  | 4                  | 4                  |
| 100-499                               | 2                  | 3                  | 2                  |
| No answer                             |                    | 1                  | 5                  |
|                                       | 100                | 100                | 100                |
| <b>Years in Business</b>              |                    |                    |                    |
| 0-4                                   | 24                 | 15                 | 11                 |
| 5-9                                   | 20                 | 21                 | 14                 |
| 10-14                                 | 17                 | 19                 | 16                 |
| 15-19                                 | 10                 | 14                 | 14                 |
| 20-24                                 | 9                  | 11                 | 13                 |
| 25 or more                            | 18                 | 19                 | 28                 |
| No answer                             | 2                  | 1                  | 5                  |
|                                       | 100                | 100                | 100                |
| <b>Industry</b>                       |                    |                    |                    |
| Construction/mining                   | 12                 | 13                 | 15                 |
| Manufacturing                         | 12                 | 12                 | 11                 |
| Transportation                        | 3                  | 3                  | 4                  |
| Wholesale                             | 9                  | 6                  | 10                 |
| Retail                                | 24                 | 21                 | 20                 |
| FIRE                                  | 8                  | 7                  | 6                  |
| Business services                     | 21                 | 21                 | 17                 |
| Professional services                 | 8                  | 5                  | 8                  |
| Agriculture                           | 4                  | 8                  | 5                  |
| No answer                             |                    | 4                  | 4                  |
|                                       | 100                | 100                | 100                |
| <b>Sales Growth (past 3 years)</b>    |                    |                    |                    |
| Decline                               | 14                 | 14                 | 15                 |
| No change (-5 to 5%)                  | 25                 | 30                 | 29                 |
| Grew 6-10%                            | 40                 | 26                 | 28                 |
| Grew 11-20%                           |                    | 12                 | 12                 |
| Grew > 20%                            | 13                 | 11                 | 9                  |
| Too new to tell                       | 5                  | 4                  | 2                  |
| No answer                             | 2                  | 2                  | 6                  |
|                                       | 100                | 100                | 100                |

**Table II. Variable definitions and descriptive statistics**

Means and standard deviations are presented for all firms that reported a commercial bank as their primary financial institution. No answer responses are excluded from the computation of the summary statistics. The summary statistics are also presented for all firms that report a commercial bank with assets below \$1,000 million (CFI) and those with assets above \$1,000 million (LFI) as of June 2001, 1995, and 1987. The sum of the CFI and LFI observations do not equal the total because of cases where the bank size could not be determined from the information provided on the survey. All data are taken from the 1987, 1995, and 2001 National Federation of Independent Business Credit, Banks and Small Business Surveys.

| Variable Name  | Definition  | 1987  |           |             | 1995   |           |             | 2001   |           |             |
|--|---|-------|-----------|-------------|--------|-----------|-------------|--------|-----------|-------------|
|  |   | Mean  | Std. Dev. | No. of Obs. | Mean   | Std. Dev. | No. of Obs. | Mean   | Std. Dev. | No. of Obs. |
| <i>Change in characteristics at principal bank in last 3 years</i> |   |       |           |             |        |           |             |        |           |             |
| Accessibility  | 1 if better; 0 if no change; and -1 if worse  | 0.05  | 0.53      | 1286        | 0.04   | 0.54      | 3122        | 0.00   | 0.54      | 1871        |
| Quality of service   | 1 if better; 0 if no change; and -1 if worse  | 0.10  | 0.59      | 1244        | 0.08   | 0.58      | 3206        | -0.03  | 0.60      | 1892        |
| Capability of staff  | 1 if better; 0 if no change; and -1 if worse  | 0.02  | 0.57      | 1301        | 0.01   | 0.54      | 3187        | -0.02  | 0.56      | 1865        |
| Staff turnover   | 1 if better; 0 if no change; and -1 if worse  | -0.05 | 0.53      | 1263        | -0.06  | 0.54      | 3072        | -0.26  | 0.56      | 1855        |
| Ease of doing business   | 1 if better; 0 if no change; and -1 if worse  | NA    | NA        | NA          | NA     | NA        | NA          | 0.02   | 0.63      | 1859        |
| Service Quality Index  | Accessibility+Quality of service + Capability of staff + Staff turnover   | 0.13  | 1.67      | 1176        | 0.09   | 1.77      | 2704        | -0.30  | 1.76      | 1823        |
| <i>Higher fees incurred in past 12 months</i>                      |   |       |           |             |        |           |             |        |           |             |
| Number of fees   | Number of services with fees (2 = 'substantially higher'; 1 = 'higher'; 0 = 'no change'; -1 = 'lower'; and -2 = 'much lower') | 0.45  | 0.82      | 1374        | 0.52   | 0.80      | 2966        | 0.53   | 0.78      | 1705        |
| Fees per unit of service   | Fees per unit of service (2 = 'substantially higher'; 1 = 'higher'; 0 = 'no change'; -1 = 'lower'; and -2 = 'much lower')     | 0.57  | 0.75      | 1250        | 0.60   | 0.74      | 2858        | 0.54   | 0.73      | 1718        |
| <i>Credit availability</i>   |   |       |           |             |        |           |             |        |           |             |
| Turned down  | =1 if turned down in last loan attempt  | 0.21  | 0.40      | 1231        | 0.16   | 0.36      | 2863        | 0.10   | 0.30      | 1544        |
| Borrowing needs met  | =1 if borrowing needs were met all or most of the time during the last three years  | NA    | NA        | NA          | 0.26   | 0.44      | 2221        | 0.10   | 0.30      | 1501        |
| <i>Loan terms</i>  |   |       |           |             |        |           |             |        |           |             |
| Loan size (\$000)  | Size of most recently reported loan   | \$ 98 | \$ 233    | 996         | \$ 178 | \$ 578    | 2297        | \$ 229 | \$ 650    | 1175        |
| Interest rate  | Nominal interest rate reported on most recent loan (all loans)  | 11.22 | 2.26      | 903         | 9.45   | 2.14      | 2297        | 8.48   | 2.71      | 650         |
| Collateral required  | 1 if collateral was required as a condition of the loan   | 0.68  | 0.47      | 1009        | 0.66   | 0.48      | 2334        | 0.65   | 0.48      | 1239        |
| Checking balances required   | 1 if business checking accounts were required as a condition of the loan  | NA    | NA        | NA          | 0.28   | 0.45      | 2322        | 0.37   | 0.48      | 1284        |

**Table III: Comparison of CFI and LFI owner and banking outcomes <sup>a</sup>**

| <b>Banking Outcomes</b>                   | <b>1987</b> |            | <b>1995</b> |            | <b>2001</b> |            |
|---|-------------|------------|-------------|------------|-------------|------------|
|   | <u>CFI</u>  | <u>LFI</u> | <u>CFI</u>  | <u>LFI</u> | <u>CFI</u>  | <u>LFI</u> |
| Service Index                             |             |            |             |            |             |            |
| (Accessibility+Quality+Capability+Staff)  | 0.22        | -0.05 *    | 0.20        | -0.06 *    | 0.03        | -0.53 *    |
| Accessibility                             | 0.07        | 0.01 *     | 0.07        | 0.00 *     | 0.06        | -0.05 *    |
| Quality of service                        | 0.10        | 0.09       | 0.10        | 0.06 *     | 0.05        | -0.10 *    |
| Capability of staff                       | 0.06        | -0.06 *    | 0.03        | -0.02 *    | 0.06        | -0.07 *    |
| Staff turnover                            | -0.02       | -0.11 *    | -0.01       | -0.12 *    | -0.16       | -0.32 *    |
| Ease of doing business                    | NA          | NA         | NA          | NA         | 0.08        | -0.03 *    |
| Increased number of services with fees    | 0.43        | 0.49       | 0.49        | 0.55 *     | 0.41        | 0.52 *     |
| Increased fees per unit of service        | 0.53        | 0.63 *     | 0.56        | 0.65 *     | 0.44        | 0.64 *     |
| Turned down on last loan request          | 0.19        | 0.24 *     | 0.14        | 0.19 *     | 0.08        | 0.12 *     |
| Borrowing needs not met over last 3 years | NA          | NA         | 0.24        | 0.28       | 0.09        | 0.11       |
| Loan size (\$000)                         | \$ 84.2     | \$ 129.2 * | \$ 130.2    | \$ 245.5 * | \$ 193.8    | \$ 259.5 * |
| Interest rate: all loans                  | 11.32       | 10.99 *    | 9.50        | 9.37       | 8.52        | 8.45       |
| Collateral required                       | 0.67        | 0.70       | 0.66        | 0.65       | 0.69        | 0.62 *     |
| Compensated balances required             | NA          | NA         | 0.25        | 0.31 *     | 0.34        | 0.40 *     |
| Loan fee required                         | NA          | NA         | NA          | NA         | 0.31        | 0.34       |
| <b>Firm Characteristics</b>               |             |            |             |            |             |            |
| Years in business                         | 14.1        | 15.0       | 15.7        | 16.6       | 18.1        | 19.9 *     |
| FTE                                       | 13.7        | 18.2 *     | 11.8        | 21.1       | 13.7        | 19.6 *     |
| Sales (\$000)                             | NA          | NA         | \$2,047     | \$2,856 *  | \$2,116     | \$3,007 *  |
| Form of business                          |             |            |             |            |             |            |
| Proprietorship                            | 0.37        | 0.29 *     | 0.33        | 0.25 *     | 0.29        | 0.22 *     |
| Partnership                               | 0.09        | 0.07       | 0.06        | 0.05       | 0.08        | 0.08       |
| Corporation                               | 0.33        | 0.64 *     | 0.40        | 0.47 *     | 0.37        | 0.44 *     |
| S-Corporation                             | NA          | NA         | 0.20        | 0.23       | 0.24        | 0.25       |
| Industry                                  |             |            |             |            |             |            |
| Agriculture                               | 0.04        | 0.03       | 0.09        | 0.05 *     | 0.08        | 0.06       |
| Manufacture                               | 0.12        | 0.14       | 0.13        | 0.13       | 0.12        | 0.12       |
| Construction                              | 0.12        | 0.10       | 0.13        | 0.13       | 0.15        | 0.15       |
| Transportation                            | 0.03        | 0.03       | 0.04        | 0.02       | 0.04        | 0.04       |
| Wholesale                                 | 0.09        | 0.11       | 0.05        | 0.07 *     | 0.09        | 0.12 *     |
| Retail                                    | 0.26        | 0.19 *     | 0.24        | 0.19 *     | 0.20        | 0.20       |
| Finance                                   | 0.07        | 0.08       | 0.07        | 0.07       | 0.07        | 0.06       |
| Services                                  | 0.18        | 0.24 *     | 0.18        | 0.22 *     | 0.15        | 0.15       |
| Professional                              | 0.09        | 0.07       | 0.04        | 0.05       | 0.06        | 0.07       |
| <b>Market Structure</b>                   |             |            |             |            |             |            |
| Urban location                            | 0.20        | 0.42 *     | 0.55        | 0.78 *     | 0.49        | 0.76 *     |
| Deposit concentration (HHI)               | NA          | NA         | 2397        | 2185 *     | 2161        | 1943 *     |
| Employment (000)                          | NA          | NA         | 365         | 585 *      | 465         | 640 *      |

<sup>a</sup> \* indicate a significant difference between the CFI and LFI mean values at the .01 level

# ENVIRONMENTAL PSYCHOLOGY AS A COMPLEMENT TO RESTAURANT REVENUE MANAGEMENT: EFFECTS ON MEAL DURATION AND TABLE TURNS

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## ABSTRACT

Environmental psychology complements restaurant revenue management. This paper reviews the literature on restaurant revenue management and environmental psychology. Hypotheses are derived and tested on the effects of environmental cues on meal duration and table turns. The results of a survey of 153 restaurants show that environmental cues such as music, lighting, and color significantly affect meal duration and table turns. Implications of environmental psychology for small business owners/managers are discussed.

## INTRODUCTION

Revenue management developed in the airlines as yield management (Cross, 1997). It involves the management of demand in order to maximize sales revenues from existing capacity (Cross, 1997). It has spread to other industries and is widely used in the communication, hotel, and shipping industries (McGill and Van Ryzin, 1999). Revenue management also can be applied in small business. Kimes et al. (1998) developed a framework for applying revenue management in restaurants. It involves methods which present customers with cues that affect their meal duration i.e., the time that they spend seated at a table in a restaurant. The net effect of these methods is to reduce and make meal duration more predictable and to increase the number of table turns. This allows a restaurant to seat more customers in a given period of time and thus to increase revenue generation.

Environmental psychology complements restaurant revenue management as a tool that owners/managers of restaurants can use to affect meal duration and table turns. Environmental psychology is based on a stimulus-organism-response (SOR) framework and examines how stimuli elicit behavioral responses. It has been applied in retail stores to study the effects of the physical context of a business acting as a cue that affects customers' behavior. There is no large sample empirical evidence on the effects of environmental psychology on meal duration and table turns in restaurants.

The purpose of this study is to examine whether environmental psychology in the form of cues such as lighting, colors, and music would have significant effects on meal duration and table turns in restaurants. This paper reviews the literatures on restaurant revenue management and

environmental psychology to derive hypotheses. Next, the results of a survey that tests the hypotheses are presented. Lastly, the implications of these results for small businesses are discussed.

## **LITERATURE REVIEW**

Revenue management manages demand in order to maximize sales revenues from a business's existing capacity (Kimes and Chase, 1998; Cross, 1997). There are several conditions that facilitate the practice of revenue management in a business. First, a business's outputs should be perishable (Weigand, 1999). For example, the airlines have a perishable product (i.e., a flight on a given date and time to a given destination flies only once). Second, a business should have primarily fixed capacity (Weaterford and Bodily, 1992). For example, the airlines have fixed capacity in their investment in their fleet of airplanes. Given fixed capacity, one means that small businesses might use to improve profitability is to increase the amount of revenue generated from fixed capacity.

A framework for applying revenue management in restaurants has been developed (Kimes et al., 1998). Restaurants have perishable outputs, i.e., the time that a seat can be filled by a customer, and they have fixed capacity that is difficult to expand, i.e., the number of seats (Kimes et al., 1998). The framework proposes methods restaurants can use to manage their demand and pricing in order to maximize revenues. One method for managing demand is to manage meal duration (Kimes, Barrash, and Alexander, 1999). Meal duration is the length of time that a customer occupies a seat in a restaurant. A restaurant can establish standard operating procedures that, among other things, present customers with cues in an effort to control the time that customers spend at a table. For example, during busy periods, waiters may clear a customer's table as soon as the customer finishes his or her entree and present the customer with the check. This standard operating procedure functions as a cue to discourage customers from lingering at their tables (Kimes et al., 1998). Predictable meal duration facilitates decision making with respect to reservations and seating. A smaller variance in meal duration facilitates the ability of the restaurant's owner/manager to predict actual meal duration. Information about meal duration is useful in deciding which reservations to accept and at what times to accept them. Further, meal duration information supports better seating decisions (e.g., which parties to seat and when they should be seated). Meal duration information can be used to take actions to minimize the time that seats in a restaurant sit empty. These actions will function to increase the revenue that a restaurant generates from its fixed capacity. Further, decreasing meal duration allows a restaurant to serve more customers in a given period of time, which in turn increases revenue generation.

The rate of revenue generation from fixed capacity in restaurant can be measured by revenue per available seat hour (Kimes, 1999; Kimes et al., 1998). Revenue per available seat hour is equal to the revenue generated over a given period of time divided by the number of seat hours available during that same time period (Kimes, 1999). This measure provides an indicator of the rate at which revenue is being generated from existing capacity. As table turns increase and meal duration decreases, revenue per available seat hour increases (Kimes, 1999).

Another method that may affect table turns and meal duration and thus function as a complement to restaurant revenue management is the application of environmental psychology to restaurants. Environmental psychology applied to business has been labeled as atmospherics (Turley and



Milliman, 2000). As such it has been defined as the intentional control and structuring of environmental cues (Kotler, 1973). Atmospheric addresses the role of environmental cues (i.e., the physical context) of a service setting in which consumption takes place such a retail store. The environmental cues of a business can be classified into external variables (e.g., size, color of building, entrances, signs), interior variables (e.g., color schemes, lighting, music, cleanliness), layout and design variables (e.g., space design and allocation, waiting areas, traffic flow), and point -of-purchase variables (e.g., displays, signs) (Turley and Milliman, 2000).

Environmental psychology is based on a stimulus-organism-response (SOR) perspective (Mehrabian and Russell, 1974). Stimuli from the environment give rise to primary emotional responses in people. These primary emotional responses then give rise to behavioral responses. Behavioral responses are classified as either approach or avoidance. In a retail context, approach behavioral responses are behaviors such as desire to stay, explore the environment, and communicate with others (Bitner, 1992; Donovan and Rossiter, 1982). Avoidance responses are behaviors such as desire to leave, remain inactive in an environment, and avoid interaction with others (Bitner, 1992; Donovan and Rossiter, 1982). These behavioral responses in a retail setting may influence the amount of time and money customers spend in a store (Donovan and Rossiter, 1982).

Empirical research has provided evidence on the affects of the environmental cues of retail businesses on customers' behavioral responses. Interior and layout and design variables affect customers' behaviors. Up beat music resulted in significantly faster shopping traffic flow times in a supermarket than slower tempo music (Milliman, 1982). Background music significantly affected the time and money customers spent in a wine store located within a restaurant (Areni and Kim, 1993).

The interior variable of lighting affects customers' behavior. Brighter lighting was associated with significantly higher levels of handling and examining merchandise in a wine store than with softer lighting (Areni and Kim, 1993). Colors also provide a stimulus that affects customers' behavior. In general, warm colors (e.g., red, yellow) stimulate higher levels of arousal than cool colors (e.g., green, blue). A blue colored store had a higher simulated purchase rate than a red store (Bellizzi and Hite, 1992).

Environmental psychology can be applied to complement revenue management to affect table turns and meal duration and hence revenue per available seat hour. Variables related to the physical context of a restaurant can be used as cues to influence customers' behaviors. For example, a restaurant with a layout and design such as a kitchen that is open to the view of customers provides a stimulus that can contribute to higher levels of primary emotional response in customers (Robeson, 1999). A primary emotional response may result in either approach or avoidance behaviors that may influence the time that customers take to complete their meal. Similarly, interior variables in a restaurant such as lighting, music, and colors may elicit approach or avoidance behaviors (Robeson, 1999). These relationships between cues and behavioral responses may be different in most restaurant settings than in retail settings because dining is different than shopping. For instance, bright lights elicit an approach behavior in retailing but would be assumed to elicit an avoidance behavior in restaurants.

In a field study located in a single restaurant, Milliman (1986) found that customers spent significantly more time at their tables and more money on bar drinks while listening to slow music than while listening to fast music. Thus, from a restaurant revenue management perspective, both meal duration and number of table turns will be affected.

For purposes of this research, high levels of environmental cues were defined as bright lights, bright colors, loud music, fast music, open kitchen design, and a noisy setting.

Hypothesis One: Higher levels of environmental cues will be negatively associated with meal duration.

Hypothesis Two: Higher levels of environmental cues will be negatively associated with the range of meal duration.

Hypothesis Three: Higher levels of environmental cues will be positively associated with the number of table turns.

## **METHODS**

The sample used in this survey research was generated from a list of 949 full service restaurants provided by a New England state chapter of the National Restaurant Association. Each restaurant was given a number and a sample of 589 restaurants was then drawn through the use of a table of random numbers. The data were collected by the use of a semi-structured questionnaire. The questionnaire mailing methods are based on Dillman (2000) Total Design Method procedures with four timed, hand-signed mailings. Five hundred and eighty-nine questionnaires were mailed. A total of 254 replies were received for an overall response rate of 43%. Of the 254 responses, 153 were usable responses from full service restaurants. No evidence was found that there were any significant differences between early and late responders.

### **Measures**

The full service status of a restaurant was measured through a question that asked respondents if their restaurant was a full service restaurant. The question used the definition of a full service restaurant from the 1997 U.S. Economic Census (U.S. Census Bureau).

Questionnaire items for environmental cues were generated from literature in environmental psychology and used seven point response scales. The stem used for these questionnaire items was "Please indicate for each of the following which best describes your main dining area". The item responses were factor analyzed (Principal Components with Oblimin rotation) and a two-factor solution explained 62% of the variance. The scale for the variable Interior Layout (Eigenvalue = 2.3, Cronbach's alpha = .60) included four items: Lighting (anchors "Bright room lighting" & "Intimate table lighting"), Colors (anchors "Bright colors" & "Subdued colors"), Kitchen open (anchors "Open kitchen" & "Hidden kitchen"), and Noise (anchors "Noisy" & "Quiet"). The scale for the variable Music (Eigenvalue = 1.4, Cronbach's alpha = .82) included two items: Level (anchors "Soft music" & "Loud music") and Pace (anchors "Slow music" & "Fast music").

Respondents provided the information for the dependent variables the number of table turns and meal duration in open-ended questions. Respondents were asked the number of table turns that their restaurant had in a typical weekend dinner period. Respondents were asked the length of meal duration they considered to be typical short, average, and long meal durations in their restaurants. The variable Range of Meal Duration was computed by subtracting short meal duration from long meal duration. The range of meal duration was used as a surrogate measure for the variance of a restaurant's meal duration time.

## RESULTS

Sixty-seven percent of the sample was male and 33% was female. The average age of the restaurants was 3.3 years with average sales in 2002 in the \$600,000 to \$799,000 range. The average number of seats in the sample of restaurants was 124, serving an average of 182 dinners with an average of 4.7 paid employees. Descriptive statistics for the dependent and independent variables are shown in Table 1.

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Table one about here

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The hypotheses were tested using simple regression. Hypothesis one, higher levels of environmental cues will be negatively associated with meal duration, was partially supported. The variable Interior Layout was not significantly associated with average meal duration (3.10,  $p = .09$ ), see table 1 panel A. Music was significantly and negatively associated with average meal duration (7.54,  $p = .00$ ) with an adjusted  $R^2$  of .06, see table 2 panel A.

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Table two about here

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Hypothesis two, higher levels of environmental cues will be negatively associated with the range of meal duration, was partially supported. The variable Interior Layout was significantly and negatively associated with the range of meal duration (4.00,  $p = .05$ ) with an adjusted  $R^2$  of .11, see table 2 panel B. Music was not significantly associated with meal duration, see table 2 panel B.

Hypothesis three, higher levels of environmental cues will be positively associated with the number of table turns, was partially supported. The variable Interior Layout was significantly and positively associated with the number of table turns (6.62,  $p = .01$ ) with an adjusted  $R^2$  of .13, see table 2 panel C. Music was not significantly associated with table turns, see table 2 panel C.

## DISCUSSION AND CONCLUSIONS

There has been no prior large sample empirical evidence on the effects of environmental psychology in a restaurant setting. This study provides evidence that environmental cues are

complementary to restaurant revenue management strategies. Specifically, environmental cues can be employed to help reduce the variation in and length of meal duration and to increase table turns.

All of the hypotheses in this study were supported by the findings; however, the detailed results provide insight regarding specific cues that affect the revenue management variables of meal duration and table turns. Brighter lights and colors, an open kitchen, and a noisier setting (i.e., Interior Layout) did not appear to affect average meal duration but they did serve to decrease the range of meal duration and they increased the number of table turns. A decrease in the range or variance in meal duration facilitates restaurant owners predicting the value of actual meal duration. This information increases the accuracy of predictions of table availability for reservation decisions. A higher frequency of table turns means that more customers can be served given the fixed capacity of a finite number of tables in a restaurant.

Increases in the volume and tempo of music (i.e., Music) appeared to have different effects from those of Interior Layout. While louder and faster paced music decreased average meal duration, it did not seem to affect the variance in mealtime (i.e., range) or the number of table turns. With respect to meal duration, however, the effect of Music was smaller in magnitude than the effect of Interior Layout on the other dependent variables, range of meal duration and table turns, suggesting that Interior Layout may be a more important factor in restaurants. Future studies should examine the interior layout cues and musical cues to explore possible relationships with other factors such as type of restaurant, etc.

### **Implications for Practice (“so what?”)**

In practice, this study confirms that owners and managers of a restaurant should examine the fit between their goals for table turns and meal duration and the environmental cues present in their restaurant. They may be able to change certain aspects of their business such as the color, lighting, and music to better fit their goals. At the margin, they may be able to reduce meal duration and increase table turns to increase their sales revenue while not decreasing their customers' level of satisfaction.

In fact, environmental psychology presents small business owners and managers of any type small business with an opportunity to improve their revenue management practices. The owner/manager should walk up to the front door of his or her business, and step inside while observing how the environmental cues of his/her business may stimulate customers. Do the physical surroundings present customers with cues that stimulate them to come in, stay, and explore the services and merchandise, and spend money? Do these cues and the business's goals for customer service times match, i.e., are cues signaling customers to leave when the business wants them to linger (e.g., a bookstore)? Adopting the perspective of a customer and continually seeking input from customers and front line associates regarding the effectiveness of various levels of environmental cues are critical activities for the small business owner.

Small business owners/managers should use a checklist consisting of external items (e.g., size, color of building, entrances, signs), interior items (e.g., color schemes, lighting, music, cleanliness), layout and design items (e.g., space design and allocation, waiting areas, traffic

flow), and point -of-purchase items (e.g., displays, signs). They should then assess the match between business goals for customer service times (e.g., desire customers to linger, such as in a bookstore, or to pass through quickly, such as in a convenience store) and the use of environmental cues (e.g., lighting, music, colors). In this way, the physical context and environmental cues provided by a business setting become more than just upkeep but a means of attracting customers and an opportunity to improve the business.

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**Table 1**  
**Descriptive Statistics for the Dependent and Independent Variables**

| Variable               | Theoretical Range | Actual Range   | Mean  | Median | Standard Deviation |
|------------------------|-------------------|----------------|-------|--------|--------------------|
| Average Meal Duration  | NA                | 15.00 - 150.00 | 64.01 | 60.00  | 28.83              |
| Number of Table Turns  | NA                | 0.50 - 19.00   | 3.10  | 3.00   | 3.00               |
| Range of Meal Duration | NA                | 20.00 - 190.00 | 58.67 | 50.00  | 31.39              |
| Interior Layout        | 1.00-7.00         | 1.00 - 7.00    | 2.88  | 2.75   | 1.31               |
| Music                  | 1.00-7.00         | 1.00 - 7.00    | 3.20  | 3.25   | 1.44               |

**Table 2**  
**Simple Regression Analysis**

**Panel A: Dependent Variable - Average Meal Duration**

| Independent Variables | Regression Coefficient | t for coefficient | F for Equation | Adj R <sup>2</sup> |
|-----------------------|------------------------|-------------------|----------------|--------------------|
| Interior Design       | -.28                   | -1.76*            | 3.10*          | .05                |
| Music                 | -.25                   | -2.75***          | 7.54***        | .06                |

**Panel B: Dependent Variable - Range of Meal Duration**

| Independent Variables | Regression Coefficient | t for coefficient | F for equation | Adj R <sup>2</sup> |
|-----------------------|------------------------|-------------------|----------------|--------------------|
| Interior Design       | -.32                   | -1.99**           | 4.00**         | .11                |
| Music                 | -.02                   | -0.20             | 0.41           | .00                |

**Panel C: Dependent Variable - Number of Table Turns**

| Independent Variable | Regression Coefficient | t for Variable | F for Equation | Adj R <sup>2</sup> |
|----------------------|------------------------|----------------|----------------|--------------------|
| Interior Design      | .39                    | 2.57***        | 6.62***        | .13                |
| Music                | .15                    | 1.62           | 2.61           | .02                |

Level of significance \*\*\* =  $\leq .01$ ; \*\* =  $\leq .05$ ; and \* =  $\leq .10$

# WOMEN ANGEL INVESTORS: THE ABCs (ACTIVITIES, BARRIERS and CONCLUSIONS)

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## ABSTRACT

Women have become a growing financial power within the United States and are becoming active in the equity financing of entrepreneurial ventures. To gain a better understanding of the emerging women angel market, research was conducted at the women angel organizational level. Fifty-eight percent of the women angel organizations in the US participated in the study, representing 300 women angel investors in 2003. Based on an analysis of the results several implications emerge. It appears that women angel groups provide a much needed venue for women entrepreneurs to pitch their business concept, with a third of the businesses being women owned or operated, three times larger than in the general angel population. In capital commitments the women angel groups in the survey had fewer investments than the general angel groups, but the percent of investments that were allocated to women led ventures were double the national average. When controlled by gender, the yield rate for women-led ventures lagged behind the general yield rates for women angel organizations. In general, women angels are active, they invest in a wide range of industries, and they provided a much needed venue for women entrepreneurs seeking equity capital. However, significant barriers exist, including investment inexperience, professional business inexperience and the inherent consequences for angel investing since the majority of the wealth is inherited. This research points to some significant market needs, including additional research on the investment process of women angels, developing educational forums for women angel investing and facilitating the development of women angel networks.



## **INTRODUCTION**

There is a limited amount of research on the business angel market, yet it is well known that angels provide the majority of seed and start-up equity capital to high growth entrepreneurial ventures in the United States. This lack of understanding of the early stage equity financing of high growth ventures exacerbates the inefficiencies in the angel market and contributes to the capital gap. More importantly, there is a paucity of research on the role of women as angel investors, even though women are developing an increasing presence in the angel market.

Women have become a significant and growing financial power within the United States over the past twenty years. Women comprise 47% of all individuals with assets over \$500,000 (U.S. Labor Department, 1997). From 1996 to 1998 the number of wealthy women, defined as having investable assets of \$500,000 or more, grew by 68% while the number of wealthy men grew by only 36% (Merrill Lynch & Cap Gemini Ernst and Young, 2002). Women now control over 51% of the private wealth in the United States (Federal Reserve) and among top wealth holders in 1995, the average net worth for women was \$1.38 million, slightly higher than for male wealth holders, and the women carried less debt (IRS, 2001). These statistics indicate that women have attained significant financial power, and therefore have the wealth required to become major players within the realm of equity financing of entrepreneurial ventures. But are women considering membership in private equity organizations as an investment option? Of the over 200 angel organizations operating within the U.S., only 19 organizations are significantly affiliated with women. How are the women that are involved as angel investors participating? What are the underlying incentives and disincentives for women to become involved as angel investors?

Some of these underlying issues can be identified by analyzing the formation, structure and investment experiences of women affiliated angel organizations that do exist. How and why have these organizations formed? How are they administered and how active are they? What industries do they invest in and how is the investment decision made? The following research answers these questions and addresses the underlying implications of the findings on the future role of women as angels.

## **METHODOLOGY**

Data was gathered using a combination of postal questionnaires and phone interviews. Organizations were targeted based on historical information indicating a membership of at least 25% women, or organizations which had at least 25% of entrepreneur presentations made by ventures with a female member on the management team. For this latter category, if at least 25% of the firms making presentations in a year were women led, then the corresponding angel organization was a potential respondent. The historical data used to identify these organizations was gathered from previous research conducted by the Center for Venture Research (Sohl, 2003). A primary contact (the executive director, board chair or president) at each organization was identified and this individual completed both the postal questionnaire and the phone interview. Questions for both the postal questionnaire and phone survey were developed with the goal of gathering information about the organization's structure and membership, as well as quantitative data related to historical investments. Phone survey questions and open ended questions on the postal survey were designed to capture the values, attitudes and beliefs of the respondents on the subject of women angels. Results were compiled and analyzed by the Center for Venture Research.

A comprehensive postal and phone survey was distributed to 25 organizations that appeared to meet the inclusion criteria for the study. Of these 25, a total of six were found to not be angel groups. Of these 19 organizations, 11 participated in the study, representing a response rate of 58%. The angel organizations surveyed represented 236 women investors in 2002, and 292 women angel investors in 2003. It should be noted that this research represents the first study of women angel investors and as such is exploratory in nature. The statistics reported are descriptive and based solely on the 11 respondents. It is important to note that this study is limited to investments made by angels that are members of organizations and does not include individual angels. These individual angels represent a larger proportion of the angel market. Thus, given the small sample size and the restriction to angel groups, the ability to generalize the results to the population of women angels is restricted. However, the high response rate (58%) and the number of women investors (292) represented by the organizations both lend support to the potential value of the descriptive statistics.

### **ORGANIZATION STRUCTURE AND FORMATION**

Seventy three percent of the organizations that responded were formed as entirely new entities, while the remaining groups formed as new entities derived from another organization. Half of the groups are comprised of 100% women. Of these, all stated that one of the reasons that the organization formed was to encourage more women to become involved as investors. A majority of the groups indicated that the reason for forming was to provide support to women entrepreneurs.

The majority of the responding angel organizations have chosen to organize as non-profit entities and to have affiliations with external private equity organizations. These external relationships are a common practice for angel organizations, which often partner with venture capitalists or other angel groups for both increased deal flow and potential sources of additional funding. In describing their modus operandi, the responding women angel organizations are split between those who meet regularly to review investment opportunities and ones that facilitate the angel investment process by organizing meetings or events that include angel investors and entrepreneurs. These types of organizational structures are also prevalent in the more general angel population. All of the organizations had a net worth requirement for membership, most common being that their members are accredited investors. Many organizations include an additional layer of membership requirement, such as past investment experience, the ability to pay membership fees or industry specific expertise.

It is interesting to note that the responding women angel groups differ with respect to the source of investment capital. The majority of the groups obtain investment funds on an individual basis, while the rest have a pooled fund from which investments are drawn. Most of the organizations conduct educational seminars for angel investors, while some conduct seminars for entrepreneurs. Of the respondent contacts interviewed, half felt that women face a barrier as angel investors due to their lack of experience and knowledge as investors in general. It appears that women angel organizations are trying to develop their members by offering educational opportunities. However this practice only addresses the women who have already joined the organization and not potential women angel investors outside of the groups.

## INVESTMENT ACTIVITY

The majority of the organizations surveyed note that their primary method for identifying investment opportunities is networking. This indicates that women use social contacts to learn about potential future investments. This preference for personal connections when considering potential investments is in line with the characteristics of most angel groups, angel investors in general prefer to rely on personal or social connections for deal flow. The notion of social capital, or the value associated with a given person's network, is relevant on both sides of the angel investment relationship. However gender may have an impact on this notion to the degree that women typically have different social networks than men do. The results on this social dimension are mixed, with 30% of the contacts interviewed indicating that they feel women face a barrier as angel investors because they are on the outside of traditional social networks, and others believing that women are at an advantage because they have better access to women entrepreneurs and women-led deals. While women may interact within different networks, leading to the possibility of losing deals with entrepreneurs who move in traditionally male dominated social circles, women in angel groups may have better access to deals where the business is led by a woman or a woman is a member of the management team.

On average, each women angel organization had 32 firms present their business concept to their membership over the course of 2002, of which 33% were women owned or operated. In 2003, on average about 28 firms presented and 32% of these firms were women owned or operated. In comparison to all angel groups, these figures indicate that women angel groups

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Figure 1 about here  
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appear to be attracting more women owned and operated firms than angel groups overall. However, the degree to which women angel groups miss opportunities or deals due to their lack of a presence within traditional networks can not be measured.

Of the women organizations that actively considered investments in 2002, 86% made an investment, resulting in an overall average of 4.1 investments per organization for 2002. Of these investments, 10.5% were in women owned or operated firms. In 2003, of the organizations that actively considered investments, all did so and made an average of 2.8 investments, per organization, for the year. Of these investments, 13.3% were in women owned or operated firms. These investment patterns are similar to those of all angel groups during the 2002-03 time period. The one notable exception is that in 2003, while the women angel groups in the survey had fewer investments per group than the general angel groups, the percent of investments that were allocated to women led ventures by the respondents were double the national average.

The yield (acceptance) rate is defined as the percentage of investment opportunities that are brought to the attention of investors (by the angel organization) that resulted in an investment. For the overall angel market, based on data collected in previous research by the Center for Venture Research (Sohl, 2003), market yield rates were 7.1% in 2002, and yield rates for women-led ventures were 5.2% for the same time period. For the women angel organizations of this study, yield rates for all investment opportunities, regardless of gender, were 9.9% in 2002 and 8.2% in 2003, similar to the general angel population. However, for women-led ventures presenting to women angels, the yield rates were 6.2% in 2002 and 5.6% in 2003. It appears that in both years yield rates for women-led ventures lagged behind the

general yield rates for women angel organizations, although this gap is less pronounced in 2003. Since the percentage of women presenting to women angel groups is three times as large as the number presenting to all angel groups, this lag in yield rates is even more prominent.

For the investments made, 65% were made in seed and start-up ventures in 2002 and 56% were in seed and start-ups for 2003. This is a key point because in general angel groups have decreased investments at the seed and start-up stages in order to allocate dollars to later stage investments as follow-on financing. For the general angel population seed and start-up investing accounted for 50% of total investments in 2002 and 52% in 2003.

The findings for the women groups in this study indicate that women may be filling a critical gap in the development of new firms by choosing to invest at earlier stages. The United States has a critical need for seed and start-up capital and if women are inclined to invest at this stage, they will both be meeting an economic need and exploiting a potential for high returns by electing a riskier investment position. However, the results of the study could be explained by the fact that 90% of the women's angel organizations are within the first four years of their life and may not have had an opportunity to provide follow-on rounds of financing to existing portfolio companies.

In terms of the industries or sectors in which women angel organizations invested, there was a fairly diversified representation and even dispersion. This indicates that women angel investors are not concentrating their efforts into one sector and are diversifying their investments appropriately. The results indicated that the majority of investments were in the high tech sector with manufacturing and software receiving the largest percentage of investments. One notable point is that the investment in the retail segment is significantly higher for women than for all angel groups overall. Research conducted by the Center for Venture Research (Sohl, 2003) identifies, for 2002, that for all angel groups, retail investments comprised only 5.5% of all investments, while the women angel groups invested 12.5% in retail.

When asked why they believe women angel investors do not make more angel investments than currently reported, the survey respondents stated that the primary reason was that women angels lack the early-stage investment experience. Respondents also stated that they believe women lack experience in pricing and structuring the investment deal, and that women have a lack of experience in conducting due diligence and monitoring the investment. Some respondents indicated that women angels lack the funds needed to make more investments. Three out of the top four reasons given indicate that a lack of experience or knowledge of early stage equity investing is the most significant barrier preventing women angels from investing more actively. This response is consistent with the findings of the telephone survey, where half of the respondents stated that a significant barrier for women angels is a lack of investment experience or knowledge. In the general workplace women are still struggling to attain professional parity with men in the fields of finance, accounting and investments. Consider that 75% of the workforce in the banking industry is comprised of women, but only 25% of these women hold executive level positions within the industry (Sraeel, 2003). Gender differences and biases in professional fields may have resulted in a current female population that is less skilled as investors, which in turn may require women angels to spend more time on education and development than their male counterparts.

Angels often indicate that there are non-financial incentives for making investments in entrepreneurial ventures. In terms of the non-financial aspects of the investment, women respondents indicated the biggest non-financial motivator for women angels was the desire to assist women entrepreneurs. This response was followed by the feeling of social responsibility, the desire to assist entrepreneurs in general and the opportunity to increase the access to capital for women entrepreneurs. These findings indicate that women angels are motivated by the chance to help other women to succeed in their ventures, given that the potential investment meets their financial criteria.

## **BARRIERS AND ADVANTAGES FOR WOMEN ANGELS**

The differences between men and women as investors are significant. A Simmons Market Research Bureau study released in 2000 revealed that women investors are both fewer in numbers and tend to be more conservative in their investment choices (Whelan, 2001). How are women angels at an advantage or disadvantage as investors? To address these issues phone interviews were conducted with the individual respondents. A third of these individual respondents interviewed felt that women are at a disadvantage as angel investors because their sources of wealth are more often inherited than earned. Women angels who have inherited their wealth may not have the professional experience or credibility of investors who have created their own wealth. Additionally, individual respondents felt that women are at a disadvantage as angel investors because they tend to be more risk averse by nature, leading to missed investment opportunities in riskier deals.

However, respondents feel that women angels also possess significant advantages as investors. Nearly half of the individual respondents stated that they see women as being better at research and more willing to ask questions and seek information when considering an investment. Also, many believe that women are more inclusive and approachable, willing to look at deals that might have been overlooked by other investors. A number of respondents also felt that women are more patient than men, which translates positively to deals that have long exit horizons, which are quite common for angel investments. Women are not expecting immediate results and are willing to nurture the investment over its life. Finally, half of the respondents felt that women are less ego driven and can work more collaboratively as investors. One respondent illustrated this difference when describing two meetings, one of male angels and one of female angels. In the male angel meeting, members frequently interrupted each other and competed for time to prove their ideas. Also, several of the men seemed to dominate the discussion. In the meeting of women angels, the members shared the speaking time, did not interrupt each other, and no one person dominated the speaking time. Personality differences in men and women seem to have an effect on the way angels interact as investors. It appears that the ability to work collaboratively and in a supportive way would have a positive effect in the area of angel investing, where much of the skill involves working with and supporting entrepreneurs.

## **FUTURE OUTLOOK FOR WOMEN AS ANGEL INVESTORS**

It appears that women face significant barriers as they consider the option to become involved as angel investors within angel groups. It is clear that a significant number of women have the wealth required to become involved, but the fact that women are still to a large extent on the outside of traditional networks, networks which often serve to spread awareness to potential angel investors, indicates that women may not even be aware of the opportunity to become involved as angel investors. Fortunately, the lack of awareness can be

addressed by educational movements. Nearly half of the survey respondents suggested that well publicized success stories of women angel investors would be the best way to assist the future growth and development of the women's angel market. A third of the respondents also suggested that the best way for women to overcome barriers as angel investors is to form special forums or organizations to help women learn the skills they need and to learn how to become involved. Some women angels suggested that promoting the concept of angel investing through social networks would raise awareness. Strategic communications initiatives are both possible and essential in order to increase the number of women who are involved as angel investors. Continuing and targeted education programs will help to ensure that any increase is sustainable over the long term.

Women may also face a bias if their wealth has been inherited versus earned, or if they do not have enough relevant professional and investment experience to be considered valuable to general angel organizations. Fortunately women are making great strides in attaining higher education, professional positions and roles as business owners and community leaders. Over half of women today are earning college degrees, one third more than men. Fifty percent of law graduates today are women and 40% of MBA graduates are women (Barletta, 2003). According to the U.S. Economic Census, the number of women-owned businesses has increased by 16% and the revenues from those businesses have increased by 33 % since 1992 (Brush, 2001). In comparison, the number of all U.S. firms grew at a rate of 6% with a 24% increase in revenue (Brush, 2001).

## CONCLUSION

The research findings indicate that the women angel organizations that do exist are active and invest in a wide range of industries and sectors. Women angel groups are motivated by the desire to attain financial returns, but also have a desire to assist women entrepreneurs in growing their ventures. It was also found that women angel organizations have invested primarily in seed and start-up ventures which indicates that women angels are filling a critical gap in the financing of entrepreneurial ventures.

Women still face barriers in the private equity community, related to their investment inexperience, professional inexperience and inherited wealth. As women continue to make progress professionally and socially some of these barriers may be overcome. As women continue to advance themselves, it will be essential to provide ways to educate and promote the concept of angel investing to women. The subject is largely uncovered territory for women and there is no established network for communicating the opportunities that exist for women angels. Facilitating the development of women networks, both formal and informal, the development of educational forums, and an improved understanding of the investment process of women angels will help in accelerating the development of a sustainable women angel market. For the number of women angels to grow in the future, targeted research, and educational programs must be employed in order to raise awareness and promote understanding.

**Acknowledgements:** The authors would like to thank all the survey participants who generously gave their time to respond to our survey and to participate in the personal interview portion of this research. We would also like to especially thank Becca Nealis for her valuable assistance in data collection and her work on the initial draft of the paper. This research was funded through grant # 20032172 from the Ewing Marion Kauffman Foundation.

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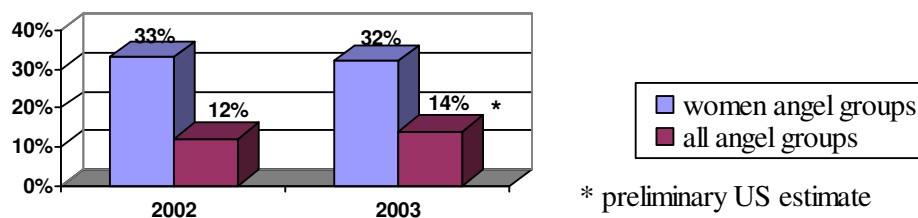
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Figure 1: Percent Women Entrepreneurs Seeking Capital



The Effectiveness of Information Provided by SCORE's Email Counseling  
To Nascent and Small Business Owner-Managers

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Entrepreneurial Counseling



The Effectiveness of Information Provided by SCORE's Email Counseling  
To Nascent and Small Business Owner-Managers\*

**ABSTRACT**

The literature on external sources of assistance to small business has not devoted much of its empirical discussion to examining the role of the SCORE, an organization of volunteer retired executives, who are frequently important advisors to small businesses. The literature is absent in regard to examining whether SCORE counseling, especially online through their web counseling program is effective based on the feedback received from online clients. Based on a sample of almost 2000 online clients who responded to an online survey in 2004, data were analyzed to determine what differences, if any, existed among client perception of the effectiveness of the information provided. Specifically, did the information help them in deciding to start a business, expand their existing business, or deal with problems in their existing business?

**LITERATURE REVIEW**

**Introduction**

Individuals, whether they are considering going into business (i.e., nascent), or they already are small business owner-managers, need information, capital, skills, and labor to start business activities. They seek advice on a variety of topics, including advertising, marketing, promotion, human resources, personnel matters, legal questions, accounting, bookkeeping, taxes, management practices or business strategy, industry-specific technical matters, computers, software, websites, telecommunications, loans, financial analysis or cash management, evaluation of prospective purchases or business investments, a government rule or requirement not including taxes, and business layout or design (Dennis, 2002).

These individuals, nascent or existing small business owner-managers, who generally seek advice or use professional advisors, have a greater chance of either starting a business or sustaining their own business than those individuals who do not seek and use informal advisors and informal sources of advice. Because there is no generally accepted set of reasons why businesses fail or succeed, advice from counselors has significant value (Lussier, 1995). In addition, research by Fann and Smeltzer (1989) indicates that the frequency with which small business managers use information sources is positively related to the firm's sustainability.

How do individuals go through the process of seeking and using advisors and sources of advice? The willingness to accept one's limitations, seeking advice and the use of advisors' and implementing the advice solicited will be discussed in turn.

Willingness to accept one's limitations. Solomon and Fernald's (2000, 1999) research examined issues surrounding the entrepreneur's

\* The authors wish to thank the National Office of the SCORE Association for access to the data

willingness to accept their limitations and their perception of the need for and usefulness of external sources of assistance, as well as its impact on the observable behavior of the entrepreneur in actively seeking assistance rather than passively accepting assistance offered by others. Their research indicated that regardless of growth status of the business, the issue is whether the entrepreneur will actively seek external assistance or passively wait until there is a crisis demanding their attention.

Seeking advice and use of advisors. Solomon, Dennis and Fernald (2004) research indicated that small business owner-managers solicit advice from a wide variety of sources outside the business. Unpaid advice often comes from bankers; paid advice often comes from accountants and lawyers, as well as consultants and engineers (Phillips, 2002). Owner-managers are able to call on the experience and objectivity of the professionals. Accountants are able to offer general advice to matters that need consideration in providing for management continuity (Dimsdale, 1974).

For an established small business the most valuable asset an outside advisor brings is objectivity. They may be able to devise a plan for the firm that is not affected by internal politics and conflicts, giving the firm a more viable chance at success. Professional management consultants can bring advice beyond that obtainable from any single individual and can devote their full attention to one specific problem, as well as assist in implementing the plan (Dimsdale, 1974). Small business owner-managers tend to use informal sources more frequently than formal sources except after the business is established (Fann & Smeltzer, 1989).

#### Implementing the advice solicited.

Soliciting advice does not necessarily mean that the advice is adopted or implemented. Suggestions and/or recommendations can be rejected for many reasons, legitimate and not. There are different ways to look at rejection of solicited advice. One is that when owners-managers solicit more sources of advice, they are more receptive to advice generally. If they are more receptive, they are more likely to implement the advice that they receive. An opposing perspective can be put in the following terms: because those who are consulted first are presumed to be most able to help, the more widely a family business owner-manager seeks advice the more likely it is that the advice increasingly will be ill-fitting or inappropriate (Solomon and Fernald, 2000, 1999). Thus proportionately, they are more likely to reject it. Two sources of small business advice not previously mentioned are the SCORE and SBDC programs.

#### SCORE and SBDC

Many new start-ups and nascent entrepreneurs turn to professional advisors and counseling programs for assistance and guidance (Barnes, 1988). Two programs of the US Small Business Administration (SBA) in particular – Senior Corps of Retired Executives (SCORE) and the Small Business Development Centers (SBDCs) offer counseling services, with their various sub-centers and chapters in many locations throughout the United States, and are willing to visit the client's workplace when necessary (Chrisman, Gatewood, & Donlevy, 2002). Chrisman and Katrishen (1995) found that the clients of the Small Business Development Center (SBDC)

program increased sales and employment significantly more than they would have if no assistance had been received. Nahavandi and Chesteen (1988) also reported that business managers were highly satisfied with the services received from a particular SBDC and that consulting had a positive impact on their businesses.

### The Internet as a Knowledge Sharing Medium

As Internet connectivity has expanded globally to even very remote places, virtual communities are gaining prominence. First, they bring together people in a cost-effective manner. Instead of organizing expensive face-to-face consulting engagements, conferences, workshops, and courses, an organization, private or public, can achieve many of the same goals by linking participants electronically to each other and to a wealth of online resources. An example of this is “The World Links for Development” (World) program, which provides Internet connectivity and training for teachers and students in developing countries.

SCORE’s attempt to use the Internet to provide real-time counseling to assist small business owner-managers is one of many new innovative approaches SCORE is piloting in cooperation with the US Small Business Administration (SBA) in order to expand and assist SCORE’s outreach to the small business community, nascent start-up and early business ventures. The idea of creating a platform to allow small business owners to 24/7 access and to share knowledge is a key component of knowledge management. A website providing online counseling is both the process and outcome of a virtual community. It can be dynamic and promote knowledge sharing between and among members. Above all, a community website, such as SCORE’s, reflects and incorporates the growing knowledge base of that community and the learning that is taking place.

One person or a group of persons, SCORE’s email counselors within a knowledge community, must play the role of coordinator/facilitator/moderator. These individuals are responsible for addressing inquiries, encouraging participation, animating discussion, exercising leadership if needed, and so forth. These tasks can be labor-intensive but, without an effective, energetic, and diplomatic facilitator, it is very unlikely a virtual community can succeed. SCORE and its cadre of email counselors took the role of developing the site and playing the role of facilitator.

Based on the literature and the absence of any empirical studies linking online knowledge transfer vis-à-vis counseling to the small business community, the national SCORE Association sought to survey its clients to ascertain their view on the usefulness and effectiveness of their email counselors. The authors obtained the results of the survey to examine more closely whether or not particular subsets of the total sample viewed the usefulness and effectiveness of the service received differently. As such, six hypotheses were developed.

### Hypotheses

H1: Those seeking advice on starting a business will perceive SCORE email counseling as more useful than will those seeking advice on operating problems of an existing business or expansion of an existing business.

- H2: Those seeking advice on starting a business will perceive SCORE email counseling as having greater capacity to assist them than will those seeking advice on operating problems of an existing business or expansion of an existing business.
- H3: Those seeking advice on starting a business will perceive SCORE email counseling as easier to work with than will those seeking advice on operating problems of an existing business or expansion of an existing business.
- H4: Those seeking advice on starting a business will perceive SCORE email counseling as more current on today's business environment than will those seeking advice on operating problems of an existing business or expansion of an existing business.
- H5: Those seeking advice on starting a business will perceive SCORE email counseling as being more knowledgeable than will those seeking advice on operating problems of an existing business or expansion of an existing business.
- H6: Those seeking advice on starting a business will perceive SCORE email counseling as meeting their needs better than will those seeking advice on operating problems of an existing business or expansion of an existing business.

## **METHODOLOGY**

Community Research, Inc. (CRI) was engaged by the National SCORE Office (NSO) to conduct research among its clients that had recently received email services from their SCORE counselors. SCORE had developed and provided to CRI its survey for posting online. The survey was then formatted for the online system to enable SCORE clients to take the survey from any location nationally that has a connection to the Internet.

SCORE clients were requested to take the anonymous survey via an email link sent to them by their counselors. Taking the survey was voluntary. No incentives were offered to the respondents in order to receive their opinions. During the fourth quarter of 2003, 2,000 responses were received, thereby producing a low statistical margin of error of just 2.2% +/- . What the margin of error percentage means statistically is that the chances are 95 out of 100 that if every respondent in the selected population had taken the survey, the results would not differ more than the indicated margin of error percentage.

## **FINDINGS**

Each of the six hypotheses were analyzed using SPSS PC+ analysis of variance (ANOVA) as we were examining mean differences among the three client types – those seeking advice in: a) starting a business, solving operational problems in their business and expanding their business in relation to the perception to a group of six attitudinal interval data sets using a 5-point Likert scale with 1=Highly Effective, 2= Effective, 3= Neutral, 4= Ineffective and 5= Highly Ineffective.

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Insert Table 1 here

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The mean for the client group seeking assistance on deciding whether or not to go into business had a lower mean (2.04), indicating a higher perceived level of effectiveness regarding the usefulness of SCORE's email counseling than those seeking advice on operating problems in an existing business (2.22) or expansion of an existing business (2.44). [Descriptive statistics are available from the first author.] The data showed that the differences between and within the three groups were significant at the .01 level. Further analysis using ANOVA's post hoc function indicated that indeed the client group seeking assistance on deciding whether or not to go into business mean was statistically significant than those seeking advice on operating problems of an existing business (-.16 at the .05 level ) or expansion of an existing business (-.39 at the .01 level). Therefore, we accept H1.

The mean for the client group seeking assistance on deciding whether or not to go into business had a lower mean (2.06), indicating a higher perceived level of effectiveness regarding SCORE's email counseling capacity to assist than those seeking advice on operating problems of an existing business (2.21) or expansion of an existing business (2.45). The data showed that the differences between and within the three groups were significant at the .01 level for Hypothesis 2. Further analysis using ANOVA's post hoc function indicated that indeed the client group seeking assistance on deciding whether or not to go into business mean was statistically significant than those seeking advice on operating problems of an existing business (-.15 at the .05 level) or expansion of an existing business (-.38 at the .01 level). Therefore we accept H2.

The mean for the client group seeking assistance on deciding whether or not to go into business had a lower mean (1.94) indicating a higher perceived level of effectiveness regarding SCORE's email counseling capacity to assist than those seeking advice on operating problems in an existing business (2.04) or expansion of an existing business (2.31). The data revealed that the differences between and within the three groups were significant at the .01 level for Hypothesis 3. Further analysis using ANOVA's post hoc function indicated that indeed the client group seeking assistance on deciding whether or not to go into business mean was not statistically significant than those seeking advice on operating problems of an existing business (-.10 at the .122 level, but was statistically significant for the client group whose sought assistance with expansion of an existing business (-.39 at the .01 level). Therefore the mixed results do not allow us to accept or reject H3.

The mean for the client group seeking assistance on deciding whether or not to go into business had a lower mean (2.03) indicating a higher perceived level of effectiveness regarding SCORE's email counseling current knowledge of today's business environment than those seeking advice on operating problems in an existing business (2.15) or expansion of an existing business (2.43). Table 1 shows that the differences between and within the three groups were significant at the .01 level for Hypothesis 4. Further analysis using ANOVA's post hoc function indicated that indeed the client group seeking assistance on deciding whether or not to go into business mean was not statistically significant than those seeking advice on operating problems of an existing business (-.12 at the .057 level), but was statistically significant for the client group whose

sought assistance with expansion of an existing business (-.40 at the .01 level). Therefore, as in the previous hypothesis, the mixed results do not allow us to accept or reject H4.

The mean for the client group seeking assistance on deciding whether or not to go into business had a lower mean (1.96) indicating a higher perceived level of effectiveness regarding SCORE's email counseling being knowledgeable than those seeking advice on operating problems in an existing business (2.08) or expansion of an existing business (2.28). The data revealed that the differences between and within the three groups were significant at the .01 level for Hypothesis 5. Further analysis using ANOVA's post hoc function indicated that indeed the client group seeking assistance on deciding whether or not to go into business mean was not statistically significant than those seeking advice on operating problems of an existing business (-.12 at the .061 level), but was statistically significant for the client group who sought assistance with expansion of an existing business (-.43 at the .01 level). Therefore, again we are unable to accept or reject H5.

The mean for the client group seeking assistance on deciding whether or not to go into business had a lower mean (2.16) indicating a higher perceived level of effectiveness regarding SCORE's email counseling ability to meet the clients needs than those seeking advice on operating problems of an existing business (2.36) or expansion of an existing business (2.59). The data revealed that the differences between and within the three groups were significant at the .01 level for Hypothesis 2. Further analysis using ANOVA's post hoc function indicated that indeed the client group seeking assistance on deciding whether or not to go into business mean was statistically significant than those seeking advice on operating problems of an existing business (-.20 at the .01 level) or expansion of an existing business (-.43 at the .01 level). Therefore we accept H6.

## **CONCLUSIONS**

As the nascent population in the United States continues to expand and maintain its level of intense activity, the need for 24/7 knowledge portals become more critical. SCORE, a federally funded program directed by the US Small Business Administration, developed a strategy to meet this need by creating an email-counseling program on their web site [[www.SCORE.org](http://www.SCORE.org)]. The purpose of this paper was to report the results of one portion of an extensive national survey measuring how individual small business owner-managers perceived the effectiveness of the program services.

Based on the data analyses, Hypotheses 1, 2 and 6 were accepted. Those hypotheses dealt with looking at the cause and effect of client's perceived needs for using email counseling –deciding whether to start a business, handling operational problems in their businesses or handling issues dealing with expanding their businesses to how they rated the effectiveness or the usefulness of the email counseling, the capacity of the counselors to assist them and the meeting of their needs by the email counseling program. The ratings of the owner-managers deciding to start a business were higher, more statistically significant [higher rating] than were the ratings of the other two groups. All three groups, however, rated the overall effectiveness around 2.3 on a five point scale with 1= highly effective.

The other three hypotheses, 3, 4 and 5, were neither accepted nor rejected in that the client groups showed no marked difference in their perception of the effectiveness of the counselor ease of working with clients, possessing current marketing information and general management knowledge. As such, SCORE needs to examine its approach to email counseling, but should be encouraged by the results.

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**Table 1**  
**ANOVA**  
**Multiple Comparisons**

| Dependent Variable   | (I) Primary Reason for contacting SCORE                       | (J) Primary Reason for contacting SCORE                       | Mean Difference (I-J) | Std. Error | Sig. |
|--|---|---|-----------------------|------------|------|
| <b>Effectiveness of information you received from the SCORE Counselor relative to the Usefulness of the Advice</b>                                     | Assistance in deciding whether or not to start a new business | Assistance with problems about existing business              | -.16                  | .068       | **   |
|  |   | Assistance with the expansion to an existing business         | -.39                  | .080       | *    |
| <b>Effectiveness of information you received from the SCORE Counselor relative to the Counselor's ability to assist you</b>                            | Assistance in deciding whether or not to start a new business | Assistance with problems about existing business              | -.15                  | .067       | **   |
|  |   | Assistance with the expansion to an existing business         | -.38                  | .079       | *    |
| <b>Effectiveness of information you received from the SCORE Counselor relative to the Counselor's being easy to work with</b>                          | Assistance in deciding whether or not to start a new business | Assistance with problems about existing business              | -.10                  | .065       | .122 |
|  |   | Assistance with the expansion to an existing business         | -.39                  | .076       | *    |
| <b>Effectiveness of information you received from the SCORE Counselor relative to the Counselor's being current about today's business environment</b> | Assistance in deciding whether or not to start a new business | Assistance with problems about existing business              | -.12                  | .064       | .057 |
|  |   | Assistance with the expansion to an existing business         | -.40                  | .076       | *    |
| <b>Effectiveness of information you received from the SCORE Counselor relative to the Counselor's being knowledgeable</b>                              | Assistance in deciding whether or not to start a new business | Assistance with problems about existing business              | -.12                  | .066       | .061 |
|  |   | Assistance with the expansion to an existing business         | -.31                  | .077       | *    |
|  |   | Assistance in deciding whether or not to start a new business | .43                   | .085       | *    |
| <b>Effectiveness of information you received from the SCORE Counselor relative to the Assistance meeting your needs</b>                                | Assistance in deciding whether or not to start a new business | Assistance with problems about existing business              | -.20                  | .071       | *    |
|  |   | Assistance with the expansion to an existing business         | -.43                  | .085       | *    |

- \*= The mean difference is significant at the .01 level.
- \*\*= The mean difference is significant at the .05 level.



# DEFINING “MINORITY BUSINESS” IN THE UNITED STATES AND IN EUROPE

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## ABSTRACT

This paper discusses the concept of minority business and related definitional issues, and then examines a recent major change in the definition of such businesses made by the National Minority Supplier Development Council, the principal link between large US corporations and the minority business community. Under this NMSDC policy change, and in contrast to long-established federal guidelines, certain companies with as little as 30% minority ownership can still be certified as “minority controlled” and thus be eligible for corporate minority-targeted purchasing programs. The discussion is then extended to the European context – the rise of immigration and the related increase in ethnic minority business enterprises, the current nature of public policy toward such enterprises in terms of programs and legislation, and the implications of the US experience for Europe. Finally, future issues with regard to European ethnic minority enterprise are raised, along with areas for future research focus.

## INTRODUCTION

Defining the concept of a “minority business” is a complex task. On the surface, it would seem that a business owned solely, or at least primarily, by members of a ‘minority’ group would constitute a “minority business.” Yet various arguments have been made that build upon or modify this seemingly simple definition, and even the basic terminology is open to debate. In the United States “minority businessperson” and “minority business” are the generally-used terms, while in Europe variations of “ethnic entrepreneur” and “ethnic enterprise” are more commonly used (Gunaratnum, 2003). (In this paper, these terms will be used interchangeably.)

While most of the literature relies on the minority or ethnic *grouping* of the business owners to identify a minority or ethnic business, some researchers argue that the minority or ethnic grouping of the business owners is less meaningful than the minority or ethnic community context of the business and/or the involvement of the business owners in that community, and that it is important to differentiate between minority business owners who are heavily involved

with the minority community and those who are less involved or not at all involved (Chaganti & Greene, 2002; Gunaratnum, 2003).

Recent analyses add further complexity to this issue, developing a “mixed embeddedness” perspective. This conceptualization considers a variety of contextual factors, including business sector, geographic locality, labor markets and institutional situation, to define a minority or ethnic business (Ram & Smallbone, 2003a).

## **THE AMERICAN DEFINITION**

The need for a definition of a “minority business” in the United States derives from the economic and social policy assumption that such businesses are both an important component of the U.S. economy and strengthen the social fabric of the country, and that the development of such businesses is therefore a desirable policy objective. And in order to assist and develop minority businesses, it is necessary to know what they are and who they are.

The development and support of minority businesses has been an objective of both the public and private sectors in the United States since the late 1960s, with the federal government taking the lead in this effort to develop such programs, primarily within the Office of Minority Business Enterprise (now the Minority Business Development Agency) and the U.S. Small Business Administration (Whistler & Wichmann, 1979; Sonfield, 1997; <http://www.mbda.gov>; <http://www.sba.gov>).

In response to economic, ethical and political pressures, many large U.S. corporations in the 1970s and 1980s initiated efforts to increase the number of minority and women-owned companies as suppliers of the goods and services they purchase. These corporations established their own programs within their procurement departments and joined with other big businesses to form minority procurement coordinating groups to act as clearinghouses between small minority firms and large corporations (Gupta, 1992; Fitzgerald, 1995; Morgan, 1995; Klimley, 1996; Sonfield, 1997).

In the 1990s, these public and private programs received both praise and criticism (Bates, 1997, 2001; Cavalluzzo & Cavalluzzo, 1998; Freeman, 1994; Theodore, 1995; Waldinger & Bailey, 1991). During this period, US Supreme Court rulings set tough new legal standards for federal, state and local government minority assistance and set-aside programs, and both President Clinton and many state and local politicians issued executive orders to constrain or halt these programs. These new legal standards require a minority business seeking affirmative action assistance to document that it faces discrimination or other concrete barriers and furthermore that the business is fully able and willing to compete with current non-minority business suppliers (LaNoue, 1994). On the other hand, most *corporate* programs were not impacted and remained strong (Holmes, 1995, 1996; ‘Many Minority,’ 1995; Kirk, Franklin & Robinson 1996; Sonfield, 1997).

Currently, in order to insure that these U.S. governmental and private programs are successful in assisting minority and women-owned businesses, most utilize formal definitions of such ownership. Central to the federal definition, and virtually all other public and private sector

definitions as well, is that at least 51% of the firm be directly and unconditionally owned by one or more members of a minority group. Often the term “minority” is now replaced by “socially disadvantaged,” but the listing of such groups clearly involves minority status: African-Americans, Hispanic Americans, Native Americans (American Indian, Alaska Native), and Asian Pacific Americans (<http://www.sba.gov>).

This listing of groups includes most, but not all, recognized minority groups, and thus enables both governmental and private sector programs to target and assist eligible existing and potential minority businesses. Each of the above groups (except Native Americans) includes both U.S.-born and first-generation immigrant business owners (for example immigrants from Latin America, the Caribbean, and Asia). U.S. policy does not differentiate between native-born and foreign-born minority individuals, as it assumes that both face barriers not faced by non-minorities and that assistance programs should benefit both groups.

Certainly these various public and private programs have proven effective. In the early years of federal and state programs aimed primarily at African-American-owned businesses, such businesses grew at a rate greater than that of the total economy (Sonfield, 1979). In more recent years, with “minority business” referring to *all* of the above-named groups, U.S. government data indicate that minority-owned businesses in general are one of the fastest growing segments of the U.S. economy (<http://www.mbda.gov>). As discussed above, this minority business growth includes businesses owned by both new immigrants and by U.S.-born businesspeople. The assumption underlying programs assisting all of these individuals and their companies is that they all face the same barriers, regardless of whether or not they recently arrived from another country, perhaps with some business experience, and that the development and growth of all of these companies is desirable social policy .

## **MINORITY BUSINESS IN THE U.S. ECONOMY**

The importance and value of minority business in the U.S. economy is well documented. The most recent federal economic census data (1997) place the number of minority businesses in the United States at a record high of 3,039,000 enterprises, and that number is growing at double the rate of all companies. These firms generate sales of almost \$600 billion, thus contributing significantly to the economy (<http://www.mbda.gov>). Various research studies over many years have further indicated that a healthy minority business sector is desirable for the nation, providing a variety of economic and social benefits, including minority employment, economic integration with the majority economy and community, community economic development, and role models for minorities and especially minority entrepreneurs (Green & Faux, 1969; Sonfield, 1986; Dadzie & Cho, 1989; Thompson & Hood, 1993; Light & Rosenstein, 1995; Edmondson & Carroll, 1999). Thus the fostering of both new minority businesses and the growth of existing minority businesses is a desirable component of U.S. social and economic policy.

### **Re-Defining ‘Minority Business’ in the United States**

Although the 51% minority ownership U.S. guidelines may seem logical, in the 1990s certain problems with this definition of ‘minority business’ arose. Many minority owners of larger businesses complained that the 51% rule limited their ability to grow their companies. If a company was currently at or slightly above the 51% point of minority ownership, then further

funding could only come from an expansion of debt or from additional minority ownership. Similarly, even firms with 100% minority ownership were limited in the amount of new non-minority equity funding they could obtain. Most minority companies wanted to grow for the same reasons as any firm does; but an additional impetus arose for minority-owned suppliers as many large U.S. corporations in the 1990s chose, for efficiency purposes, to reduce the number of their suppliers to a group of fewer and larger firms.

In response to both the complaints from large minority firms looking for new equity financing and from major corporations looking for larger minority suppliers, a major minority-oriented organization shook up the minority business community by changing its definition of “minority business.” The National Minority Supplier Development Council (NMSDC) is a private organization which provides a link between large U.S. corporations and minority-owned businesses. Chartered in 1972, it is supported by 3500 corporate members, including most *Fortune 500* companies, which rely on the NMSDC’s evaluation process by which it certifies the ‘minority’ status of firms wishing to become eligible as suppliers to these large corporations. About 15,000 U.S. minority-owned businesses have been NMSDC-certified and in 2002 its corporate members reported \$72 billion in contracts with minority suppliers (<http://www.nmsdc.org>).

In 1999, the NMSDC proposed a change in its definition of a “minority business,” entitled the “Equity Capital Initiative.” (More recently the title has been changed to the “Growth Initiative.”) Basically, the NMSDC proposed to allow currently-certified minority-owned firms to sell equity to venture capital firms and reduce minority ownership to as low as 30% and still maintain NMSDC-certification as “minority-controlled.” The objective was to provide equity-funding opportunities to those minority firms that desired to grow in this manner.

However, this proposal proved to be much more controversial than the NMSDC expected, with many minority organizations voicing strong opposition to the proposal, arguing that it would erode the concept of affirmative action and not benefit most minority businesses. On the other hand, many large corporations supported the proposal, arguing that it would allow minority companies to grow and compete with larger white-owned firms. This, in turn, would also allow big corporations to satisfy their concurrent needs for larger and fewer suppliers *and* for minority-owned suppliers.

After a prolonged effort to ease concerns and opposition by emphasizing the safeguards built into this new definition of a minority business, the NMSDC approved and implemented this new policy in February 2000 with the following provisions: only currently-certified minority companies would be considered, and consideration would be on a case-by-case basis. Furthermore, minority interests would still have to maintain 51% of the *voting* stock, control of day-to-day operations, and have a majority of seats on the company’s board of directors (Schwab, 2000; Wynter & Thomas, 2000).

## **THE FIRST FIVE YEARS**

The NMSDC had high expectations for this significant change in policy. Minority firms with growth potential would be free to obtain the equity financing needed for such growth, without

jeopardizing their minority certification status and their eligibility to compete for minority-targeted supplier opportunities. It was expected that a good number of businesses previously certified by the NMSDC under the 51% definition of “minority business” would soon seek new equity financing and concurrently seek this new certification.

However, a number of economic and other business factors have worked against this happening. After the NMSDC’s Equity Capital Initiative implementation in 2000, the U.S. economy became much weaker than most experts had expected, with the slump in technology-based industries being especially strong. Thus, sources of venture capital financing largely dried up. Furthermore, with a weak economy, many minority companies that in 2000 envisioned significant growth potential for themselves in the next decade reduced their expectations considerably (Dingle, 2003, Long, 2003, 2004).

Rather than a surge in venture capital funding activity, the past five years have seen a significant number of mergers and acquisitions, including the acquisition and absorption of some of the largest minority-owned companies by much larger *Fortune 1000* corporations. This trend has resulted in some of the strongest minority-owned businesses losing their independence and minority status, a situation very different from the NMSDC’s vision of the Equity Capital Initiative as the appropriate mechanism for the support and growth of these strongest minority-owned companies, and the maintenance of their minority-controlled status.

Similarly, during these past several years, some large U.S. mainstream companies have taken an equity position in some minority-owned firms, often in the same industry. These equity positions have usually been less than 50%, thus allowing the smaller firm to keep its independence and minority status. While such corporate investments have created effective and profitable partnerships and joint ventures, few of these minority-owned companies have grown significantly as a result of the injected equity financing (Long, 2004).

In fact, as of mid-2004, only one company has been certified by the NMSDC under its Equity Capital Initiative. This company, En Pointe Technologies, Inc., headquartered in El Segundo, California, is a leading national provider of business-to-business information technology products and services, with fiscal year 2003 revenues of \$290 million and net profits of \$383,000.

In discussions with NMSDC and En Pointe officers, it is clear that the company’s top management had high expectations for their re-certification by the NMSDC. However, the company has found the benefits of this re-certification to be mixed. While the corporate members of the NMSDC understand that a potential supplier can be “minority-controlled” and yet have less than 51% minority ownership, most other potential customers of En Pointe, in both the private and public sectors, do not understand or do not recognize this change in ‘minority business’ definition and continue to use the more established definition of a “minority business” – a business that has at least 51% minority ownership. Thus, other than for NMSDC corporate members, En Pointe has had major difficulties in securing minority-targeted sales contracts from most large potential customers. Federal, state and local government agencies and offices are generally required to continue to use a 51% minority ownership guideline when awarding contracts under minority-targeted programs, and non-NMSDC member businesses in the private

sector simply do not understand the concept of “minority-controlled” as opposed to “minority-owned” and continue to use the 51% guidelines out of habit rather than requirement. En Point’s salespeople find themselves often having to try to educate potential customers about their “minority-controlled” status rather than simply sell the quality of their company and its products and services (Turner, 2003).

## **LESSONS AND IMPLICATIONS FOR THE UNITED STATES**

Clearly, U.S. minority-owned businesses that desire to grow, yet maintain their “minority” status, have some difficult choices facing them. Assuming that the U.S. economy is now improving and therefore provides future opportunities for growth, such businesses must consider alternative methods of financing growth, and the advantages and disadvantages of each alternative. To maintain traditional “minority business” status, the company must maintain at least 51% minority ownership, and therefore finance growth via debt and/or equity investment from current owners, other minority investors, or main-stream companies that will be satisfied with a less-than-50% equity position in the company. Yet, as recognized by the NMSDC (and thus the purpose of its Equity Capital Initiative), *major* growth usually requires greater additional funds than can be provided by these methods.

However, significant amounts of venture capital funding and subsequent re-certification by the NMSDC as a “minority-controlled” company (rather than “minority-owned”) will forfeit or jeopardize most opportunities for minority-targeted sales contracts from government agencies or business purchasers that are not NMSDC members. So such a company contemplating the financing of further growth must choose between two less-than-ideal alternatives. Only if the company’s top management believe that significant growth is possible without participating in governmental and non-NMSDC corporate minority-targeted purchasing programs should they consider Equity Capital Initiative re-certification.

If a company does opt for such re-certification, there is one way to maintain some federal government set-aside contract business - through the U.S. Small Business Administration’s “Mentor-Protégé” Program. Under this program, any mid- or large-sized company, including a “minority-controlled” company with less than 51% minority ownership, can serve as a “mentor company” in partnership with a smaller minority-owned “protégé company” and be eligible to bid for minority-targeted federal sales contracts (<http://www.sba.gov>). En Pointe, in fact, has pursued this route to government contracts following its re-certification. But opportunities under this program for companies such as En Pointe are much more limited than under programs for “minority-owned” companies.

Consultants and other advisors to U.S. minority-owned businesses should be aware of the NMSDC’s programs for both “minority-owned” and “minority-controlled” businesses. In the United States, most minority business owner/managers have at best a limited understanding of minority-targeted governmental and corporate purchasing programs, including the NMSDC’s, and most are totally ignorant of the NMSDC’s “minority-controlled” certification. Thus, consultants will need to educate their minority clients about these various programs and the advantages and disadvantages of each of them. And for minority clients that have strong growth potential, consultants should familiarize themselves with the NMSDC’s Equity Capital Initiative

so that they will be able to guide such clients through the complex decision of whether to pursue this new certification.

Implications also exist for future U.S. research in the field of minority business. If and when more U.S. businesses are re-certified as “minority-controlled” by the NMSDC, it will be appropriate to investigate the experiences of these companies. Is the Equity Capital Initiative a potentially beneficial program that will offer otherwise unavailable growth opportunities to minority-owned businesses, or do the disadvantages of the program outweigh the advantages?

## **LESSONS AND IMPLICATIONS FOR EUROPE**

The issues of ethnic business and its definition are especially timely in Europe as well. A significant rise in ethnic and immigrant business ownership has been seen in recent years throughout much of Europe, and a policy-related focus on such businesses has become especially important (Ram & Smallbone, 2003a). Recent studies have argued that past analyses of ethnic enterprises in Europe have been too narrow, focusing largely on class, ethnicity and ethnic resources, and that broader macro-economic and regulatory issues should also be studied (Kloosterman & Rath, 2003). Furthermore, other studies have concluded that various European policies and programs aimed at small enterprises in general may not be of value to, or may even have a negative impact upon, ethnic minority enterprises (Kontos, 2003).

In Europe, the existence and details of both governmental and corporate minority procurement programs and other assistance programs for minority-owned businesses vary considerably. While in the United States, the terms “minority business” or “minority-owned business” as well as the current eligibility listing of specific minority groups seem appropriate, in various European countries an assortment of different terms and listings are used.

For example, in the U.K., terms such as “ethnic business,” “black and minority ethnic business” (BME), and “ethnic minority business” (EMB) are all used, and the five largest groups of “historically ethnic minority entrepreneurs” are African-Caribbean, Indian, Pakistani, Bangladeshi and Chinese (Centre for Enterprise and Economic Development Research, 2001). In other European countries, the terms used and the ethnic groups listed may be different, but most minority groups are ethnic immigrant groups and therefore issues of “ethnic minority business” are usually considered a component of the larger general issue of immigration. Furthermore, EMBs have been the subject of growing interest in recent years, and the reasons for this are both economic and social. As such businesses constitute an increasing component of many national economies, they are thus important to economic growth. Also, as immigration in Europe has increased, strong and growing EMBs can contribute to reducing social exclusion and to raising living standards among disadvantaged minority immigrant groups (<http://europa.eu.int>).

Still, throughout Europe, there is limited *specific* targeting of EMBs within small business assistance programs run by governmental and other agencies (Ram & Smallbone, 2003b). In a study by DG Enterprise for the European Commission (2000), it was found that only 15% of 288 business support agencies surveyed had a specific program, department, group or individual dealing with ethnic minority entrepreneurs. Rather than having public and private-sector

programs specifically targeted toward minorities as in the United States, the European response to the issue of minority business development is more often one of non-discrimination policies for small business assistance and public procurement. For example, all public sector procurement contracts within the European Community are covered by EC treaty, no matter what their value, and this treaty includes a number of non-discriminatory principles (<http://www.sbs.gov.uk>).

Furthermore, most ethnic minority businesses in Europe are owned solely by minorities. Thus the need for a “definition” involving the *percentage* of minority versus non-minority ownership is rarely an issue of concern (<http://europa.eu.int>). This definitional issue exists in the United States because some minority-owned businesses have grown fairly large and have brought in non-minority owners, and also because of a need to identify “minority-front” companies that are not truly minority-owned and therefore illegally receiving minority-targeted procurement contracts. Until EC countries implement legislation or other programs specifically aimed at minority enterprises (equivalent to U.S. “affirmative action”), the issue of “minority-front” companies is not relevant in Europe.

Yet it appears that a greater focus on the *definition* of minority business would be of value in Europe. With clearer and more concrete definitions, more specifically minority-targeted assistance and procurement programs can be developed in those countries where appropriate, and the companies eligible for such programs can be better identified. This will be especially important as many minority businesses in Europe grow and eventually bring in non-minority ownership. And in the current situation, with relatively few specifically minority-targeted programs in existence, those minority companies in need of existing non-discriminatory protection can also be identified. Furthermore, perhaps private-sector corporate procurement programs for minority businesses, similar to the NMSDC’s programs in the United States, might be of value in certain European countries. For all of these reasons, the U.S. issue of minority business *definition*, and the NMSDC’s established procurement programs for “minority-owned” companies and its experience with its new “Equity Capital Initiative” for “minority-controlled” businesses in the United States, should be of interest and provide lessons for any nation’s existing or future social policies relating to the development of ethnic minority businesses.

## CONCLUSIONS

This paper has focused on policy-related issues of ethnic minority business and ownership. Much recent research in the U.S. has been policy-oriented, and future research with regard to ethnic minority business in Europe should include this focus too. What is the role of the EU and of individual countries in protecting, supporting and fostering ethnic minority enterprises? Is current non-discriminatory legislation sufficient to achieve these goals, or is there a greater need for proactive programs and legislation that specifically identify and target ethnic minority enterprises and their owners? As European policy toward ethnic minority enterprise continues to develop, these and other questions must be answered.

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A listing of the 42 references is available from the author.



# **ECONOMIC DEVELOPMENT, TECHNOLOGICAL INNOVATION AND OPPORTUNITY CREATION**

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## **ABSTRACT**

Opportunity recognition by entrepreneurs has become a central focus of much recent research literature in entrepreneurship. Opportunity recognition is linked to wealth creation by entrepreneurs but does not address entrepreneurship's important link to wealth distribution. This paper argues that Schumpeter's creative destruction, when combined with the current literature on management of technology, shows the wealth creation role of entrepreneurship is primarily achieved by opportunity creation rather than simple recognition. Specifically we argue that disruptive technologies match Schumpeter's description of creative destruction and that such technologies are resisted by existing markets. Thus, we conclude that no market opportunity exists for disruptive technologies and entrepreneurs must create demand by developing new markets for the technology.

## **INTRODUCTION**

Interest in entrepreneurship today arises from the recognition that it contributes to economic growth. However, emphasis on growth overlooks entrepreneurship's vital role in wealth distribution. Economists recognize that economic and social progress must incorporate not only growth but also equitable distribution of wealth. Moreover, the broad use of the entrepreneurship concept leads to problems when researching the subject. It is difficult to create definitions of entrepreneurship that capture the divergent usages in today's research literature. Many definitions only deal with specific issues.

Much research makes no distinction between innovation in small new and existing large firms. Additionally, empirical inquiry becomes fragmented; it is difficult to compare studies based on different concepts of entrepreneurship.

The purpose of this paper is to explain how entrepreneurship theorists have misinterpreted the role of technology entrepreneurs in capitalist economies and to emphasize both the reality of and importance of entrepreneurs to wealth distribution. To this we add technology management's theoretical affirmation of Schumpeter's belief that entrepreneurs create opportunities. Following this, we provide an overview of contemporary definitions of entrepreneurship. We conclude that the most important function of entrepreneurs is to create opportunities for their technologies in otherwise resistant markets thereby assuring a continuing process of wealth creation and redistribution; in other words, creative destruction.

We begin with a review of Schumpeter's theory of creative destruction with emphasis on wealth distribution. Next we examine the general equilibrium model to show that it omits

entrepreneurs and does not address wealth creation. Then we examine Kirzner's theory of the entrepreneurs' vital role in establishing equilibrium in neo-classical economics, which underlies current focus on opportunity recognition. Fourth, we venture into the management of technology literature to find the reinforcement for Schumpeter's view that entrepreneurs vigorously push their technology upon resistant markets. This is followed by an overview of contemporary views of entrepreneurship. We conclude by arguing that entrepreneurs provide a very important but rarely recognized service to capitalism.

### **SCHUMPETER'S WEALTH DISTRIBUTION**

According to Schumpeter (1942), entrepreneurs provide a fundamental role in the capitalist system that fulfills a necessary condition for its existence. Schumpeter argues that without creative destruction, wealth would become increasingly concentrated in the hands of a few large firms and this would destabilize society. Entrepreneurship, by his definition is innovation by new firms. Entrepreneurs 'discipline' incumbent firms through the fear that new firms may enter their markets and destroy the existing market structure. When entrepreneurs do so, a process of creative destruction and redistribution of wealth occurs (Schumpeter, 1942, p. 132-134).

In creative destruction, wealth distribution occurs as new firms use innovations to acquire a major market share in a market dominated by existing large firms. The innovations also create new demand for better or unique new products. As market shares transfer from existing to new firms, new firms' wealth grows and the existing firms' wealth declines. This wealth transfer process extends to the employees, suppliers and shareholders of the new firms who gain income and wealth while employees, suppliers and shareholders of the incumbent firms lose wealth. In this way, new wealth is created and new and old wealth is redistributed.

Unfortunately, Schumpeter goes on by prophesizing that large firms would become more efficient innovators through organized R&D departments, reducing the number of entrepreneurs. Wealth would become more concentrated, requiring emergence of a socialistic system to equitably redistribute wealth. His assumption about the decline of entrepreneurship has been rejected by empirical evidence showing that small firms are major innovators (Futures Group, 1984). Furthermore, small firms are important for job creation and economic growth as shown by Birch (1987) and Kirchoff (1994). Even if Schumpeter's prognosis on capitalism has turned out to be wrong, his logic on the importance of new independent firms is still valid.

Wealth creation and distribution may occur as established firms destroy established competitors by means of innovation. However, this will only change wealth distribution among the existing, wealthy firms and this leads to increased concentration of wealth rather than redistribution of wealth to other parts of society. It is important for researchers and policy makers to make a distinction between the two in order to better understand the nature of the redistribution mechanism and to ensure that it is still at work. This is difficult using the definitions of entrepreneurship provided by Shane and Venkataraman (2000) and Wennekers and Thurik (1999) for two reasons. First, there is no distinction made between entrepreneurship in new firms and established firms. Second, Shane and Venkataraman only focus on opportunity recognition. Limiting entrepreneurship to opportunity recognition implies that entrepreneurs are only responsive to changes in market equilibrium. Neo-classical economics hypothesizes market equilibrium but relegates, according to Schumpeter (1934), wealth creation to exogenous effects. It also by definition leaves out the entrepreneur.

### **GENERAL EQUILIBRIUM ECONOMICS**

The gain in social well being within nations is often referred to in a dual statement: "economic growth and development", referring to the two main measures of economic welfare –

growth in wealth and distribution of wealth. In today's social melee, there is so much focus on growth in wealth that we often forget the importance of wealth distribution. One of Marshall's (1890) motives for developing "neo-classical theory" 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 argued that markets 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 organizing of effort; and so forth.

Today, Marshall's neo-classical theory is widely known and underlies the area of "general equilibrium theory." But general equilibrium theory has significant weaknesses that are important in this context. First, it does not provide a mechanism for wealth creation. Second, it provides no explanation for economic growth but only for the process of equilibrating markets. Third, the theory assumes that generation of new technology is external to the economic system. Finally, there is no room for entrepreneurs as all suppliers offer undifferentiated products, have access to perfect information about market activities, and follow a specific pattern of decision making towards the single objective of profit maximization.

Recent developments in general equilibrium theory, most notably within a field termed 'new growth theory' (see Scherer, 1999 for a review) have tried to amend these weaknesses but still there is no role for the entrepreneur in the theory (Walsh, 1970). As Kirzner (1997) persuasively notes, although most economists today agree that markets work, general equilibrium theory does not explain how they work (p. 9). He proposes a theory where the entrepreneur is a central actor.

#### **KIRZNER'S ALERTNESS TO OPPORTUNITY**

Kirzner's (1997) theory assumes that temporary disequilibria will occur in perfect markets. Such disequilibria reduce the efficiency of the market process. But, such disequilibria represent opportunities for someone to make a profit by finding a way to enter the market and reset the market equilibrium. Given perfect information, all suppliers know about the disequilibrium but an alert entrepreneur can identify such disequilibrium and act quickly to equilibrate the market while making a profit. Thus, the entrepreneur actually facilitates the equilibration of a market that is in disequilibrium. Kirzner gives the entrepreneur an important and vital role in maintaining equilibrium in the perfect market.

Kirzner (1979) further concludes that the most important capability the entrepreneur requires is an alertness to discover existing disequilibria and the innovativeness to equilibrate them. Entrepreneurial alertness is the key to success. Since information about the disequilibrium is available to everyone, alertness is necessary to be first to recognize an opportunity (market disequilibrium) and to profit from it. However, Kirzner, attempting to reconcile mainstream and Austrian economics, has formulated his theory in the context of the neo-classical market equilibrium model. This focus on entrepreneurs operating in the neo-classical model definitely does not fit markets dominated by technological innovation. The entire meaning of technological innovation is introducing new, differentiated products that behave differently and are priced differently than existing products. Differentiation is the motive for introducing new technology. This is one reason the neo-classical model is rejected by Schumpeter (1934).

#### **DISRUPTIVE TECHNOLOGY AND INNOVATION**

Schumpeter focuses his discussion of innovation on two factors, invention and commercialization. Innovation is the commercialization of invention. An invention is the new idea but a new idea is of no value to society until it is introduced in the market. Schumpeter

(1934, p. 46-47) defined technological innovation as the introduction of new combinations of methods for supplying commodities in the economy. Combinations, or inventions, could consist of: “(1) a new good, (2) a new method of production, (3) a new market, (4) a new source of supply of raw material or half-manufactured goods, or (5) a new organization of any industry (p. 66).” Schumpeter’s view of the importance of innovation is widely accepted by many economic researchers within new growth theory. New growth theorists believe innovations are the most important contribution to economic growth and development. More recently, technological innovations have begun to be recognized as a major source of innovation in industrialized societies (see Scherer, 1999).

Schumpeter (1934) provides a relatively detailed guide to the commercialization of inventions that are the basis for creative destruction. He describes the entrepreneur’s attack on existing market structures and success therein in spite of resistance by both the potential buyers and sellers in the market. This resistance to commercialization of new inventions is also a description of commercialization of inventions based upon disruptive technologies.

### **DISRUPTIVE TECHNOLOGY, INNOVATION AND CREATIVE DESTRUCTION**

Unlike Marshall’s (1890) model, Schumpeter (1942) theorizes that competition is not from 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” (p. 84). In the process the entrepreneur gains a temporary monopoly situation, which transfers market shares (and wealth) from existing, declining firms to the entrepreneur).

Along with the literature on the economics of innovation there has emerged a discipline interested in the management of technology and innovation. One focus of this research is understanding the difference between innovations that change market structures, and those that do not. However, the technology management literature has not consolidated into a consistent use of terminology let alone a well formulated theory. Thus, it is necessary to examine the literature and use it to define terminology that can provide a basis for our further discussion.

Bower and Christensen (1995), Bitindo and Frohman (1981) and others identify two classes of technology: (1) disruptive, radical, emergent or step-function technologies; or alternatively (2) evolutionary, sustaining, incremental technologies. We will use the term disruptive technologies and focus solely on this since incremental technologies are not likely to underlie creative destruction. Bower and Christensen (1995) offer a definition: “... disruptive technologies disrupt the current capability set required by a given market. Disruptive technologies are those that do not support current firm based manufacturing practice.” They note that disruptive technologies may not be “... radically new from a technological point of view but have superior performance trajectories along critical dimensions that customers value.” Thus they adopt Schumpeter’s perceptions that inventions can be new combinations of existing technologies.

Commercialization of disruptive technological inventions have a unique characteristic. Abernathy and Utterback (1988) 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. Bower and Christensen (1995) reinforce this buyer behavioral characteristic by stating that a technology is considered disruptive when “... its utility generates products with different performance attributes that may not be valued by existing customers.” There is a clear understanding that a category of innovations exist that are radically different and create entirely new market structures.

It is the impact of these innovations on society that returns us to our discussion of economic development. Schumpeter (1934) describes capitalism as an economic system that finds its competitive strength in innovation. The product innovative activity he 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 resistance to adopting disruptive technologies is the commercialization process that Schumpeter (1942) ascribes solely to entrepreneurs. The entrepreneur must demonstrate that the technologies embodied in a new product or service provide significant cost reductions and/or performance improvements. Since there may be no existing markets and new markets are opaque to potential customers (Abernathy & Utterback, 1988) the entrepreneur must create a commercialization opportunity by pushing the technology upon customers. In this way, customers are eventually found who are willing to take the risks of newness (Mansfield, 1968). A truly disruptive technology eventually finds its uses in many product innovations and in different markets.

Disruptive technologies and discontinuous innovations logically embody Schumpeter's concept of creative destruction. Many, but not all, of these disruptive technologies emerge from newly formed firms as Schumpeter believed they would. One advantage new firms have is that they do not have an established customer base to satisfy. Instead, they are free to invent and commercialize for a whole new set of customers. They therefore play a vital role in creating new economic opportunities that can be exploited.

Just as current views on technological innovation are richer and more inclusive than Schumpeter's so has the concept of the entrepreneur and entrepreneurship become broader.

### **CONTRASTING CONTEMPORARY VIEWS OF ENTREPRENEURSHIP**

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). Kirchoff (1994) 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/services sales so as to achieve firm survival and growth." (p. 62). Up to this time, the formation of a new organization is clearly a component of entrepreneurship.

However, a number of researchers within the field have emphasized entrepreneurial and innovative behavior of managers that is not limited to new organization formation. Stevenson (1997) defines entrepreneurship as the "pursuit of opportunity without regard to resources currently controlled." And Shane and Venkataraman (2000) 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" (p. 218). Shane and Eckhardt's (2003) definition goes even further by broadening the number and topics covered by entrepreneurship; "... entrepreneurial opportunities as situations in which new goods, services, raw materials, markets and organizing methods can be introduced through the formation of new means, ends, or means ends relationships." Note there is no mention of new organization

formation. The definitions above view entrepreneurship as the act of innovation rather than the function of the entrepreneur derived from the creation of new firms.

Hébert and Link (1989) and Casson (1982) both propose definitions of entrepreneurship based upon the role of entrepreneurs as decision makers. They see the entrepreneur as an individual that is specialized in decision making concerning the reallocation of resources. On the other hand, Wennekers and Thurik (1999) propose a definition based on the interaction between entrepreneurship and economic growth. They define entrepreneurship as the “the manifest ability and willingness of individuals, on their own, in teams, within and outside existing organizations,” to “perceive and create new economic opportunities (new products, new production methods, new organizational schemes and new product-market combinations) and to introduce their ideas in the market, in the face of uncertainty and other obstacles, by making decisions on location, form and the use of resources and institutions” (p. 46-47). In similar fashion Baumol (1993) defines the entrepreneur as an individual that locates new ideas and puts them into effects without certainty about the results. This includes all “non-routine activities by those who direct the economic activities of larger or smaller groups or organizations.” (p. 8). To summarize, the entrepreneur is therefore involved in creating changes in the economic system as well as identifying existing opportunities and responding to them in a range of different organizational contexts, facing uncertainty. Baumol’s definition combines the three basic economic perspectives and suggests that they are not incommensurable. He states that the entrepreneur is “incapable of leaving matters where they are.” (Baumol, 1993, p. 11) Baumol adds that entrepreneurs face uncertainty, thereby combining Schumpeter’s view on the creative powers of the entrepreneur, Kirzner’s view of the alert entrepreneur, and Knights view on the entrepreneur as an economic actor dealing with uncertainty.

Baumol’s synthesis of the three different schools of entrepreneurship can be interpreted to include 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 potential effects of this broader definition of entrepreneurial innovation on wealth distribution. We cannot specifically investigate, understand or promote entrepreneurship as a mechanism of wealth distribution using this definition as it does not distinguish between the innovations that can redistribute wealth and those that may concentrate wealth. Successful innovation by existing firms may change the wealth distribution but such changes are more likely to increase concentration of wealth rather than redistributing it. Socially beneficial wealth redistribution is only possible through new, independent firms. In other words, innovation is necessary but not sufficient for social welfare unless the innovating is done by new, independent firms.

## **CONCLUSIONS**

The purpose of this paper has been to show that the concept of entrepreneurship should include the concept of opportunity creation and that special attention should be given to entrepreneurs in new and small firms who pursue the role of opportunity creators. If the field of entrepreneurship is to contribute to the understanding of the link between innovation and the redistribution of wealth, research focused solely on opportunity identification is inadequate .

We began our argument by acknowledging the growing interest in entrepreneurs’ opportunity recognition capabilities. This concept is frequently referenced back to Kirzner’s (1997) theoretical model of entrepreneurship’s role in general equilibrium theory. He sought to develop a theory that put entrepreneurs back into the dominant neo-classical economic theory. He

succeeds but his addition to theory does not alter the fact that general equilibrium model is plagued by many other weaknesses that have not been resolved. We then argued that the appropriate starting point is the work of Schumpeter who stressed the opportunity creation aspect of entrepreneurship in the first part of the 20th century. Schumpeter (1934; 1939; 1942) saw the entrepreneur as introducing new combinations of methods for supplying new commodities and other innovations to the economy that lead to creative destruction and the growth and redistribution of wealth.

Next we showed that the technology management literature supports Schumpeter's theory. Abernathy and Utterback (1988) and others have shown that "disruptive technologies" that yield "discontinuous" innovations that are disproportionately introduced by new entrants. This suggests that creative destruction and Schumpeterian entrepreneurs are alive and well in the major capitalist countries. Our analysis of the disruptive technology literature shows that entrepreneurial alertness to opportunity is inadequate to explain commercialization of disruptive technologies. Instead, we argue that commercialization of disruptive technologies requires entrepreneurs to create opportunities in markets that resist entrepreneurs' efforts to achieve success. Reliance upon opportunity alertness will not identify nor commercialize a disruptive technology. And, as noted above, successful commercialization of disruptive technologies by entrepreneurs in new firms are the core of Schumpeter's creative destruction that creates new wealth — and redistributes old.

Later work has studied the technology innovation process in much more detail and painted a more complex picture than Schumpeter did. There are important differences in the technologies that provide the basis for innovation. Disruptive technologies introduced by independent new firms organized and driven by entrepreneurs destroy market structures and create and redistribute wealth. But, imitators may enter these developing new markets relying on evolutionary technologies derived from the disruptive technologies. Such evolutionary technologies (Foster, 1986; Bower & Christensen, 1995) are used to modify and improve the existing innovations within the emerging new market structure. In this way, these entrepreneurs create new wealth.. Such entrepreneurs may well possess opportunity alertness rather than creation but, to the extent they are new independent firms, they may also redistribute wealth as they contribute to the destruction of existing market structures.

We argue that current definitions of entrepreneurship are incomplete for two reasons. First, it is important to pay special attention to new, independent firms. Wealth redistribution is unlikely to happen through existing firms, or through new firms owned as components of existing firms. This does not mean that innovation from within existing firms is not important. We stress only the specific economic role of wealth redistribution by new, independent ventures. Second, both opportunity creation and opportunity recognition have to be included in the concept of entrepreneurship. By including both opportunity recognition and opportunity creation in the concept of entrepreneurship, and paying special attention to the establishment and growth of new, independent firms, it becomes clear how the subject of entrepreneurship relates to wealth redistribution, at least through technological innovation. We believe the same principles can be applied to non-technical innovations but leave that for future research.

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FROM MINORITY BUSINESS TO MULTICULTURAL ENTERPRISE:  
Changing Descriptions, Demographics and Dimensions of Cultural Diversity

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## INTRODUCTION

The language that is used in the United States to describe and analyze businesses started, owned and operated by persons of color is quite diverse: “minority business,” “minority and women-owned business enterprise (MWBE),” “ethnic enterprise,” “diversity business,” and “multicultural enterprise.” These are five of the most widely used terms. Of course this list omits specific racial/ethnic references to describe group-designated types of business such as Black, Hispanic, Asian and Native American. There are also designations for immigrant businesses that usually are considered as yet another and seemingly unrelated demographic and cultural category. The listed terms have overlapping meanings and some of them are used interchangeably. They generally have distinct meanings and uses with respect to administrative and policy purposes in the public and private sectors of the economy. There are also substantive analytical differences in how they are used to study this area of business and management. Their meanings also have changed with time and different periods of political and cultural expression.

This paper provides a review of the enterprise classification terms included under the USASBE’s Minority and Women Entrepreneurship Division. Attention is focused on the ones that are most widely used in the business and management literature. My three main objectives are to: (1) compile illustrative definitions and uses of the terms; (2) compare and contrast uses with substantive program and policy applications; and (3) provide illustrations and interpretations of the increasing importance of a multicultural perspective in business and management along with the challenges that are presented in the academic, practitioner and policymaking communities.

But the paper is about much more than semantics. This sector of U.S. business is quite substantial and growing rapidly. According to the 1997 Survey of Minority Business, there were 3.04 million firms that generated \$591.3 billion in gross receipts and provided employment to 4.5 million individuals. Their combined payroll was \$96 billion. (U.S. Department of Commerce, 2001) While this is a small percent of the national business economy, the entry and growth rates as well as the relative importance of these firms as sources of wealth building in their respective communities is noteworthy. Individuals in these groups have a business start-up rate that exceeds that of the White population.

Yet these businesses have long faced barriers that inhibited growth and participation in the economy. Indeed, until the 1960s and the emergence of the Civil Rights movement this issue was largely neglected in both the public and private sectors of the economy. Efforts since then to remove the barrier that have inhibited the growth and success of this sector of the economy have had uneven support and results.

Some level of support for the continuation of investments in this sector can be seen at all levels of government. In states where political opposition has placed restrictions on the use of minority business programs, the private sector has generally maintained interest and support in recognition of the value of diversity in business.

Further, there is the growing demographic trend that places the populations most directly served by and associated with these businesses as being visible and important in terms of spending power in the economy. This has increased the potential and importance of multicultural perspectives in business.

## MULTICULTURAL ENTERPRISE CLASSIFICATION DESCRIPTIONS

The classification descriptions discussed in this paper are presented in Exhibit 1. This provides an overview of how the language has changed over time. Some additional contextual background is also provided in this section of the paper.

### Minority Business

The term “minority business” has been used since at least the 1960s. One significant date in this regard is that on March 5, 1969 President Nixon issued an executive order establishing the Office of Minority Business Enterprise (OMBE). (U.S. Department of Commerce 1973, p. 146) In June of that year the U.S. Bureau of the Budget published a study on minority entrepreneurship. Besides having the longest period of general usage, it is the most familiar term. It is also likely to be the most enduring. Because of its brevity, longevity and popularity, it is widely institutionalized in various forms. At the federal level, there is still a Minority Business Development Agency as a successor to the Office of Minority Business Enterprise. Every five years (with endings of 7 and 2), a survey of minority-owned business enterprises is conducted by the U.S. Department of Commerce.

In the private sector there are innumerable minority business development councils. Examples include: National Minority Supplier Development Council (NMSDC); Southern California Minority Business Council (SCMBC) [one of 40 affiliated regional councils]; the National Minority Business Council (NMBC) [an advocacy and professional service group with headquarters in New York City and founded in 1972]; and the Minority Business Enterprise Legal Defense & Education Fund (MBELDEF), an organization that has pursued litigation, completed training, consulting and conducted disparity studies in relation to minority business enterprise). Minority business opportunity days and related business development and networking events are other ways in which the term has been institutionalized. There is a Minorities in Business magazine as well as other group and organizational names that illustrate the terms’ widespread use. Many studies and reports on this business sector use minority business in their title. Even when multicultural is used in a program designation such as “Multicultural Supplier Development” the detailed program description is likely to have “minority business enterprise” prominently in the text of the document

# Exhibit 1

## Description of Terms Related to the Emergence of Multicultural Enterprise

| TERM AND USAGE   | DEFINITION  | COMMENTS  |
|--|---|---|
| <b>Minority Business:</b><br>Historical, general and demographic description based on population under-representation in the economy and society.  | Businesses owned by persons of color that include Blacks, Hispanics (Spanish-surnamed groups), Asian and Pacific Islanders, and Native Americans. [This is contemporary language rather than the terms used in the 1960s.]                                    | Defined officially in the Survey of Minority-Owned Business, 1969.  |
| <b>Minority and Women-Owned Business Enterprise: (MWBE)</b> Extensively used in federal, state and local government as well as private-sector programs designed to provide contracting and business opportunities for this sector. | Small business that is at least 51% owned by one or more minority-group members or women. For a corporation at least 51% of the stock must be owned by and management and daily business operations controlled by one of more of such individuals             | Developed mainly since the 1970s and generally includes a certification process to ensure legitimate participation in MWBE programs.                          |
| <b>Ethnic Enterprise:</b><br>Generally used more in scholarly or academic writing than in administrative programs.   | Business ownership among groups of color defined with respect to their socio-cultural, linguistic characteristics and national origin. Often combined with the term “minority-ethnic” to identify overlapping distinctions of race and ethnicity in business. | Emerged from the 1970s and the scholarly work of Ivan Light in <u>Ethnic Enterprise in America</u> . (1972) and others.                                       |
| <b>Diversity Business:</b><br>Used to emphasize the diversity goals and purposes of programs aimed at increasing business opportunities and employment for under-utilized groups and firms in the economy.                         | Businesses owned by women, Blacks, Hispanics, Asians, Native Indian and other racial/ethnic groups. “Disadvantaged business” should be included here as well as in programs associated with minority and women-owned business enterprise.                     | Emerged in the 1990s as an alternative to minority and related terms that were considered more political and controversial. (See DiversityBusiness.com)       |
| <b>Multicultural Enterprise:</b><br>Used to emphasize the changing orientation from an ethnocentric or one-culture focus to the inclusion of acculturation and cultural diversity in shaping business policies and practices.      | Reflects businesses owned by racial/ethnic groups of color as well as business practices in the market environment in which people of color live, work and compete in the enterprise economy.   | Emerged in the 1990s as a recognition of the changing demographics of the nation as well as increasing cultural influences on business policies and practice. |

An important addition to some of the descriptions are identified ethnic groups that can be sorted out from “Other.” One example is “Asian-Indian American” which identifies persons whose heritage or origin is from India, Pakistan, or Bangladesh. The point here is that business or enterprise classification descriptions need to be broader and more inclusive now than in the past because of the changing demographics and varied cultural influences that need to be understood and responded to.

#### Minority and Women-Owned Business Enterprise (MWBE)

This category of enterprise carries with it specific ownership rules as well as documentation or certification that the business qualifies for agency contracting and business opportunities. The criteria used in the definition involve controversy. For example, the 51% rule is criticized as placing limitations on business and investment relationships that are detrimental to some of the businesses. It is argued, for example, that access to some sources of capital is constrained by the rule. Proposals have been made to attempt to reduce the 51% rule without opening the firm up to criticism as a front that provides cover for ostensibly White or non-minority ownership. As reported by Sonfield (2004), the National Minority Supplier Development Council (NMSDC) has proposed that the ownership rule be reduced to as low as 30% in order to increase access to equity capital. As a result of the strong and vocal political opposition from other minority organizations, the reluctance of corporate firms to become embroiled in controversy, the percent reduction in minority ownership has not gained much ground. As Sonfield (2004, p. 166) reported, after three years only one firm had been certified under the new rule by NMSDC.

An even more protracted and volatile controversy has surrounded the program and policy uses of the definition. Contracting opportunities and efforts to ensure wider participation of these businesses in purchasing and contracting by public agencies, in particular, has led to a movement to quash MWBE programs. Ironically, most of the cases to invalidate such programs have pertained to minority rather than women-owned businesses. This is partly due to the greater volatility of race-based issues of contracting when compared with gender-based disparities. Also, gender-based coverage includes White women. This apparently removes claims of reverse discrimination based on race. Litigation has gone all the way to the U.S. Supreme Court. Restrictions have been placed on alleged uses of so-called race preferences or set-asides in public contracting. Nevertheless, the programs have generally not been eliminated. They have been changed to remove perceived or actual preferences for minority or women-owned firms. Even in California and Washington where statewide referendums have been approved to ban the use of race and ethnicity in public sector decisions regarding employment, contracting and school admissions, some version of MWBE programs remain in effect. However, as a result of the sustained controversy and attacks since at least the 1980s, such programs have been substantially weakened as a policy tool for advancing minority and women-owned business.

#### Ethnic Enterprise

The term “ethnic enterprise” carries with it considerable academic and analytical cache. It does so because racial/ethnic background and affiliation really matter in business education and management practice. It matters in term of history and the experiences of individuals and entire groups based on social customs, attitudes and economic practices. Various processes are in place to limit the viability and growth of ethnic enterprise. Denial or restricted access to

labor markets, for some groups can be widespread. Denial of access to capital markets is well known. Considerations of patterns of discrimination in housing, education and other areas of economic and social life add further constraints on ethnic enterprise development.

However, the term ethnic enterprise explicitly omits race. Thus, its usage in practical and policy terms is likely to remain somewhat limited. However, it provides a bridge between immigrant and minority business. That makes it attractive for academic and some policymaking purposes.

#### Diversity Business

This term has come into usage as a neutral or less politically-charged description of business pertaining to people of color. Diversity is seen as a desirable goal in bringing differences and sensitivity to broadening the participation of people in business. However, it lacks specific associated meanings and explicit recognition of groups of people. For example, it seems awkward to me to say that a business is “diversity-owned.” In one case where the term was used it was followed in parenthesis by women, Blacks, Hispanics, Asians and Native Indian and other minority groups. So what has been gained in communication by using the term diversity? The term may communicate to some people in business when the term “diversity suppliers” is used. This is likely to suggest that a firm or agency is seeking to broaden the participation of suppliers from different groups, sources of business and the like. So it seems that it would be best to say that it is unclear how the usage of this term will fare in the coming years. However, because of its implied goal-oriented neutrality, its usage is likely to increase. Generally, there will still need to be an accompanying explanation of who is included, how they are contributing to the goals of inclusion, correcting under-representation or otherwise supporting the achievement of cultural diversity.

#### Multicultural Enterprise

The notion of U.S. society becoming more multicultural has helped in the acceptance of the term multicultural enterprise. At least in academic circles the ideas of multicultural education, multicultural communication and other fields as well make it seem appropriate that the term multicultural also applies to business enterprise. Moreover multiculturalism has come to business through advertising and marketing in a big way. Corporations now have senior managers who are responsible for multicultural products and markets. As noted below there is growing acceptance of multicultural influences in business.

### CHANGING DEMOGRAPHICS AND MULTICULTURAL INFLUENCES

#### Changing Demographics

In the decade of the 1990s the general population of people of color grew from three-to-eleven times as fast as the Anglo-American population increase of 4.4%. Asians increased by 49.6%, African Americans by 39% and Hispanics by 14.3% (Aspirations of Minority Business, 2000). These groups now represent 28% of the U.S. population with expected growth to one-third by 2010 and to about 50% at mid-century. Already the phrase “majority-minority” is a demographic reality in some areas. When combined with spending power estimated in excess of \$1.1 trillion, their status in emerging markets is attracting more and more attention in the larger economy.

The racial/ethnic composition of these groups is as follows: Hispanics (35.3 million people) 40.6%; African Americans (34.6 million) 39.0%; Asian/Pacific Islanders (10.6

million) 12.3% and Native Americans (2.5 million) 2.9%. (Minorities in Business, 2001). The numbers translate into sizable measures of economic activity.

Comparative business ownership among the groups follows a noticeably different pattern: Hispanics 39.5%; Asians 30.0%; Blacks 27.1% and American Indians 6.5%.

Changes are occurring in other aspects of minority business. Strong networks of business alliances and relationships are in place. Efforts are being made to change perceptions, capabilities and the delivery of goods and services. Firms in the sector are becoming more competitive.

### Multicultural Influences

Cultural diversity is now widely recognized and generally supported as a desirable quality in organizational, community and national life. This stems from recognizing that our world is about as diverse as it is vast. Through commerce, communication and advances in technology, differences are brought to us just about wherever we are. Understanding cultural differences has been an essential part of doing business abroad for a very long time. Increasingly the demographic and cultural diversity from within are resulting in more and more recognition of the multicultural influences at home.

Its scope is very broad and includes differences in language, life styles and cultural traditions. Aspects of institutional life are also embraced through education, churches and church life, newspapers and in other ways that reflect various dimensions of community and culture.

Indeed diversity is big business. One of the prime influences in the corporate sector that affects minority business is "minority supplier development." This includes programs that are designed to diversify their supplier networks. This support is strongest in the U.S. automobile industry. The big three companies (Ford, Daimler-Chrysler and General Motors) spent \$3.5 billion, \$2.7 billion and \$2.3 billion, respectively, for a total of \$8.5 billion. According to Hannon (2001) these firms lead in diversity supplier spending.

Another and even larger influence is the evolving multicultural orientation in the U.S. business environment. This is represented by a complex diversity infrastructure that includes many different policies, programs, procedures and institutions.

## EDUCATIONAL, PROGRAM AND POLICY IMPLICATIONS OF A MULTICULTURAL FOCUS

### Educational Implications

The changes reviewed in this paper are evident in many aspects of business education. Many business schools are responding in a variety of ways. Attention to diversity in admissions is one way. Curriculum changes with course development is another. Learning experiences that include group projects with minority business and student consulting are common adaptations to reflect diversity in the business school environment.

Some, like University of Arizona – West, have acknowledged the importance of faculty diversity. (Maimon and Garcia 1997) These faculty members emphasize such benefits of cultural diversity as providing different perspectives and voices in learning, learning how to think critically and adapt to different people and situations. They go on to say: "The business community has already realized that a diverse workforce will lead to a successful

enterprise...bringing with it diversification as in portfolio diversification.[and generally]... leading organizational members to reach their full potential.”

Similarly, encouraging the development of minority and women-owned businesses adds to the diversity of opportunity in business and carries with it as well the strengths associated with diversification. In addition it recognizes the strengths and contributions of extending cultural understanding and opportunity to historically-denied groups. It helps us understand better the structure of barriers associated with racial, ethnic and gender discrimination.

#### Minority Business Development Program and Policy Implications

The wide range of MWBE programs from school districts and port authorities to city and county government, states and federal levels suggest that the infrastructure of minority business support is essentially a permanent part of the policy framework of the nation. Despite efforts to curtail or close such programs, they are still present just about everywhere.

An even bigger support system exists in the private sector. According to the National Business Supplier Development Councils total private sector spending in 2002 was \$72 billion. This compares with the federal government investment in the Small Business Administration of less than \$6 billion (Lum, Spratlen and Verchot 2004). While the total for all government procurement would obviously be much higher, even that represents between two and three percent of procurement among the Departments of Defense and Transportation as the two largest spending federal agencies in support of minority business.

### CONCLUSIONS

Multicultural enterprise has evolved from minority enterprise over the past several decades. Although the term minority business may be demographically inaccurate to describe this sector, it is still in widespread use. And is likely to remain so. Yet the focus, content and orientation in the contemporary business environment are decidedly multicultural. Academics, practitioners, policy makers and the general public will need to learn to live with the continued use of diverse terms and phrases as applied to the multicultural enterprise sector of the economy. But after all that is merely a reflection of complexity and diversity in the business world of the contemporary Information Age.

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## Age Characteristics and Personality Traits of Current and Prospective Women Small Business Owners

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### ABSTRACT

The Center for Women's Business Research (formerly National Foundation of Women Business Owners--NFWBO) estimated that between 1997 and 2002 the number of women-owned firms increased by 14 per cent nationwide – twice the rate of all firms. Employment increased by 30 per cent--1.5 times the U.S. rate, and sales grew by 40 per cent--the same rate as all firms in the U.S, and \$1.15 trillion in sales was generated by 2002. (Center for Women's Business Research, 2002)

This paper looks at possible age characteristics of Women Small Business Owners (WSBOs) as well as some personality traits. It is based upon previous studies, literature review and a pilot study recently tested (June 2004.) This paper is also setting the stage for a larger research project that will go to a wider population than the limited respondents used in the pilot study. The researchers hope to find what relationships have remained the same through the years since 1980, as to the average age of the women starting their own business, as well as what changes are taking place. This will include whether there has been influence of other family (parents, grandparents, siblings) who have already taken the entrepreneurship route, or if these women are making their own pathway. By identifying trends, educators may be more able to provide the support needed by these women in their entrepreneurial journey.

Until the late 1980s research on women entrepreneurs had been a neglected area of academic study. Increasingly, research is focusing on women small business owners as an identifiable group separate from their male counterparts.

### LITERATURE REVIEW

For many women business owners, the management of the combined responsibility for work and family is an issue of significant concern and leads to a search for flexibility to manage these dual responsibilities and have a more balanced life. (Olson and Currie, 1992; Fierman, 1990; Taylor, 1995; Zelner, 1994). Many women see small business ownership as a way to achieve this balance. Family security has been identified an important value by all respondents to a 1992 study of women business owners in the construction industry. This characteristic might also impact studies done of women starting businesses during their child bearing/child rearing years. These years may range from teen years through to the mid-forties.

In the mid-1980s, women small business owners frequently identified frustration and boredom in their previous jobs as key reasons for starting their businesses (Hisrich and Brush, 1985). Other reasons were interest in the business and personal autonomy. Women small business owners (WSBOs) usually had liberal arts backgrounds and, typically, had work experience in areas such as services, teaching, middle management or secretarial positions. Most American female owner/managers had worked in a business similar to their current one. However, these same women lacked experience with finance, marketing, and routine business operations. The 1980s female entrepreneur was most likely to be the first-born child from a middle-or upper-middle-class family. Her father was probably self-employed. Over half of these

women were married; and, on average, they had two children. Nearly 70 per cent had a college education, majoring in mostly non-business fields.

In the early 1980s in Japan, WSBOs were heavily involved in small retail businesses in a single commercial neighborhood, while their husbands worked as salaried employees elsewhere. Some of these shops were inherited. However, most women were involved in family businesses run jointly by husband and wife, often with each spouse running a branch store in different neighborhoods (Daiichi Kangyo Bank, 1989).

A decade later, the 1990s women who were or became small business owners were more likely to have management experience in a private-sector for profit business according to the National Association of Women Business Owners (1998a.) Fifty-six percent of these women owned businesses totally unrelated to previous careers and 14 per cent had turned a personal interest into a business pursuit.

The 1990s “modern” female entrepreneur usually arrived at business ownership in one of three ways: (1) by developing an entrepreneurial career early in life – the “intentional entrepreneur”; (2) by becoming entrepreneurs after a substantial [“incubator”] period in a corporation or other organization—the “organizational entrepreneur”; or, (3) by following a “career without boundaries,” going back and forth between corporate experience and business ownership (*Moore, 2000*).

### **Age, marital, and maternal status:**

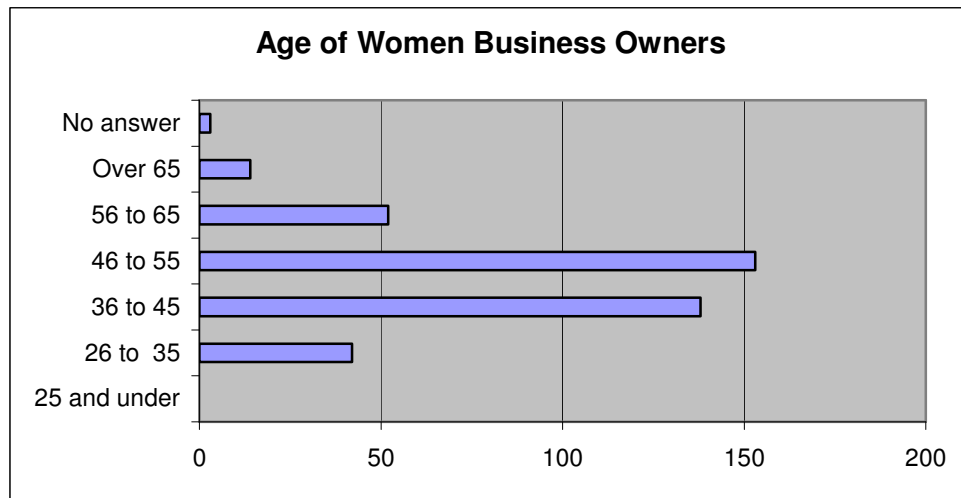
A majority of women small business owners are in their 30s and 40s. This seems to be the case internationally. In a study of female business owners in Poland, the majority were between 35 and 50 years old (median age 45) (Zapalska, 1997). Canadian women business owners (Lee-Gosselin and Grise, 1990) were found to be between 31 and 45 years old, married with an average of 2.4 children (Deng, Hassan, and Jivan, 1995). A majority of women business owners in Asia were in their 30s and early 40s.

A study in the USA compared women corporate managers and women small business owners and found that the managers were in their 30s, most likely to be married and had few or no children. The business owners were somewhat older (41-60+ years) than the managerial group, and somewhat more likely to be married and have children (Brodsky, 1993). In central Ohio (USA), female owner/managers were mostly under 51 and married with few children (Burdette, 1990).

In the Taylor (1995) study of the Dallas/Fort Worth (U.S.A.) geographic area, approximately seven out of ten of the 402 respondents were between the ages of 36 and 55. (See Figure 1) This is similar to the Poland and Canadian studies. The respondents in the Taylor study were all women who owned their own businesses and the majority had been doing so for at least five years. Marital status of this group indicated that 68 per cent were married at the time they started their business, 15 per cent were single and another 15 per cent were divorced. Only 35 per cent of the total number of respondents had dependent children still living at home, and of those, the majority only had two children.

Authors examining age cohorts in the USA have predicted that individuals born between 1960 and 1980, sometimes referred to as Generation Xers (or Gen X) as a group have strong entrepreneurial characteristics (Zemke, Raines, and Filipczak, 2000; Strauss and Howe, 1991). Potential entrepreneurs, ages 11 years and older, are the targets of a book, Girls and Young Women Entrepreneurs. Aimed at the next generation of female small business owners, the book includes first person success stories and provides instructions on how to be an entrepreneur.

Figure 1



Ages of respondents in U.S. study. (Taylor, 1995)

A group of low-income women in a rural area of a Midwestern (USA) state opted for sole business ownership as a strategy for becoming economically self-sufficient (Egan, 1997). These women averaged 35.7 years and had one to four children. All had received welfare for 2.5 years to 12 years after divorcing husbands or leaving partners. Subsequent to starting their own businesses, all had completed self-employment training programs.

The decision to become self-employed often fulfills a lifelong dream. Two-thirds of the women reported having empowering families, including decisive women and entrepreneurial role models during childhood and youth. The family's reinforcement of a woman setting her own goals and achieving success in self-initiated efforts was coupled with the women's familiarity with people who were entrepreneurs and embodied these familial messages. The other third, having no such early experiences, reported that self-employment was related to negative employment experiences [in low-paying jobs] and the presence of a mentor. These women described how the experience of being an employee failed to match their sense of autonomy and capability and helped them learn how differently they would behave as bosses.

It is these areas that the new study will attempt to research. Indications in the limited pilot study imply that more women may be thinking of starting their own business long before becoming entrenched in a career track. It may also be more of a choice for personal preference of being their own boss and have little to do with family security, very similar to why men make the same choice.

Self-assurance and strong personality are two more tendencies that are being examined in the new study. Is the tendency of continuing towards masculine attitudes (as far as business leadership style) gaining momentum among the newer female entrepreneurs? In a USA study comparing female managers and female entrepreneurs, neither group self-identified with the stereotypically feminine sex role (Brodscky, 1993). Two thirds of the total sample held culturally masculine attitudes. One third of

the entrepreneurs and one fourth of the managers adopted an androgynous self-perception. The managers perceived themselves as bright, analytical, strong, articulate, politically aware, linear thinkers, who are determined, self-assured and work long hours. Like their managerial counterparts, the entrepreneurs saw themselves as bright, determined, verbally skilled, analytic and strong. The entrepreneurs' personalities, however, tended to be less warm, very dominant, expedient, bold, suspicious, shrewd, self-assured, somewhat conservative, self-sufficient, and tough minded. By self-report their pace appeared to be faster, they worked longer hours. They also were seen as more aggressive and less bound by convention.

Personality traits such as self-discipline, perseverance, and an intense desire to succeed have an impact on the success of the female-owned business. Other success factors related to managerial practices include: the inclination and ability to plan, willingness to seek professional assistance, attendance at business courses, and realistic profit expectations (Taylor, 1995). Planning is critical since it helps in setting goals, meeting deadlines, predicting future growth, and obtaining future financing, and should be done continuously in the course of business operations.

Women may seek outcomes other than business growth as a measure of their success (Larwood and Gattiker, 1989). For example, women tend to have a stronger preference for jobs that offer opportunities for professional growth and challenge, while men preferred jobs that offered higher income (Bigoneess, 1988; Brennen and Tomkiewicz, 1979). Moore and Buttner, 1997) suggest internal standards mattered more than external measures and that an "ethic of care" figured more predominantly for women than men small business owners. Women entrepreneurs focused on the process in their work and enjoyed it more than on the outcomes.

Female managers believed they could obtain personal and career support by working inside the system and valued the resources and team effort found in corporations. In contrast, female entrepreneurs relied on individualistic drive and energy and were not as concerned about the opinions of others. They looked for support in strong external networks.

## **EXPLORATION OF THE SPECIFIC ISSUES INVOLVED IN THE NEW STUDY**

The new study has recently (June 2004) been tested in a group of women (and 1 man) enrolled in an entrepreneurship class. Far from an objective group of respondents, this was an upper level elective class for all students and open to people regardless of major at a public university. Age ranges in the class were broken down to "younger than 25" (37.5% of respondents), "25 to 35" (37.5%), and "older than 35" (25%). Twenty-four people out of 29 responded to the survey. Seventy-five percent were scheduled to graduate within one year. Twenty-nine percent of the respondents had already owned their own business, or were currently business owners. When asked how many of the respondents had a family member who was an entrepreneur, 63% replied affirmatively. An expected fault in the questionnaire for this group of respondents' (since they had elected to take the class) occurred with the question "How likely do you think you are to be an entrepreneur at some time in the future". A solid 62.5% replied "very likely" while 25% replied "somewhat likely" and only 3 respondents were "undecided." None of the students chose one of the two negative responses available.

At this point, a statistical analysis has not been completed on the respondents' answers to the questions concerning organization, assumed risk, and perceived challenges for an entrepreneur. This is currently in process and will be completed on the pilot study by mid-October of 2004.

## Implications for future study

An expanding role for women's involvement in small businesses ownership is an international fact. Age does not appear to be a limiting factor in describing female entrepreneurs. In fact, women of child-bearing age continue to start businesses at a record setting pace. This study will be given in several venues this coming year. An attempt will be made to include current business owners (chosen at random and from different localities) as well as university students in other types of classes. Community members not currently involved with owning their own business will also be surveyed. Gender personality differences as well as age differences and the impact on entrepreneurial choices will be closely examined.

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# **BOARDS OF DIRECTORS FOR SMALL BUSINESSES AND SMALL PRIVATE CORPORATIONS: THE CHANGING ROLE, DUTIES AND EXPECTATIONS – PART III**

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## **ABSTRACT**

*Today the governance and management structure of business organizations, particularly publicly traded corporations utilizes a board of directors. Organization use of boards of directors is considered an openly accepted and utilized structure to provide leadership and management direction in business organization. Because large public companies recognize the value to the corporation and because of the increased regulatory requirements placed on publicly traded companies, the use of boards of directors are strongly endorsed. For small businesses and privately held companies, however, a board of directors is not always viewed as a useful part of the corporate structure.*

*A survey of 180 small, often family owned, non-public corporations was conducted in one Midwestern state to review the status of board usage and value. This paper reports PART III data of a study which focused on the board functions and operations of small privately held corporations. The study corroborated the expanding body of literature suggesting the lack of formality in board functions for small privately held companies. The study identified the most important factors influencing board function, activities and performance as: needs of the company, skills and specialized expertise of the directors, sophistication of ownership and management, as*

*well as life cycle stage, family ownership and trading status of the corporation's stock.*

## **INTRODUCTION**

Solid corporate governance has been a long held positive perspective as an indicator of the quality of a company. This follows in start-ups where establishing corporate governance early in an organization's life cycle sets the tone for building and growing a solid foundation (Comtex, 2002). The involvement of a board of directors is considered to be an integral part of the governance and management structure of most publicly traded corporations, particularly large organizations (Cain, 2002). However, board decisions are not accepted on faith. Today investors, governments, communities and employees are all reviewing board performance and are not afraid to challenge board decisions (Conger, Lawler and Finegold, 2002).

Caution and sometimes apprehension about the future has resulted from the expansion of the 90's, the tech burst, September 11th, and the accounting scandals which have left the business community hurting. A rapidly changing business world encompasses multiple themes, two of the most important are that regulation matters and that "boards count" (Business Week, 2002).

Principles of Corporate Governance are being actively addressed by such recognized authorities as "The Business Roundtable." The roundtable is an association of CEOs of leading

corporations representing over 10 million employees in the US with \$3.5 trillion in revenues (The Business Roundtable, 2002). The Business Roundtable endorses the following guiding principles for boards of directors for public corporations:

- Selection of and oversight of a CEO.
- Effective/ethical operations which produce value for stockholders.
- Financial statements which present the accurate financial condition
- Use of an independent accounting firm to audit the financial statements.
- The independent accounting firm must insure that it is independent, without conflicts of interest.
- The corporation has a responsibility to deal with its employees in a fair and equitable manner (Business Roundtable, (2002)

Principles of guidance are intended to provide boards directors and management leadership with best practices and serve as milestones on ever improving standards. In keeping with the attention given to board governance, Business Week magazine has ranked the best and worst boards since 1996. Their research involves polling of top experts, reviews of dozens of boards, and considers factors of credentials, stock ownership and even attendance. Starting in October 2002 they added new categories of Most Improved Boards, Boards That Need Work, and a Hall of Shame. All of this attention is insuring that board members are taking their responsibilities more seriously. Jeffrey Sonnenfield, Associate Dean of the Yale School of Management perhaps best sums it up, "Boards of directors will be rolling up their sleeves and becoming much more closely involved with management decision-making" (BusinessWeek, 2002).

More and more boards are utilizing guidelines, policies and working instruments in their corporate governance role. Siebens in his Journal of Business Ethics article "Concepts and

Working Instruments for Corporate Governance," indicates that a qualitatively better direction can be achieved through:

- Complete openness
- Spreading of knowledge in the board's composition
- Frequent meetings
- Splitting-up of special functions
- Thorough preparation and recording of all meetings
- Replacement of weak or regularly absent directors
- Sufficient time to discuss (Siebens, 2002)

All of the attention to corporate governance has impacted all types of organizations. When comparing the governance of large public to smaller organizations, one finds that in privately held companies and small businesses a board is not always seen as an integral part of the corporate structure. Reasons include fewer regulatory governance requirements or perhaps the closer relationship between managers and owners. In addition there is the sometimes inaccurate perception that boards, even where legally required, add little value to the corporation (Narva, 2001). Perhaps the most significant legislation since the U.S. Securities and Exchange laws of the 30's, the Sarbanes-Oxley Act has redesigned corporate governance and reporting obligations, expands and strengthens accountability standards for directors and officers, and identifies specific securities violations to be crimes. The message in Sarbanes-Oxley is that for private businesses a new aspect to decision making will be critical. The act may have been directed at public companies, but it impacts privates also (PricewaterhouseCoopers, 2003). Small firms are not exempt from Sarbanes-Oxley but may well have difficulties meeting the more rigorous regulations under the act (Hansard, 2002).

This paper reports PART III – Informal Function findings of a study which focused on the functions and operations in the small

privately held corporate environment. The interest in this topic evolved from the involvement of the authors on boards of directors, advisory committees, and planning task force activities for small corporations, small businesses and non-profit organizations. The intent was to provide a link from the extensive literature sources, materials, training, and development programs available for boards of large organizations to smaller organizations.

The authors were encouraged to pursue their work in this area during a statewide SCORE (Service Corps of Retired Executives) conference. In addition, SBDC (Small Business Development Center) and SBA-BIC (US Small Business Administration - Business Information Center) and T-BIC (Tribal -Business Information Center) affiliates supported the concept. This paper is a component of a multi part series which centers on small privately held corporations and non-profit organizations affiliated with small business and entrepreneurship. Given the changes in corporate governance, ethical issues, and challenges facing board members of all organizations today (Carver, 2002), interest in organizational governance will continue to expand. The Small Firms Association's launch of a publication "Corporate Governance: Guidelines for Small Business," is an example of a number of resources now available (Delaney, 2001).

## **BACKGROUND**

An extensive body of material exists concerning the roles, functions and duties of boards of directors, however, there is no one work that clearly describes board requirements (Cain, 2002). Despite the growing emphasis on corporate governance one must adapt the approach to have a structure useful for small privately held companies, small businesses and non-profit organizations. Selected works examine the unique aspects of small company

boards and assess the challenges required to recruit effective directors (Thurman, 2000).

Past work on small private firms where CEO's have significant power to effect board composition and level of CEO involvement has been accomplished. Results affirmed that CEO's with greater ownership and family stakes tend to have small boards with less representation by outside directors and greater representation by dependent directors, primarily family directors (Fiegener, Brown, Dreux, and Dennis, 2000).

Much of the work related to corporate governance discusses the need to seek board members with skills and experiences to match the needs of the organization. For example the publication entitled, "Trends in Corporate Governance Series: Changing Roles for Boards of Directors in Entrepreneurial Companies, Modern Corporate Governance Practices," by the accounting firm Grant Thornton LLP was reviewed in the PART I – SBIDA paper (Teksten, Moser, Elbert, 2003) delineating the functions on which a board must focus. Two particularly critical functions are...

- Periodic evaluation of its own performance.
- Performance evaluation of individual directors (Grant Thornton, 2001).

The focus on family business planning has received more attention of late. Lussier and Sonfield for example, provide a unique perspective with their focus on family business planning, management activities, styles and characteristics (Lussier, Sonfield, 2004). Narva provides credible reasons for utilization of an independent board with experienced directors for a family controlled enterprise.

They include...

- Credibility with non-family managers.
- Credibility with Financial Institutions.
- Disaster Management.
- Coordination with Non-Management Owners (Narva, 2001).

Each organization needs to review a variety of factors including their unique critical needs, abilities of personnel, stage in organization life cycle and a variety of other factors. Because of the multitude of needs, requirements and individual aspects of private corporations, one could easily surmise that there are no definitive answers for board organization, orientation, education, utilization or administration. The contribution of directors in small and medium enterprises was examined. Results showed that non-executive directors foster formality and discipline but also face challenges related to the perception of adding value to the boardroom (Mileham, 1996). The **PART III – Informal Function** results being presented here were designed to explore areas of board emphasis for small incorporated businesses. In addition, the study reviewed the roles that boards play at various points in the firm's life cycle and the impact of the percentage of family ownership on board organization and usage. **PART I - Primary Function** and **PART II – Formal Function** data was presented at the 2003 and 2004 SBIDA conferences (Teksten, Moser, & Elbert, 2003; Teksten, Moser, & Elbert, 2004).

## **METHODOLOGY**

As part of the project, a mail questionnaire survey of 180 businesses was conducted as part of this project. Businesses were selected from a database maintained by the North Dakota Department of Commerce. Participants of the survey were board members of incorporated firms with a minimum of twenty employees. Of the 180 surveys mailed, 53 were returned. Eighteen were deemed unusable because they were completed incorrectly, were not really corporations or were subsidiaries owned by out of state parent entities that had no local boards of directors. As a result only 35 surveys were considered usable. While this is short of the 50 typically expected, it does

represent the best effort of the researchers to elicit responses. The response rate was 19.4% (35/180). Personal interviews were conducted to further explore initial findings derived from the questionnaire. A significant amount of information was compiled as a result of the survey and personal interviews. It is the intent of the authors to present the findings of the study as part of a multi-part series.

## **RESULTS**

The study validated much of the literature noting the **lack of formality** in board functions for small privately held companies. Critical factors influencing board function and action included needs of the company, abilities of the directors, sophistication of ownership and management, as well as life cycle stage, percent of family ownership and whether or not a corporation's stocks are traded. The responses to survey questions related to board functions and operations were summarized under various classifications. The classifications and relative numbers for each category were as follows: All Responses (35) - further delineated as, Life Cycle (Mature - 27, Early and Rapid Growth Life - 8). Secondly, Ownership further delineated as (100% Family Owned - 16, 51 - 100% Family Owned - 9, Less than 51% Family Owned - 9, Failed Response - 1), Traded (3). Respondents were also asked to provide their opinions regarding whether board functions or objectives were carried out in an informal or formal manner. Survey completion instructions indicated that...

**“Formal would mean that the objective or function is documented as such in a board manual, is included in the training of old and new board members, is in the minutes, is included on a written agenda, etc.”**

**“Informal would mean that such formal attention is not brought to bear but the objective or function is still considered as a primary function to all board members as evidenced by periodic (at least annual) board discussions or actions on the topic.”**

Data presented at the 2003 and 2004 SBIDA conferences centered on the **PART I – Primary Functions** of Service – providing counsel and advice to CEO and Management, Fulfill Legal Requirements, Long Term Strategy and Policy Formulation and Approve Major Investments, Acquisitions and Sale of Assets and **PART II – Formal Functions** which included functions noted in Part I plus the functions of Selecting and compensating directors and Selecting and compensating the CEO/Top Management. Table 1 – Boards of Directors of Small Private Companies: **Informal Functions** further details the responses based on state of Life Cycle and % of Family Ownership. As noted in the table the four functions rated highest across all classifications include...

- Service – providing counsel and advice to CEO and management (60%)
- Networking (Access to capital, markets, agencies, people, expertise) (46%)
- Innovation (new venture / product development/expansion) (49%)
- Provide energy and outside perspective to the organization. Select & compensate directors (49%)

Many of the Primary Functions - Informal received high responses across all classifications as shown in Table 1.

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Insert Table 1 about here

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The data compiled in the study were too extensive to completely include in this paper, however the complete study is available from

the authors upon request. Expanded details and emphases within categories regarding top ranked functions and a recap of the project will be provided as part of the next component of the series.

## ***DISCUSSION***

The results of the study of board primary function, formal function and informal function assessment reveals high consistency with the listing developed by Grant Thornton (2001) and other training, educational development firms including NACD (National Association of Corporate Directors) and consulting firms to include PricewaterhouseCoopers. Further, the primary, formal and informal functions that were not rated as being as board critical provides further understanding of the wide range of expectations and needs of small business boards.

## ***IMPLICATIONS***

This study examined board functions and operations as reflected in the literature to ascertain implications and potential applications for small non-public corporations. The intent was to review the changing role of board responsibilities as a result of unique world and corporate events. Primary Functions, Formal Functions and Informal Functions of board operations were, for the most part, verified. The study verified some interesting perspectives with regard to how boards of small organizations viewed their purpose. The intent of presenting a practical overview of recommended practices for boards of small private companies as well as providing a glimpse into how smaller companies may be approaching corporate governance was accomplished in part. Further verified by the research and the ever increasing attention in the literature is the realization that there are many further opportunities to study the changing roles of board members for organizations of all size and structure.

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|  | Table 1  |               |          |          |                       |             |                    |              |  | Traded |
|--|----------|---------------|----------|----------|-----------------------|-------------|--------------------|--------------|--|--------|
|  | ALL      | Life Cycle    |          |          | % of Family Ownership |             |                    |              |  |        |
|  |          |               |          |          |                       |             |                    |              |  |        |
|  |          | # Respondents | 35       | Mature   | Early & Rapid Growth  | 100% Family | 51% to 100% Family | < 51% Family |  |        |
|  | 35       | 27            | 8        | 16       | 9                     | 9           | 3                  |              |  |        |
|  | Informal | Informal      | Informal | Informal | Informal              | Informal    | Informal           |              |  |        |
| Service - providing counsel and advice to CEO and management         | 60% *    | 56%           | 75% *    | 63%      | 67%                   | 56% *       | 0%                 |              |  |        |
| Resource Acquisition – aid in acquiring resources for the company    | 37% *    | 37%           | 75% *    | 44%      | 33%                   | 33% *       | 33%                |              |  |        |
| Control - monitoring function  | 40% *    | 30%           | 75% *    | 31%      | 44%                   | 56% *       | 0%                 |              |  |        |
| Fulfill Legal Requirements   | 34% *    | 33%           | 38% *    | 38%      | 44%                   | 22% *       | 0%                 |              |  |        |
| Window Dressing  | 6% *     | 7%            | 0% *     | 6%       | 11%                   | 0% *        | 0%                 |              |  |        |
| Stockholder/Stakeholder Improvement                                  | 43% *    | 41%           | 50% *    | 38%      | 44%                   | 56% *       | 0%                 |              |  |        |
| Networking (Access to capital, markets, agencies, people, expertise) | 46% *    | 44%           | 50% *    | 31%      | 56%                   | 67% *       | 67%                |              |  |        |
| Long Term Strategy & Policy Formulation                              | 37% *    | 37%           | 38% *    | 25%      | 67%                   | 33% *       | 33%                |              |  |        |
| Independent Assessment/Review/Audit of management                    | 20% *    | 15%           | 38% *    | 19%      | 22%                   | 22% *       | 0%                 |              |  |        |
| Management continuity and succession planning especially of CEO      | 43% *    | 44%           | 38% *    | 31%      | 44%                   | 67% *       | 67%                |              |  |        |
| Specialized expertise (financial / international / technical)        | 29% *    | 19%           | 63% *    | 13%      | 44%                   | 44% *       | 33%                |              |  |        |
| Innovation (new venture / product development / expansion)           | 49% *    | 44%           | 63% *    | 44%      | 67%                   | 44% *       | 67%                |              |  |        |
| Arbitration (owner and non owner family members / multiple owners)   | 3% *     | 4%            | 0% *     | 6%       | 0%                    | 0% *        | 0%                 |              |  |        |
| Crisis Management  | 29% *    | 26%           | 38% *    | 31%      | 22%                   | 33% *       | 0%                 |              |  |        |
| Legal and ethical conduct oversight                                  | 26% *    | 26%           | 25% *    | 25%      | 22%                   | 33% *       | 33%                |              |  |        |
| Evaluate board processes and performance                             | 20% *    | 19%           | 25% *    | 25%      | 22%                   | 11% *       | 0%                 |              |  |        |
| Select and compensate directors                                      | 20% *    | 19%           | 25% *    | 19%      | 33%                   | 11% *       | 0%                 |              |  |        |
| Select and compensate CEO/Top Management                             | 23% *    | 19%           | 38% *    | 6%       | 44%                   | 33% *       | 33%                |              |  |        |
| Assist in mentoring or training of CEO and top management            | 34% *    | 30%           | 50% *    | 25%      | 33%                   | 44% *       | 67%                |              |  |        |
| Assist in mentoring or training of new board members                 | 23% *    | 22%           | 25% *    | 19%      | 22%                   | 33% *       | 33%                |              |  |        |
| Approve major investments, acquisitions, and the sale of assets      | 26% *    | 26%           | 25% *    | 25%      | 44%                   | 11% *       | 0%                 |              |  |        |
| Provide Credibility with non family managers                         | 20% *    | 22%           | 13% *    | 25%      | 33%                   | 0% *        | 33%                |              |  |        |
| Provide Credibility with financial Institutions                      | 26% *    | 30%           | 13% *    | 19%      | 44%                   | 22% *       | 0%                 |              |  |        |
| Coordination with non-management owners                              | 17% *    | 7%            | 50% *    | 13%      | 22%                   | 22% *       | 0%                 |              |  |        |
| Provide energy and outside perspective to the organization           | 49% *    | 41%           | 75% *    | 44%      | 44%                   | 56% *       | 67%                |              |  |        |



# DO FAMILY MEETINGS REALLY MATTER? THEIR RELATIONSHIP TO PLANNING AND PERFORMANCE OUTCOMES

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## ABSTRACT

This empirical research focused on examining the relationship of family meetings and the characteristics of those family meetings (who attends, issues discussed and issues decided) to planning processes (succession planning, estate planning, family mission and business mission) and performance outcomes (revenues and number of generations survived). Of the 926 surveys sent to family businesses in a midwestern state, 241 were returned with useable data. Multivariate analyses of variance were used in drawing out the relationships. Significant differences were found in the planning processes between businesses that hold family meeting and those that don't. These differences, however, were not found significantly related to the performance outcomes. Significant relationships between family meetings and both planning processes and performance outcomes were found when comparing family businesses based on who participated in the family meetings. The results of the research are then discussed with respect to other family business research, and finally several practical implications are identified.

## INTRODUCTION

Family meetings are "...periodic gatherings (that) bring the family together to share goals and decisions, discuss common problems, learn about the business, and preserve family identity, values and traditions" (Aronoff and Ward, 1992, p.3). In their 1992 monograph entitled Family Meetings: How to Build a Stronger Family and a Stronger Business, Craig Aronoff and John Ward emphatically stated that these family gatherings can help build both a stronger family and a stronger business, and that they believed "...family meetings are one of the two most important steps a business owner can take to ensure the continuity of the family business (p.3)."

These thoughts followed John Ward's 1987 discussion of his study of successful family businesses in which he identified three principles that appeared to guide such companies. The three principles were a commitment to the future, the existence of a system of extensive communication and conscientious planning (Ward, 1987, p.9). The family meeting was viewed as the key vehicle for implementing these principles.

Given the strong reputations of Aronoff and Ward in the family business arena, it is not surprising to then find that since the late 1980's numerous books and articles written regarding how to manage family businesses have discussed the significance of family meetings (or their more formal form, the family council) in creating healthy, successful family businesses. Rarely do educational programs on building family businesses not mention family meetings as a key to success. In fact, family business forums and centers offer specific programs on how to establish successful family meetings. While there is logic to claiming that family meetings are a key to family business success, there has been little empirical research that demonstrates the value of family business meetings or that identifies under what conditions they are valuable.

Only one of the three most comprehensive empirical data gathering surveys (Arthur Anderson & Co., 1995, Arthur Anderson/Mass Mutual, 1997; and Mass Mutual Financial Group/Raymond Institute, 2003) in the series entitled the “American Family Business Survey” even had any questions regarding family business meetings. That study, the one in 1995, found 32% of family businesses held formal family meetings. Of those that held such meetings, 91.4% reported discussing business, 52% ownership, and 49% non-business topics. Those were the limited findings. Outcomes related to having a meeting, or from the issues discussed, were not examined in the study.

A more limited study by Joseph Astrachan and Thomas Korendo (1994) found 51% of their family businesses surveyed hold regularly scheduled family meetings limited to family members in the business. Further, the research found that those firms with governance practices that included strategic plans, boards of directors, and family meetings were “...correlated with business longevity over multiple generations” (p.119), and to a lesser degree with firm revenues. Family meetings were not broken out as a separate item in the correlations so it is not possible to determine if one of these practices or some combination are related to longevity.

In a more focused study on the way family meetings impact family business, Timothy Habbershon and Joseph Astrachan (1997) built a model to show how family meetings develop family unity through the creation of perceived shared beliefs regarding goals that may be an important stimulant of collective family activity focused on actions to achieve those goals. The study keyed on the theoretical model and on the ability of instruments to measure perceived agreement and not on empirical measurements of relating family meetings to outcomes.

Empirical studies prior to 1997 did not demonstrate a relationship between family meetings and family business success. Since 1997, empirical research relating to family meetings doesn’t appear to exist. Despite the lack of empirical findings, advisors continue to discuss the merits of family meetings. Thus, in moving family business research forward, there is a significant need for empirical research focused on the impact of family meeting outcomes. The results of that research could then be used in providing a firmer foundation for advocating that families to engage in such meetings, and depending on how the research is structured, possibly provide advice on how to structure the meetings.

The research discussed in this paper is intended to help fill the gap of a lack of focused research on family meeting impact noted above. Two performance and four planning outcomes were identified for consideration in the study. The two performance outcomes are level of revenues and number of generations of the family managing the business. Both are measurable, obtainable and are generally considered to be measures of success in family businesses over time. In getting at the performance and planning outcomes, the research also includes gathering information relating to who participates in the meetings and topics discussed in the meetings.

Recognizing the importance of planning to the successful completion of engaging in directed activities to accomplish goals, completed key family business planning documents were also looked at as possible positive outcomes related to family meetings. The specific planning outcomes examined are the existence of business mission statements, succession plans, estate plans and family mission statements.

In structuring the study, the focus was on the following three questions:

1. Are family meetings related to specific performance and planning outcomes?
2. Are characteristics of family meetings (who attends, issues discussed, and issues decided) related to performance and planning outcomes?
3. Can family meetings be grouped in a meaningful way based on who attends the meetings?

The first question focuses on the fundamental issue underlying the project, which is identifying the relationship between family meetings and specific outcomes. If there is an affirmative answer to that question, then questions two and three are intended to assist family businesses in structuring family meetings to increase their impact. The inclusion of information regarding who attends meetings and what items are typically discussed are intended to look at possible mitigating variables.

## METHOD

926 family businesses in a Midwestern state were sent a survey concerning family business governance, of those, 244 returned surveys. Respondents were asked if the business was a family business, and if not, they were dropped from the sample. Only three such businesses were identified; thus reducing the sample to 241 for a response rate of 26%.

The survey was a single page with 22 questions. The first set of questions was about general characteristics of the business that could be viewed as outcome measures, including the generation currently in control of the business and revenues of the business (see Footnotes to Table 1 for coding). The second set focused on planning with questions asking if the organization had a mission statement, if the family had a mission statement, if there was a succession plan and if there was an estate plan. Finally, governance of the family business was assessed by asking if the family held family meetings, who attended those meetings and what issues were decided at those meeting. Table 1 summarizes the descriptive statistics for all of these variables. The final variable *Decision* is the number of topics decided in the family meeting for each family that held formal family meetings.

As seen in Table 1, the average company is in its second generation, most have estate plans and business missions, but many fewer have succession plans and family mission statements. Of the family businesses, 35% hold family meetings with those in attendance typically being family members employed in the business. Items most frequently decided were role and responsibilities of members in the business, stock ownership, succession, and community involvement.

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Table 1 about here

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The first analysis was to determine if holding family meetings was related to the existence of planning and/or outcomes. The second analysis was to determine if the comprehensiveness of family meetings (number of issues decided in family meetings) was related to planning and outcomes. The third analysis was performed to determine if it was possible to cluster family organizations in a meaningful way based on who was allowed to attend family meetings. If the clustering process resulted in identifiable groups, the final step was to determine if these groups differed on issues discussed, existence of an active planning process (succession plan, estate plan, family mission, business mission) and performance measures (revenue and number of generations the organization has survived).

## RESULTS

In order to determine whether holding family meetings was related to a planning process and outcome measures, two multivariate analyses of variance were conducted comparing family businesses that held family meetings and those that did not. Results from the analysis using the four planning variables indicated that the overall multivariate F was significant [ $F(4,214) = 167.87, p < .001$ ]. The univariate F ratios for existence of a family mission [ $F(1,217) = 9.74, p < .003$ ] and existence of a succession plan [ $F(1,217) = 6.07, p < .02$ ] were significant. The other two variables had F ratios with a probability of  $p < .06$ . Not surprisingly, family businesses that held formal family meetings were more likely to have a family mission statement (21% versus 7%) and more likely to have a succession plan (44% versus 28%) than those that did not. For the other two variables, the pattern was the same but less pronounced. Results for the outcome measures indicated no significant differences between family businesses that held family meetings and those that did not.

Correlations were calculated between *Decisions* and the planning and outcome variables. Results showed that there were no significant relationships between comprehensiveness of family meetings (number of types of decisions made in a family meeting) and these variables. Apparently just having family meetings, regardless of their extensiveness, is all that is needed to increase likelihood of more formal planning.

To determine if there were types of family meetings based on who participated in them, a cluster analysis was performed using just those organizations that held family meetings ( $n = 77$ ). Results of this analysis indicated a three group solution. (The four group solution resulted in two groups of four (4). These cell sizes were too small for subsequent analyses.) Table 2 presents a summary of the three groups that held family meetings plus those family businesses that did not hold meetings. A Multivariate Analysis of Variance was performed to determine which of the family meeting participant variables differentiated among the three groups of businesses that held family meetings. The results indicated that three variables differentiated between the groups, with children attending generating a significant F ratio (Metchild ( $F(2,74) = 5.91, p < .005$ )). The other two differentiating variables (those not employed in the business and in-laws) did not produce an F ratio because the within group variance was zero. See Table 2 for a summary of differences between the groups. The first group is labeled *Inclusive* (everyone is at the meeting), the second group is labeled *Adult* (only blood relatives 18 years and older attend), and the third group is labeled *Employed* (only those employed in the business attend). In effect, the *Inclusive* group is most inclusive and the *Employed* group the least.

These three groups with family meetings were then compared on the kinds of decisions made. A MANOVA was performed using the three types of family meeting participants as the independent variable and issues decided at these meetings as the dependent variable. The multivariate F ratio was not significant. There was only one univariate ratio that was significant and that was for stock ownership ( $F(2, 70)=3.97, p < .03$ ). As Table 2 shows, the more inclusive the group, the more likely they are to made decisions about stock ownership.

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Table 2 about here

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Two other MANOVA's were conducted using the groups of family meetings types plus the group that held no family meetings as the independent variable and planning activities as dependent variables in one analysis and performance outcomes as dependent variables in the other. The multivariate F ratio for planning was significant ( $F(12,609)=2.95, p < .001$ ) as were the univariate effects for three of the four planning variables estate plan ( $F(3,204) = 3.74, p < .02$ ), family mission ( $F(3,204) = 3.66, p < .02$ ) and business mission ( $F(3,204) = 3.28, p < .03$ ). As Table 2 shows the *Inclusive* group had the lowest percentage of family businesses with an estate plan. This group in contrast has the highest percentage with a business mission and the *Adult* group has the highest percentage with a family mission statement.

The performance outcome measures resulted in a significant multivariate F ratio ( $6, 428$ ) = 3.004,  $p < .01$ ) with univariate F ratio for *Revenue* [ $F(3,214) = 4.05, p < .01$ ] being significant but that for *Generation* did not quite reach the .05 level [ $F(3,214) = 2.60, p < .06$ ]. Given the exploratory nature of this study, the results for *Generation* are included with the caveat that they did not reach the present significance level. Overall, the results indicate that *Inclusive* companies have had more generations of ownership and generate more revenue with the *No Meeting* companies having the second largest number of generations but were third in generating revenue. While there were no significant effects when just comparing family businesses that had family meetings with those that did not, there were significant effects when comparing family businesses based on who participated in family meetings.

## DISCUSSION

The analysis was unable to find significant differences for outcome variables between family businesses utilizing family meetings and those that do not utilize family meetings. No relationship was found between the comprehensiveness of the decisions made in the family meetings and any of the outcome variables (*Revenue, Generation*) in the study. Significant differences were found in the planning processes between family businesses that hold family meetings and those that don't. However, these differences were not significantly related to the performance measures used in the study. This seems to run counter to the prevailing thought in family business literature. Previous research (Astrachan & Kolenko, 1995) found a relationship between a combination of governance practices including family meetings and generations and revenues. While not conclusive, this suggests that if a relationship exists, it is a more complex relationship, than has been previously examined. The complexity of the relationship became

more evident when we examined family meetings more closely on the basis of who attends the meetings. When grouping the family firms on the basis of who attends the family meetings, we found significant relationships between the different groups and the firm performance measures. Overall, the results indicate that the *Inclusive* group companies, those that include the largest percentage of family members, regardless of age, in-laws and others, have survived for more generations and generate the most revenue. However, this group of firms had the lowest percentage of firms reporting a formal estate plan. Possibly the distribution of stock ownership, given that this decision is discussed most prevalently in this group, has reduced the need for estate plans.

The group of family businesses excluding family members under 18 years-of-age and in-laws had the lowest levels of revenues and had been in existence for the fewest number of generations. These values were even lower than the values for family businesses without family meetings. However, this group does have the highest percentage of firms with estate plans and a family mission statement.

This is interesting because it suggests that just having family meetings doesn't necessarily lead to a higher level of performance. To add greater value to the family businesses, it appears that family firms need to focus on the composition of the family meeting, not just on having them. The data seems to tell us that the more inclusive the family meeting membership is, the greater will be the positive effect on the firm. What is discussed and decided upon is not as important as who participates in the process. This makes sense if we think about how the inclusion of all family perspectives and interests has the potential to have a positive effect on the quality of decisions made in the firm. The improved quality and quantity of communication, the inclusion of more perspectives and skill sets in making decisions, and the increased probability of having all of the key stakeholders in the business agreeing on the goals and direction for the business, are all potential positive outcomes of inclusive family meetings. When all of these elements are combined, they lead to better decisions which can lead to better performance of the firm. In addition, if younger family members are included, it may help to encourage them to become a part of the business when they grow up. This could be an important factor in providing future family involvement in the business assuring the continuity of the family business.

The results also imply that just creating a mission statement and having an estate plan doesn't guarantee better performance for the family business. The group with the highest percentage of firms with these plans performed at the lowest level. These plans must be communicated and implemented to have a positive impact on the business. This is more likely to occur in businesses where all family members are included in the family meetings.

Future research could be conducted with samples from other geographic regions to improve the generalizability of the research. Research should include other measures of financial performance if possible. It should also look at the value of the family meetings to family itself. Perhaps these meetings assist the family in providing family management and leadership for successive generations in the business thereby increasing the probability of successful transition from generation to generation. This would provide a valuable contribution to our understanding of family businesses.

**Table 1**

Descriptive Statistics and Variable Names for All Variables Used in Analyses

| <b>Variable Definition</b>                       | <b>Name</b> | <b>Mean</b> | <b>Std.<br/>Deviation</b> | <b>Valid<br/>N</b> |
|--|-------------|-------------|---------------------------|--------------------|
| <b>Outcomes</b>                                  |             |             |                           |                    |
| Generation controlling the business <sup>1</sup> | Generat     | 2.15        | 0.907                     | 222                |
| Revenue <sup>2</sup>                             | Revenue     | 3.50        | 1.759                     | 219                |
| <b>Planning</b>                                  |             |             |                           |                    |
| Have a written succession plan <sup>3</sup>      | Sucplan     | 0.33        | 0.472                     | 217                |
| Have a written estate plan                       | Estplan     | 0.66        | 0.474                     | 216                |
| Have written family mission statement            | Fammisn     | 0.12        | 0.325                     | 218                |
| Have a formal business mission statement         | Busmisn     | 0.61        | 0.489                     | 222                |
| <b>Family Meetings</b>                           |             |             |                           |                    |
| Hold formal family meetings                      | Fammeet     | 0.35        | 0.477                     | 223                |
| <b>Who Attends</b>                               |             |             |                           |                    |
| Family members employed in business              | Metfamin    | 0.95        | 0.223                     | 77                 |
| Adult family members not employed in bus         | Metfamot    | 0.53        | 0.502                     | 77                 |
| Family members under 18                          | Metchild    | 0.06        | 0.248                     | 77                 |
| In-laws  | Metinlaw    | 0.22        | 0.417                     | 77                 |
| Others   | Metothr     | 0.08        | 0.270                     | 77                 |
| <b>What Issues Decided</b>                       |             |             |                           |                    |
| Business roles and responsibilities of family    | Dcroles     | 0.72        | 0.454                     | 74                 |
| Which family members can be employed             | Dcemploy    | 0.34        | 0.476                     | 74                 |
| Qualifications of family to be managers          | Dcmgmt      | 0.31        | 0.466                     | 74                 |
| Compensation policies for family members         | Dccomp      | 0.46        | 0.502                     | 74                 |
| Stock ownership                                  | Dcstock     | 0.61        | 0.492                     | 74                 |
| Voting stock control                             | Dccontrl    | 0.35        | 0.481                     | 74                 |
| Dividend policy                                  | Dcdivid     | 0.32        | 0.471                     | 74                 |
| Succession                                       | Dcsucc      | 0.64        | 0.485                     | 74                 |
| Code of conduct family/business relationship     | Dccode      | 0.49        | 0.503                     | 74                 |
| Community involvement                            | Dccommu     | 0.54        | 0.502                     | 74                 |
| Methods of family conflict management            | Dcconmg     | 0.24        | 0.432                     | 74                 |
| Other decision topics                            | Dcothr      | 0.10        | 0.296                     | 73                 |
| <b>How Many Different Issues Decided</b>         |             |             |                           |                    |
| Number of decision topics chosen                 | Decisions   | 11.00       | 5.11                      | 74                 |

<sup>1</sup> Actual generation, first = 1, second = 2, etc.

<sup>2</sup> Coded 1=\$0-\$999,999, 2=\$1Mil - \$4Mil, 3=\$5Mil - \$9Mil, 4=\$10Mil - \$24Mil, 5=\$25Mil - \$49Mil, 6=\$50Mil - \$99Mil, 7=\$100Mil - \$199Mil, 8 = \$200Mil or more

<sup>3</sup> For remainder of questions a "1" indicates response was a yes, "0" it was a no.

**Table 2**Company Profiles based on Who Attends Family Meetings

| <b>Group</b>                  | <b>Family Members Attending</b>   | <b>Decisions Made</b> | <b>Planning Process Elements</b>                              | <b>Generations Revenue</b>      |
|-------------------------------|---|-----------------------|---|---------------------------------|
| 0<br>n=151                    | No Meeting  | No Meeting            | 60% estate plan<br>7% family mission<br>55% business mission  | 2.21 Generation<br>3.39 Revenue |
| 1<br>n=17<br><b>Inclusive</b> | 100% Employed<br>100% Not employed<br>24% Under 18<br>100% In-laws<br>18% Other | 87% stock ownership   | 50% estate plan<br>19% family mission<br>94% business mission | 2.47 Generation<br>4.88 Revenue |
| 2<br>n=24<br><b>Adults</b>    | 87% Employed<br>100% Not employed<br>00% Under 18<br>00% In-laws<br>04% Other   | 61% stock ownership   | 86% estate plan<br>27% family mission<br>68% business mission | 1.76 Generation<br>3.19 Revenue |
| 3<br>n=36<br><b>Employed</b>  | 97% Employed<br>00% Not employed<br>03% Under 18<br>00% In-laws<br>06% Other    | 47% stock ownership   | 79% estate plan<br>18% family mission<br>59% business mission | 1.99 Generation<br>3.51 Revenue |

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**SESSION**  
**TECHNOLOGY, INNOVATION AND BUSINESS DEVELOPMENT:**  
**THEORETICAL PERSPECTIVES**

by

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**ABSTRACT**

The concept of innovation is usually restricted to the technology or technical field. Until the 1990s, scarcely anybody talked about social innovation except, in certain cases, to refer to the likely effect of society on the emergence of technical innovation. The analysis stopped there. Thus, this article aims to broaden the analysis of innovation by examining not only its technological dimension, but also its social and territorial dimension, a notion that has recently come into use in the theories of “new economic sociology” and “socio-economic geography”. The paper is divided into three parts. Part One will review the bases laid by Schumpeter and Veblen’s founding analyses in reference to technology, innovation and entrepreneurship. Part Two will address innovation from the perspective of evolutionary economists. We will reconstruct an explanation of social innovation as a cognitive process confronted with localized social resistance, thus posing the problem of social and territorial diffusion of innovation. Part Three concludes by emphasizing the strong link between sociality, territoriality and market.

**INTRODUCTION**

The concept of innovation is usually restricted to the technology or technical field. Until the 1990s, scarcely anybody talked about social innovation except, in certain cases, to refer to the likely effect of society on the emergence of technical innovation. The analysis stopped there. Thus, this article aims to broaden the analysis of innovation by examining not only its technological dimension, but also its social and territorial dimension, a notion that has recently come into use in the theories of “new economic sociology” (Levesque et al. 2001) and “socio-economic geography” (Benko and Lipietz, 2000).

From our perspective, innovation is not considered to be the simple mechanical insertion of technical novelty into production. This perspective extends beyond the idea that there is, downstream of the invention, a social usage that is ready or naturally disposed to integrate a

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technique, a process or a particular type of organization of social relations. We argue that the continuous presence of society must be taken into account throughout the “process of innovation production,” starting with the inventor’s instinct, the different mechanisms leading to its institutionalization, the necessary efforts to construct the social usage of the invention, and ending up with its diffusion.

This perspective does not deny the role of the market in the production of innovation, but argues that the latter is embedded in society. It is essential to examine this link in order to understand the different dynamics of development which take place in territories which, while certainly specific, are related to global processes. In this paper, our analysis of the role of society in innovation processes consists of an overview, indeed a summary, of the different perspectives developed to study the innovation process. We suggest an approach that will allow us to revisit some of the different stages marking the evolution of the concept of innovation.

The article is divided into three parts. Part One will review the bases laid by Schumpeter and Veblen’s founding analyses. Part Two will address innovation from the perspective of evolutionary economists. Part Three will conclude by emphasizing the strong link between sociality, territoriality and market. In this perspective, we consider that innovation and innovative business development constitute a social and territorial construction, whose production and effects depend on local and global socio-economic contexts that are conflict ridden and hierarchical. From this perspective, the territory mediatizes and structures arrangements of production actors, organizations and decision makers, thus allowing for the emergence of specific innovation cultures but that are not isolated from nor independent of more global contexts.

### **INNOVATION AND SOCIETY: FOUNDING ANALYSES**

It must first be specified that the works by classical analysts of society and its evolution did not focus much on the notion of innovation. This lack of interest is explained, in our view, by the deterministic and unilinear conception of social change held by these authors. This conception, against which Braudel (1985) rebelled, was held by important authors such as Durkheim, Weber, Spencer and Marx. It was only towards the end of the 19th century that the concept of innovation entered into the language of sociology in a veiled way. This occurred when the notion of “imitation” was used by Tarde (1890) who explained that societies evolve through the daily accumulation of inventions -- “innovations”-- which gradually alter the lot of human behaviour. According to Tarde, the distinctive feature of human beings is to imitate fellow human beings and therefore when a new behaviour appears, it entails an “epidemiological” reaction whereby “the innovation” is imitated as soon as conditions permit. However, Tarde did not dwell on the conditions of this imitation and this vision remained marginal. It was not until the analyses by two trail-blazing authors, namely Schumpeter and Veblen, that a more comprehensive conceptualization of innovative processes emerged.

### Schumpeter's entrepreneur-innovator

Schumpeter's main contribution to the analysis of innovation is the entrepreneur-innovator. He borrows his vision of the entrepreneur or business leader from the notion of *Führerschaft* which refers to the fact that in all fields of social activity, the leader has a special role. The abilities of this leader essentially amount to initiative and will. By transposing this notion into the field of economics, Schumpeter derives from it the notion of business and entrepreneur. Business is the act of achieving and the entrepreneur is the agent who carries out new combinations of production factors (Tremblay, 1989).

For Schumpeter, the entrepreneur is not the inventor of a discovery but the one who introduces this discovery into the firm, the industry, the economy, that is, strictly speaking, the person responsible for its diffusion. In his view, economic society is run by human decisions, those of entrepreneurs, and not by ideologies or abstract social classes. This is what basically distinguishes Schumpeter's theory from the deterministic and macro-social perspectives mentioned above. Thus, change stems from the concrete exercise of a function and not from the function per se, which means that when somebody is an "entrepreneur," it is because he implements new combinations; he creates a context through which the framework of social intervention broadens and is transformed. Only this act of entrepreneurship corresponds to the role and function of an entrepreneur. Schumpeter constructs his analysis in the economic environment and sees an actor-transformer in anybody who can implement a new combination of arrangements in a firm, an organization with an economic vocation. (Tremblay, 1989)

From this perspective, the function of the entrepreneur consists in overcoming a series of obstacles. According to Schumpeter, innovation is a creative response to these obstacles. Three major types of resistance to innovation can be identified. First, the entrepreneur-innovator acts in a context of uncertainty, that is, given the information that he has, he is not sure that his project will be successful. He may use retrospective data, but these bring little certainty since nobody is using them the way he suggests. The second type of obstacle appears to be fairly obvious and was described by Schumpeter in 1935 as follows: "It is objectively more difficult to innovate than to use what is usual and proven." (translation) Lastly, the third type of obstacle -- in our view, the most important-- involves the reaction of the social milieu to the innovation, or "to anybody who wants to innovate" (Schumpeter, 1935) (translation). Thus, Schumpeter said: "It is not enough to produce satisfactory soap, it was also necessary to induce people to wash."<sup>4</sup> This metaphor still applies to the present day since it raises the issue of the social construction of usage of the invention, which is the specific feature of innovation. (Tremblay, 1989)

Although Schumpeter's works have made it possible to isolate the role of the entrepreneur as a key agent of change in economic organizations, he did not broaden the role of the entrepreneur to other types of actors in the social, political and cultural spheres. To grasp

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4. This is an excerpt of *Business Cycles* (pp. 243-244) taken up again in Marty (1955: 92).

the full complexity of the recognition of usage, the link must be made between Schumpeter and Veblen's works.

### **Veblen and the role of technology**

Veblen makes an important contribution to the economic analysis of innovation, but especially to the global and interdisciplinary examination of this subject. For Veblen, just as for Schumpeter, technology or, in his words, "the state of the industrial arts," is the key and determining economic factor in social evolution. What Veblen meant by "technology" can be summed up in two series of elements: on the one hand, a system of tools, instruments and machines, and on the other, what we consider to be the most important aspect – know-how. Veblen also used the terms "intangible assets," "collective assets" and "immaterial wealth" while referring to this technical know-how that he deemed to be more important than the tools and instruments which make up physical capital. Veblen viewed technology as an "indivisible possession of the community at large, whereas the instruments created by this technology can become man's individual property" (Corbo, 1973; Tremblay, 1989, 1992).

For Veblen, technology will only be effective if it finds the appropriate material conditions, if the required material forces are available, and if it is located in an appropriate diffusion or "propagation environment." To a certain extent, Veblen's theory is thus imbued with a degree of "technological determinism." However, Veblen brings other forces into play which will help to tone down this determinism that tends to be emphasized. Among these other forces is "culture." Indeed, Veblen views technology not as a static reality but a dynamic reality "that continuously evolves and whose effectiveness depends on a number of specific conditions." "Although it is true that technology influences culture, it is also true that culture can facilitate as well as inhibit the effectiveness and progress of technology" (Corbo, 1973, p. 295) (translation). Once again, we are getting closer to a global rather than a solely economic vision of technology.

Thus, to sum up, for Schumpeter, innovation lies in the process that leads to the generalization, even the creation of the social usage of invention. Although the entrepreneur is in charge of constructing the usage, he does so by creating on his own something that the inventor did not have, which in itself also constitutes an invention. In this respect, Veblen completes and even goes beyond Schumpeter's analysis by bringing out the effects of reciprocity between technique/technology and the social environment. For him, not only do technologies have an effect on the cultural and institutional environment, but this institutional environment itself exerts an effect on the technologies. Thus, a form of reciprocity of effects exists between the social context and the technologies (or innovation, a term that we prefer but Veblen hardly uses).

### **THE EVOLUTIONARY APPROACH: FROM CYCLICAL TO SPATIAL EFFECT**

As we have just seen, Schumpeter and Veblen's works constitute important background for the development of an analysis which embeds innovation in society. However, it was the "evolutionary" economists who completed their work by proposing a global vision of

innovation. For this movement, innovation is a *process* (Freeman et al., 1982), a “process which transmits and receives impulses, connects new technical ideas to the markets” (Le Bas, 1995) (translation), a process of problem solving, a learning process which brings into play knowledge, skills, competencies, know-how, capacities and abilities (Winter, 1987).

### **Cyclical effect of innovation**

According to evolutionary economists, the innovation process occurs in an organization or a firm; thus, their vision is closer to that of Schumpeter (Dosi, 1988). For Schumpeter, at first small or medium-sized firms were the initial sites of innovation, whereas the concentration of capital over the years has given rise to the domination of large firms and their research and development departments. However, for the evolutionary economists, these two places (SMEs and large enterprises) do not necessarily succeed one another in time but can, on the contrary, co-exist.

This seems to correspond better to today's reality in which, depending on the sectors and the degree of maturity of the sector involved, it is in some cases SMEs and in other cases large enterprises which dominate the innovation process. Moreover, these two innovation regimes can be explained by the phase a given industry is going through (Dosi, 1988). As observed by Dosi, when an industry is in an emerging phase (for example, multimedia, biotechnology, optronics, etc.), innovation tends to proceed by trial and error.

Entrepreneurs take risks and new technologies appear, leading to the creation of new enterprises. On the contrary, during the maturity phase --for example, the steel and automobile sectors where markets are quite saturated and generally oligopolistic -- technological changes and innovation in general constitute one of the, if not the main, weapons of competition.

The revitalizing potential of an innovation thus does not last forever. It runs out, which explains technological revolutions as well as the appearance of new technological cycles and the obsolescence of former technologies. As explained by Vernon (1976), whose analysis is similar to those by Dosi (1988), the revitalizing potential of an innovation is closely related to the life cycle of a product. Vernon's works show that there are five phases to a product initiated through innovation: novelty, growth, maturity, standardization and decline.

The revitalizing effect of innovation is felt during the first phases when the manufacturing of the new product creates new market opportunities, attracts capital and thus generates new enterprises, including small ones, where new usages and types of the product are developed. The creation is subsequently replaced by mass production with stricter and more intensified standards, and the revitalizing potential of the innovation diminishes. Based on his analysis of the United States, Vernon put forward an explanation of the effect of innovation on economic development. According to this explanation, development is linked to the capacity of a country, or a regional or local milieu, to specialize in the manufacturing of products which are still in their first phases and then to withdraw from it as the cycle advances in order to redirect its economic specialization towards other emerging products.

It thus paves the way for a new development strategy centred on the capacity to innovate, where growth depends on the specialization in the first phases of goods production.

### **The spatial effect of innovation**

As highlighted by the evolutionary perspective, innovations have an effect on temporal dynamics. However, they also have a major effect on the territory. This spatial effect is due to the fact that an innovation stems from the combination of the technical discovery or invention with a community's organizational and economic capacity to develop it. Yet, this combination is a specific phenomenon. As Perroux (1986) asserts, innovation does not appear everywhere nor at the same time. It appears in specific places where it brings about changes in the methods of production and therefore of consumption, where it changes production standards and from where it is diffused.

Perroux puts the diffusion of innovation in the context of a process which brings into conflict production and consumption practices induced by innovation on the one hand with, on the other hand, a community's potential to adapt to them. But to adapt to innovation does not simply mean to imitate it, as suggested by Rostow (1960) in his study on the stages of economic growth. It also and especially refers to the voluntary actions taken jointly by entrepreneurs and organizations to appropriate the innovative process, develop it, extend it, and generate a recurrent dynamic capacity. This obviously implies various types of innovation (Perrin, 1985).

Thus, a question arises: How can a milieu adapt so as to create productive groups capable of taking advantage of the effect of innovations? To pose this problem means to turn the question around. Thus, we must examine how communities react to the diffusion of the innovation. Rather than considering what effect the innovation has, we must consider how to move over to the new production practices induced by the innovation, either by specializing in the types of production that have a revitalizing potential, or by putting forward social conditions that allow the community to innovate.

Based on the evolutionary analysis, innovation is thus viewed as a social process that is linked with technologies or technical systems, as well as with the goods market and the labour market (Le Bas, 1995). This process is therefore uncertain, although not entirely so. The firm acts as an interface between these elements, mediating and making choices within the context of this set of social facts of which it is part. According to this vision, the diffusion of new production practices induced by innovation occurs through changes in production standards – changes that are passed on from firm to firm, and thus from place to place, through their productive interrelations. This diffusion is carried out within the boundaries of the firms which contribute to the innovation-induced production and is then generalized across the industries which include combinations of firms and actors.

### **The systemic territorialized effect of innovation**

The diffusion of change is accompanied by or confronted with social changes which are related to the social structure and the cultural characteristics of the different milieux. These

changes have to do with the communities' ability to adapt to the technological change induced by the different types of innovation and to appropriate them, thus in turn generating a recurrent capacity to develop innovations and produce growth. The combination of social changes which include the organizational and social structure of a community as well as the capacity to get in step with the innovations diffused throughout the industries, are conditions for the emergence of production systems characterized by innovation in specific regions and milieux (Lundvall, 1988; Wolfe, 2002; Braczyk, Cooke, Heidenreich, 2003).

Several studies have addressed the relationships between innovation and territory in this type of place by using the notions of "innovative milieux" (Aydalot, 1986; Maillat, 1992), industrial district (Becattini, 1991; Piore and Sabel, 1984) and technopole (Benko, 1991). In all cases, despite the different approaches, these notions have been used to designate the methods of arranging a community's technology, territory and organizations (Storper, 1997). The result is communities where production and society are interlinked by configuring territorial production systems. Territorial proximity allows the territorial system of firms to practically rely on economies of scale linked with the entire production process while not losing their flexibility and adaptability to the vagaries of the market owing to the segmentation of this process (Klein, Tremblay, Fontan, 2003).

The agglomeration effect of these territorial systems encourages the establishment of local forms of co-operation so as to collectively take charge of a series of individual production problems and thus ensure local governance. Therein lies the synergy induced by this type of system. This synergy is made possible by the fact that firms are part of comparable production processes and the goal of the established collective learning processes is to solve common difficulties. The implementation of these solutions means new infrastructures and is expressed through the will to strengthen the partnerships between the large enterprises, SMEs, institutions of higher learning (universities, research institutes), local authorities (municipalities, local organizations) and government institutions.

The analysis of the relationships between innovation and territory highlights the system effect created by the strengthened links between the economic, social, political and cultural actors sharing the same geographical space within a context of reticular interrelations constructed at the global level. The place is more than a localization, it is a system. There is a "place effect" which directs the action of actors. This effect is economic, political, social, cultural and ideological. It is the effect of place which leads to the hierarchical structuring of local systems, as a result of the territorial arrangements of stages and actors of a globalized network (De Bresson and Amesse, 1991; Holbrook and Wolfe, 2002).

#### **INNOVATION EMBEDDED IN THE LOCAL, THE GLOBAL, THE INDIVIDUAL AND THE COLLECTIVE**

To study innovation is to explain a process with dimensions that become determining factors and eclipse others, depending on what is being innovated. Though certainly technical and economic, the innovation process is just as social as it is political and obviously has a cultural impact. To study an innovation is to shed light on the social,

technical, economic, political and cultural characteristics that are put forward by individual and collective actors. This set of factors is significant in that it occurs in a specific place and time. Therefore, it is important to take into consideration both the territory and the temporal dimension.

We hypothesize that innovation is conditioned by a social context. Therefore, for us, the dynamic of social innovation brings into play actors who hold positions within a set of institutional arrangements. Since these groups, as demonstrated by Hollingsworth and Boyer (1996), are geographically structured on the basis of different but complementary regulatory modes of social systems, social innovation operates on the basis of these regulatory levels. Therefore, reference can be made to the existence of a set of social innovation systems that belong to geographical spaces ranging from the global space to the local space, transiting through the intermediary spaces (continental, national and regional). We are thus faced with a spatialized map linking a combination of innovation systems, some of which are moreover cross-border. Thus, innovation cannot escape from the cultural determinism of the world and the social system which embeds it, but this cultural determinism is itself organized into a hierarchy around the reality of the global economy.

Our vision of innovation emphasizes the social construction of innovation and the processes and interrelations which come into play at all levels. Our main intention was to put forward an overall perspective which views actors as well as territories as interrelated elements that are sometimes under tension. From this perspective, innovation does not in itself have a positive function linked to social progress. Social usage becomes positive or negative for a community, depending on what the social actors will do with it. Socially innovative action pertains to the field of strategy since it works on the action system of an organization or a community. Socially innovative action implies a greater structuring of the social milieu (1) prior to the innovation, through a redefinition of cultural orientations; (2) during its implementation, through the new methods of managing social relations, consultation and partnership for example; and (3) following its implementation, through pressures exerted in order to change individual and collective consumption habits. This is how 'milieux' are constructed where invention and novelty can emerge more easily and where the cycle leading to the recognition of its social usage and institutionalization speeds up, thus establishing innovation systems.

This brief overview of the different approaches to the role of society in innovation processes and business development leads us to conclude that innovation results from acts that are certainly individual, in the sense of a leadership exerted by an individual, but that are reticulated, framed and made possible by a favourable or unfavourable cultural and social context, by a fairly conciliatory economic context and by negotiations taking place between actors who are more or less in agreement with the definition of a new social usage. Therefore, social innovation encompasses both the fact of innovating, that is, a culturally-oriented inventive act, a product of the imagination or chance, and the institutional process of social recognition of its usage, that is, as it becomes established.

**BIBLIOGRAPHY (FOR LACK OF SPACE, SUPPLIED BY AUTHORS UPON REQUEST)**



## **OFFSHORE OUTSOURCING: THE IMPACT ON BUSINESSES**

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### **ABSTRACT**

The concept of outsourcing is a business practice that has gained momentum. However, many view this trend as a plague that is deteriorating American professional jobs. At the same time, many companies have incorporated outsourcing as a critical strategy in business planning. However, political opposition across the nation to outsourcing American jobs is strong. Legislatures without a doubt are going to introduce new bills or laws to prevent or at least limit offshore outsourcing. This paper investigates the advantages and disadvantages of outsourcing, the global market, and the political ramifications of outsourcing information technology, especially offshore.

## **INTRODUCTION**

The popularity of outsourcing continues to gain momentum in both the private and public sectors. In the mid-1990's, outsourcing was viewed as a viable solution to achieving cost control and production efficiency. Many companies began to incorporate outsourcing as a critical strategy in business planning. Today, because of historical successes, corporations are turning to outsourcing for a wide range of functions from logistics to human resources to customer relations. The reasons include cost, quality, performance, supplier pressure, access to special technical and application skills, and other factors. (Applegate, 2003)

The government sector also is increasing its use of outsourcing. At one time, government outsourcing was primarily applied to contracts in areas such as maintenance, security, and food services. However, the government is finding it necessary to follow the commercial trend to outsourcing a wide range of functions, including information technology functions. (Office of Information Technology, 1998)

Outsourcing is critical to U.S. organizations as they endeavor to become or remain competitive in the global economy. It is for this reason that this paper investigates the advantages and disadvantages of outsourcing, the global market, and the political ramifications of outsourcing information technology, especially offshore.

## **IT OUTSOURCING**

Outsourcing is typically defined as when a buyer transfers ownership of a process to a supplier. Manufacturing, for example, has been using offshore arrangements for decades as a way to drive down costs and boost production. The IT industry is following a similar path. Before 1990 the major drivers for outsourcing were primarily: cost-effective access to computing power or system development skill, avoidance of building IT in house, access to IT skills, and access to special functional capabilities (Applegate, 2003). In the 1990s the production of IT hardware moved offshore, resulting in price reductions of 10% to 30%. Thus, if moving jobs offshore means lower costs, then a company can sell its products at a lower price, and everyone gains. When computer hardware began to be made abroad, prices plummeted. Therefore, if software prices decline, then small- and medium-size companies will be able to afford to adopt more technology solutions. (Mann, 2003; Haydik, 2004)

Two factors have affected the growth of IT outsourcing:

1. Acceptance of strategic alliances - The value of strategic alliances is widely recognized and interrelated forces motivate their creation.
2. Changes in the technological environment - IT integration of internal systems with those of customers and suppliers and the process of changing organizational structure to compete efficiently in the global marketplace.

According to a study by IDC, spending by US customers on offshore IT services will continue to concentrate heavily on applications, with most activity in the areas of custom application development, application management and systems integration. Global investment in offshore

IT services will grow from nearly \$7 billion in 2003 to \$17 billion by 2008, new research has predicted. It is predicted that the countries poised to win from this growth in outsourcing will be India, the Philippines and China, joined by central and eastern Europe. The procurement of IT services is not only growing as a share of the total IT services market, but is expanding from traditional IT services, such as application development and maintenance. (Intetics, 2003).

## **GLOBAL MARKET**

Businesses are beginning to look outside of established outsource providers for a variety of reasons: cost, risk mitigation, specialized technology and language skills and proximity to the U.S. But the infrastructure to support IT services varies from region to region. India, China and Russia (among others) are churning out vast numbers of very bright and capable technology workers. These countries have discovered that the initial investment in a technology infrastructure is far lower than the initial investment in a traditional asset-intensive industry, i.e. manufacturing automobiles. With a sense of vigor and vision these nations have burst onto the tech scene in a very short time. Currently, India leads the pack as the prime location for offshore IT operations such as code maintenance, help desk and desktop maintenance. As the worker base becomes more skilled and as demand increases for India services, wages are increasing. Some economists feel that India's wages could rise so fast that they could push much of the offshore labor market from India to China and Southeast Asia in the next decade (where wages remain lower). Outsourcing service providers in African countries are at a more basic stage of growth than those in the Philippines. Although South Africa is already home to a handful of international services providers and homegrown providers, other countries on the continent are just beginning to build industrial parks to capture a share of the offshore outsourcing market. U.S. companies, however, might not need to look very far abroad for outsourcing services, especially if cost is not the major issue, and language is a consideration. Canada has a telecom infrastructure virtually identical to the U.S. Mexico, however, offers some cost advantages and is particularly appropriate when Spanish services are required. (Swoyer, 2004)

## **ADVANTAGES TO IT OUTSOURCING**

The drivers of outsourcing include general managers' concerns about costs and quality, breakdowns in IT performance, intense vendor pressure, simplified general management, financial factors, corporate culture, eliminating an internal irritant, and other factors (Applegate, 2003). It appears that organizations that outsource for long term, strategic reasons often are more satisfied with the outsourcing results than those that outsource for short term, tactical reasons. U.S. companies cut or at times eliminate unwanted costs when jobs are outsourced to international suppliers. By doing so, these companies now have the freedom to be more flexible when making IT business decisions for their companies. Outsourcing is a means by which revenue is generated, production is improved, and the U.S. economy is increased. More resources are also made available which in turn provides quicker products to the marketplace.

Moving certain business functions to other offshore companies allows a company to have no overhead costs. For instance, offshore companies provide their own facilities to do the work. There is no need to recruit, hire, or train new employees at all for the company. Also, other expenses related to employees such as insurance, worker's compensation, social security, and

company benefits are all gone. Offshore companies "pick-up" the tab where in the meantime U.S. companies are again cutting costs and increasing profits to boost the American economy. In deciding which company to choose, U.S. businesses can tap into an international pool of highly talented, experienced workers who can do the same skilled job at a lower price. With this in mind, any project that is handed over to a potential vendor will be placed under highly qualified proven individuals who work together effectively. U.S. companies are then able to vary their involvement however they wish. Having well documented processes in place for service jobs, corporations can trust that it will be completed on time, within project budget, and meets the specified criteria as given to the offshore vendor. It can be argued that outsourcing projects to offshore companies improves a company's main focus on the job at hand and not on unneeded tasks. (Kalakota, 2004)

Coupling innovative approaches with offshore outsourcing can payoff for everyone. Consider the case of Net Scalar Inc., a Silicon Valley maker of network switches that speed online applications such as Google searches. It had to cut its 100-person staff to 55 in 2002 after the September 11 attacks dried up sales. To survive, it launched an operation in Bangalore. Round-the-clock work in the U.S. and India helped it pack leading-edge data compression and security features into its latest product. Now, with sales jumping more than tenfold, to well above \$10 million last year, it has boosted its U.S. staff to 105, even larger than before. (Hof, 2004)

## **DISADVANTAGES TO IT OUTSOURCING**

As with all new initiatives that are implemented into a company's business strategy, there are some drawbacks to outsourcing. They include but are not limited to language and cultural differences, displaced American IT professionals, loss of intellectual property or trade secrets, foreign political infrastructure, hidden costs, unfamiliarity and lack of experience with offshore providers and their capabilities. All of the aforementioned weaknesses are important and significant for a company that is considering outsourcing. Language and cultural differences are the critical weaknesses that are causing some corporations to reevaluate which IT functions should be outsourced. One big name company that has decided to return certain offshore work to the U.S. is Dell Corporation. Dell brought back a technical support center after corporate clients complained about communication and service. Fundamental language and cultural differences derail the cost savings that are suppose to be achieved with outsourcing.

The losses of intellectual property or trade secrets are threats to corporations because offshore workers come in contact with specific operations during the course of normal work. As part of learning operations, offshore workers can gain knowledge that can be applied to other projects down the road. This is a positive thing if these projects are done on the company's behalf. On the other hand, the company's accumulated knowledge may be applied to solutions for other customers at a later date. Since most offshore workers are employed as contractors, there is the distinct possibility that this knowledge will be applied to competitors' solutions.

Various studies show that 20% to 35% of IT outsourcing contracts are not revived after the y expire. Most customers in these cases are not satisfied with the quality and/or price of the services. (Intetics, 2003; Swoyer, 2004)

## **POLITICAL RAMIFICATIONS**

Losing jobs to offshore outsourcing has created a hot political issue in the United States. As long as the economy continues to struggle, the pressure to keep IT jobs in the U.S. will be strong. Today, state and federal legislatures are trying to discourage offshore outsourcing of IT jobs to foreign countries. In May 2004, Tennessee was the first state to pass legislation aimed at preventing offshore outsourcing of its IT services. The new law states that contractors that keep data entry, call center and other IT support jobs in the U.S. will receive significant preferential treatment during the bidding process on future new contracts. This is not surprising because many other states are considering similar actions too. Legislatures are being pressured to introduce new bills or laws to prevent or at least limit offshore outsourcing.

Political opposition across the nation to outsourcing American jobs is strong. An amendment known as the Dodd Amendment, which was introduced in February, 2004 and passed in March by the Senate, is another step to stopping the needless exporting of American jobs. It prohibits offshore outsourcing of federal, state, and local government contracts where federal dollars are involved. However, the Dodd Amendment includes a provision that the Secretary of Commerce must certify that these anti-offshore outsourcing measures will not harm the U.S. economy. So far, the House of Representatives has yet to consider the Amendment as law yet and it is unclear what will happen in the future. Nonetheless, the issue is not going away.

## **SUMMARY**

Outsourcing will continue to grow to be an accepted way of doing business as companies focus more directly on customer service and cost/budget reductions. As the concept becomes more accepted and outsourcing opportunities expand, the process will be more clearly outlined. Companies will accept outsourcing as another tool to improve services and reduce costs. Properly used, along with modular contracting, past performance initiatives, outsourcing will provide firms with the means to achieve excellence. Finally, firms will become comfortable with the entire process. They will approach outsourcing as a management tool that solves long term, strategic problems rather than short term, tactical problems. In doing so, companies will work with their alliances to realize successful outsourcing efforts.

IT outsourcing will continue to be a critical strategy to efficient and effective business operations. There are obvious benefits that offset the disadvantages. However, the political ramifications are certain to drive the decision-making regarding the market exchange process.

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## **LIVING WAGE ORDINANCES AND SMALL BUSINESS**

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### **ABSTRACT**

During the last decade over 100 governmental units (primarily cities) have implemented living wage ordinances. These regulations require employers who receive public funds through subsidies and contracts to pay their workforces a wage based on a definition of “need” rather than “skills.” Such ordinances feature a minimum wage floor that is higher—and often much higher—than the traditional minimum wages set by state and federal legislation. This paper provides a history of the living wage movement and presents challenges small business owners must address in their decision-making regarding this highly controversial and politicized issue.

### **INTRODUCTION**

Two key efforts in the United States wage movement attempt to assist low-income families in freeing themselves from poverty by increasing their incomes. The first involved the enactment of a minimum wage. At the outset of the 20<sup>th</sup> century individuals and pro labor organizations lobbied for a minimum wage and this quest for wage reform turned to a fight for a legislated minimum wage and, ultimately, to the passage of the national Fair Labor Standards Act in the 1930s (Glickman, 1997). Numerous states have at times imposed a higher minimum wage than today’s \$5.15 per hour.

The second effort in the wage movement involved the development of a living wage at local levels and is a more recent innovation. Recently a number of books have addressed issues of the working poor and how laws at (chiefly) the city and county levels can be designed to assist these individuals not only in terms of a higher minimum wage, but also with respect to medical coverage (Shipler, 1998). Collectively, these local wage campaigns have emerged under the rubric of “living wage” statutes. A living wage involves local legislation that requires employers to pay a certain wage above the federal or state minimum wage level under predetermined conditions to a specific set of employees. In general, beneficiaries include employees of contractors or subcontractors with city service contracts or those businesses that have received economic development subsidies or financial assistance from cities or other governmental entities (Varricchione, 2001). Living wage mandates differ from a traditional minimum wage in that the living wage is, at least theoretically, tied to meeting some standard of living and only applies to employers who receive some benefit from the government. The goal of living wages, like that of minimum wages, is to raise incomes of low-wage workers in order to reduce poverty.

### **A HISTORY OF LIVING WAGE**

In 1994, Baltimore, Maryland was the first major United States city to pass a living wage ordinance, followed a year later by ones in Milwaukee, Wisconsin, and by Santa Clara County,

California. By mid 2004, according to the Association of Community Organizations for Reform Now's (ACORN) Living Wage Resource Center (ACORN, n.d.a), there were 120 entities (cities, counties, school boards, colleges, and universities) with living wage policies.

Such ordinances require wages to be paid based on some definition of need; that is, a wage that is commensurate with workers' needs as consumers (Glickman, 1997). A needs-based or consumerist understanding marks a departure from a more traditional one that asserts workers may expect wages corresponding to the value of the product(s) or service(s) they produce (Glickman, 1997). Living wage opponents object to the idea of paying workers above that which they currently draw in the labor market, thus interfering with the workings of the free market.

Living wage ordinances have been selectively applied to private sector employees who receive public funds from city or county contracts or economic development subsidies to pay at least enough to keep a family of four out of poverty (Reynolds & ACORN, 2003). Supporters of living wages argue that requiring a set-level of wages in government contracts is nothing new and that, for example, the Davis-Bacon Act was enacted by Congress in 1931 and required that union-level wages (higher than non-union wages) be paid to all workers on federal construction projects. This concept was incorporated into many state laws and local ordinances which are commonly referred to as "prevailing wage" laws, a mandate still in force throughout the U.S., and one commonly accepted by both the buying and selling communities (Matthews, 2002).

The "living wage" label communicates that the higher wage levels are closer to the pay that full-time workers need to support themselves and their families at a subsistence level (Matthews, 2002). By restricting the beneficiaries of ordinances to a select group of full-time workers, advocates of living wages highlight the inherent moral worth of *earning* rather than *receiving* a living income and thereby negating the "...danger of the 'undeserving' poor receiving 'something for nothing'" (Nadeem, 2004).

The living wage movement in the United States has gained momentum and has become a significant local public policy trend as evidenced by those having implemented living wage laws over the last decade or so (Elmore, 2003). A number of trends in national and global economies may have contributed to these living wage campaigns and resulting ordinances. Some factors may be attributable to the growing gap between rich and poor, growth of the temporary workforce, mounting large scale lay-offs, declining real wages, the loss of union membership, the failure of the federal government's minimum wage to keep pace with inflation, and loss of various governmental supports for the working poor (Buckley, 2003).

Even though living wage policies seem to be gaining popular support across the country, not all responses have been favorable. Opponents, such as Michigan State Senator David Jaye (R), have gone so far as to introduce legislation to outlaw the living wage ordinances which were passed by five communities in southeastern Michigan. Senator Jaye stated, "These bleeding heart liberal advocates of paying people an artificial high minimum wage are actually destroying the jobs of welfare recipients, minorities and young people" (Ellis, 2004). Other states and lesser legislative governmental units have not taken such an adversarial approach and have basically acquiesced to the concept by doing nothing to prohibit it. With such an emotionally charged issue, legislative authorities and small business people must be prepared to address the concept.



## CURRENT IMPLEMENTATION

While living wage campaigns vary in scope, they generally are founded on two basic beliefs: 1) public tax dollars should not be used to subsidize employers who pay poverty-level wages and 2) workers who have full-time jobs should not be trapped in poverty. The Economic Policy Institute estimates that most living wage ordinances cover less than 1% of the local workforce (Economic Policy Institute, 2004). Even supporters understand the campaigns to be merely necessary first steps in poverty alleviation (Spain & Wiley, 1998). Pollin and Luce (1998) argued that “among other things, successful living wage campaigns create political momentum that can be used to build support for more ambitious measures to eliminate low-wage poverty in the United States” (p. 3). Thus, living wage campaigns appear to aim for short-term victories and then seek to extend those gains on a larger scale through a process of “imitation and diffusion” (Martin, 2001) so that more and more political entities adopt living wages. Narrowing the coverage of ordinances to employees of contractors and sometimes of city or county governments enhances the passage of such ordinances. “The ultimate potential of a living wage campaign is not just changes in government policy, but the opportunity to take concrete steps toward building an economic democracy movement” (Reynolds & ACORN, 2003).

Living wage regulations vary considerably in coverage and scope (see Table 1) and are often explicitly pegged to the wage level needed for a family with one full-time, year-round worker to reach the federal poverty level. The rates specified by living wage ordinances range from a low of \$6.25 in Milwaukee, Wisconsin to a high of \$14.75 in Fairfax, California (*Living Wage Facts*, n.d.). Some ordinances incorporate yearly adjustments based on the annual update of the federal poverty index. Some calculate adjustments according to an inflationary index. Still others mandate that both of the above adjustment methods be computed and that the one producing the highest living wage be implemented.

Many ordinances include requirements for health benefits. For example, the Hartford Municipal Code provides that if health benefits are not given, compensation must be made based on the average cost of comprehensive health insurance in Connecticut. Most ordinances clearly state that no employer shall respond to its provisions by reducing health insurance benefits. Some living wage laws exempt certain categories of city contractors, such as non-profit agencies. Many apply the requirements only to service contracts or business subsidy awards above a specific size, or to firms with a certain minimum number of employees. Most laws require employers to pay the higher wages and benefits only during the time that employees actually perform publicly funded work. Under some laws, the city or county may grant exemptions to individual firms that demonstrate that they cannot reasonably afford to pay their employees a living wage due to budgetary or other constraints (Elmore, 2003).

Posting, record keeping, and reporting requirements, as well as penalties for violations, are often included in living wage ordinances. Actual compliance with living wage laws is generally left to the employer, subject to audit and verification by a political entity. If an employer is discovered to have violated the specific provision by not paying a living wage, the statutes generally impose some form of penalty, though there is no uniformity of penalties among the existing statutes. For example, a Somerville, MA ordinance not only suspends contract payments to employers if they

fail to comply with its living wage law, but also imposes a \$500 a week penalty for each employee found to have been paid incorrectly (City of Somerville Ordinance, 2004).

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Insert Table 1 about here  
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There are three prominent features of living wage laws nationwide (Neumark & Adams, 2003a). First, all living wage ordinances feature a minimum wage floor that is higher than the traditional minimum wages set by state and federal legislation. Many ordinances are directly tied to guidelines establishing the federal poverty level, therefore automatically establishing a new wage level needed for a family each year, which is above this level.

A second feature of living wage ordinances is static family size, even though poverty levels vary dramatically depending on number of children and adults in a household. Generally, ordinances do not consider the income of other family members. For example, if two adults of the same family work for a covered contractor both would receive the living wage, placing their combined family income well above the poverty level. These situations suggest that living wage laws may not target genuine family needs, a criticism also leveled at minimum wages (Neumark & Adams, 2003b). However, living wage laws may affect a substantially different set of workers than do minimum wages, implying that the effects of living wages on poverty require separate study.

Finally, coverage by living wage ordinances is far from universal. The most common coverage—and also the most narrow—is restricted to companies under contract with a given city or public entity and the percentage of workers covered is typically, as indicated earlier, in the 1% range. Some living wage laws are applied to companies receiving business assistance from the city (ACORN, 2004). The least living wage coverage is that imposed on cities themselves in covering their own employees. Regardless, narrow coverage contrasts with minimum wage laws which apply to nearly all workers. Thus, living wage laws impose high wage floors, have an antipoverty objective that is often reflected in the choice of the wage floor, and often apply to what may constitute a relatively limited group of workers.

## **LIVING WAGE CONSIDERATIONS FOR SMALL BUSINESS**

Small firms have had a significant positive impact on the United States economy (Megginson, Byrd, & Megginson, 2003). One way that they do this is by providing jobs and training to low-skilled workers. Card and Krueger (1995) conducted an important systematic inquiry into the characteristics of employers who hire minimum-wage employees. Among their main findings were that almost 60% of all minimum-wage workers are employed at establishments with less than 25 workers. Firms in retail trade and service industries were found to employ over 80 percent of minimum-wage workers, with more than half of all such workers being employed in the retail industry alone. Card and Krueger (1995) additionally found that small businesses were more likely to pay the minimum wage than large businesses. These findings are consistent with the work of Brown and Medoff (1989) who determined that smaller employers pay lower wages than larger ones. This is especially true for adult low-skilled workers, for whom small businesses provide a disproportionate

number of jobs. Similarly, Loeff and her colleagues (Loeff, Berger, Black, Scott, & Allen, 1999) found that of all minimum-wage workers, about 54% work in firms with less than 100 employees, while 46% work in firms with 100 or more employees, and about 40% of all minimum-wage workers are employed in firms with less than 25 employees. Smaller firms, then, tended to have a greater share of minimum-wage workers than did larger firms.

Loeff and her research associates (Loeff et al, 1999) also examined the effects of raising the minimum wage by firm size. This analysis of wage growth in small and large firms turned up no major surprises. In general, while the effects were small, raises in the minimum wage appeared to have adverse effects on workers in terms of job loss in both small and large businesses. However, as indicated above, small firms employ a greater share of minimum-wage workers than do large firms. Therefore, it is important to take into account the effects of minimum wage changes on small businesses when contemplating a change in the minimum wage because they and their workers are likely to disproportionately bear any adverse effects resulting from the change.

Following this rationale, if living wages essentially require a higher mandated minimum wage for covered businesses and these organizations are smaller firms tending to have a greater share of minimum-wage workers than larger ones, then it could be expected that such small firms will be impacted to a greater degree by living wage ordinances than other organizations. Consequently, it would benefit owners of small firms considering city/county contracts to make sure that they are fully aware of the ramifications of living wage laws for their organization.

With this in mind, small business vendors may elect to review the following questions so as to prepare themselves for dealing with living wage legislation that is increasingly being passed in local jurisdictions across the nation. Not all questions may be relevant to each business but hopefully these items will trigger appropriate action by key decision makers in small firms to address this significant threat in their operating environment. Such questions might include:

- Does the city/county have a living wage? What is the actual amount/level of this living wage? Are health benefits or other benefits such as mandatory vacation or sick leave required as part of the living wage ordinance? Have these increased labor costs been included in a small business's contract pricing?
- How and when will increases in the base wage be determined? Yearly increases pegged to inflation level or poverty level?
- Which of small business employees are covered by the living wage ordinance? Full time or part time or both?
- In some cities there are exceptions for certain businesses due to such things as hardship? How does this apply to a particular small firm?
- Which city/county department will oversee implementation and enforcement of living wage ordinances and how will this impact a specific organization?
- What kind of reporting will be required by participating businesses?
- Who will administer the living wage in the small business?
- If violations occur, what kind of penalties could be imposed on businesses? One-time monetary fines? Fines and back-wages due to covered employees? Immediate suspension of a service contract and/or future prohibition from bidding for other contract awards or financial assistance?
- Are the higher labor costs inherent in living wage ordinances absorbed by contractors

- or can such cost increases be easily passed through to cities?
- Are layoffs an option in addressing increased labor costs?
- With the higher mandated living wage, can small firms recruit more skilled employees?—perhaps employees with more experience, better English language skills, more education?
- To compensate for the higher wage costs, can certain functions be automated?
- Will your organization simply stop bidding on city contracts requiring a living wage to be paid?

## CONCLUSIONS

In recent years, living wage ordinances and campaigns have emerged as a grassroots response to the declining real value of the minimum wage, the growth of a low-wage service sector, and widening economic disparities. While living wage ordinances have been passed in over one hundred jurisdictions, it should be noted that some municipalities and counties have repealed such legislation (ACORN, n.d.b), and some ordinances declared in violation of state constitutions. For example, the city council of Omaha, NE simply repealed the ordinance after one year (over the veto by the mayor) (Employment Policy Foundation, n.d.), and the living wage ordinance passed by the city of New Orleans, LA was subsequently invalidated by the state supreme court as being unconstitutional because it was said to usurp the power of the state (*New Orleans Campaign*, 2002).

Small business owners doing business with (chiefly) cities, considering doing business with cities, or receiving subsidies or assistance from local jurisdictions, should be aware that living wage legislation is increasing significantly and must factor such mandated wage increases into their budgets and proposals to municipal authorities. Failure to do so may result in a seemingly favorable relationship with a city becoming burdensome and potentially unprofitable.

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Table 1. Information on Living Wage Laws (after ACORN\*; Neumark & Adams\*\*)

| City                    | Coverage Specified in Legislation  | Wage Provisions  |
|-------------------------|--|--|
| Baltimore, MD           | Construction and service contracts > \$5000.   | Passed in December 1994 but wage requirements were as follows: July 1995 (\$6.10); 2003 (\$8.70)   |
| Cincinnati, OH          | The city itself as well as any city service contractor with a contract > \$20,000  | 2003 (\$8.70, \$10.20 w/o health benefits)   |
| Hartford, CT            | Contractors > \$50,000; commercial development projects receiving subsidies > \$100,000  | 110% of poverty level with health benefits; 2003 (\$9.54; \$11.55 w/o health benefits)   |
| Berkeley, CA and Marina | Direct city employees, businesses with city contracts, financial assistance recipients, and businesses that lease land from the city; later amended to include the Berkeley Marina, which is City-owned public land thereby creating first area-based living wage policy | 2003 (\$10.76; \$12.55 w/o health benefits)  |
| St. Louis, MO           | Contractors and businesses receiving tax breaks  | 130% of poverty level for family of three (assuming 2080 hours annual hours with benefits, plus \$1.39 per hour for health insurance: 2003 (\$9.54, \$11.63 w/o health benefits) |
| Burlington, VT          | Direct city employees and employees working on city service contracts or for businesses that have received grants from the city of at least \$15,000   | 2003 (\$11.67; 13.49 w/o health benefits); wage rate adjusted annually guided by a state-issued "basic needs budget;" at least 12 compensated days of leave                      |

\*ACORN (n.d.b). *Living wage wins*. Retrieved May 27, 2004, from <http://livingwagecampaign.org/shortwins.php>.

\*\*Neumark, D., & Adams, S. (2003a). Do living wage ordinances reduce urban poverty? *The Journal of Human Resources*, 38, 490-521.

# TEACHING ENTREPREURSHIP TO THE CREATIVE ARTS

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## Abstract

### Teaching Entrepreneurship to the Creative Arts

The theory is that students provided with a better understanding of the unique business practices and industry models found within their performance arts career areas of their interest will be better able to complete elements of a typical business plan. This includes market analysis research that corresponds to both the product and service methods of delivery and corresponding historical, current, and future industry trends. In addition, a market analysis in the performance arts industry should consider external and internal influences and financial variables that may positively or negatively affect the success of the company's products which are often based on successful emotional consumer satisfaction.

***"We didn't know this was a business, we just thought it was a rock & roll party."***

— Vince Neil of Motley Crüe<sup>i</sup>

## Introduction

The process of teaching entrepreneurship to the creative arts community is often perceived as the same as teaching entrepreneurship to any business related industry. After all, entrepreneurship is entrepreneurship. However, the purpose of this paper is to theorize that additional industry related concepts, information, constructs, and methods of operations should be added to the curriculum for performance arts students in entrepreneurship classes. Thus, this paper is a concept analysis of the additional subjects that entrepreneurial instructors may want to add to their traditional curriculum and business plan presentations.

***"Entertainment - not autos, not steel, not financial services - is fast becoming the driving wheel of the new world economy."***

— Michael J. Wolf Media Consultant<sup>ii</sup>

## Entrepreneurship Education in the Performance Arts

The Arts, Entertainment and Recreation Industries Report by the United States government, claims that the industry generated about \$128,904,000,000 from taxable and tax exempt employer firms in 2001. Thus, it is important that entrepreneurship classes be offered to individuals interested in careers in this lucrative business.

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Table or Figure about here

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The down side is that the entertainment industry is very unique and at the same time, an exceptionally mature business struggling to reinvent itself due to technological, computer, internet, and copyright issues. The shift in the business model is one toward consolidation of traditional media corporations and in unison, entrepreneurial opportunities for creative artists. Hence, it is vital that instructors provide more than a business plan based on the traditional curriculum materials when teaching performing arts students.

**"The brain seems to be a sponge for music and, like a sponge in water, is changed by it."**

**—Newsweek Magazine by Sharon Begley<sup>iii</sup>**

### **Entertainment and Intelligence**

Research appears to support that some forms of human intelligence are actually enhanced by the performing arts (music). There is an indication that our brains may even be pre-wired for it! Scientists have interspersed PET scans and MRIs with snatches of Celine Dion and Stravinsky to show a correlation for the biological foundations of music.<sup>iv</sup> *Music affects the mind in powerful ways: it not only incites passion, belligerence, serenity or fear, but does so even in people who do not know from experience, for instance, that a particular crescendo means the killer is about to pop out on the movie screen.*<sup>v</sup> Research at the University of California and the University of Wisconsin recently found a connection between the use of music and young peoples improved math skills. They found that the neurons connecting the two sides of the brain in young musicians are larger which appears to help planning and foresight skills.

### **Product Value**

Many years ago, a young man walked into a Memphis recording studio, cut a record for his mother, and became at that time, the biggest rock star to grace the planet. Elvis Presley made it happen by having the talent to sing, a passion to entertain, the initiative to learn from others through listening, watching, and asking questions, and, most importantly, by being in the right place at the right time. Elvis didn't, however, become a world famous recording artist by himself. He used his vocal talents, good looks, and assertiveness to get his foot into the door of the music business, and it was the music business, or more precisely, the people who make up the music business, that helped make Elvis "the king" of rock and roll.

Artists often believe it is their "talent" that makes them rich and famous. Sculptors, songwriters, painters, scriptwriters, film producers, actors, and countless others perceive their personal expressions of creativity as valuable. In reality, it is the consumers who buy, rent, lease or simply use products developed out of an artist's creativity that determine its' (and therefore the artists') economic and social value. As a result, instructors in entrepreneurship classes of creative artists should understand and convey the difference between the value of a widget sold to consumers to fulfill a need such as a type of soap or mode of transportation, then a creative product (song, film, book, sculpture, painting) sold, rent, leased or used by consumers to satisfy a personal emotional construct. Thus, the potential value of products created by artists should be based on consumer emotional gratification instead of quality. Consequently, artists with vary limited talent, such as recording star Eninem or film maker Michael Moore, often become very wealthy entrepreneurial "personalities" because of their abilities to provide an emotional message through the entertainment products they create. Consumers discover varies levels of emotional satisfaction from their use of the entertainment products and thus, dive into their pocket books and purses to pay for the products.

Instructors should teach how performing arts products have communicative values instead of projecting potential profits and losses based on an artists' perceived talent. Historical research on the gross income and consumer trends of similar products (film, and music as examples) with similar communicative messages can project market typologies and potential sales quotas. Business plan projections may be tied to best and



worse case scenarios correlated to similar product successes. In addition, the economic value of the performance arts products should be based on copyright ownership valuations tied to income streams and equity multiples. Marketing plans and therefore the cost of distribution, promotion, and publicity, should be based on the communicative message perceived by and used emotionally by various types of consumers to drive sales and usage. Thus, the artist's image (hero, warrior, rebel, or lover as examples), are tied to communicative messages linked to the products being sold or used by consumers. Successful messages (products) generate billions of dollars. Products (songs, movies, books, poems, pictures, painting, and sculptures) that do not communicate a viable and clear message (image or theme) to consumers (no matter how talented the artist and of high quality the product) usually fail to generate profits.

### **Business Plans**

In the performance arts industry the business is often defined as both a product and a service. Different revenue streams correspond to the same message provided as a service (recordings broadcast on radio or sung live on television) as opposed to a same recordings sold on DVD and CD. Market analysis must correspond to both the product and service methods of delivery and corresponding historical, current, and future industry trends. Thus, a market analysis for a business in the performance arts often requires a deep niche of relevant information based on similar products successes and failures that convey emotional communicative constructs to potential consumers. However, to make it even more complicated, consumer's emotional needs are not always stable. Hence, a market analysis should consider external and internal influences that may positively or negatively affect the success of the company's products. Once the proper projections are made a strategic analysis can be used to establish the economic of scale that fit the projected demographic and psychographic consumer typologies. Then, because the instructor has added additional information about the unique variables in the performance arts industries, the projected balance sheets, cash flow analysis, and profit and loss statement may be completed.

### **Entrepreneurial Opportunities**

Internet use and file sharing are causing traditional media and entertainment companies to merge and change their business models. Of course, change in the performance arts industry opens the doors to many creative entrepreneurs who previously sold themselves and their creative products to traditional industry related marketing companies. Now with the use of technology and the ability to link industry related knowledge of entrepreneurship to the performing arts industry, creative artists can actually become financially successful businesses themselves by selling their own image and products and by lowering the economics of scale to a more profitable and controllable margin.

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### **Business Equity and Value**

The artist's and their corresponding products often enhance a listener's constructed pathos. Thus, there is little doubt that the value of an artist's product is tied to consumers' emotional constructs (personal satisfaction) and therefore economic value. It is important for students to understand how business is conducted in each of the unique area of the performing arts. As an example, in the music business thanks to the consumers, fans, and businesses who continue to buy and use music songwriters and

music publishers own valuable assets in the gross potential of their songs (copyrights). The following is a detailed example of information that is important for entrepreneurs who want to start a company in the entertainment business. As an example in the music industry, *publishers* build their company's value through the revenues they generate from the songs they own. *Songwriters* also build a personal/company value through the royalties they have been paid and the potential royalties they are to be paid from the songs they have written and the publishing deals they have made. *Both have financial values far beyond the typical annual royalties paid.*

Therefore, compared to a straight job, payment scheme are often different in the performance arts industries. It is important that instructors provide this information to students. Most of us get paid for the work we do each week. The wonderful thing about the music business, as an example, is that great songs and recordings continue to earn royalties years after they were originally created. As an example, in 1998, the Beatles made more money then when they were together playing concerts and recording. Most artists think they have to work next week to pay the bills from last week. However, in the music business as an example, the money from great songs and recordings just keeps rolling in if, you have a good original deal and didn't get taken when you signed your contract. Music publishers use a *business facto multiple* of between 5-12 times the average gross revenues generated by their business over several years to determine the value of their businesses. Thus, a music publishing company that averages a gross income of \$12 million could be sold (if they can find the right buyer) for as much as \$144 million (12 million dollars average gross times a factor of 12). Songwriters can also leverage their potential royalty revenues for bank loans and stock market mutual funds to banks and companies that work with entertainment personalities. In addition, equity is usually defined as the amount of the company (music publisher) or share of the revenue stream (songwriter) you own.

Permission to use a copyright (a song) is usually granted through the issuing of a license. Compensation for the use of the song is paid as a licensing fee. Both songwriters and music publishers must continually monitor infringement actions. However, songwriters often feel the publisher may have failed to place the song with the right artist, advertising agency and so on. Nevertheless, it is important to remember that honest music publishers are only paid from the royalties they generate. Publishers take a financial risk when they sign a song. They must complete a demo recording, print sheet music, file for a Certificate of Recordation, and pay the salaries of the administrative staff and songpluggers.

Publishers can only be pro-active concerning a song's potential selection by an artist to record and at the chance of placing the song with movie companies, advertisement agencies and other music users. Contracts customarily state that music publishers have satisfied their contractual obligations when they have "*to the best of their ability*" attempted to place a song with music users. It is very difficult for a songwriter (or their attorney) to define and prove that a music publisher did not attempt to place the song with various music users. In addition, publishers can usually provide a stack of invoices and paid statements as "*proof*" of their attempt to place the song with record labels, recording artists and other types of music users. Sometimes the marriage between the songwriter and music publisher fails. The quality of their agreement means very little unless both profit. Written contractual goals that are not fulfilled often lead to either side

terminating the contract. However, legal action is customarily required to prove non-performance of a contractual agreement. Publishers may *default* in their contractual obligation if they fail to provide licenses to music users, fail to pay royalties in a timely manner, fail to place the song with a major recording artist or an artist signed with a record label, fail to provide sheet music (of the song) to music stores and other retail outlets, fail to “place” the song in radio and TV commercials, advertisements, and movie soundtracks, or fail to protect the copyright against infringement.<sup>vi</sup>

Music Publishers offer licenses to music users for the use of their songs. The publishers control the copyright and, therefore, must be paid by the music users for the use of their songs. There are many licenses, each with its own specific purpose:

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Table or Figure about here

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Publishers or their *authorized agents* issue mechanical licenses to record labels for the use of a song in a recording. The royalty rate, called the *statutory rate*, is currently 8.5 cents for each song or 1.65 cents per minute for songs over 5 minutes in length.<sup>vii</sup>

Publishers typically split the collected mechanical royalty's 50/50 with the signed songwriters who wrote the songs. However, in reality, most music publishers have the policy of first *recouping* (deducting) any advances paid to the staff writer out of the writer share of the royalties. Therefore, negotiated percentages of profits are paid to the songwriter after recoups are satisfied.

Mechanicals are paid quarterly by record labels, yet as much as 50% of the fees are held in reserve until the products are sold. No mechanicals are paid on promotional copies and free goods, which are promotional albums sent to radio stations, other mass media outlets, and retail stores to increase sales. Mechanicals are paid at 50% of the statutory rate for records sold through record clubs.

Labels use the *controlled composition clause* in the copyright law to negotiate a mechanical royalty of 75% of the statutory rate. To be considered a controlled composition, the recording artist must be a writer, or co-writer or granted part ownership (part of the publishing share) or control of the copyright. Record labels save money by requiring their recording artists and producers to record controlled composition songs. Music publishers and songwriters who do not accept the controlled composition royalty rate may find their songs dropped from an album project. However, if one label requires the song to be a controlled composition, another may not. Labels often pay statutory rates for great songs they think may help one of their artists increase record sales. On the other hand, have you ever wondered why some of your albums have only 8 or 9 songs on them? If the record label determines that it will only pay the controlled composition clause rate per album and the artists or producer want a song(s) licensed at the statutory rate, fewer songs are placed on the album. The controlled composition clause does make a difference in the “bottom line.” It saves the record labels 25% of their mechanical licenses fees.

Unlike the American practice of individual song mechanical licenses, most foreign countries require one mechanical license for all songs on an album. Registration is mandatory. Mechanicals are collected by government-owned agencies and turned over to the foreign music publishers. A percentage of the retail price is collected for the mechanicals royalties that is then split among all the songs on the album and between the foreign and American publishers. Therefore, there is not a set foreign mechanical rate,

and the amount of money collected varies from country to country and album to album. Totals collected also depend on the number of songs on the album and how many albums were sold. Foreign sub-publishers often collect the mechanicals from the government agencies and split the royalties with American publishers by making payments directly or through an American collection agency, such as The Harry Fox Agency.<sup>viii</sup>

In 1967, the United States Supreme Court approved a lower court ruling that upheld the rights of songwriters and music publishers to authorize an agency to represent them in the collection of performance royalties. The ruling states: "... a central licensing agency, such as ASCAP, is the only practical way that copyright proprietors may enjoy their rights under federal copyright laws and that broadcasters and others may conveniently obtain licenses for the performance of copyrighted music."<sup>ix</sup> Hence, performance rights organizations collect performance royalties from the *users of music in a public performance* for their affiliated writers and publishers. *The American Society of Composers, Authors, and Publishers (ASCAP)*, *Broadcast Music Incorporated (BMI)*, and *SESAC* are the three American performance rights organizations. SESAC is now the registered name for The Society of European Stage Authors and Composers, which is not used anymore. After business fees are deducted, the remaining royalties are split 50/50 and sent to the songwriters and music publishers by means of separate checks. Performance royalties are collected for the "performance" of a song, not for the recording artist who sings it. In some European countries, a fee is collected and paid to the recording artist for the number of times their recordings are played on radio stations. There have been several attempts in the United States to change the law to allow recording artists to be paid a "performance" or "play fee."

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### **Payment Rates and Schedules**

ASCAP and BMI pay competitively but not equally for the same chart placement. Different levels of payment are offered for different genres of music. To make it even more confusing, ASCAP and BMI do not pay the same amount of money for songs within the same genre. In other words, due to the way the charts are compiled, the time of the year, the PRO's payment scheme methodology, and the competition from other records and recording artists, some number one records receive more airplay (performances and, therefore, money) than other number one records. Since ASCAP and BMI pay performance royalties based on the number of performances, plus bonuses, all of the records charted do not receive equal payments. SESAC is unique in that it pays performance royalties based on trade magazine chart placement. SESAC bases its Chart Payment Schedule on a record's placement on the weekly *Billboard Magazine*, *Radio & Records*, and *The Gavin Report* charts.

### **Synchronization, Print, Direct, and Other Licenses**

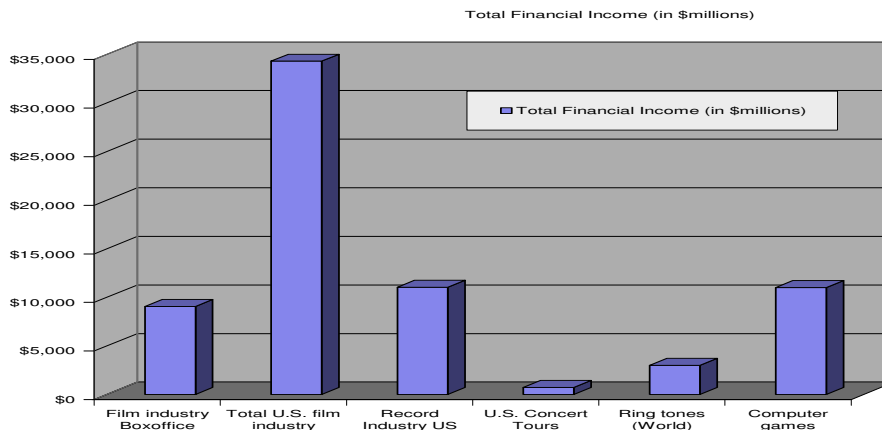
*Sync, grand, transmission, and commercial license fees are negotiated.* Sync license for music videos are often granted free to the record label in exchange for the label's production of a promotional music video. The cost for the music used in the production of motion pictures, TV shows, etc. is ordinarily based on the size of the production budget and the talents of the negotiators. Commercial licenses are commonly paid as a one-time lump sum. It is not unusual for a writer and publisher to receive a million or more dollars for the use of their song in a national major food or soft drink commercial.

## Conclusions

The author recommends that additional research be conducted to determine the validity of the stated theory that creative students in entrepreneurship classes for the performance arts benefit from additional specific industry related information. In the performance arts industry the type of business is often defined as both a product and a service. Different revenue streams correspond to each. In the business plan the market analysis for a business in the performance arts may often requires a deeper niche of relevant information than non performance arts based businesses. Similar product successes and failures that convey similar emotional communicative constructs to potential consumers should be fully examined. Instructors may want to consider providing market analysis research that corresponds to both the product and service methods of delivery and corresponding historical, current, and future industry trends. However, consumer's emotional needs are not always stable. Hence, a market analysis should consider external and internal influences and financial variables that may positively or negatively affect the success of the company's products. Once the proper projections are made a strategic analysis can be used to establish the economic of scale that best fit the projected demographic and psychographic consumer typologies. The premise is that with this type of additional information creative minded performance arts students will be better able to complete the business plan's projected balance sheets, cash flow analysis, and profit and loss statements.

| Industry   | NAICS CODE | <u>2001 Income</u>       |
|--|------------|--------------------------|
| <b>Arts, Entertainment and Recreation</b>            | 71         | <b>\$128,904,000,000</b> |
| Performing arts, spectator sports                    | 711        | \$46,391,000,000         |
| (a) Performing arts companies                        | 7111       | \$9,252,000,000          |
| (b) Spectator sports                                 | 7112       | \$18,416,000,000         |
| Promoters of performing arts events                  | 7113       | \$8,131,000,000          |
| Agents & Managers (artists & public figures)         | 7114       | \$3,468,000,000          |
| Indy artists, entertainers, writers & performers     | 7115       | \$7,125,000,000          |
| <b>Museums, historical institutions</b>              | 712        | \$8,173,000,000          |
| <b>Amusement, gambling and recreation industries</b> | 713        | \$74,331,000,000         |

Source: Library of Congress, U.S. Census Bureau, Statistical Abstract of the United States: 2003.



—Sources:

- {a} MPAA (Motion Picture Association of America: MPA Worldwide Market Research Report 2003
- {b} MPAA (Motion Picture Association of America: MPA Worldwide Market Research Report 2003
- {c} RIAA (Recording Industry Association of America) [www.riaa.com](http://www.riaa.com) Market Research Report 2003
- {d} [Billboard BoxScore](http://Billboard.BoxScore) [www.billboard.com](http://www.billboard.com), 2004
- {e} [Www.informa.com](http://Www.informa.com) 2004
- {f} “Hollywood Interest in Video Games Grows” by Mae Wong.; AP Hi Tech, [www.Exciteneews](http://www.Exciteneews) May 15, 2004

| <i>Type of License</i>   | <i>Collection Agency</i>   | <i>Key Issues-Factors</i>  |
|--|--|--|
| <ul style="list-style-type: none"> <li>Mechanical License</li> </ul>                 | <ul style="list-style-type: none"> <li>Harry Fox Agency</li> <li>Copyright Management Inc.</li> </ul>                                      | <ul style="list-style-type: none"> <li>Record Labels</li> <li>Statutory Rate</li> <li>Controlled Composition Clause</li> <li>Internet Downloads</li> <li>Indirect Payment Routine</li> </ul>                             |
| <ul style="list-style-type: none"> <li>Public Performance</li> </ul>                 | <ul style="list-style-type: none"> <li>ASCAP</li> <li>BMI</li> <li>SESAC</li> </ul>  | <ul style="list-style-type: none"> <li>Blanket License</li> <li>Internet Performance</li> <li>Sonny Bono Act and 1999 Copyright law</li> <li>Direct Payment Routine</li> </ul>   |
| <ul style="list-style-type: none"> <li>Synchronization License</li> </ul>            | <ul style="list-style-type: none"> <li>Harry Fox Agency</li> <li>Direct to Publisher</li> </ul>  | <ul style="list-style-type: none"> <li>Internet Movies and Advertisements.</li> <li>Movie, TV, Video Productions</li> <li>Indirect Payment Routine</li> </ul>  |
| <ul style="list-style-type: none"> <li>Foreign, Print &amp; Miscellaneous</li> </ul> | <ul style="list-style-type: none"> <li>ASCAP</li> <li>BMI</li> <li>SESAC</li> <li>Harry Fox Agency</li> <li>Direct to Publisher</li> </ul> | <ul style="list-style-type: none"> <li>Catch-all provisions</li> <li>Internet Downloads</li> <li>Merchandising Rights</li> <li>Advertising Campaign</li> <li>Title use</li> <li>Greeting cards</li> <li>Print</li> </ul> |

| <i>Performance Rights Organization</i> | <i>Type of Business</i> | <i>Membership</i>                      | <i>Year Founded</i> | <i>Owned By</i>      | <i>Operated By</i>                                |
|--|-------------------------|--|---------------------|----------------------|---|
| ASCAP                                  | Non-Profit              | 160,000 Songwriters & Publishers       | 1914                | Members              | 24 member board made up of members                |
| BMI                                    | Non-Profit              | More than 350,000 writers & publishers | 1940                | 675 Radio Stations   | Operations supervised by CEO & Board of Directors |
| SESAC                                  | For Profit              | Less than 15,000                       | 1930                | Private Organization | Private Company                                   |

<sup>i</sup> Behind the Music, VH-1, Intermedia Cable, Nashville, TN. (12/14/98).

<sup>ii</sup> Michel J. Wolf, His new book is The Entertainment Economy: How Mega-Media Forces Are Transforming Our Lives [www.randomhouse.com](http://www.randomhouse.com) (04/12/99).

<sup>iii</sup> Music on the Mind by Sharon Begley, *Newsweek*, (07/24/2000).

<sup>iv</sup> Ibid.

<sup>v</sup> Ibid.

<sup>vi</sup> Placement is defined as the use of the song in an actual master recording that will be released for sale to the public. An artist (or producer) placing a “hold” on a song (for a recording to be made in the future) is not usually considered compliance of the publisher’s obligation to get a song recorded;

<sup>vii</sup> The “Statutory Rate” is scheduled to increase January 1, 2000.

<sup>viii</sup> Foreign Sub-Publisher splits range from 10% to 25% for collecting American product and up to a 50/50 split for foreign-recorded “cover tunes.” Passman, All You Need To Know About the Music Business (1993), pp. 242-243, & The Essential Songwriter’s Contract Handbook by NSAI (The Nashville Songwriters Association International) (1994), p. 50.

<sup>ix</sup> The Music Business Handbook & Career Guide, Baskerville (1990).

# **NO PREREQUISITES FOR ENTREPRENEURSHIP COURSES? ARE YOU CRAZY?**

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## **ABSTRACT**

This paper presents the origins and logic underlying the establishment of the “no course prerequisites” (NCP) policy for entrepreneurship courses. Five key elements influencing this policy include:

1. Prior difficulties with the “by permission of instructor” approach
2. Entrepreneurial Boot Camp for non-business faculty
3. Development of an interdisciplinary, project based learning (IPBL) proposal
4. Creation of a Technology Entrepreneurship Certificate Program
5. Development of new undergraduate and graduate entrepreneurship programs

Finally, in an attempt to assist other universities with solutions to potential opposition, six specific faculty objections are discussed in the second section of the paper that relate to demand, resources, qualifications, impact on enrollments, rigor, and governance.

## **INTRODUCTION**

This paper presents the origins and logic underlying the establishment of the “no course prerequisites” (NCP) policy for all entrepreneurship courses at the authors’ university. This approach is a key step in creating an entrepreneurial university environment. Three points of view are expressed, including a senior faculty member with over 30 years of teaching experience in entrepreneurship, the Dean of the College of Business, and the Dean of the College of Engineering. The NCP approach has resulted in 25% to 30% of enrollment in the new entrepreneurship courses (offered to date) coming from outside the College of Business. Five key elements influencing this policy include:

1. Prior difficulties with the “by permission of instructor” approach
2. Entrepreneurial Boot Camp for non-business faculty and professional staff
3. Development of an interdisciplinary, project based learning (IPBL) grant proposal
4. Creation of a Technology Entrepreneurship Certificate Program
5. Development of new undergraduate and graduate entrepreneurship programs

Each of these is discussed in the following sections. In addition, a section on faculty objections to the NCP policy and the responses to them has been highlighted in an attempt to assist other universities with solutions to potential opposition, if they wish to implement such a policy. Finally, a summary of the goals for the future of entrepreneurship across the curriculum is discussed.

## **I. CORE ELEMENTS OF THE NCP POLICY**

The NCP policy was proposed as a part of the formation of a new entrepreneurship specialization that includes nine undergraduate and three graduate courses. The NCP policy was the result of the vision of the founder of the program, the support of the Provost, and active involvement of two Deans in the process. This vision positively impacts other colleges because those students will be able to enroll in a limited number of business-based courses without having the extensive prerequisites normally associated with typical prerequisite policies. This approach does not assume that the business prerequisites serve no purpose, only that the business students enrolled in these courses will share their knowledge gained from those prerequisites with the interdisciplinary team. Likewise, the engineering student, communications major, health and exercise sciences student, and the arts major will bring unique knowledge, contacts, research skills, and points of view to the team that are consistent with the nature of the proposed entrepreneurship specialization. These include:

- Entrepreneurship is an opportunity seeking mentality.
- Students and faculty from all disciplines will benefit from exposure to entrepreneurial thinking and analysis.
- Waiver of traditional prerequisites is based on the use of project teams that utilize the talents and knowledge of each team member to succeed.
- We do not all need to be the same! We learn from diversity of thought and talents.

The five key elements influencing the policy as noted in the introduction are discussed below.

### **Key Elements Influencing the NCP Policy**

#### **1. Difficulties with the “by permission of instructor” approach**

Teaching experience at two other United States universities and two European universities that used a “by permission of instructor” approach to admitting non-business students to courses pointed to consistent difficulties. The primary problems were the lack of clear “rules” for admission, timing difficulties for students to meet with faculty having limited office hours, and low levels of student requests as a direct result of student reservations regarding course approval and competition from business students. Prior experiences also showed that under circumstances where non-business students were admitted, they typically met or exceeded performance expectations. The epiphany that led to the decision to abandon this approach and move to a NCP policy came from a team of three Master of Fine Arts students who lost their “business” student partner. They completed a four state competitive analysis, a market demand, and a financial feasibility study of an indoor show horse arena and stables without the business student. The analysis showed the project was not viable; opposite to the client’s beliefs and personal desires, but was eventually accepted by the client as a result of the high-quality work. The team’s success and ability to overcome concerns about the capability of “art” students to complete the business portions of the work helped paved the way to create the NCP policy. Teaching experiences have led to a firm belief that the concept of “less is more” can apply to academics where interdisciplinary teams can result in higher quality learning experiences.

#### **2. Entrepreneurial Boot Camps for Non-Business Faculty**

The “Entrepreneurial Boot Camp for Non-Business Faculty” model grew from recognition of the need to provide an opportunity-focused experiential environment to create entrepreneurial



champions for a new program. The overriding goal was to create a way to capture non-business faculty attention to encourage a focus on entrepreneurial concepts to make their research and teaching more effective, while showing methods of professional or financial gain through participation. Additionally, the “Boot Camp” attempted to form a core group of faculty champions to help build support for the entrepreneurship specialization and programs.

The philosophy of the “Boot Camp” concept was grounded in the belief in the importance of ‘idea generation and building on ideas’ in a creative and supportive environment. This pre-supposes the ability of the process to harness the creativity and divergent thinking of academics (non-business in this instance) to the concept of entrepreneurial education and creating supporting champions for innovation. Commitment to a philosophy of entrepreneurship as a foundation for change-based growth in education and business underpinned the objectives of the “Boot Camp.” An overriding university goal was to enhance knowledge and encourage the use of innovative and alternative sources of funding and to apply entrepreneurial project ideas to research, teaching, and commercialization of university generated technologies.

One of the key outcomes of the “Boot Camp” was the need to eliminate the prerequisites for the entrepreneurship courses if faculty and students were going to capitalize on the opportunities identified in the “Boot Camp” projects. Engineering, health and exercise science, art, and communications were especially interested in having their students take courses and build on their program-specific areas of study. Internal surveys of alumni by these colleges showed that approximately 40% of their students ended up running a business within 10 years of graduation. Since the entrepreneurship courses typically involved multiple areas of business in the projects, business plans, and consulting engagements, the consensus was that the students could use the entrepreneurship courses to fulfill their business information needs.

### 3. Interdisciplinary Project Based Learning (IPBL) Initiative

The university has begun a process of creating the IPBL model for university wide adoption. The need for a highly educated citizenry has never been greater, yet U.S. college graduation statistics do not meet many expectations according to the Bureau of Labor Statistics (*Occupational Outlook Handbook, 2004-05 Edition*). Widespread access to higher education has led to a reputation for the “best system in the world” but unfortunately, accessibility and degree completion rates are not one and the same. According to Mourad, (*Guide to Measuring Up*, 7, 2002) in an environment where people must move freely and efficiently between education and jobs, the clear communication of demonstrated learning outcomes is essential and the new currency of the labor market is demonstrated competencies rather than academic degrees. Students must become active participants in their educational process rather than passive recipients of knowledge. Mourad also suggests that rigid disciplinary boundaries often impede the synergies possible in an interdisciplinary environment. The university proposed an IPBL model to address both internal and external problems that existed. Internal problems that can be improved by the IPBL Model Program include:

- **Student retention**-greater focus on student needs and competencies
- **Development of critical thinking skills** – need to work interactively on projects
- **Preparation of students for a more flexible, self-controlling career path**

External problems/issues that can be solved include:

- **Increased access** to a competency based workforce for public and private sectors
- **Increases in external funding** for the university and specific project activities

- **Increased economic growth** from start ups and expansion of existing economic base
- **Creation of a process** that can be replicated in other regions

Thus, IPBL breaks down barriers between disciplines and enables diverse student teams to solve problems that could not be solved by a single discipline. It also considers multiple points of view, emphasizes researching and summarizing skills, and promotes the types of interactions that are goals of the entrepreneurship curriculum.

#### 4. Technology Entrepreneurship Certificate Program

The Technology Entrepreneurship Concentration (TEC) program implemented by the university is an integration of existing, new, and reformatted courses. The concentration leverages resources to develop a high profile, attractive program that can produce entrepreneurial teams (E-teams) that create products or services that can ultimately be commercialized. The curriculum is the first major collaborative effort between the College of Business and the College of Engineering and is seen as a model for expansion to other technology areas. The Technology Entrepreneurship Concentration (TEC) is a concentration and certificate program that integrates the core entrepreneurship concepts that increase the chances of success that reside in the College of Business with the outstanding clinic/project/lab *modus operandi* of the College of Engineering. With the extremely full slate of engineering courses that exist, students needed a NCP policy if this cooperative effort was to be a success.

All four courses in the TEC program are team-based courses. The logic behind this is that one person does not possess all of the knowledge and skills needed to create and launch a successful business. Combining the talents and skill sets from multiple colleges is a way to enhance the performance of each team. Exercises from books like *What a Great Idea* by Chic Thompson, *How to Really Start Your Own Business* by David Gumpert, and repeated iterations of exercises shape ideas into high potential ventures. The goal is to think about “problems” that need to be solved as opposed to technological possibilities. This opportunity/need focus is a basic entrepreneurial tenant and underlines the need for the integration of business and technology.

#### 5. Development of new undergraduate and graduate specializations

The development of the nine new undergraduate courses and three new graduate entrepreneurship courses led to the TEC discussed above and negotiations with other colleges to create similar certificate programs. At the core of these interdisciplinary efforts is the NCP policy. Currently, students from across the campus are enrolling and are learning new ways to interact and to approach problem solving. Initial enrollment records show that students are likely to take the following courses: Entrepreneurship and Innovation, New Venture Development, Financing and Legal Issues, Field Consulting, and Small Business Management. Enrollment outside the college of business of 25% to 30% in each class provides the variety of ideas that help make the entrepreneurship courses a more positive learning experience for all the students. The addition of a New Venture Fund, sponsored by a grant, has also paved the way for the creation of more student “start-up” companies based on interdisciplinary team work.

The expansion of the courses to the graduate level creates new learning and consulting opportunities for the university. Economic development outreach initiatives can link students from all majors into teams with MBA students to conduct projects for local economic

development councils. The NCP policy is essential to this type of outreach and in assembling the skill sets needed for success.

## **II. SURELY IT HASN'T BEEN THAT EASY!**

No good deed ever goes unpunished in academics and the NCP policy is no exception. The Dean and the faculty leading the effort encountered several often highly vocal objections from some faculty members. The following section outlines the key faculty objections to the new NCP policy for the entrepreneurship specialization and presents the written response the Dean of the College of Business provided to the entire faculty prior to an open forum and discussion of the change.

### **Principal Objections to the NCP Policy**

**Objection (1):** There is insufficient documentation of student demand.

**Response:** College of Business (COB) faculty interested in promoting the new specialization polled their classes and determined that there was a significant level of student interest in the entrepreneurship specialization, that a substantial number of students wanted to pursue the entrepreneurship specialization because they intend to start their own business, and that many of the students perceive themselves to be emerging entrepreneurs. Non-COB faculty who participated in entrepreneurship “Boot Camps” provided another gauge of non-business student interest in the program.

The findings which suggest that students are interested in the entrepreneurship specialization are not surprising. The recent Global Entrepreneurship Monitor study by the Kauffman Foundation showed 11.9 percent of people started a business in the last 12 months. The National Federation of Independent Business monograph, *The Public Reviews Small Business (2004)* shows that over 90% of parents would approve of their daughter and/or son starting a business. It further shows that over 70 percent of respondents feel that small business owners have more control and independence in their lives. The report also shows that 66 percent feel ownership is the best way to get ahead in the United States.

In the local area, the average size of business firms is 16 employees and 98% of all firms are classified as small business. Furthermore, estimates are that 35% to 40% of firms are “family businesses.” The mission of the College of Business is to provide “education that allows students to compete and succeed in the 21<sup>st</sup> century workplace.” The entrepreneurship program is designed to respond to student interest in starting a company, working as a “corporate entrepreneur,” engaging in social entrepreneurship, working with economic development groups, and entering family businesses.

**Objection (2):** There will be insufficient full-time faculty to staff the new specialization in entrepreneurship and the program will become a haven for adjunct faculty.

**Response:** Academic Affairs has approved a new faculty position in Entrepreneurship and another faculty position is included in the five-year faculty staffing plan. These new positions do not come at the expense of, or cause a forfeit of an academic position in, any academic department. In addition, several COB faculty members have expressed an interest in teaching in the Entrepreneurship Program even though it requires them to undertake a new course

preparation. While we have included adjunct faculty staffing in the Entrepreneurship Specialization, they will be used in areas of expertise that usually demand practical experience such as the franchising course.

**Objection (3):** The failure of the entrepreneurship specialization to require students outside the COB to have completed prerequisites for the entrepreneurship courses will weaken the rigor of the program and pose difficulties with AACSB accreditation.

**Response:** The Entrepreneurship specialization has a vision that encompasses a university wide perspective and is not only COB specific. Key elements of the vision include:

- Entrepreneurship is an interdisciplinary educational vehicle
- Everyone has some entrepreneurial tendencies
- Teams are key to organizational development and success
- Individuals, not majors, create value
- Prerequisites are motivation and diversity, not specific educational modules

This vision means that teams will be used in a project based learning environment that uses the best each person has to offer to the solution of problems and analysis of opportunities. Other programs and universities have successfully integrated multi-disciplinary teams into courses that expand student learning and expose people to other points of view. The faculty members sponsoring the Entrepreneurship proposal believe that the university has the quality of students and interest in innovation and student development to accept this concept.

Moreover, both the recently approved and the former AACSB accreditation standards encourage curricular innovation, and require not that prerequisites are strictly enforced, but that achievement of the program's learning goals and objectives are clearly demonstrated. The NCP policy for non-COB students is designed to achieve the learning goals of the program: providing different perspectives and viewpoints in a project based curriculum. Business students bring business knowledge to the team; non-business students bring engineering, music, graphic arts, science, health and exercise science, and/or computer science knowledge to the team. In accordance with the additive model of learning, each team member will learn from the others what they need to succeed in the course, and all will be better prepared for the workplace in which they must work in teams of individuals with vastly different areas of expertise. This approach increases the rigor and does not reduce it.

**Objection (4):** The proposed specialization in entrepreneurship may have a negative impact on enrollments in existing specializations.

**Response:** The proposed specialization in entrepreneurship is not based on a zero sum gain model within the COB, but anticipates that 30% to 40% of the enrollments will come from outside the COB and encourages students to take electives in other specializations. Admittedly, some students in existing specializations will be attracted to the entrepreneurship specialization, because it offers them features not available in the other specializations and they may feel that they will be better served by pursuing entrepreneurship studies. Specializations not meeting the needs and expectations of students will inevitably experience a decline in enrollment. That has always been the case in the evolution of academic programs. If there is insufficient demand for the program to justify the specific courses in that specialization, a decision must be made regarding the redeployment and reassignment of faculty resources.

**Objection (5):** The proposed entrepreneurship specialization is interdisciplinary in nature, but is housed within the Management/MIS Department.

**Response:** The proposed entrepreneurship specialization is indeed interdisciplinary in nature, but is more closely identified with the disciplines represented in the Management/MIS Department. Moreover, the faculty who are most supportive of the new specialization and who volunteered to undertake new course preparations, prepared the curriculum proposals, and assisted in the course design, are in the Management/MIS Department. There is no general business department within the COB, and the research related to entrepreneurship has emerged from the field of management.

**Objection (6):** Two faculty members who plan to teach in the program lack journal article publications in the field of entrepreneurship. The lack of sufficient scholarly success in the field of entrepreneurship will impair AACSB accreditation. We should not move forward with any new academic program until we have sufficient faculty in place to meet accreditation standards.

**Response:** The five-year faculty staffing plan includes two new positions in entrepreneurship, and presumably the faculty hired for those positions will have achieved scholarly success in the field of entrepreneurship. Moreover, the approval process for new specializations creates a one to two year window in which faculty can transition their research interest before the courses they teach come on line. AACSB accreditation standards do not mandate the acquisition of academically or professionally qualified faculty before an institution can embark on the creation of new programs. On the contrary, the accreditation standards implicitly recognize that research and teaching interests of faculty change over time, and provide flexibility in the area of faculty resources and credentials to accommodate the evolution of academic programs and faculty interests.

These objections were openly discussed in a faculty forum and the result was that an overwhelming majority of the faculty understood the vision and goals of the program and voted to approve the NCP policy.

### III. SUMMARY AND CONCLUSIONS

In the entrepreneurship specialization, diversity of background is a decided advantage, because the program focuses on an additive, rather than a duplicative, model of learning. In the additive model, students are not required to learn the same body of knowledge; rather, they bring new perspectives and viewpoints to opportunity development. Using this approach, we anticipate enrollments of approximately 30% to 40% non-business students in the entrepreneurship courses based on freshman surveys and discussions with other departments. Prior teaching experiences at the University of Alabama, Bradley University, University College Dublin and Oslo Business School demonstrate that interdisciplinary teams of students from different colleges result in better business plans, more creative problem solving approaches in consulting engagements, and a creative career-development mode of thinking on the part of non-business students. They bring valuable perspectives to the team-based projects required in the entrepreneurship courses. This does not detract from the rigor of the program, but enriches the program.

The following is a testament to the necessity of the NCP policy as it relates to the college of engineering. Several specific observations related to the interdisciplinary nature of the NCP

policy have emerged based on the *Engineer of 2020 National Education Summit* in 2004, attended by Dianne Dorland. The Summit spelled out the need for business and entrepreneurial skill development in the “engineer of 2020.” In addition, the need for more cooperation among the creators and advocates of technology was stressed. The engineer of 2020 faces increased global pressure with commodity engineering tasks being awarded to the lowest bidder. This will mean continued outsourcing of engineering jobs to the mushrooming population of engineers being educated in Asia and India. Consequently, our future engineers must have a value-added facet in their engineering skills and applications to successfully compete in the engineering market. Attributes that focus on interdisciplinary education, innovative projects, entrepreneurial exposure, and development of business acumen firmly grounded on a foundation of engineering provide engineering graduates with a competitive edge. The NCP policy is clearly an approach that is consistent with the Summit discussions. The potential for interdisciplinary teams created as a result of this policy should result in a well-rounded education for all students.

Other universities thinking of adopting such a policy should openly discuss the impacts on rigor, AACSB accreditation, class sizes and demand, and interest of students outside the college of business. The authors’ university used the “Boot Camps,” an Entrepreneurial Fair (E-Fair) event including information and games, the Student Venture Fund, and the certificate programs to gauge the interest of non-business students. The NCP has been successful to date and is continuously reviewed to ensure that the experiences are positive and that both the rigor and results of the courses are maintained. There has been no “lowering” of standards, no reduction in work loads, and no major issues to date. The only area where some additional remedial work has been done is in basic accounting and financial topics. The implementation of this policy revealed that the business students needed the interdisciplinary teamwork as much as the non-business students. Clearly taking a course does not mean understanding how to use the information!

Would we do it again? YES. Do we want to expand the reach of the program? YES. The successes and high quality projects are a testament to the need for the enriching nature of the interdisciplinary teams, resulting from the NCP policy.

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# **LIFE LESSONS FROM THE PROCESS OF DYING AND DEATH: METAPHORICALLY EXPERIENTIAL OPPORTUNITIES FOR ENTREPRENEURIAL EDUCATORS**

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## **ABSTRACT**

Shakespeare offers some provocative lessons about the dawning of life and life's uncertain voyage. For example, Octavius Caesar was successful at work but otherwise a hollow person. Or, Cassius explains to Brutus that responsibility "is not in the stars but in ourselves." End of life concerns provide worthwhile metaphorical associations with entrepreneurship. The authors examine a number of illustrations to relate the dying process to entrepreneurship. There are many profound and distinctive lessons from health care providers and terminally ill patients on the journey of life. The paper provides experiential activities that encourages active student learning by metaphorically connecting the process of dying with the students' own future entrepreneurial philosophy, and lifestyle. The interactive learning includes field trips to a funeral parlor and a cemetery. With specific discussion about the experiential learning activities and anecdotal student feedback, entrepreneurial educators have intriguing opportunities to adopt, modify, or add other experientially learning dimensions for their own teaching style and research agenda.

## **INTRODUCTION**

The literature abounds with the interface of metaphors and entrepreneurship. Metaphors provide an opportunity to encourage customized interactive student learning experiential exercises. In Greek, a metaphor is meant to carry something across or transfer between two disciplines. Aristotle described metaphors as the act of giving something a thing or name that belongs to something else. In fact, in "Poetics," Aristotle notes that the greatest attribute is to be a master of

metaphors. It is a sign of genius since a good metaphor implies an intuitive perception of the similarity in contradictory terms.

Business educators have been using metaphors, such as sports, military, religion, gardening, marriage, parenting, complexity science, science fiction, anthills, biology, health, historical figures, magic, theatre, Aesop's Fables, Shakespeare, and weather for some time. A few of the sample references discuss the use of metaphors (Augustine and Adelman 1999; Dodd 2002; Gassner 1999; Gozzi 1994; Hyrsky 2000; and Perren and Atkin 1997). Popular metaphors can serve as an exciting tool for making practical analogies with entrepreneurship. More specifically, at a recent USASBE conference, Hoy and Farah (2003) offered a discussion on three ways through which films can be adopted to teach practical and theoretical entrepreneurial concepts.

Naturally, the specific process and teaching methods in applying the metaphors to enhance learning and understanding of entrepreneurship may be of concern. Nevertheless, Dodd (2002) notes that, metaphorically, life narratives provide access to the most fundamental and important form of human cognition, which results in a better understanding of our lives. Metaphors therefore constitute a first attempt at creating mental models to make sense of one's life narratives. Hence, a process that encourages people to use metaphors in their life narratives can interest, inform, and provoke (Aldrich, 1992).

## **PURPOSE OF THE PAPER**

Over the years, one of the writers has adopted many metaphors in the teaching of entrepreneurship. However, too often the teaching approach was to merely describe the metaphors and tell how they adeptly relate to some aspect of entrepreneurship. Alternatively, another method was to have students relate a metaphor to a brief question and answer format. These two approaches frequently culminated in passive student learning with a modicum of interactive learning. Furthermore, there seemed to be little creativity among the students.

Consequently, experiential activities were created (see Table 1 for the highlights and brief overview) that recognizes the dying process and death. It was decided to experiment with some new and untested metaphors that bridged the dying process and death, musical lyrics, entrepreneurial behavior, and making life choices. At first glance, the metaphorical fields may seem to be unrelated, but the authors found them to be effective in encouraging students to actively think about their personal future. Since there is strong student interest in career planning, career enrichment, and discovering an enjoyable lifestyle, the subject of dying and the thought of someone facing death might motivate students to think about their own immortality and lifestyle accomplishments.

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Table 1 about here

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To implement the intent of the student assignment and thought process, students took two class field trips to a funeral home and a cemetery. The students then placed themselves in a mental “time machine,” which enabled them to envision the life that they experienced. Although a bodacious objective, it was hoped that the students would try to emotionally and logically think about their own future and final resting place. Concurrently, how can this metaphorically convert to aspects of entrepreneurship?

In a nutshell, the purpose of the paper is to offer a brief discussion on bridging the dying process and death, music, and projecting an entrepreneurial lifestyle. The paper briefly demonstrates the potential value of integrating these fields. Secondly, the authors provide some experiential activities for student learning. The actual assignment and required student deliverables are further explained to the readers. And lastly, the readers are provided some anecdotal student reactions and perceived learning experiences to the assignment. The authors will also provide some professorial observations, limitations, and implications.

### **LIFE LESSONS ON THE PROCESS OF DYING AND DEATH**

Perhaps Shakespeare offers some provocative lessons about the dawning of life and life’s uncertain voyage. Octavius Caesar was successful at work but otherwise a hollow person. And, Macbeth notes that it was too late for an essential quality of life. “My way of life has fallen into the sear. And that which should accompany old age, as honor, love, obedience, troops of friends, I must not look to have.” In addition, Cassius explains to Brutus, and learns that responsibility “is not in our stars but in ourselves.” (Augustine & Adelman, 1999).

Greek and Roman philosophers have recognized that death and life are inextricably related. People arrogantly assign cosmic importance to their day-to-day concerns. Death is always present to restore them to a more appropriate sense of proportion (Gonda & Ruark, 1984). Yalom (1980) profoundly writes that although the physicality of death destroys us, the idea of death saves us.

Since one of the authors has health care experiences in Hospice, Oncology, Gerontology and Palliative Care, it is possible to suggest some anecdotal comments. Terminal sick patients, who were from all socioeconomic and professional groups, have an uncanny perspective on the mysteries of living and life. Although time was relatively short, the dying patients had a keen viewpoint on what was relevant and significant in their lives. In a profound paradoxical way, they felt free from mundane and insignificant worries and established a new freedom. Despite their likely demise, they eventually found peace with themselves and had a better understanding of life itself. They started to do things that they enjoyed and became involved with meaningful projects in their short life expectancy. It was a new form of independence whereby they were in control with how they would spend their time. (Are locus of control or self-employment for self-satisfaction implicit connections for entrepreneurship?) They did not have to impress some “boss” or work at uninteresting tasks. It is beyond the scope of this paper to metaphorically relate this boundless feeling when one is at death’s door. Yet, these feelings have an interesting metaphorical transferability to some of the motivational forces of entrepreneurship. For example, making positive contributions for society before it is too late.

In a fascinating book, *Life Lessons*, one of the authors is a cancer victim and physician. The co-authors offer an interesting and potential parallel between death and an entrepreneurial career. To paraphrase, it is essential to find a balance between our own opposing forces. Life has storms that will always pass. People move back and forth on this pendulum of life, the yin and the yang. And, in the midst of death, people sometimes find life. On thousand deathbeds, people learned that following their dreams was vital in truly enjoying life. (Kubler-Ross & Kessler, 2000).

Adaptation becomes a mantra for many terminal patients. They learn the mystery of “going with the flow.” A few more illustrations can delineate the transferability of lessons from dying to entrepreneurship:

\*\* A team of health providers will use a team approach for “crisis intervention” which enables terminal patients and family members to make decisions and deal with grief (Sheehan, 1996). This could be analogous to a turnaround business situation with a team of turnaround specialists.

\*\*During the course of terminal illnesses, individuals move through denial and isolation; anger; bargaining; depression; and acceptance of death (Gonda & Ruark 1984). This too has interesting connections with small business life cycles as well as encountering the “growth wall.”

\*\*Thoughts of death among terminally ill patients and family members will remind all of us about the value of each moment (Gonda & Ruark, 1984). There is the nagging concern of dealing with the emotional distress of an uncertain future (Preston, 2000). Entrepreneurs certainly must deal with uncertainty and their decisions could easily impact a number of family members and dear friends. Concomitantly, terminal patients will sometimes decide to hide their fatal illness and not tell anyone (Preston, 2000). This behavior is emotionally devastating to family members (Sheehan & Forman, 1996). This attitude is analogous in lacking a succession plan.

\*\*Planning for contingencies is critical: getting one’s estate in order; making sure that one’s house is in order; closure for loved ones; and preserving pleasant memories (Sheehan & Forman 1996). In the entrepreneurial process, there is constant interest with harvesting a business, developing an exit strategy, and concerns with life after a business is sold or closed.

### **BRIDGING THE METAPHORS**

Students, especially 19 to 25 year olds, occasionally have a difficult time in projecting their careers and lifestyles right after graduation. They are frequently myopic with finding a “job” or making money. They seem preoccupied with immediate issues and fail to think strategically about career planning and its associated way of life. Some merely state that they want to be very wealthy and happy. This generalized attitude—with little specifics—creates confusion and a reactive strategy for inspirational lifestyle choices.

The metaphorical experiential activities test the students to think about their future career, expected lifestyle, and eventual demise. Optimistically, the students would formally contemplate their own core values, preferences in a career, preferred lifestyle, and the entrepreneurial philosophy that would be agreeable to them. Moreover, the students have the opportunity to be creative in conjecturing about their own future. The experiential assignment also required the

selection of mentors, possibly some entrepreneurs. Mentoring stressed the importance of networking and learning from successful or unsuccessful careerists. The use of mentors captures the life narratives of influential people that students hypothetically met during their lives.

To create the ideal and surreal environment and take field trips within the context of death, the experiential activity included a trip to a family owned funeral parlor and a local cemetery. A husband-wife team owned four funeral parlors and thus assisted with an interesting discussion on the mysteries of death and entrepreneurship. The aim of the field trips was to craft a proper frame of mind. Although no corpse or embalment was actually viewed, class was held in the funeral parlor, and an informative tour was given. This included viewing various caskets, waiting rooms, hearses, grieving areas, mini chapel, and other rooms. For personal reasons or beliefs, two students did not take the entire tour, such as viewing the caskets that were for sale. But, everyone did participate in the discussion and question/answer session at the end of the tour.

For the next class, the class visited a local city cemetery. An elderly employee of the funeral parlor and one of the owners accompanied the visit. They were able to tell stories of the history of the town and the famous as well as infamous people who were buried in the cemetery. Students asked a few remarkable questions about burials, people, tombstones, and rules and regulations.

### **ANONYMOUS STUDENT COMMENTS AND FEEDBACK**

After the assignment was turned in, the students were asked during class to provide written anonymous comments on the value of the field trip and learning experiences. For sake of brevity, a few of the more representative comments are paraphrase below:

- It is important to do prior planning (both financially and legally) before your death.
- Plan early for your death and funeral. This will help out the family once you pass away.
- Families must communicate the wishes of love ones.
- Just as in life, death is a great responsibility.
- I should plan now for the ultimate exit strategy.
- I never thought of all of the complexities of arranging for death and a funeral.
- I also really liked how you talked about when you have a job; you should put your head, heart, and hands into it. I've always believed in having a passion.
- I was impressed with the counseling services offered by your company. It's that "thinking outside the box" that really makes a difference.
- I also gained a little more insight towards planning ahead for a meaningful life, and I believe it is definitely something more people should think about. Thank you very much!
- Lessons learned: Death is the great equalizer. Your legacy is made by what people think of you, not what is on your resume.
- The reality of life – it's short and valuable and unpredictable.
- Make the most of your life – take risks.
- Try new things – be different because in the end we will all die.
- I had fun doing the funeral/cemetery since it was out of the normal class setting and made us see life from a different perspective.

- It made me appreciate the little things in life that most people (sometimes myself) don't think about much. "Live life to the fullest!!"

## **LIMITATIONS, IMPLICATIONS AND CONCLUSIONS**

The authors thought that the students would enjoy the serenity of the cemetery environment. Students could then let their imagination expand and get a better "feel" about their own possible entrepreneurial lifestyle. Based on the written comments, the students enjoyed the funeral home more than the cemetery visit. Unpredictably, two students could visit the cemetery but not the funeral home, while two others felt more comfortable with a visit to the cemetery. Educators will have to adjust to the students' cultural beliefs and/or any taboos. In this case, the visits were optional if there was an honest personal reason. To compensate for the absence, a couple of students were asked to select one extra song that might reflect their perceived lifestyle. It should be stated that no student missed **both** the funeral home and cemetery visits.

By promoting metaphorically interactive student learning, students had a chance to think about future careers. And, by meditating about the dying process, an entrepreneurial philosophy might come to fruition. This way of thinking might embrace such variables, as freedom, risk taking, social entrepreneurship, career enrichment, opportunity focused, innovation, societal contributions, positive change, and even corporate entrepreneurship.

Those who learned to know death, compared to fearing and fighting it, become our teachers about life and its purposes. Death is shedding the physical body, like the butterfly shedding its cocoon and flying away from fear and into freedom ((Kubler-Ross, 2004). These thoughts may certainly have some interesting and profound implications and meaningful associations.

It is recognized that critics may be concerned with what students may have actually learned from the assignment and field trips. The authors did not undertake a pretest and post-test to measure changes in attitude or the level of student learning. Participants have an opportunity to build on the pedagogical process described herein and empirically research the learning value.

One potential limitation deals with cultural attitudes, beliefs, and behavior of some students. A few students may feel very uneasy or even upset about using the dying process as a metaphor for entrepreneurial behavior. They may feel that it is too morbid or a forbidden topic. In other cases, students may have experienced a recent death of immediate family members or very close friends. Consequently, alternative experiential activities may have to be created and assigned to these students.

Another limitation is the age of some students. Some are relatively young, and it is hard for them to project thirty to seventy years into the future. Since so many life experiences can intervene over the decades, the assignment may seem like pure fantasy. Nonetheless, this may be a good time to pinpoint the opposing forces of planning versus adaptation and controlled chaos.

An interesting sidelight to the experiential learning was giving the students freedom and latitude on how to present their written assignment. They were instructed to be creative and avoid handing in written prose in paragraph format. As a result, a number of students turned in

artwork, mind-mapping visuals, figures, drawings, written student poems, flow charts, timelines, and collages of vignettes that depicted the student's professional life span. The written output gave the students another opportunity to be creative. However, a major caveat is required. It was difficult to grade the assignment. There was a wide range of output, and the content was hypothetical. Consequently, the assignment was graded very liberally, and everyone was rewarded in the senior level course.

In conclusion, the assignment enables them to see how they can apply and transfer the metaphoric lessons of dying to entrepreneurship. There are vast opportunities to illustrate the similarities between the mystery of death and entrepreneurial intensity. Just the Darwinian metaphor of evolution and survival rates of firms (Henderson, 1999) has some intriguing learning applications and implications from the survival process of terminal illness. Or, when one may be near death it is common to rethink one's passion and the meaning of life. Leaving a legacy is sometimes a major consideration, which certainly has some worthwhile metaphorical applications to social entrepreneurship, letting go the business, eschewing micromanaging, as well as overcoming workaholic behavior. There are so many teaching possibilities to expand the experiential activities herein that we only need to use our own creativity.

**Table 1**

| <b>Class Assignment. A Funeral Home and Cemetery Visit<br/>Projecting One's Entrepreneurial Behavior and Philosophy<br/>Written Instructions</b>  |  |
|---|--|
| <p>We will meet at the Hooper Huddleston &amp; Horner funeral home (Wednesday) and on Friday at the Cookeville cemetery. At the funeral home, we will have a tour and mini-lecture on life lessons on death and the mysteries of career planning and lifestyle success. We will then break and for the next class period (Friday) you will drive to the cemetery, carefully walk around and look at tombstones. Please be careful with the flowers and stepping on graves. Also, in case there is a funeral or people paying their respects, please talk softly and look at tombstones that are a distance from the funeral or cemetery visitors. Due to parking, see if you can carpool with a few classmates. If transportation is a problem, feel free to join me in my car.</p> |  |
| <p>At the cemetery, please pay particular attention to the dates that this person lived and the events that were taking place during this period. After picking the person's grave, you should project a hypothetical narrative on the type of entrepreneurial career that this person experienced. We may have a guest from the funeral home to highlight some of the famous people from the region. In your paper, you should explain why this person was "successful or unsuccessful" with this life. Your typewritten paper should reflect:</p>   |  |
| <p>1. The period of time...were the economic conditions (nationally or locally) favorable?</p>  |  |
| <p>2. Why did the person select entrepreneurship as a career? Motivations?</p>  |  |
| <p>3. A. Why did this person succeed or not succeed?<br/>B. What impact did this person have on planning your own career and philosophy on life?</p>  |  |
| <p>4. Pick a song that you would like played at your funeral ...with this musical metaphor discuss how the lyrics integrate with your own perceptions on your career and lifestyle that covered your life span. You will hand in the lyrics at the end of your four-page paper.</p>   |  |

5. And finally, what will people be saying and writing about you and your behavior in this career and your entrepreneurial philosophy... Your own obituary and epitaph.

Your paper is due a week later, and it should be approximately four typewritten pages. You can use your books, any experts, and/or internet research for input. Also, you could use the Internet to read anything relevant in writing the paper or about a particular business you started or company that you worked for during your lifetime. If you do any secondary research, just reference the sources on a separate sheet. Please note: you are encouraged to use a lot of visuals and creative tools in your paper. For example, you can use poetry, tombstone drawings, mind mapping, figures, exhibits, and the like. These tools are preferred instead of writing the typical prose and paragraphs. You can even use three or four figures, "tools" on one page.

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# U.S. FEDERAL GOVERNMENT INTERVENTION FOR MINORITY ENTREPRENEURS

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## ABSTRACT

Prior to 1967, minority entrepreneurs experienced barriers to entry into the U.S. federal government marketplace. Then the government intervened with minority business procurement policies geared toward reducing social and economic barriers. This study compares minority-owned businesses to two control groups—small businesses and large businesses. The analysis supports a conclusion that government intervention has contributed to increased growth of minority-owned businesses. It also concludes that competing regulations meant to improve government efficiencies can inhibit minority-owned business growth.

## INTRODUCTION

The United States government spends approximately \$270 billion annually purchasing goods and services (US Census Bureau, 2002) making it the largest single market in the world. These expenditures are greater than the gross domestic product of many nations (S&P, 2000). The source of funds that provides for these expenditures comes from U.S. taxpayers in the form of income taxes (48%), social security (34%), and corporate income taxes (10%) (OMB, 2000).

Because taxpayers provide the funds for these federal expenditures, it is reasonable to assume that all taxpayers will have the right and opportunity to sell goods and services to the federal government in a competitive environment. It follows that minority entrepreneurs will have the same opportunity to access the federal procurement system as any other taxpayer. That was not the case prior to 1967; therefore, the government intervened and continues to intervene through a variety of programs.

The purpose of this study is to determine whether government intervention on behalf of the minority entrepreneur in the federal market is justified and to determine whether any changes are needed. The analysis is based upon federal purchases at three points in time—1979, 1989, and 1999.

The study examines minority-owned business performance in the federal market against that of two control groups—small businesses and large businesses (LB). Since large businesses have traditionally been awarded the majority of federal contract dollars, this study assumes that LB performance is representative of the federal market.

## OBJECTIVES OF THE RESEARCH

The objective of this research is to investigate the thesis that “increased government regulatory intervention in support of small minority-owned businesses improves their economic growth and development.”<sup>1</sup> The thesis can be dissected into three parts for clarification and definition. First, a small minority-owned business is defined by the Small Business Administration (SBA)

as a business that is not dominant in its field of operation and that is owned or controlled by one or more socially or economically disadvantaged persons.<sup>2</sup> Second, this study concerns intervention as promulgated through the SBA 8(a) program and the Small Disadvantaged Business (SDB) program. Extensive definition, rules and regulations surround each of these programs, but in essence—the federal government can set-aside a percentage of contracts for exclusive bidding by SDBs or 8(a)s (commonly referred to as “set-asides”).<sup>3</sup> The third part of the thesis requiring clarification is economic growth and development, which is traditionally measured in a variety of ways including firm creation, job creation, and revenues.

### **General Hypotheses**

Several hypotheses are consistent with the thesis that federal intervention in support of minority-owned businesses improves their performance and capacity. These are:

Hypothesis 1: The SDB and 8(a) programs have contributed to an increase in small minority-owned business capacity.<sup>4</sup>

Hypothesis 2: As a consequence of the SDB and 8(a) programs the capacity of the small minority-owned business community has increased and is now approaching that of the small business community.

Hypothesis 3: As the federal government adopts stronger laws and regulations to increase business and administrative efficiency, the capacity of minority-owned businesses decreases.

Each of the hypotheses is tested in multiple ways by operationalizing capacity using measures derived from prior researchers. These measures include: (1) number of contracts awarded; (2) number of firms in the federal market i.e. actual number of minority-owned businesses or small or large businesses ; (3) average number of contracts per firm; (4) average award amount per firm; (5) number of contract actions; (6) total award value of all contracts; (7) average contract action amount; (8) industry sector; and (9) firm survival rate. (Measures were derived from prior research by (Acs,1998; Boulay, 1984, Skolnik, 1992; Faucett, 1987; and Fullenbaum, 1992). Two additional measures were added that have not previously been addressed in other studies—deobligations and terminations.

Deobligations occur when the government issues a contract modification that removes funds previously awarded to a contract. There are a variety of reasons for these actions including error corrections, change in work requirements or an agency decision to reallocate funds to other projects. Contract deobligations are important because they reduce the value of awards. Terminations are issued for reasons similar to deobligations. It is included as a study element because some observers have argued that more MB contracts are terminated than others.<sup>5</sup>

### **MEASURING THE EFFECTIVENESS OF GOVERNMENT INTERVENTION**

A determination of whether federal procurement policy has been effective for minority entrepreneurs was undertaken by examining performance measures extracted from previous studies and compared minority-owned businesses to two control groups—all small businesses and large businesses as presented in Table 1. The data used for this study comes from the Federal Procurement Data Center (GSA, 2000).

Performance measures for MB's should be similar to those of all small businesses, but based upon performance measures, MB growth for the entire study period has increased and exceeds



that of SBs in a majority of measures. The comparative analysis shows variations in performance between the two groups at different time periods ranging from small to very large differences. One of the important measures for gauging capacity and performance is 'total award value'. From 1979 to 1999, the percentage of total award value for minority-owned businesses increased more than 5 times, while that of all small businesses fluctuated between 11 to 16%. These differences are so large that government intervention is the most likely explanation.

### **Measurements Related to Hypotheses**

Hypothesis one and two questioned whether minority-owned business growth and development increased as a consequence of the SDB and 8(a) programs. As MBs are a subset of the small business community, the expectation is that without intervention MBs should experience at least similar levels of growth. However, the analysis shows large differences in the majority of performance measures across the time periods examined. Following is an overview of the findings.

#### Finding One

There are distinct differences in performance measures between the two study intervals 1979-1989 and 1989-1999, and between the groups being studied. During the first and second intervals, the comparative analysis showed MB performance exceeded that of SBs and LBs in a majority of performance measures. For the entire study period, MB performance exceeded that of SBs, LBs and the overall market in a majority of the performance measures.

#### Finding Two

Procurement for MBs versus SBs is a near zero sum game which results in a seesaw effect (i.e., when an MB performance measure increases then the corresponding SB measure tends to decline).

#### Finding Three

MBs consistently lagged SBs and LBs in two measures—deobligations and terminations. The data do not provide information sufficient for ascertaining the rationale behind the deobligations, but the differences shown in the analyses are significant.

#### Finding Four

The largest positive gain for MBs over the entire period was in the total award value, where MBs increased by 4,650 percent versus 824 percent for SBs and 890 percent for LBs while the number of contract actions for the entire market increased only 206 percent.

#### Finding Five

Analysis shows that awards to SDBs and 8(a)s began to decline in the late 1990s, while awards to WBEs began to grow.<sup>6</sup> This is consistent with previous findings, which showed a general slowing in performance measures during the 1989-1999 interval.

The analytical findings lend strong support to the hypothesis that the SDB and 8(a) programs have contributed to an increase in MB capacity and performance. In terms of market share, the gap between MBs and SBs is narrowing. This supports the hypothesis that the SDB and 8(a) programs aid MBs in reaching the capacity of other SBs.

## POLICY RECOMMENDATIONS

When the SBA's 8(a) program was initiated, program managers rushed to utilize 8(a) firms, because it allowed them to reduce contract award times from one to two years down to six months. This was evidenced by the dramatic increases found during the analysis of data during 1979 to 1989. During that time, MBs experienced a 500 percent increase in awards. Reductions in award time afforded by the 8(a) program translated into success not only for program managers, but also for agencies and end users of the products or services. When FASA was implemented, that incentive disappeared.

What is needed today is a new incentive for government program managers to use MBs. As long as agencies are forced to use MBs, SBs or WBEs and other groups, more resources, more oversight and more regulations will be needed. An incentive at the agency level alone will not work because program managers are the ones who make procurement decisions either directly or indirectly. An example of a program with sufficient incentives is Mentor Protégé. Large firms participate in this program because they get paid to mentor. It is self-policing because if the protégé firm is dissatisfied, it can complain and the mentor may lose revenue generated by the relationship. Therefore, it is in the best interest of the mentor to keep their protégés satisfied. There is no cost to the mentor, and they are paid whether the relationship is successful or not—incentives work. It is a matter of finding the right one.

Another recommendation is to increase, monitor and enforce goals for subcontracting. Analysis shows that the small business share of contract dollars is increasingly being subdivided among more groups (i.e. women, 8(a) s, SDBs, and most recently—veterans). Analysis also shows that the white male-owned business has been losing market share though many believe they have been shifting business ownership into the name of female associates.<sup>7</sup> One must keep in mind that business owners who survive in the market tend to be better educated, have more management experience and are more nimble. It follows that a white-male-owned business threatened with loss of market share may be tempted to put ownership of the business in the name of a female associate. Business owners should not be placed in a position where they have to resort to fraudulent activities. The Adarand vs Pena case is an example of what happens when business owners feel that they are unfairly losing to other groups. In light of the new women-owned business goals, incumbent firms will feel additional pressure as contracting officials move to meet the new goals (SupremeCourt, 1995). As stated earlier, the small business community is in a zero-sum relationship—as WBE awards increase, awards to other business groups will decrease.

Currently, the small business goal is set at 23 percent. If small business is essential to the growth and development of this country, then the government should extend the goal to require large prime contractors to subcontract the same amount (23 %) to small businesses. This level of subcontracting would ameliorate the infighting (i.e., Supreme Court cases) between the various small business subgroups that are pitted against one another.

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Table about here

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On average, large prime contractors garner approximately 80 percent of all procurement dollars. Implementation of the 23 percent LB subcontracting goal would benefit small businesses by expanding their market share, while capitalizing on the efficiencies and productivity of large businesses. In order to determine whether subcontracting goals are met, it is necessary to establish systems that are capable of collecting the information. Therefore, a subpart to the subcontracting recommendation is to examine existing data collection procedures to determine the best way to optimize collection and reporting.

Another recommendation concerns economic development versus welfare. GAO reports that Congress is concerned about the large concentration of contracts with a few 8(a) firms (GAO, 1996, 2000, 2001). The SBA states that the concentration of 8(a) contracts is no different than the concentration among other groups of firms—both large and small. In fact, preliminary analysis of data used in this study confirms the concentration of contracts with a few firms for all groups of businesses.

The GAO counters that the Congressional intent was a fair and equitable distribution of contracts (GAO 1996). The idea that contracts should be equitably distributed goes against the grain of business growth and development. In the business world, the strongest, quickest, and most nimble firms grow fastest and gain larger and larger shares of the market. Equitable distribution of contracts has the potential for stunting the growth of MBs, by denying them the opportunity to capitalize on their experience, reputation, and agency knowledge. Therefore, a recommendation is to develop a scheme for awarding contracts that acknowledges and encourages the growth of MBs instead of artificially stunting their growth.

A final and related recommendation concerns the psychology associated with a “disadvantaged business.” Many minority entrepreneurs chafe at being called disadvantaged or 8(a), but must accept the label to participate in minority procurement programs. Additionally, those who are designated as minority business champions are called “small disadvantaged business utilization specialists” or SADBUS—pronounced SADBOOs.

Not only does the term “disadvantaged” have a derogatory connotation to the potential buyer, but it also has the potential to affect the belief system of the firm and those who must champion them. In 1992, the Presidents Commission on Minority Business Development recommended that it be replaced with “historically underutilized business” (HUB) yet the term “disadvantaged” still lingers (Smith 1992). It is time to change the name. If government wants to work more like the private sector then they should take a cue from them and come up with a creative, positive term that goes beyond a 3-letter acronym (i.e., Accelerators, or Triple-A Certified).

As long as Congress views MB procurement as “welfare”, there will be a continuous push to “distribute” contracts among an even larger number of minority-owned firms. As stated by Nixon (1968) “Black Americans - no more than white Americans - want more Government programs, which perpetuate dependency. They don't want to be a colony in a nation. They want the pride and the self-respect and the dignity that can only come if they have an equal chance.” That equal chance is provided through a competitive market that acknowledges that some firms will remain small and others will grow large.

## ENDNOTES

<sup>1</sup> Originally minority referred to African Americans, Native Alaskans, and Native Indians.

<sup>2</sup> Sec. 124.103 of Small Business Act. Who is socially disadvantaged?

(a) General. Socially disadvantaged individuals are those who have been subjected to racial or ethnic prejudice or cultural bias within American society because of their identities as members of groups and without regard to their individual qualities. The social disadvantage must stem from circumstances beyond their control.

(b) Members of designated groups. (1) There is a rebuttable presumption that the following individuals are socially disadvantaged: Black Americans; Hispanic Americans; Native Americans (American Indians, Eskimos, Aleuts, or Native Hawaiians); Asian Pacific Americans... and members of other groups designated from time to time by SBA according to procedures set forth at paragraph (d) of this section. Being born in a country does not, by itself, suffice to make the birth country an individual's country of origin for purposes of inclusion.

<sup>3</sup> For definition of the 8(a) and SDB programs is at website ( <http://www.sba.gov/>).

<sup>4</sup> The term 'capacity' comes from the Small Business Act". Throughout this report the terms capacity and performance are used somewhat interchangeably. For example, if it is the case that the number of minority businesses increased considerably over the study period one could say the capacity of the MB sector has increased (relative to an earlier time). But it may also be said that the MB sector's performance increased because net new MB companies were created.

<sup>5</sup> Suggestion made by Anthony Robinson who is Executive Director of the Minority Business Education Legal Defense (MBELDEF) association formed by U.S. Representative Parren Mitchell. Mr. Robinson stated that his membership, composed exclusively of minority-owned business federal contractors, believes terminations are on the rise.

<sup>6</sup> The SBA defines a small business as one with 500 or fewer employees for services firms and 1,000 employees or less for a manufacturing firm.

<sup>7</sup> Data for women-owned businesses is not shown in this report, but is available upon request.

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Table 1: Performance of Business Groups by Measure and Year (Percentage)

| Growth Measures                                   | 1979 |     |     |           | 1989 |     |     |            | 1999 |     |     |            |
|---|------|-----|-----|-----------|------|-----|-----|------------|------|-----|-----|------------|
|   | MB   | SB  | LB  | Total     | MB   | SB  | LB  | Total      | MB   | SB  | LB  | Total      |
| 1. Number of Contracts                            | 8%   | 51% | 41% | 35,901    | 8%   | 30% | 62% | 55,776     | 18%  | 48% | 34% | 63,121     |
| 2. Number of Firms                                | 8%   | 62% | 30% | 14,004    | 7%   | 35% | 58% | 25,152     | 15%  | 56% | 29% | 31,048     |
| 3. Number of Contract Actions                     | 5%   | 37% | 59% | 75,021    | 10%  | 23% | 67% | 135,120    | 17%  | 32% | 51% | 229,848    |
| 4. Total Award Value                              | 2%   | 16% | 81% | 7,227,580 | 5%   | 11% | 84% | 32,121,452 | 9%   | 14% | 76% | 76,295,751 |
| 5. Number of Deobligations                        | 2%   | 22% | 75% | 2,269     | 8%   | 21% | 71% | 5,084      | 18%  | 25% | 57% | 12,594     |
| 6. Amount of Deobligations                        | 0%   | 26% | 74% | 290,546   | 4%   | 10% | 86% | 798,406    | 9%   | 8%  | 83% | 2,832,824  |
| 7. Number of Contracts Terminated for Convenience | NA   | NA  | NA  | NA        | 7%   | 39% | 53% | 304        | 11%  | 28% | 61% | 400        |
| 8. Amount of Contracts Terminated for Convenience | NA   | NA  | NA  | NA        | 8%   | 19% | 73% | 70,581     | 9%   | 24% | 67% | 61,759     |

Source: GSA, 2000    Dollars are in thousands of 1999's. NA = not available