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## LETTER FROM THE EDITOR

Welcome to the *International Journal of Entrepreneurship*. We are extremely pleased to be able to present what we intend to become a primary vehicle for communication of entrepreneurship research throughout the world.

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Nelson O. Ndubisi  
Monash University, Malaysia

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## **MANUSCRIPTS**

**MANUSCRIPTS**



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# AN EXPLANATION OF INTERNATIONAL FRANCHISORS' PREFERENCE FOR MULTI-UNIT FRANCHISING

**Vinay K. Garg, Missouri State University**  
**Abdul A. Rasheed, The University of Texas at Arlington**

## ABSTRACT

*Most international franchisors seem to follow multi-unit franchising. But it is often treated as an anomaly from an agency theory perspective. We argue that multi-unit franchising can be explained by agency theory, if we consider the full range of agency problems. These include: shirking, adverse selection, information flow, inefficient risk bearing, free-riding, and quasi-rent appropriation. Although past agency theoretic examinations have mostly focused on single-unit franchising, our analysis shows that in the international context, multi-unit franchising may be more appropriate considering the significant geographic and cultural distance between franchisors and franchisees.*

## INTRODUCTION

Franchising has become a very popular means for rapid organizational growth in the U.S over the last four decades. Starting with the fast food industry, franchising has now become pervasive in a variety of industries ranging from auto repair to day care. The rapid diffusion of franchising is also reflected in a surge in the number of academic studies of franchising as well as greater attention in the popular press. A significant number of academic researchers have relied on agency theory to analyze a variety of franchising related issues such as the structure of the franchising agreement, the choice of a specific type of franchising, and financial success of the franchising system (Bates, 1998; Shane, 1996a). The appeal of agency theory stems from the fact that the relationship between the franchisor and the franchisee is essentially an agency relationship. Interestingly enough, most of the theoretical arguments based on agency theory implicitly seem to assume that franchisees are essentially single unit operators (Kaufmann and Dant, 1996: 346). This assumption, however, is surprising given that multi-unit franchising (MUF)

seems to be the norm in many industries. For example, using Bureau of the Census data, Bates (1998:114) noted that "among the recently started restaurant franchise units, 84% were units of multi-establishment corporations." Kaufmann and Dant (1996: 346) note several other examples leading to the conclusion: "It is clear that the typical location-based franchising system (of which the fast-food franchises are the prime and modal example) is populated with multi-unit franchisees." Interestingly, the prevalence of multi-unit franchises is even more widespread in the context of international franchising (Alon, 2000; Dant and Nasr, 1998).

Prior research, by and large, has focused mostly on single-unit franchising (SUF) because of the assumption that agency problems can be best resolved by having owner operators. The moment they become multi-unit systems, individual units are managed by employees, thereby reintroducing the agency problem. This led Kaufmann and Dant (1996) to call the prevalence of MUF "a curious anomaly" in search of a clear theoretical explanation. The objective of this paper is to answer the question: Why do international franchisors prefer MUF over SUF? We argue that there is no need to embark on a search for a new theory to explain this preference. Our position is that MUF is not a theoretical anomaly and that agency theory can adequately explain the preference for MUF among international franchisees.

Multi-unit franchising differs from single-unit franchising in one fundamental way. In MUF, the franchisees own, operate, or control more than one outlet (Kaufmann and Dant, 1996). Even within MUF, there are many different types (Alon, 2000). Incremental or sequential MUF occurs when a single-unit franchisee is awarded additional units based upon the performance of existing units. In master franchising, on the other hand, the franchisor grants a franchisee rights to multiple units from the outset (Kaufmann, 1992). Area development agreements are a special type of master franchising which requires the master franchisee to open and operate multiple units within a geographical area according to a pre-specified schedule. Individual outlets, in turn, are run by employee-managers hired by the master franchisee.

Kaufmann and Dant (1996) suggested that though MUF is an anomaly from an agency theoretic perspective, it has merits over SUF as an entry mode from a capital acquisition perspective. However, this suggests that somehow MUF cannot be explained from an agency perspective. This is intriguing, given the enormous success that agency theory has had in explaining a variety of principal-agent relationships in general and the franchisor-franchisee relationship in particular. The domain of agency theory is relationships between a principal and an agent who are

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engaged in cooperative behavior, but have differing goals and differing attitudes toward risk (Eisenhardt, 1989). A large volume of both conceptual and empirical work has been published in recent years, applying agency theory to diverse settings (see Sharma, 1997, for some examples). How can a theory that has enjoyed such enormous success in analyzing principal-agent relationships in other settings prove so inadequate to explain the overwhelming prevalence of MUF in international franchising?

We argue in this paper that it is possible to explain the prevalence of MUF using agency theory. We focus on international franchising for two reasons. First, international franchising is growing much faster than domestic franchising (Shane, 1996b). Second, international franchising offers a unique setting for the comparative evaluation of the magnitude of agency problems associated with MUF and SUF. In the domestic context, we see some firms following a single unit franchising strategy and others following a multi-unit franchising strategy. In most cases, this can be explained by either factors specific to an industry or a firm. In the international context, on the other hand, the preference appears to be predominantly for multi-unit systems. This suggests that internationalization introduces a set of management considerations that are unique to foreign operations.

The paper is organized as follows. First, we present a review of the agency theory perspective of franchising. Then, we apply the agency perspective to analyze how international multi-unit franchising addresses agency problems. Finally, we discuss the implications for research and practice.

### **EXPLANATION OF FRANCHISING FROM AN AGENCY THEORY PERSPECTIVE**

An agency relationship involves two parties: the principal and the agent. There will always be some divergence between the interests of the principal and the agent. The principal delegates work to an agent because the principal does not have the skills or resources to carry out the task. The principal wants the agent to act in his best interest but the agent's self interest dictates otherwise. This assumption of goal divergence is at the heart of agency theory (Eisenhardt, 1989; Jensen and Meckling, 1976). Agency theory assumes that agents are likely to misrepresent information concerning their skills and behavior and to withhold effort (Jensen and Meckling, 1976). The options available to the principal to mitigate these problems are incentive alignment and monitoring (Shane, 1996a). In incentive alignment, the agent's incentives are set in such a way that in maximizing his own incentive, the

agent also maximizes the principal's interests. Franchising seeks to bring about incentive alignment through residual claimancy. Monitoring involves any action aimed at providing principals with information concerning the behavior of agents (Eisenhardt, 1988).

### **RESIDUAL CLAIMANCY**

Theoretically, a franchisor has two options: either to open an outlet and hire salaried managers to run it or to enter into a franchise agreement with an owner operator. Agency theory would suggest that there is likely to be greater goal divergence between franchisors and hired managers than between franchisors and franchisees. This is because franchisees have stronger incentives for maximizing the profits of their franchises (Anderson, 1984; Brickley and Dark, 1987; Carney and Gedajlovic, 1991; Caves and Murphy, 1976; Combs and Castrogiovanni, 1994; Norton, 1988a, b). In a franchise relationship, the franchisee is the residual claimant. That is, the franchisee is entitled to all the profits after paying all the business costs as well as the royalties to the franchisor. This means that if the franchisee succeeds in lowering costs and increasing revenues, his profits tend to grow. As Brickley and Dark (1987:404) point out, "the costs and benefits of franchisees' actions that affect the value of their individual units are capitalized onto their own shoulders" (Brickley and Dark, 1987: 404). Because franchisees are residual claimants, not only do they have no reason to shirk but they also have an incentive to put forth higher levels of effort. If, on the other hand, the firm proceeds with the option of opening company-owned outlets, the hired managers are likely to shirk because they are typically promised fixed pay-offs, though some variable payments are possible. In other words, although agency problems exist both in the case of a firm's relationship with a hired manager as well as a franchisee, they are better resolved through incentive alignment in the case of franchising. This is primarily because residual claimancy provides incentives to a franchisee that are not available to the hired manager.

### **MONITORING**

The growth and the size of firms are, in the final analysis, constrained by monitoring problems (Norton, 1988a). That is, as the firm keeps growing additional layers of hierarchy are added whose only function is monitoring lower layers. The problem of monitoring is not solved by delegating monitoring to hired managers

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because then, the monitors will have to be monitored. Eventually the cost of such monitoring becomes so high that the firm is better off not expanding. Franchising is an institution that helps to "circumvent the entrepreneurial capacity constraint" (1988a: 107). Residual claimancy ensures that franchisees can not afford to shirk because that would reduce their revenue from the local unit. In addition, compared to a hired supervisor, a franchisee stands to lose substantially more wealth if shirking is detected because the franchising contract can be terminated in the event of the breach of the contract. Thus, franchising, by substituting owner-managers (franchisees) for the hired supervisors, effectively reduces monitoring costs by reducing the need to monitor.

### **FREE RIDING**

Although residual claimancy reduces monitoring costs, it does not completely solve a somewhat different problem, namely, free riding by franchisees (Carney and Gedajlovic, 1991; Combs and Castrogiovanni, 1994). One of the biggest assets of a franchise system is its brand name capital. It is the presence of brand name capital that gives rise to the opportunity for free riding. This can happen in two ways. First, brand name capital leads the customer to believe that each unit in a retail system provides the same levels of quality. Second, it may even potentially reduce the ability of customers to detect differences in the quality of service received from different units of a retail system. This may lead an opportunistic franchisee to free ride on the brand name capital and shade input quality, especially if located in a low repeat purchase location. A franchisor must necessarily incur monitoring costs to detect and prevent free-riding by franchisees so that the brand name capital of the system is not diluted. Such costs are, however, absent in the case of company owned units run by hired managers because they do not have similar economic incentives to shade quality. This, to a great extent, explains the presence of company owned units in a franchising system.

### **GOAL CONFLICTS IN FRANCHISING**

Although residual claimancy and monitoring are theoretically alternative mechanisms to address agency problems, in practice, most firms use a mix of both. Dant and Nasr (1998) have emphasized that a perfect alignment of incentives is unlikely despite residual claimancy because of the differences in the perspectives of the franchisor and the franchisee. These differences lead to basic conflicts

between franchisors and (single-unit) franchisees, making monitoring necessary even when incentive alignment is attempted. The conflicts arise from the differences in priority, time perspective, and form of earning. We argue that these problems are less pronounced in a multi-unit franchise relationship than in a single-unit franchise relationship. This is because a multi-unit franchisee has greater system-specific investments relative to a single-unit franchisee (e.g. region specific advertising). Therefore, the perspectives of a multi-unit franchisee concerning brand name and time will be better aligned with the franchisor relative to the alignments between a single-unit franchisee and franchisor concerning the same issues. Because a multi-unit franchisee is likely to face the negative effects of opportunistic practices in one unit on other units in her block, she has greater likelihood of safeguarding brand name capital and maintaining a longer-term profitability perspective than a single-unit franchisee, as summarized in Table 1. Based on these general conclusions about multi-unit franchising, we now move to a more detailed examination of international multi-unit franchising (IMUF).

<b>Table 1: Basic Goal Orientations in Franchising<sup>a</sup></b>			
Subject	Franchisor	Single-unit franchisee	Multi-unit franchisee
Priority	Brand name capital	Profitability	Both
Time perspective	Long-term	Short-term	Long-term
Form of earnings	Percent of sales A fixed initial fee	Net profits	Net profits

<sup>a</sup> Adapted from Dant and Nasr (1998: 9).

### **AN AGENCY THEORY PERSPECTIVE OF INTERNATIONAL MUF**

Most studies of franchising, especially those that use an agency perspective, implicitly assume a single-unit franchisee in their arguments. For instance, Shane (1996b: 74) defines franchising as "an organizational form based on a legal agreement between a parent organization (the franchisor) and a local outlet (the

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franchisee) to sell a product or service using a process..." Other examples include Brickley and Dark (1987) who provide a detailed discussion of the magnitude of some of the agency problems such as shirking and perquisite-taking by unit managers, inefficient risk-bearing, free-rider problems, and quasi-rent appropriation associated with owning versus franchising, and Shane (1996a) who addresses another important agency problem, namely, adverse selection.

The assumption that franchise systems are populated by operators who own single units does not fit with observed reality, especially in the case of international franchising. This led to a growing chorus of calls for paying greater attention to MUF (e.g., Alon, 2000; Bradach, 1995; Dant and Nasr, 1998; Kaufmann and Kim, 1995). Kaufmann and Dant (1996) compared agency problems in MUF and SUF and concluded that overall, these problems are better addressed by SUF than by MUF. The obvious question, therefore is, what explains the prevalence of MUF? They suggested that "Although from an agency theory perspective, multi-unit franchising may have detrimental effects on growth, from the perspective of capital acquisition, its impact is positive" (1996: 349). In their study, they hypothesized that franchising system growth would be positively correlated with MUF in general, but negatively correlated with master franchising. However, their results did not support the predicted negative relationship between master franchising (which, incidentally, was used by 45 % of franchisors in their sample) and growth. This unexpected outcome suggests the need to re-examine the original rationale that led to the conclusion that MUF does not adequately address agency problems. It is possible that in addition to its relative advantage based on capital acquisition, MUF may also have advantages in dealing with agency problems inherent in a franchise relationship. In the case of international franchising, as Shane (1996b) suggests, franchisors' capabilities to reduce franchisee opportunism may be of paramount importance. These capabilities must necessarily include "the ability to provide franchisees with an incentive not to act opportunistically" and "the ability to monitor more closely the actions of franchisees" (1996b: 77).

The basic argument we develop in this paper is that the capital acquisition explanation alone is not adequate to account for the widespread prevalence of MUF and that there are indeed situations where MUF is preferable for both capital acquisition and agency reasons. We believe it is important to develop a theoretically coherent explanation for the preference for MUFs exhibited by international franchisors for a number of reasons. First, agency problems such as monitoring are likely to be a greater challenge in distant, unfamiliar, overseas markets (Dant and Nasr, 1998). The sheer physical distance that separates the service delivery system

from corporate headquarters can only compound the problem of incomplete information regarding agent behavior (Fladmoe-Lindquist and Jacque, 1995). Second, in the case of international franchising, physical distance is compounded by cultural, administrative, and legal distances as well (Ghemawat, 2001; Fladmoe-Lindquist and Jacque, 1995: 1239). Third, MUF is even "more ubiquitous" in the international context than in the domestic context (reflecting, for example 100% incidence in the former, Dant and Nasr, 1998: 22).

In the following sections, we develop our core argument that international MUF (IMUF) provides to franchisors greater ability to reduce opportunism than does international SUF (ISUF). Our argument is based on a careful analysis of a larger set of agency theory problems than are usually considered in MUF research. Our position is that, because IMUF has lower magnitude of agency problems, it has a relative advantage over ISUF. We now present our analysis concerning each agency issue. To help our discussion, we have summarized key terms in Table 2.

<b>Table 2: Key Definitions</b>	
Term	Definition
<i>Franchising</i>	The granting of exclusive rights by one party (principal, called franchisor) to another party (agent, called franchisee) for the local sale of a service or trademarked product and receiving in return fee and/or royalty and conformance to quality standards, price controls, and other practices (Caves and Murphy, 1976).
<i>Single-unit franchising (SUF)</i>	Form of franchising in which the franchisee is restricted to only operate one unit (Kaufmann and Kim, 1995).
<i>Multi-unit franchising (MUF)</i>	Form of franchising in which the franchisee can operate many units (Kaufmann and Kim, 1995).
<i>Shirking</i>	Agent's tendency to supply less effort than agreed (Jensen and Meckling, 1976).
<i>Adverse selection</i>	Problems arising from uncertainty regarding the characteristics of an individual (Levinthal, 1988: 156).



Term	Definition
<i>Inefficient risk-bearing</i>	The tendency of franchisees to under-invest in business or expect higher returns on investments than franchisors due to their lack of diversification of investments causing them to engage in risk avoidance (Brickley and Dark, 1987).
<i>Free-riding</i>	Situations in which individuals fail to participate in collectively profitable activities in the absence of coercion or individually appropriable inducements (Stigler, 1974).
<i>Quasi-rent appropriation</i>	When the full value of a firm-specific asset (e.g., brand name) cannot be extracted if deployed in an alternative use, both the principal and the agent can resort to opportunism by way of quasi-rent appropriation (Brickley and Dark, 1987).

## SHIRKING

Because the franchisees are residual claimants, there is general consensus that the incentives of franchisors and franchisees are better aligned than the incentives between the franchisors and hired managers. This has led some to suggest that ISUF would have an advantage over IMUF because, at the unit level, SUF involves supervision by owner-managers whereas MUF involves supervision by hired managers (Kaufmann and Dant, 1996). Our examination of incentive alignment perspective, however, suggests that ISUF is unlikely to have any advantage over IMUF and that, in fact, the opposite may be true.

Analysis of incentive alignment within IMUF systems requires consideration at two separate levels, namely, at the store level and at the country level. At the store level, the alignment is likely to be better in the case of ISUF than for IMUF because ISUF involves residual claimancy whereas IMUF does not. But, any study of large MUF systems requires the consideration of incentive alignment at the next level, namely, the country level. As a franchising system grows, in order to maintain brand name capital, it becomes important to monitor the outlets. In the case of IMUF, such monitoring is done by multi-unit franchisees. But in the case of ISUF, this task is carried out by hired foreign managers. Because franchisors' incentives are better aligned with franchisees than with hired managers (Anderson,

1984), it follows that at the country level, incentive alignment is better in IMUF than in ISUF.

Further, our analysis shows that monitoring costs are likely to be lower in IMUF than in ISUF. This is because the task of monitoring to prevent shirking at the unit level will be delegated, by and large, to foreign multi-unit franchisees in IMUF (Alon, 2000). This delegation can lead to higher monitoring efficiency. Under ISUF, a franchisor may need a much larger, and therefore costly, foreign subsidiary to monitor individual units operated by a large number of single-unit franchisees than that required in IMUF. A small foreign subsidiary may be adequate in IMUF to monitor individual units operated by the managers hired by a multi-unit franchisee. Shirking at the store level can be detected by the multi-unit franchisee more easily than by hired subsidiary managers of the franchisor in ISUF, due to geographical and cultural proximity of the multi-unit franchisee. Thus, the overall likelihood of shirking is lesser and the probability of its detection higher in the case of IMUF than ISUF.

### **ADVERSE SELECTION**

Adverse selection refers to the problem of less qualified individuals misrepresenting their abilities in order to obtain employment (Shane, 1996a). The ability of an organization to grow is limited by the entrepreneurial capacity constraint (Martin, 1988a). Franchising addresses entrepreneurial capacity constraint by recruiting franchisees who are themselves entrepreneurs. But in doing so, the problem of adverse selection rears its ugly head. Although the problem of adverse selection can never be completely solved, we suggest that it would be less in IMUF than in ISUF. Interviews that Bradach (1995: 74) conducted with the executives of five leading fast food restaurant chains showed that finding appropriate candidates for franchising is a key factor in limiting growth: "To get franchises they could "work with," chain operators spent considerable resources on selecting and developing new franchisees." This suggests two advantages of IMUF over ISUF. First, in the case of IMUF the franchisee can increase the amount of information concerning each applicant and process it in more depth than is possible in the case of ISUF where typically there will be a much larger number of applicants. . Increased information in IMUF can reduce the potential for adverse selection. Second, franchisors can economize on recruiting, screening, and training franchisees and devote their limited managerial resources on other tasks by selecting one multi-unit franchisee instead of numerous single unit franchisees (Kaufmann

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and Kim, 1995). The problem of adverse selection can never be completely eliminated, but its likelihood can be greatly reduced in the case of IMUF by collecting greater amounts of information about the potential franchisee while also simultaneously economizing on selection costs.

Third, unlike in ISUF, the task of recruiting, screening, and training unit level monitors (i.e., managers) is delegated to the franchisee in IMUF. The franchisee has the advantages of both geographical and cultural proximity. That means that the problem of adverse selection of unit level monitors would be less for the local multi-unit franchisee than for the foreign franchisor. The local franchisee can more easily check the credentials, background, and references of a potential employee than the franchisor can from a distance.

Multi-unit franchisees can play a significant role in the development of unit-level monitors given the cultural distance between those monitors and the international franchisor. Since "both the service concept and its management system are an extension of the cultural roots of the principal's home-country" (Fladmoe-Lindquist and Jacque, 1995: 1239), they require some level of adaptation to the local culture, whose norms need to be integrated into employee training procedures. Assuming that the franchisee has been selected carefully, a multi-unit franchisee is likely to possess a significant level of financial resources, considerable managerial experience, and country-specific expertise, especially in terms of local culture and customs. This combination of managerial resources and cultural expertise facilitates the process of local adaptation in IMUF relative to ISUF. The franchisee's embeddedness in the local culture and social milieu provides him with the necessary expertise in evaluating applicant traits such as diligence and honesty. In the case of IMUF, the applicants' knowledge that a local recruiter is involved, who is simultaneously a residual claimant, would discourage him from engaging in opportunistic misrepresentation of abilities. The possibility of adverse selection remains high in the case of ISUF because of the franchisor's lack of knowledge of local conditions and also because of the large number of franchisees involved.

### **INFORMATION FLOW**

The success of a franchise system critically depends on the smooth flow of information between the franchisor and the franchisee (Dant and Nasr, 1998; Dant, Li, and Wortzel, 1995). Especially in the case of foreign franchisees, the upward flow of information from the franchisee to the franchisor is vital to ensure control. We suggest that in this respect IMUF has a relative advantage over ISUF. When

there are a large number of single-unit franchisees, the franchisor will have to create an administrative hierarchy in order to monitor them. In the case of IMUF, only one franchisee needs to be monitored since the monitoring of individual units is primarily the responsibility of the multi-unit franchisee. Organizations have considerable discretion in designing a structure that is most appropriate for their strategy. However, there is a general tendency for organizational hierarchies to grow taller as the number of units to be monitored increases. But, a multi-unit franchisee will have less number of units in her mini-chain than the franchisor would have under ISUF. In addition, a multi-unit franchisee is usually in a location relatively close to outlets under his control and those outlets are typically geographically contiguous (Kalnins and Lafontaine, 2004). Due to contiguity of outlets and geographical as well as cultural proximity of the multi-unit franchisee to the hired unit managers (Fladmoe-Lindquist and Jacque, 1995), IMUF will likely have a greater span of control that would reduce the number of management layers. Thus, other things being equal, ISUF will need a taller hierarchy than IMUF.

A taller hierarchy would result in two disadvantages. First, it would be costly. Second, information flows in tall hierarchies may be slow as well as subject to potential loss and distortion because information has to be channeled through an increasing number of people (Shane, 1996a). Distortion, withholding of information, or slowness of its flow, may fuel suspicion of opportunistic franchisee behavior. Such suspicions may necessitate higher behavioral monitoring on the part of the franchisor, leading to higher monitoring costs. In addition, the lack of information flow would likely blunt the capability of the franchising system to plan and implement counter-moves to local competitors' actions, especially when competition is high (Dant and Nasr, 1998). On the other hand, timely and accurate upward flow of information can greatly help in cementing franchisee-franchisor relationship. Such sharing of information signals cooperative intent. It also helps build mutual trust and commitment to the relationship. Dant and Nasr (1998: 11) further point out that

*"...the more sticky knowledge (i.e., knowledge not readily packaged for dissemination) franchisees share with their franchisor partners, the greater the likelihood that they will be perceived as invaluable to the partnership, and the more they will be compensated for their gestures in terms of assistance like customized supportive treatment and/or marketing advice."*

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One of the most important resources that a foreign franchisee brings to the franchisor-franchisee relationship is the possession of superior knowledge of the local market (Dant, Kaufmann, and Paswan, 1992). Interviews we conducted with some franchisors, such as Decorating Den and Minuteman Press International indicated that many franchisors tap into a much wider set of franchisee inputs. For example, Minuteman Press International stresses local marketing and customer responsiveness. Even in the case of restaurant chains, which usually are characterized by a low degree of strategic discretion, Bradach (1998) noticed variations. Fisherman's Landing and Jack in the Box permitted little strategic local responsiveness, whereas KFC, Pizza Hut, and Hardee's "allowed for greater latitude in varying elements of the uniform format in response to local circumstances" (Bradach, 1998: 25). Franchisees can contribute greatly to the process of knowledge creation within a franchise system by sharing how they solved unique problems in their business (Phan, Butler, & Lee, 1996). Often, what starts out as a small tactic for a local market can lead to a system-wide strategy: "Thus, Pizza Hut's '2 Pizzas for 1 Price' which became the cornerstone of its growth strategy in 1991, was developed by a Florida franchisee responding to a local competitor" (Bradach, 1997: 295).

The sharing and utilization of franchisees' inputs depend, however, on an efficient flow of information, especially in the context of international franchising. There are several reasons to believe that IMUF is less likely to be susceptible to the loss or distortion of information, or retardation of its flow than ISUF. Dant and Nasr (1998) suggest that MUF facilitates more upward information flow than ISUF because IMUF entails better alignment of franchisor-franchisee goals in areas such as maintenance of brand name capital. Because they have less incentives to engage in opportunistic behavior such as shirking and free-riding, and more to lose from it in the event of getting caught, international multi-unit franchisees are more likely to engage in information sharing than single-unit franchisees.

### **INEFFICIENT RISK-BEARING**

Agency theory assumes that, in addition to being unwilling to fully exert themselves on behalf of principals, agents are also risk averse. Therefore, inefficient risk-bearing is another important source of agency problems. When a franchisee has a large proportion of his wealth and income tied to the performance of a unit, his investment portfolio is undiversified (Brickley and Dark, 1987: 405). Thus, inefficient risk-bearing leads to two related problems: likelihood of

under-investment by franchisees and their expectation of higher returns. Our analysis suggests that these problems are likely to be less in IMUF than ISUF.

First, finance theory suggests that an investor owning a less diversified investment portfolio is likely to make sub-optimal investment decisions than one with an efficiently diversified portfolio because the latter would be concerned only with the systematic risk associated with a specific decision, whereas the former would likely be concerned with the total risk. For example, let us take the case of a large local advertising and promotion campaign involving billboards, newspaper ads, two-for-one specials, etc. Now let us apply the agency logic to compare the two types of agents under consideration, namely a multi-unit franchisee and a single-unit franchisee. It can be argued that the investment portfolio of the multi-unit franchisee would be more diversified (e.g., outlets placed in different parts of a city), leading to higher likelihood of making adequate investment in such a campaign. In the international context, this difference is likely to be even more pronounced because a single-unit franchisee is less likely to be able to influence the adaptation of such investments to local conditions than would a multi-unit franchisee. Bradach (1995) provides two reasons for this expectation. First, issues demanding a local response, such as customer tastes, are frequently of a regional nature rather than pertaining to a single unit. Given their ability to spread specific investments over a larger number of units, multi-unit franchisees can amortize the costs of developing local adaptation responses. Thus, the problem of under-investment by franchisees is likely to be far less in IMUF than in ISUF.

Second, compared to more diversified risk-bearing agents in IMUF, a higher perceived risk by less diversified risk-bearing agents in ISUF might lead to their demanding a higher compensation (Brickley and Dark, 1987). Multi-unit franchisees would likely have greater expectations of recovering their investments such as advertising and sales promotion due to economies of scale among all units in their portfolio than single-unit franchisees. Thus, multi-unit franchisees would likely accept less compensation per unit than single-unit franchisees. Again, this difference is particularly relevant in an international context because a multi-unit franchisee may be better able to tailor such investments to his portfolio than the single unit franchisee.

### **FREE-RIDING**

As we mentioned earlier, the presence of brand name capital can potentially encourage free-riding by franchisees (Carney and Gedajlovic, 1991). This is

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because brand name capital signals quality to customers and potentially reduces their ability to detect differences in the quality of service received from different units of a retail system. Therefore, an individual franchisee can potentially free-ride without losing business because of the spillover benefits from those units whose franchisees do not shade input quality. Our analysis shows that free-riding is likely to be less prevalent in IMUF than in ISUF. Shading quality by one franchisee "amounts to reneging on the franchisor's promise to other franchisees of a specific system-wide quality" (Fladmoe-Lindquist and Jacque, 1995: 1241).

When multiple units in a geographic area are owned by a single franchisee, the detrimental effect of free-riding would largely be borne by the franchisee himself, thus discouraging the likelihood of opportunism (Bercovitz, 2004b). In addition, a multi-unit franchisee has to keep in mind that if the franchisor detects free-riding, it would jeopardize the franchisee's prospects of getting the approval for adding more units. The caution is especially important because the chances that the franchisor would notice free-riding are higher in MUF than in SUF. The multiple locations owned by one franchisee in MUF allow the franchisor more opportunities for evaluating that franchisee's adherence to contractual stipulations (Bradach, 1998). Moreover, the efficiency of such evaluations, on a cost-per-franchisee examined basis, is greater. Thus, the international multi-unit franchisee would likely refrain from attempting to free-ride because his units will bear most of the cost of such free riding, which if detected, would also jeopardize future growth of his franchise. Further, at the individual outlet level, managers hired by the multi-unit franchisee in MUF would also have no incentive to free-ride compared to single-unit franchisees.

### **QUASI-RENT APPROPRIATION**

Both the principal and the agent have the potential to engage in post-contractual opportunistic behavior in an agency relationship to appropriate quasi-rents. Quasi-rents are said to exist "if the value of the asset is higher in a given use than its value in alternative uses" (Brickley and Dark, 1987: 406). That is, quasi-rents arise when firm-specific assets such as a franchisor's brand name are present. On the one hand, the franchisor can refuse to renew the franchise contract unless higher fees are paid, thereby appropriating quasi-rents. On the other hand, the franchisee can negotiate for a lowering of the same if the contract enforcement costs are higher than benefits. Our analysis shows that the likelihood that either the franchisor or the franchisee will engage in opportunistic behavior aimed at

appropriating quasi-rents is lower in IMUF than in ISUF. This is because, in IMUF, the existence of multiple units gives the franchisees better ability to earn an acceptable return on their mini-chain investments such as training of employees and advertising. The franchisee also has the possibility to open additional units increasing his overall profits. Bercovitz (2004b), for example, suggests that allocation of multi-unit expansion opportunities by the franchisor acts as an effective "carrot". A single-unit franchisee, without such incentives, is more likely to engage in post contractual opportunism, especially where legal enforcement is difficult or costly. Interestingly, in IMUF, the franchisor is also unlikely to engage in excessive appropriation of quasi-rents because he is dealing with a franchisee with multiple units, who may have greater resources to retaliate than a relatively small single-unit franchisee.

## DISCUSSION

The foregoing analysis suggests that agency theory can provide a theoretical explanation for the prevalence of multi-unit franchising by systematically comparing IMUF and ISUF in terms of various agency problems. In the following paragraphs, we present the implications of our analysis for future theoretical and empirical research.

First, our analysis treated MUF as a homogeneous category. There are, however, several different types of MUF. These types include sequential multi-unit franchising, master franchising, and sub-franchising (Alon, 2000; Kaufmann and Kim, 1995). Each one of these types requires detailed analysis in terms of their differential solutions to the agency problem. Such an examination would help us in developing a more comprehensive theory of franchising as well as providing practitioners with intelligent choices that best address the most crucial agency problems in a given context. For example, when a franchisor has to decide about opening a new unit in a foreign location where it already has a franchise, sequential multi-unit franchising can address the adverse selection problem better than master franchising (Kaufmann and Dant, 1996). This is because in sequential MUF, the franchisor has greater information about the capabilities and behaviors of a franchisee compared to master franchising. The primary sources of information about an aspiring master franchisee are external and self-presented. External information can be costly and potentially less reliable than that can be obtained through a close working relationship with a franchisee. The information provided by franchise applicants may be even less reliable due to incentives to misrepresent



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abilities and traits (Shane, 1996a). Thus the franchisor's choice of franchise form may be driven by the characteristics of the country as well the franchisor's strategic objectives. In overseas markets where opportunism is a more manifest aspect of local culture (see Dant and Nasr, 1998, for some examples), franchisors might prefer sequential multi-unit franchising to master franchising. On the other hand, where speed is more critical for competitive reasons, and where local culture is low on opportunism, master franchising may be more suitable. In situations where speed is critical but opportunism is a major issue, franchisors might pursue sub-franchising. This involves a trade-off between sharing the returns with one more layer of agents and mitigating the problem of opportunism by adding those agents that possess crucial knowledge of the local culture.

Second, the preference for one type of franchising over another may also be driven by industry-specific factors. For example, the need to protect brand name capital is likely to be more strongly felt in those industries that provide services that are relatively easily imitable and difficult to protect using legal means such as patents (Fladmoe-Lindquist and Jacque, 1995). Examples of such industries include fast food restaurants, hotel chains, etc. This suggests that the need for monitoring would vary from industry to industry. As a result, the relative advantage of IMUF over ISUF would also vary across industries. Some industries might be more labor intensive rather than knowledge intensive. Fast food restaurant industry would be one such example. In labor-intensive industries, monitoring problems are more critical due to increased incentives to shirk and shade quality. This suggests that based on industry characteristics, different agency problems may become more salient and therefore the solutions to the problem in terms of type of franchising may also vary.

Third, consideration of cultural differences across countries is relevant even in an agency theoretic analysis of IMUF. A basic axiom of agency theory is the assumption that agents would act opportunistically. However, the extent of opportunism may vary significantly across cultures. For example, Dant and Nasr (1998: 15) suggest that in Lebanon, there was evidence of franchisees who sometimes attempted to bribe the market research firms in order to provide franchisors with rosy, inaccurate market information (Nasr, 1995). On the other hand, Churchill Coffee Company USA, a coffee shop chain based in Springfield, Missouri has recently granted a license to a Japanese company, JEL, for opening up to 300 coffee shops. The company feels that trust can be easily taken for granted in business deals in Japan. Often, formal contracts either do not exist or merely

outline the agreed terms. Therefore, Churchill feels that there is very little need for monitoring the conduct of a Japanese franchisee.

Finally, our agency theoretic analysis seems to suggest that IMUF may always be preferred over ISUF. Therefore, we may need additional non-agency considerations to explain the existence of international single-unit franchising. We expect that more power over a franchisor will be enjoyed by a multi-unit franchisee than by a single-unit franchisee. Therefore, a multi-unit franchisee would be able to extract significantly higher concessions from a franchisor than would a single-unit franchisee. This suggests that some franchisors may be willing to risk some channel satisfaction by using single-unit franchisees in order to avoid sharing power with multi-unit franchisees, who might demand higher quality of service or sharing of information, both of which may be very costly in an international context.

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# ENTREPRENEURIAL FIRMS IN THE INTERNATIONAL ARENA

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## ABSTRACT

*This paper presents some of the findings of an ongoing, longitudinal study of high growth entrepreneurial firms that had successfully implemented their global strategies. While most SMEs produce a service or product that could be competitive in international markets, many are unsure of the appropriate strategy for entry. In 1993-1994, in order to provide insights into how domestic SMEs could successfully enter the international arena, a study was conducted of 100 high-growth firms that had recently "gone international." The sample was drawn from Inc. magazine's list of the top 500 smaller U.S. companies. It was noted at that time, however, that the performance and relative success of these firms need to be ascertained over a period of time. Thus, the present study discusses an in-depth investigation of these same firms-ten years later- in order to assess their performance over a time span. Follow up data was obtained from each firm by mail survey and telephone and personal interview. Accordingly, we explore the changes that occurred as internationalism proceeds. The results provide more insights into patterns and experiences of foreign market entry among SMEs and suggest several recommendations for overcoming obstacles and continued growth in the international arena.*

## BACKGROUND

In the past, international business was frequently viewed as the domain of large enterprise. To some extent that was, and still is, true. In every country a majority of smaller enterprises continue to operate domestically because the nature of their business is oriented to personal service for local clientele. At the same time, changes that have swept through Europe and Asia as the world slipped into the 1990s, have reshaped business opportunities in the global arena.

International business is no longer the province of the large multinational firm. Many smaller firms recognize that the opportunities offered by global markets are increasingly important to the success of their operations. Most SMEs produce

a service or product that could be competitive in international markets, but are unsure of the appropriate strategy for entry. This often resulted in failing to follow up on global opportunities, or in entering the international arena with insufficient knowledge of managerial and economic considerations (Barnara 1991). Academic literature and popular writings on international business are filled with cases and studies of firms that have attempted to internationalize their operations or enter the global market only to face numerous obstacles that led to failure (Johnson 2003).

Aside from the decision to launch or to end the venture, the decision to "go international" is perhaps the most important strategic decision for a firm to make. This decision must be made only after careful discussion and analysis because it must be viewed as a major, long-term commitment. In many respects, being involved in the international arena is different, and often more difficult, for the small, growing entrepreneurial firm than it is for a major corporation. For example, the large business often has more strategic alternatives; in-house staffs to direct international operations; and, in many instances, direct investments in another country.

Research on international business has proliferated during the past two and a half decades with a steady stream of studies dealing with larger multinational corporations (for example, see comprehensive literature reviews by Aaby and Slater (1989). At the same time, knowledge about the internationalization of SMEs was relatively limited until the past few years. As recently as 1988, Miesenbock pointed out in his literature review, that *the literature based on empirical studies is full of inconsistencies and a conclusive theory of small business internationalization is far from being available*(1988:42). More recently international entrepreneurship has received considerable interest from researchers, practitioners, and governments (Welch and Welch, 2004).

A review of the numerous more recent studies dealing with the internationalization of SMEs further reveals that most of the research relates to some aspect of exporting, typically covering topics such as: reasons for non-exporting; problems with export operations; key variables affecting exporting; demographic characteristics of exporting firms; managerial characteristics of exporting firms; and incentives to stimulate exporting. (For examples, see Pope 2002). While these studies have extended the theoretical understanding of the export performance paradigm and provided important insights for public policy makers regarding exporting, at the same time, as markets have become more complex and more international, firms have followed different modes to internationalize such as franchising, licensing agreements, joint ventures, and foreign acquisitions. While

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"it is evident that an exporting firm will face different problems, show a different organization structure, pursue a different marketing strategy, etc. than a firm that runs several subsidiaries abroad,"(Miesenbock: 43-44) the preponderance of research on SME internationalization continues to focus on exporting.

Back in 1991, the authors of a Finnish study (Aaltonen, Lindgren, Pennanen, et.al, 1991) similarly noted that:

*The character of international trade is changing. In many cases, conventional export no longer corresponds to the companies' needs for international business operations. Conventional export has been replaced by new modes of international business operations, one of the most important being strategic alliances.*

Furthermore, as Peridis in his study of 16 small Canadian technology-based companies noted, "For smaller technology-based firms strategic alliances may be the only avenue to international expansion, especially when swift changes and competitive pressure hasten the evolution of products and relationship" (1992:42). Small and medium-sized enterprises (SMEs) are not small versions of large companies, but because of their size they do tend to differ from large multinational firms with regard to managerial style, ownership, and independence (Coviello & McCauley, 1999). In addition, their limited resources may lead to different international strategic choices compared to the large firms (Zacharakis, 1997).

In view of this past research gap, in 1993-1994 an exploratory study of relatively new high-growth businesses that had recently internationalized their activities was conducted. The purpose of that study (Klatt, 1994) was to develop a profile of these successful firms and provide some insights into how and why they had successfully entered the international arena. Answers were sought in this preliminary study to several important questions including:

What was the primary reason(s) for the firm to develop an international strategy?

What is the nature of the firm's global activities (e.g. exporting, importing, wholly -owned foreign operation, licensing, joint venture, and so on)?

What major obstacles were faced in implementing the international strategy?

What specific recommendations can be made to other SMEs considering the decision to "go international?"

A preliminary report on the research project was presented at the *1993 Conference on the Development and the Strategies of SMEs in 1990s*, held in Mikkeli, Finland. It was noted at that time, however, that the results and implications drawn from the study should be viewed in light of the research method employed. For example, *dynamic processes such as entry mode choice may require more than a temporal focus making longitudinal designs more appropriate. Similarly, the performance and relative success of the firms need to be ascertained over a period of time.* (Klatt: 14). Thus, approximately ten years later, in 2003-2004, a follow-up investigation of these same firms was conducted in order to assess their performance and *successes* and to obtain more insights into patterns of foreign market entry among new ventures and the strategic decisions necessary for continued growth.

### **METHODOLOGY**

The analysis in this longitudinal study is based on the information obtained from 100 high-growth SMEs originally selected from *Inc.* magazine's list of the top 500 smaller U.S. companies in 1993. To be eligible for listing in the *Inc. 500*, a company must be independent and privately held on the day applications are due. Holding companies and regulated utilities are not eligible. The rankings were based on the percentage increase in sales for the previous five years. Companies had to show at least \$100,000 (U.S. dollars) in sales five years ago (but no more than \$25 million) and an increase in sales between the previous two years. Information in each business was verified by tax forms, confirmation letters from C.P.A.s, and telephone confirmations with company officials.

From the list of high growth SMEs, a sample of 100 firms, known to be profitable and operating to some degree in foreign markets, was compiled in 1993. Since all the firms were relatively new at the time the sample was drawn, the implication was that they had gone through the process of internationalization in recent years.

Because the list measures growth rather than absolute dollars, it has a strong bias toward newer, emerging companies. As a result, while a company had to exist for at least five years, the majority of the businesses in our sample were founded within the past several years. The list also provided the number of employees, sales



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figures, and profitability figures for each company. Additional data was obtained from each firm in the sample by mail survey and telephone interview, using a questionnaire that included several open-ended questions designed to elicit a wide range of information regarding the international strategies and activities of the firm, as well as top managements' perceptions about the internationalization process. In most cases, the respondent was the company C.E.O. Since the firms were relatively new and smaller, the C.E.O. frequently was the founder (or one of the founders) of the company. In a few instances the respondent was a top manager who headed up the international activities for the firm.

These same 100 SMEs were revisited in 2003-2004 and are the subject of the second stage of the research project. While all but one of the firms were still in operation, seven had different identities -- four had been acquired by larger companies and three had merged with other firms, creating new legal organizations. This left a total of 92 of the original 100 for the second stage study. Similarly, while efforts were made in the second stage study to contact the original respondent in each SME, this was not possible in 11 cases where the respondent was no longer involved in the operation of the business.

The current study is based primarily on the second stage, which took place in 2003-2004, although the characteristics and contextual data from stage one were critical in interpreting information obtained in stage two. In essence, stage one provided the foundation for an emerging understanding of certain aspects of the internationalization process among SMEs while stage two allows for a more detailed investigation and an assessment of the relative *successes* over a time span.

Performance and success was evaluated through two perceptual measures: the satisfaction of the firm and the business performance. Satisfaction was selected in that it is one of the most frequently used performance variables in the literature, having been found to be a predictor of a firm's future actions in strategic alliances (Beamish 1984; Anderson and Narus 1990). The second variable, business performance was measured along several dimensions, ranging from profitability to overall performance.

## RESULTS

### Sample profile

In stage one, the firms included in the study (Table 1) were relatively small, with almost 75 percent of the firms employing less than 250 employees worldwide. The firms also were relatively new with 46 percent of the firms having been in business for only 5 years or less. The average age of the firms in the sample was slightly more than 6 years. However, nine years later, in the second stage study, these same firms had grown significantly in terms of number of employees and annual sales.

During a period of time (i.e. 1994-2003) when many larger businesses in the U.S. were undergoing considerable downsizing, the businesses in the study had increased the number of their employees, with 76 percent reported employing more than 100 workers worldwide in 2003 versus 66 percent in 1994. Similarly, while only 14 percent of the SMEs reported annual sales exceeding \$50 million (U.S.) in the stage one study, the number had increased significantly in stage two, with the average reported annual sales more than doubling by 2003. Even when adjusted for inflation, the increase in total sales was significant. Much of this increase in total sales was attributed by the respondents to the increase in non-domestic sales. For example, non-domestic sales averaged about 22 percent of total annual sales in 1993 versus approximately 40 percent in 2003. Almost one out of four SMEs in the study attributed approximately 45 percent of their total sales to non-domestic sales. It was also found in the study that the percentage of total sales allocated to non-domestic sales is an understatement of actual international activity in that it does not reflect non-sales activity taking place with foreign companies, such as joint ventures to develop new technology.

Finally, the majority of firms in stage two were still engaged primarily in products or services for the industrial and/or institutional (e.g. governments and hospitals) markets. Follow-up interviews with a number of respondents from this category suggested that as many as one-half could be characterized as a technology-intensive company. However, a number of SMEs now find themselves developing foreign markets in both the industrial/institutional and consumer categories

### Motivation for developing an international strategy

An important component of the stage one study was to gain insights into the primary reasons for developing international strategies. Why, for example, did these high-growth SMEs venture into foreign markets while the vast majority of SMEs restrict their business to the domestic scene? For instance, one study found that while SMEs in the U.S. were increasing their export rate faster than large firms, only approximately one in five SMEs in 1995 were exporting their goods or services (Barrett, 1995). A recent NFIB survey found that only 13 percent of small business owners reported that they had foreign sales in the past three years (Chamberlain, 2004). Thus, each respondent was queried as to the motivation for developing an international strategy in their respective SME.

<b>Table 1: Sample Profile</b>		
	Stage 1 % N=100	Stage 2 % N=92
Employees Worldwide		
100 or less	34	24
101 to 250	40	44
over 250	26	32
<b>Total</b>	<b>100</b>	<b>100</b>
Company Age (years)		
6 or less	46	---
7 to 9	40	82
over 9	12	18
Total	100	100
International Experience		
3 or less	52	---
4 to 7	48	---
over 7	---	100
<b>Total</b>	<b>100</b>	<b>100</b>

<b>Table 1: Sample Profile</b>		
	Stage 1 % N=100	Stage 2 % N=92
Annual Sales (U.S. \$)		
less than \$5m	34	10*
\$5m to \$10m	34	30
\$10m to \$50m	18	34
over \$50m	14	26
<b>Total</b>	<b>100</b>	<b>100</b>
Non-Domestic Sales		
1 to 15%	32	10
16 to 30%	28	34
31 to 45%	26	30
over 45%	14	24
<b>Total</b>	<b>100</b>	<b>100</b>
Nature of Product/Service		
Consumer	30	24
Industrial/Institutional	70	66
Both	---	10
<b>Total</b>	<b>100</b>	<b>100</b>
*Part of the increase in Stage 2 sales is due to inflation.		

As shown in Table 2, the vast majority of firms described their rationale for becoming international as part of a broader, overall strategy for growth which included entering foreign markets . A number of respondents went on to explain how internationalizing was not a sudden, unplanned occurrence for their firm, but rather was the logical extension of some strategic plan which was implemented after considerable cost, research, and discussion.

A large number of explanations offered for internationalizing might be combined into a market-driven categorization to include such perceptions as the

local market being too small; or stagnant; or declining; or dominated by large, multinational firms. Several of the firms produced innovative, technology-intense products that had relatively short life cycles and faced potentially intense competition from multinational firms. Thus, they explained the need to gain immediate access to the large European, Canadian, Asian markets. Similarly, some SMEs look to foreign markets as long-term protection from downsizings in the domestic economy.

Explanation	Frequency
Part of an overall strategy for growth	72
Local market too small	54
Domestic market stagnant or declining	42
Domestic market dominated by large, multinational firms	38
Acquire technological knowledge	38
Acquire knowledge concerning competition and international markets	36
Protection from downsizings in the U.S. economy	18
Other: e.g. to gain legitimacy and/or prestige	12

It is interesting to note that a large number of firms became global in an attempt to acquire certain types of knowledge. For example, obtaining knowledge of the markets in targeted countries apparently was an important motive for a number of firms to initiate agreements with foreign companies in the form of joint ventures or licensing agreements. Since a number of the SMEs in the study were involved in the development of new technology, they viewed these alliances as low cost, efficient opportunities to obtain access to new technological developments in their industry. Similarly, several firms indicated a need to have a presence where their competition is located in order to monitor events -- or as one respondent said, "We have to be there to keep an eye on things."

A large number of reasons for internationalizing dealt with the perceived need to gain legitimacy and/or prestige. Eighteen firms saw internationalizing as a means to convey to customers and investors that they are truly a legitimate, established firm. As one medical supplier commented, "Since we are relatively small and somewhat new to the industry, being able to say that we are an international company with markets in several countries, has helped us in obtaining venture capital for expansion purposes."

### **Nature of the global activities**

As seen in Table 3, almost two-thirds of the SMEs in the study were, and still are, involved in exporting to some degree. In stage one, 44 of the SMEs that exported did it directly to the end user of the product or service, while 20 SMEs exported through trade intermediaries. These middlemen typically bought the goods at as much as 15 percent below the producing firm's discount price and resold them overseas. Some of the firms used export management companies that did not take possession of the exported goods but worked primarily at obtaining orders for the SMEs goods or services. Most of these export management companies served essentially as a manufacturer's representative, working on a commission basis and forwarding orders to the company for direct shipment. Several companies also reported that they got started in exporting by teaming up with SMEs that were already exporting complementary products. Apparently the existing exporter had the foreign contacts and distribution system in place.

Activity		Stage I (N = 100)		Stage 2 (N = 92)
Exporting		64		64
Direct	44		56	
Trade intermediaries	20		8	
Licensing agreements		50		54
International joint ventures		42		60
Wholly-owned subsidiaries		32		20
International Franchising		--		6
*A number of SMEs indicated multi activities.				

In stage two, the same number of firms were still exporting their product or service. However, with increased experience, as a group there is now less reliance on trade intermediaries and more direct exporting.

The next most frequently mentioned entry mode to foreign markets was some form of licensing agreement with a foreign firm. Typically, the arrangement included contracts to manufacture and market products and to provide services. However, a number of different types of licensing agreements were utilized by the SMEs in the study, the end result often being to permit a foreign company to utilize a proprietary technology. For example, several high technology firms licensed their technology to established foreign firms in return for royalties from expected future sales. No direct investment was required by the licenses and the licensees are responsible for developing the markets. In stage one, 50 SMEs had made international licensing agreements all of which were still in existence in 2003. Four additional SMEs were found to have licensing agreements in the stage two study.

Forty two firms in the study were involved in some type of joint venture in international markets. Unlike the licensing agreements whereby the SMEs surveyed made no direct investments, the joint ventures required specific investments by all parties. These strategic alliances varied from firm to firm. For example, two technology-intensive firms in the study were part of a consortium consisting of several private companies and a state-owned organization. In most cases the SME jointly owned a foreign entity with a local, foreign business. Usually the SME contributed some critical component or technical expertise while the foreign firm carried out the production and/or marketing of the product or service. By 2003 the number of SMEs involved in joint ventures had increased significantly to become the second most common mode of international activity. While 42 firms initially chose some form of a joint venture to enter foreign markets, all of these firms plus an additional 18 were found to be engaged in a foreign joint venture in the second stage study.

The least frequently mentioned entry mode to foreign markets in stage one was via the creation of a wholly-owned subsidiary (WOS) in a foreign country. Of the 32 firms having subsidiaries in a foreign country, most operated as a manufacturing or sales branch of the parent company. Seven of the 32 SMEs acquired small firms in another country and operated them distinct from the parent company. In the stage two study it was learned that most of the SMEs were dissatisfied for various reasons with their WOS and, in fact, 12 respondents indicated that they had sold or closed their WOS.

*Franchising* has become a major export industry for the United States. Although large franchisers were already well established in Canada, Japan, Mexico, and most European nations, smaller companies were beginning to seek entry into these markets through franchising (Baron, 1993). Several respondents mentioned in 1994 that they were considering franchising as an entry mode into Canadian and European markets. In stage two, 6 SMEs were involved in international franchising.

### **Level of success of foreign entry modes**

Foreign entry modes have been measured and evaluated along a number of performance dimensions which can be broadly classified as objective or perceptual (Herbert 1994), both of which have limitations (Beamish and Delios 1996). However studies have found strong correlations between perceptual and objective measures of performance (Geringer and Herbert 1991). Thus, the level of success of the foreign entry modes in the present study was evaluated through two perceptual assessments of success: overall satisfaction and business performance. The latter, business performance, was the respondent's perception of the extent to which the entry mode has achieved the expectations the SME had of it when it was initiated. It was measured along five performance dimensions, ranging from sales to overall performance.

The respondents' assessments of their firms' mode of entry into foreign markets are summarized in Table 4. In general, high marks are given for both overall satisfaction and business performance for exporting, licensing, and international joint ventures. On the other hand, based on mean scores, the respondents were much less satisfied with the wholly-owned subsidiaries (WOS). As mentioned earlier, in the first stage study, 16 SMEs had one or more WOSs in a foreign country. In the second stage study six of the 16 respondents indicated that they had sold or closed their WOSs, citing reasons such as "too expensive to operate"; "too difficult to control"; "didn't meet our expectations"; and "found better ways to have a presence in that foreign market." The respondent, elaborating on the latter comment, explained how they had established an overseas manufacturing and marketing subsidiary with very poor results. They then closed the subsidiary and set up a joint venture with a distributor in that country, which so far is working out quite well.

It should also be noted that, excluding WOSs, the mean scores for overall satisfaction are generally higher than the mean scores for the business performance indicators. For example, the majority of respondents appear to be at least moderately



satisfied with their exporting, licensing, and joint ventures. At the same time, they assess the profitability and market share of these entry modes to be about equal, or slightly below equal to their initial expectations. One explanation might be that several of the respondents, while they are satisfied overall with the entry mode, view it as a long-term commitment which has not yet been fully realized, or which is taking longer than they initially expected.

It is also noteworthy that the performance assessment for the international joint ventures among these SMEs is higher than reported in the joint venture literature (Bemish and Delios 1997), which found that joint ventures often perform unsatisfactorily. International franchising is not listed in the above Table since 5 of the 6 involved in this activity indicated it was still too early to assess its effectiveness.

**Table 4: Assessment of Foreign Entry Modes (Stage2)**

	Exporting N=64	Licensing N=54	IJV N=60	WOS N=20
Overall satisfaction*	3.81	3.62	3.52	2.12
Business performance**				
Sales	3.16	3.10	3.20	2.12
Profitability	2.94	2.97	3.00	2.00
Market share	3.02	3.00	2.92	2.00
Product or technology development	n/a	3.00	3.58	2.42
Overall performance	3.12	3.02	3.20	2.20
*1=very dissatisfied. 3=neither dissatisfied nor satisfied. 5=very satisfied **1=much below initial expectations. 3=equal to expectations. 5=much above initial expectations.				

### **Major obstacles in implementing international strategy**

In order to determine the difficulties faced by SMEs in implementing their strategic decision to enter foreign markets, the respondents in stage one were asked to discuss the major obstacles faced in carrying out their international strategy. Their numerous comments were categorized as presented in Table 5.

The smaller entrepreneurial firm typically lacks the middle managers or functional specialists who in a large firm play a major role not only in developing an international strategy but also in successfully seeing that it is implemented. Not surprisingly then, lack of management depth was the most frequently cited obstacle to carrying out a firm's strategy to internationalize.

A closely related, and almost as common, obstacle to going global was the lack of international management skills. Along with the functional specialists and middle managers in large multinational firms comes the legal expertise, administrative experience, negotiation skills, as well as, cultural understanding, all of which play a role in successfully becoming an international firm. Seventy out of the 100 firms surveyed in stage one indicated that the lack of these skills proved to be a major problem in reaching their strategic plans. Several firms found the solution to the problem by hiring a manager with the necessary skills from larger multinational firms. Intermediaries were also commonly utilized to assist in implementing strategic plans, especially with regard to exporting activities and establishing joint ventures. Two-thirds of the respondents discovered that entering the international arena ended up being more expensive than anticipated. Even with considerable strategic planning the start-up phase of the global activity proved to exceed financial estimates. A number of firms reported that their negative cash flows, resulting from the international activity, continued beyond expectation, putting a drain on their limited financial resources. Also included in this category are the responses related to the difficulty in financing business deals in foreign markets, a significant obstacle found to exist in other studies (Chamberlain, 2004; Mangelsdorf, 1991).

Dealing with government bureaucracies was listed as another common hurdle to internationalizing. Follow-up calls to the respondents requesting that they elaborate on this point revealed that the dissatisfaction was aimed at governments in the U.S. as well as foreign governments. A number of the SMEs received financial and other types of assistance from local and federal government agencies. The respondents described the paperwork, delays, and confusion involved in obtaining this assistance. Similarly, the rules and regulations of the foreign nations

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created costly delays and frustration in attempting to carry out strategic plans, as did trade barriers in the form of tariffs and quotas.

A growth-oriented SME needs to find growth markets and opportunities. Forty of the firms in stage one suggested that this was a gigantic challenge to carry out. Even after a systematic study was conducted to identify target markets and opportunities, locating suitable foreign contacts and/or partners was difficult for 32 firms in stage 2. Several respondents representing firms that are successfully engaged in licensing arrangements and joint ventures felt that an unexpected amount of time and money was spent in pursuing partners that later proved incompatible with their needs, interests, or values.

Twenty one of the SMEs initially had to overcome direct opposition, or a generally negative attitude, from key members of their own firm toward venturing beyond the domestic border. Finally, included in the "other" category are such reported obstacles as not getting paid, fear of the unknown, and language and culture barriers.

Nine years later in the second stage study, the responses received to the "major obstacle(s)" question were significantly changed. To begin with, the absolute number of major obstacles had diminished. Equally important, as a group the relative rankings of the responses changed. For example, while "lack of management depth" continued to be the number one identified problem, "lack of international management skills", which was a very close second in the first stage study, now is one of the lesser mentioned problems (frequency of mention dropping from 70 to 26). Apparently as the SMEs have gained more experience in the inter-national arena, their deficiencies in international skills have been remedied to a great degree. Similarly, the added experience, or perhaps changes in the political/economic environment, has had an important impact on the problem of dealing with government bureaucracies or trade barriers, as suggested by the substantial drop of responses in both categories.

As for the 21 SMEs that faced internal direct opposition or a negative attitude, only one felt that this was still an obstacle in stage two. Further questioning revealed that the "problem" people had left or been replaced, or that success in entering the foreign markets had converted skeptics into believers.

Lastly, one new obstacle was mentioned in the stage two and is included in the "other" category. CEOs at two smaller manufacturing firms said that they are unable to do business in Europe because they are still waiting to be ISO certified.

Obstacle	Stage 1 Frequency**	Stage 2 Frequency
Lack of management depth	74	60
Lack of international management skills	70	26
Inadequate financing	66	30
Dealing with government bureaucracies	60	21
Trade barriers	40	18
Locating suitable foreign partners and/or opportunities	40	32
Negative attitudes	21	1
Other	19	10

\*Most frequently mentioned are listed \*\*Many respondents mentioned more than one obstacle

### **Recommendations for success in entering foreign markets**

One of the purposes of this research project was to present recommendations for SMEs that are considering entering foreign markets. The recommendations that follow are based on responses received from the participants in both stages of the research as well as the experience gained in the course of conducting this longitudinal study.

Since all the respondents had numerous specific recommendations to offer, an attempt was made to categorize their answers and present in this study the most frequently mentioned. Some of the recommendations that are generally accepted, such as "be sensitive to cultural difference," or that pertain primarily to the uniqueness of a specific country, are not included.

- 1) Accessible travel, split-second electronic communications, and increased regulation are transcending barriers and compressing time. Broad distances no longer hinder opportunities or prevent

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people, products, information, and capital from going virtually anywhere at any time. Thus, owners and managers of SMEs must change their attitude with regard to entering foreign markets and recognize that good business and world trade are synonymous. Many respondents indicated that they wished they had internationalized sooner. The SME considering global opportunities should do some current reading such as McFarlin & Sweeney (2006) which provides an excellent survey of global trends and challenges .

- 2.) While there are several foreign entry modes, one might try exporting to get a toehold in a foreign market, which is what a number of SMEs in this study did. But before even taking this step, go back to the basics and do the market research to determine who will buy your product or service, where are they located, and so on. Doing these "basics" helped reduce the intimidation experienced by many respondents. Direct exporting is the simplest and most cost effective way to export. Still, the SME lacking international business experience or familiarity with the targeted foreign market may initially find the use of trade intermediaries to be quicker and more desirable. A company may benefit by using both strategies if it has different products with different customer profiles
- 3.) Become familiar with the various trade groups and agencies that provide information and assistance of all types to SMEs desiring to internationalize. For example, the Trade Promotion Coordinating Committee (TPCC) agencies in the U.S. developed numerous programs to help SMEs compete in the global marketplace, including financing, training, seminars, insurance, and information services. Properly selected Trade Shows and Trade Missions sponsored by chambers of commerce and state agencies can provide valuable networking opportunities. A number of respondents in the second stage study indicated that initially they were not aware of the many existing programs and data bases but are not finding them to be extremely beneficial.
- 4.) Compared to the domestic market, the global market is different, difficult, and more fast-paced. Therefore, an SME must approach internationalizing with a different mind-set and a different

- managerial approach. For example, unlike the smaller domestic firm where the founding entrepreneur often makes all the important decisions, the international C.E.O. must become an effective delegator. If business units exist in more than one country, the units need to be encouraged to network without coordinating all decisions through the home office. At the same time electronic communication systems need to be set up in order to allow for effective communications and frequent conference phone calls.
- 5.) Develop a detailed strategic plan; do not enter the international arena haphazardly. Several respondents emphasized the importance of setting goals, defining objectives, and involving all personnel who will be responsible for implementing the plan. One C.E.O. emphasized that in getting the international venture started at his firm, he encountered numerous unforeseen problems that would not have been solved without the total support of all personnel in his organization.
  - 6.) Approach internationalizing as a long-term commitment. A number of respondents suggested that for many SMEs, internationalizing simply meant exporting their product or services when sales were down in the domestic market. When sales increased at home, the firms retreated from the foreign market. Not only was this costly, but the firms never developed the potential market that they entered.
  - 7.) Evaluate different ways of entering foreign markets. A point repeated many times was that a good strategic plan should answer the question, what does the firm intend to achieve from internationalizing. It was felt by the respondents that most SMEs embark on global ventures for the purpose of short-term increases in sales and, as mentioned above, view exporting as the only means to achieve that goal. While most of the SMEs in the study initially were engaged to some extent in exporting, the majority as they acquired experience, made successful strategic alliances, in the form of licensing agreements and joint ventures. Several respondents from high-technology firms explained how they entered into cooperative agreements with foreign firms in order to develop their technology when they lacked certain resources. One firm acquired a small foreign firm for the purpose of obtaining a

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patent and a skilled researcher. At the same time, caution is advised in selecting a wholly owned subsidiary as the entrance mode to a foreign market. Not only did WOSs receive less that favorable assessments by the respective respondents, but in addition, several mentioned WOSs as their "failures" in implementing their global strategic plans.

- 8.) Acquire the skills necessary to internationalize. It was felt that the typical SME does not have the specialized skills to effectively implement an international strategy. A number of respondents suggested that this deficiency should be overcome by utilizing trade intermediaries (especially for developing new markets), acquiring personnel with the necessary skills from multinational firms, or employing consultants on a part-time or project basis.
- 9.) Develop realistic cost estimates, not only for the start-up of the venture, but also for the maintenance of the venture, as well as the added personnel costs for the domestic operation. It became apparent from the responses that international ventures always take longer than anticipated to reach their objective or a positive cash flow. During this early phase, as well as the initial start-up phase, substantial resources will be needed. Several respondents emphasized that personnel costs are frequently underestimated. For example, training costs will be incurred for domestic employees for everything from using the metric system to learning customs and regulations of foreign transport systems. Similarly, in spite of the internet and electronic communication systems, in a smaller firm the C.E.O. is likely to be devoting considerable time to the venture as well as incurring significant entertainment and travel costs.

## **CONCLUSION**

This paper has presented some of the findings of a longitudinal study of high-growth SMEs that had successfully implemented their global strategies. The first-stage of the research project, completed in 1994 developed a profile of these successful SMEs and provides some insights into how and why they had entered the international arena, as well as identifying the major obstacles they faced. It was felt at that time that dynamic processes such as entry mode choice required more than

a temporal focus. Thus, a follow-up investigation was conducted in 2003-2004 in order to assess how these firms have fared and to obtain more insights into foreign market entry among SMEs and the strategic decisions necessary for continued growth.

Not only was it found that, approximately ten years later, all but two of the 100 SMEs were still in existence, but that they had substantially increased in size as measured by number of employees, dollar sales volume, and percentage of non-domestic sales volume. Also in stage two changes were noted in foreign entry modes and major obstacles faced in implementing international strategies. In general, high marks were given for both overall satisfaction and business performance for exporting, licensing, and international joint ventures, while wholly owned subsidiaries received lower assessments.

Since the SMEs in the study were originally ranked among the highest growth, smaller firms in the U.S., and all were profitable, and all have internationalized in recent years, it is hoped that this in itself will encourage other smaller firms to consider entering the international arena. Similarly, since it was found that, while most of the firms were involved in exporting to some degree, other modes of entering the global market were also common, including various licensing arrangements, joint ventures, and, to a lesser degree, wholly owned subsidiaries. Thus, one might conclude that researchers should redirect some efforts from the vast number of exporting studies to the lesser explored, and fertile area of strategic alliances among SMEs. Also, a number of recommendations were offered to assist firms that are considering entering foreign markets.

Finally, it should be noted that this study has a number of limitations that in turn suggest further research. First, the research is limited in scope in that the findings are based on foreign entries by SMEs in the U.S.A.. Comparable studies of SMEs from other countries would provide further insights regarding the external validity of the findings of this study and add a much needed comparative element to the study. Second, future studies may provide additional understanding of underlying causal factors of the success or failures of foreign entry modes rather than the mere identification of these modes along with the assessment of their performance over a period of time.

Another limitation is that much of the results reported are self-report responses to a survey questionnaire which may then result in self-report bias. In addition, as in many longitudinal studies, it was not possible to have all the same respondents in the second stage study as in the first stage. Also, for reasons already mentioned, it was not possible to include 8 of the 100 SMEs from the first stage in



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the follow-up second stage. Hopefully, other studies using a more rigorous quantitative analysis will find this exploratory longitudinal study useful for continuing research in this important area of successful entry to foreign markets for SMEs.

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# AN INVESTIGATION OF THE SUCCESS FACTORS OF YOUNG CHINESE ENTREPRENEURS IN HONG KONG

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## ABSTRACT

*The aim of this study is to investigate multi-perspective success factors of a group of second generation Chinese entrepreneurs in Hong Kong. Results show that the common success factors differ slightly from those of last-generation entrepreneurs and international entrepreneurs. This study also suggests that a new level of success factors – Spiritual Value and Fate including luck, religion, life philosophy (Mission Value) and ultimate life value (Image Value) of the 32 interviewees is different at different stages.*

## INTRODUCTION

Many people want to become rich and successful by starting their own businesses as entrepreneurs. Hong Kong is famous for its wealth. Its average per capita wealth in 2003 was US\$28,700, the highest level in Asia. Friedman (1980) called Hong Kong the world best example of a capitalist city. It is a place where East meets West, and where capitalist ideology goes hand in hand with traditional Chinese beliefs. Hong Kong success is partly due to the efforts of entrepreneurs from China who fled to the territory after 1949 to escape the Civil War in China. These entrepreneurs led Hong Kong rapid economic development in the 1960s and 1970s. At present small and medium enterprises account for 98 percent of all local enterprises. It is no exaggeration to say that entrepreneurs are among Hong Kong most important assets.

In Hong Kong, many young Chinese entrepreneurs have become a special power group with their own culture and common values, which are likely to be different from that of the traditional and global entrepreneurs. Do these values differ

from those identified in previous studies? There is an obvious interest in exploring the factors that have influenced their entrepreneurial success.

### **THE CONTRIBUTION OF THIS PAPER**

Interestingly, few studies have focused specifically on Chinese entrepreneurs, despite their importance. One of the most distinctive studies was done by Redding (1990). His book *The Spirit of Chinese Capitalism* was the first study of Chinese family business in the Asia-Pacific region, and sampled mostly representatives of the first generation of overseas Chinese. Another important study is Wong's book on Shanghainese entrepreneurs, *Emigrant Entrepreneurs* (1988).

Individuals value different things at different stages of their lives. The values held by entrepreneurs during the initial stage in which they struggle to build a business are probably different from those held after they become established and successful. Changing values may conceivably affect the operational direction of an entrepreneur company, and it is therefore interesting to see if these values do change over time and, if so, how they influence entrepreneurs' success.

By studying these topics, we should be able to identify a new set of success factors relevant to Hong Kong entrepreneurs. Furthermore, a study of how values change over time will provide a new perspective on entrepreneurial success factors and their relationship with values.

### **RESEARCH STUDIES ON ENTREPRENEURIAL SUCCESS FACTORS**

Researchers are generally agreed that entrepreneurial success factors can be categorized into three types: personality attributes, demographic factors and the environment.

#### **PERSONALITY ATTRIBUTES**

According to Gartner (1989), the belief that entrepreneurs have distinctive personality characteristics has a long tradition in entrepreneurship studies, and the research based on this premise is known as the trait approach. The influence of the trait approach is great and a recent study by Schmitt-Rodermund and Vondracek (2002) noted the relationship between personality traits and entrepreneurial orientation among German subjects.

### **Need for Achievement**

McClelland (1965) suggested that the key to entrepreneurial behavior lay in achievement motivation. The need to achieve is the driving force of a person who spends more time on considering how to do a good job, and accomplish something. Robinson, Stimpson, Huefner, Hunt and Keith (1991) suggested that the self-esteem of entrepreneurs is an important factor in their success in business affairs. Others noted the importance of satisfaction in being self-employed (Hofstede *et al.*, 2004; Falter, 2002).

### **Locus of Control**

Rotter (1966) developed the notion of locus of control of reinforcement as part of a wider social learning theory of personality. Borland (1975) developed this notion, and his study suggested that locus of control was a better predictor of entrepreneurial intentions than need for achievement. Hayton, George and Zahra (2002) maintain that high individualism and high masculinity could promote entrepreneurship.

### **Tolerance of Ambiguity**

There is evidence that entrepreneurs tend to have a relatively high tolerance of ambiguity. Begley and Boyd (1986) demonstrated that the founders of small firms showed a higher tolerance of ambiguity than non-founders. Timmons (1989) indicated that successful entrepreneurs tolerate risk, ambiguity and uncertainty.

### **Risk Behavior**

Risk taking is one of the most distinctive features of entrepreneurial behavior, since entrepreneurs typically organize, own, manage, and assume the risk of businesses (Kreiser *et al.*, 2002). Creating new ventures is by definition a risky business. McClelland (1961) suggested that entrepreneurs have only a moderate level of risk propensity, while Timmons (1989) suggested that entrepreneurs take calculated risks. Palich and Bagby (1995) argued that entrepreneurs are generally no more disposed to taking risks than non-entrepreneurs, but simply perceive risky situations more optimistically than others. In other words, they are more willing to undertake entrepreneurial efforts that others see as too risky.

### **Persistence**

Hill book *Think and Grow Rich* (1960) discussed the reasons for the success of more than 500 wealthy individuals from various countries. He noted that one of the main human weaknesses is that most people are far too ready to consider a task impossible. Many individuals cannot enjoy success because they throw in their hands for fear of failure. Successful entrepreneurs, by contrast, realize that they can learn from failure, and that if they persist they may be more successful next time. Persistence is an important psychological attribute of successful entrepreneurs.

### **Networking Interpersonal Relationship**

Redding study (1990) found that networking is extremely important. Gartner (1985) found that social support is an element in the creation of a successful business. Chinese entrepreneurs prize personal relationships first and business relationships second.

### **Ethics**

Little research has been done into the ethics of entrepreneurs *per se*, though some relevant work has been done in the fields of psychology and management. In the field of psychology, studies have mainly focused on the level of moral development of individuals (Kohlberg, 1969; Rest, 1979). In the realm of business ethics in the study of management, most studies have examined the level of moral development of the individual as demonstrated within the context of a business situation (Barnet and Karson, 1987; Derry, 1987; Elm and Nichols, 1993; Trevino, 1992; Weber, 1990).

### **Other Factors**

Besides the aforementioned studies on different factors affecting the success of entrepreneurs, Timmons (1989) conducted a detailed study on entrepreneurship and stated that entrepreneurial skills can be learned and improved. He suggested fifteen types of behavior which are desirable and learnable. These are:

- ◆ Total commitment, determination and perseverance
- ◆ Drive to achieve and grow

- ◆ Orientation to goals and opportunities.
- ◆ Taking initiative and personal responsibility
- ◆ Persistence in problem-solving
- ◆ Veridical awareness and a sense of humor.
- ◆ Seeking and using feedback
- ◆ Internal locus of control
- ◆ Tolerance of ambiguity, stress and uncertainty
- ◆ Calculated risk taking and risk sharing
- ◆ Low need for status and power.
- ◆ Integrity and reliability.
- ◆ Decisiveness, urgency and patience.
- ◆ Dealing with failure.
- ◆ Team building

<b>Table 1: Literature on the Relationship between Personal Attributes and Entrepreneurial Success Factors</b>	
Personal Attributes	Literature
Need for Achievement	<ul style="list-style-type: none"> <li>• McClelland (1965) suggested that the key to entrepreneurial behavior lay in achievement motivation.</li> <li>• Robinson, Stimpson, Huefner, Hunt and Keith (1991) suggested that the self-esteem of entrepreneurs is an important factor in their success in business affairs.</li> <li>• Hofstede <i>et al.</i> (2004) and Falter (2002) noted the importance of satisfaction in being self-employed .</li> </ul>
Locus of Control	<ul style="list-style-type: none"> <li>• Rotter (1966) developed the notion locus of control of reinforcement as part of a wider social learning theory of personality.</li> <li>• Borland study (1975) suggested that locus of control was a better predictor of entrepreneurial intentions than need for achievement.</li> <li>• Hayton, George and Zahra (2002) maintain that high individualism and high masculinity could promote entrepreneurship.</li> </ul>

<b>Table 1: Literature on the Relationship between Personal Attributes and Entrepreneurial Success Factors</b>	
<b>Personal Attributes</b>	<b>Literature</b>
Tolerance of Ambiguity	<ul style="list-style-type: none"> <li>Begley and Boyd (1986) demonstrated that the founders of small firms showed a higher tolerance of ambiguity than non-founders.</li> <li>Timmons (1989) indicated that successful entrepreneurs tolerate risk, ambiguity and uncertainty.</li> </ul>
Risk Behavior	<ul style="list-style-type: none"> <li>Kreiser <i>et al.</i> (2002) noted that risk taking is one of the most distinctive features of entrepreneurial behavior.</li> <li>McClelland (1961) suggested that entrepreneurs have only a moderate level of risk propensity.</li> <li>Timmons (1989) suggested that entrepreneurs take calculated risks.</li> <li>Palich and Bagby (1995) argued that entrepreneurs are generally no more disposed to taking risks than non-entrepreneurs.</li> </ul>
Persistence	<ul style="list-style-type: none"> <li>Hill study (1960) noted that persistence is an important psychological attribute of successful entrepreneurs.</li> </ul>
Networking Interpersonal Relationship	<ul style="list-style-type: none"> <li>Redding study (1990) found that networking is important.</li> <li>Gartner (1985) found that social support is an element in the creation of a successful business.</li> </ul>
Ethics	<ul style="list-style-type: none"> <li>Kohlberg (1969) and Rest (1979) have mainly focused on the level of moral development of individuals.</li> <li>The following studies have examined the level of moral development of the individual as demonstrated within the context of a business situation (Barnet and Karson, 1987; Derry, 1987; Elm and Nichols, 1993; Trevino, 1992).</li> </ul>
Other Factors	<ul style="list-style-type: none"> <li>Timmons (1989) stated that entrepreneurial skills can be learned and improved. He suggested fifteen types of behavior which are desirable and learnable.</li> </ul>

### DEMOGRAPHIC FACTORS

Mancuso study (1974) indicated that successful entrepreneurs tended to be eldest children, younger, and married with an exceptionally supportive spouse.



Cooper and Dunkelberg survey (1987) found that half of the subjects had at least one parent or guardian who was self-employed, which showed a sizable family business experience background.

Evans and Leighton (1987) found that more educated individuals were more likely to become self-employed. Cooper & Dunkelberg (1987) noted that a third of their subjects had at least a college degree, but very few had progressed to more advanced studies. A female-based study by Dolinsky *et al.* (1993) indicated that the incidence of initial entry, continuous stayer, and re-entry status increased with increasing levels of education attainment. However, the role of education in entrepreneurial success is complicated. Although these studies suggest that they are correlated, some of the world best-known entrepreneurs, including Bill Gates and Ka-shing Li, do not have a university degree.

Literature on the relationship between demographic factors and entrepreneurial success factors	<ul style="list-style-type: none"> <li>• Mancuso study (1974) indicated that successful entrepreneurs tended to be eldest children, younger, and married with an exceptionally supportive spouse.</li> <li>• Cooper and Dunkelberg survey (1987) showed a sizable family business experience background on entrepreneurship.</li> <li>• Evans and Leighton (1987) found that more educated individuals were more likely to become self-employed.</li> <li>• Cooper &amp; Dunkelberg (1987) noted that a third of their subjects had at least a college degree.</li> <li>• The study by Dolinsky <i>et al.</i> (1993) indicated that the incidence of initial entry, continuous stayer, and re-entry status increased with increasing levels of education attainment.</li> </ul>
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## **ENVIRONMENTAL FACTORS**

The focus of the study of entrepreneur success factors has gradually shifted in recent years from sole personality characteristics of entrepreneurs. George and Zahra (2002) provide a review of empirical studies that have examined the

relationship between culture and entrepreneurship and Gartner (1985) noted the interaction of environment, individual, organization and entrepreneurial behavior.

### **Career-Related Experience**

Hoad and Rosko (1964) suggested that prior working experience was associated with the greatest entrepreneurial success. Prior experience might take the form of either managerial or non-managerial work, and a variety of experience seemed to correlate with greater entrepreneurial success.

### **Socio-Cultural Dimensions**

Some researchers have studied the socio-cultural dimensions that influence individual decisions to start up a business. Studies showed that uncertainty avoidance pushes individuals to become entrepreneurs (Noorderhaven *et al.*, 2003; Wennekers *et al.*, 2002). Shapero and Sokol (1982) noted that common inducements to forming a business were displacements such as losing one job, leaving school, getting divorced, or moving to another country.

Several other socio-cultural dimensions have been suggested, including placing a high value on innovation, risk taking, and independence (Kolvereid & Obloj, 1994), personal values (Huisman, 1985), a high social status for entrepreneurship (Davidsson, 1995; Ray & Turpin, 1990; Shane, Kolvereid, & Westhead, 1991), and the importance placed on work in a society (McGrath, McMillan, Yang, & Tsai, 1992). Interestingly, McGrath, McMillan and Scheinberg (1992) made a cross-country comparison between entrepreneurs and non-entrepreneurs, and found that entrepreneurs were less likely to agree that failure was associated with a loss of respect but Ray (1994), on the other hand, argued that fear of failure drove Singaporean entrepreneurs to strive harder to avoid insolvency.

Begley *et al.* (1997) found that the higher an individual perceived the status of entrepreneurs to be, the greater was that individual's desire and intent to become one. They also found that in the United States, people who want to innovate are often viewed as starting a business to give them the opportunity to do so. However, Singaporean and Indonesian MBA students who were asked to comment on the findings stated that they would only be inclined to start a business if they regarded it as a sure thing, and would therefore probably only start a business in a field where there was a low risk of failure. Fear of failure did not predict entrepreneurial tendencies. These MBA students also commented that the shame of failure might not

stop a person from starting a business. Instead, it would make them extremely unwilling to give up a struggling business as a failed enterprise.

<b>Table 3: Literature on the Relationship between Environmental Factors and Entrepreneurial Success Factors</b>	
<b>Environmental Factors</b>	<b>Literature</b>
Career-Related Experience	<ul style="list-style-type: none"> <li>• Hoard and Rosko (1964) suggested that prior working experience was associated with the greatest entrepreneurial success.</li> </ul>
Socio-Cultural Dimensions	<ul style="list-style-type: none"> <li>• Studies showed that uncertainty avoidance pushes individuals to become entrepreneurs (Noorderhaven <i>et al.</i>, 2003; Wennekers <i>et al.</i>, 2002).</li> <li>• Shapero and Sokol (1982) noted that common inducements to forming a business were displacements such as losing one job, leaving school, getting divorced, or moving to another country.</li> <li>• Several other socio-cultural dimensions have been suggested, including placing a high value on innovation, risk taking, and independence (Kolvereid &amp; Obloj, 1994), personal values (Huisman, 1985).</li> <li>• Some studies noted a high social status for entrepreneurship (Davidsson, 1995; Ray &amp; Turpin, 1990; Shane, Kolvereid, &amp; Westhead, 1991).</li> <li>• McGrath, McMillan, Yang, &amp; Tsai (1992) noted the importance placed on work in a society.</li> <li>• McGrath, McMillan and Scheinberg (1992) found that entrepreneurs were less likely to agree that failure was associated with a loss of respect.</li> <li>• Ray (1994) argued that fear of failure drove Singaporean entrepreneurs to strive harder to avoid insolvency.</li> <li>• Begley <i>et al.</i> (1997) found that the higher an individual perceived the status of entrepreneurs to be, the greater was that individual desire and intent to become one.</li> </ul>

## **NEW PERSPECTIVE ON SUCCESS FACTORS SPIRITUAL FACTORS & VALUES**

Besides the factors discussed above, this study also wants to explore other possible success factors of entrepreneurs which have not been considered in previous studies. They include luck and fate religion ultimate life value (Image Value) d ream life (Ideal Value) and life philosophy (Mission Value)

### **Religion**

Religion seems to be a link to success in entrepreneurship. In the West, Weber (1958) believed that the protestant ethic was a powerful force in fostering the acculamation of wealth. To many religious Chinese, religion involves not only a religious outlook but also the realization of this outlook through the practice of daily rituals. The final goal is not only self-salvation or self-perfection but also the enrichment of the human community and even cosmic integration.

### **Luck & Fate**

Luck means both happiness and good fortune. The Oxford English Dictionary defines luck as he fortuitous happening of an event favorable or unfavorable to the interest of a person

### **Image Value - Life Value & Philosophy**

This study defines Image Value as how people value an individual, or the image they project onto others. Agar (2001) found that the life ethic has the most profound and immediate implications for our view of our own planet. The intrinsic value associated with life forms the foundation of an environmental ethic, enabling us to recognize nature moral importance. Agar concluded that values of life are all about realizing an individual inner, true life. One has to be able to live one own life, express one own life, and experience the wisdom inherent in one own life. We can live fully only when our life goals are actualized.

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## THE RESEARCH

The results of previous studies have already enabled several common factors for successful entrepreneurs to be identified. These will serve as a guideline for assessing the factors which apply to young Chinese entrepreneurs.

### Face-to-Face Personal Interview

In this study, in-depth interviews were adopted to explore if there were any common success factors of young Chinese entrepreneurs in Hong Kong. The interview questions evolved around the different factors contributing to the success of entrepreneurs, as discussed above. Each interview took around an hour and was tape-recorded. With the limitation of personal interview, 32 highly qualified interviewees were selected. The standard of a reputable international organization for young entrepreneurs was taken as a guideline. All the samples met the following qualifications:

<b>Age:</b>	below 52
<b>Position:</b>	Must hold title of president, chairman and CEO, managing director, publisher, head partner or equivalent.
<b>Employees:</b>	Have at least 50 full-time employees
<b>Volume:</b>	Sales/Service/Manufacturing = US\$8 million annual turnover, or
<b>Financial</b>	Institutions = US\$160 million average annual assets, or
<b>Agency</b>	-Typed Business = US\$6 million annual commissions or fees.

Thirty-two interviews were conducted. Only three of the interviewees were female. Thirty-one percent were aged under 40, 56 percent were between 40 and 50 and 13 percent were either 51 or 52. Thirty-one percent worked in manufacturing, 28 percent in construction and property management, and 19 percent in trading.

Twelve percent were professionals and 9.4 percent were in various types of service industry.

### **Research Questions**

The study aimed to establish:

- 1) What contributes to the entrepreneurial success of today young Chinese entrepreneurs in Hong Kong and are these factors consistent with the previous findings from the literature review?
- 2) Do entrepreneurs change their entrepreneurial values between starting a business and achieving success, and are these changes significant?

By answering the two research questions, this research aims to find out the common success factors and the influence of values that fit the scenario of Young Chinese Entrepreneurs in Hong Kong.

## **ANALYSIS OF SUCCESS FACTORS**

### **Demographic Factors**

#### **Eldest child**

Only 41 percent of the interviewees were eldest children, compared with the 60 percent documented in Mancuso 1974 study. The lower proportion may be due to a particular Chinese cultural trait. In traditional Chinese society all sons used to take a share of a family business, not just the eldest son. Even today, every child is expected to contribute equally towards a family responsibility.

#### **Married with Exceptionally Supportive Spouse**

Aside from 5 interviewees who are still single, the others were all married and 66 percent of them (consistent with Mancuso findings) claimed to have a supportive spouse. The following responses were common:

Interviewee P: *I have a very supportive wife. I would not be able to succeed without her support.*

Interviewee C: *She supports me very much. In order to look after the family, she quits her job. She never disturbs me when I am in a bad mood. She is my best friend since I always share my problems with her.*

### **At Least One Parent is Self-employed**

Cooper and Dunkelberg study (1987) found that half of the entrepreneurs had at least one self-employed parent or guardian. In this study, 62.5 percent of the interviewees had inherited their businesses from their parents.

### **Education**

The findings confirm the study of Evans & Leighton (1987), as 81 percent of the interviewees possessed at least one college degree.

### **Further Studies**

Unlike Cooper and Dunkelberg findings (1987), where only 15 percent of entrepreneurs had a college degree plus some advanced studies, an overwhelming 93.5 percent of the interviewees have pursued further studies. They all believed in the importance of continuous education. As Interviewee A mentioned: starting up a business depends on opportunity. Once you have seized the opportunity, you need to have the knowledge to maintain your success. We now live in a knowledge-based rather than a capital-based society, so lifetime learning has become an important success factor.

Interviewee E echoed: *If you are not updating yourself continuously, you will lose. Interviewee K shared similar response: continuous education is the key point. I attended the seminars of Harvard Business School for three years. I attended an internet course at University of Science and Technology. I will attend many lectures when I have time. I may have no time to*

*write a dissertation, but thinking, absorbing and learning is important to me*

## **Environmental Factors**

### **Prior Working Experience**

More than half of the interviewees (56%) had career-related experience. According to Hoad and Rosko (1964), prior industry experience was associated with entrepreneurial success. However, this study shows that prior working experience has become less important, since 62.5 percent of the interviewees have inherited family business without prior career-related experience.

### **Displacement**

In Shapero and Sokol study (1982), the usual inducement to forming a business was a displacement, e.g. losing one job, leaving school or the armed services, getting divorced, or moving to another country. In this study, 81.5 percent of the interviewees inclined to run business because of certain displacements. These included 37.5 percent due to displacement of job; 22 percent due to graduation and 22 percent owing to moving to Hong Kong, of which 9.4 percent were forced to return Hong Kong to take over their family business.

### **Other Socio-Cultural Dimensions**

In this study, 66 percent of interviewees claimed that the social and economic environments were good when they started their business. They said that there were lots of opportunities at that time. A good economic environment made it easier to start a business. Sometimes, when the social economic environment was not good in general, it was maybe the right time to enter the market. Interviewee A entered the computer component market when others were pessimistic about the future of Hong Kong. He said:

*In 1985, lots of people wanted to immigrate to other countries. This was an opportunity for me. I know some people who were doing well when I started my business wanted to leave Hong Kong. They did not believe in the future of Hong Kong so they shifted their*



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*focus from Hong Kong. I had the opportunity to develop because of that.*

Around two-thirds (62.5%) of the interviewees perceived that the social status of entrepreneurs was high when they started up their business. This response is consistent with the findings of Begley *et al.* (1997) that the higher an individual perceived the status of entrepreneurs to be, the greater was that individual's desire and intent to become one.

### **Fear of Failure**

Begley *et al.* (1997) found that shame of failure might not stop a person from starting a business, but rather it would make them extremely unwilling to give up a struggling business as a failed enterprise. In this study, only 29 percent of the interviewees would have a negative effect on financial status or social evaluation if they failed in running businesses since most of them could get family support if they met failure. On the other hand, 48 percent have never thought of the fear of failure. It is understandable that as young entrepreneurs, failure seldom crosses their mind.

### **Personality Factors**

#### **Need for Achievement**

Hull *et al.* (1980) found that need for achievement was a weak predictor of an individual's tendency to start a business, but it was one of the reasons for every interviewee in this study. McClelland (1965) suggested that the need to achieve is the driving force for a person to spend more time on considering how to do a good job and how to accomplish things. Interviewees seem to echo his view. An interviewee said his father was twice as harsh to him as to others. It stimulated him to achieve something in business. Another example is Interviewee A. He said:

*I wanted to have my own career. I did not have a good educational background and was not good at dealing with other colleagues and supervisors. My supervisor was a foreigner. He scolded me everyday and I did not know how to explain. Therefore I wanted to prove that I could do better at that time. Besides, a good opportunity came up.*

### **Locus of Control**

Most of the entrepreneurs agreed that success needed some luck, but that their own efforts were normally decisive. Eighty-four percent of the interviewees believed that they could control their destiny. When they experienced adversity, they fought back even harder. They thought that only 50 percent of their success came from luck, and the rest depended mainly on their own contribution.

### **Risk Propensity**

Around two-thirds of the interviewees accepted a low or medium level of risk at the startup stage. Others who are willing to take more risk will handle it with care. All interviewees indicated that they took calculated or moderate risks, and tried to minimize risk in doing business. These findings echo those of McClelland (1961) and Timmons (1989).

Palich and Bagby (1995) suggested that entrepreneurs were more optimistic in risky situations than others. Interviewees confirmed this. For instance, in the cases of interviewees A, X, and W, friends and family were not optimistic about their startup. Interviewee X was told that it was very risky to start another business, which was so similar with the one that he had been expelled from. He is in the same industry, and selling the same products as he did before. He said: "I think there is risk, but it is not as big as they think. He saw the opportunity and perceived risk more optimistically than others did."

### **Tolerance of Ambiguity**

Half of the interviewees had a high tolerance of ambiguity, and 16 percent had a medium tolerance. This agrees with Begley and Boyd findings (1986) that the founders of small firms showed a higher tolerance of ambiguity than non-founders.

### **Self Motivation**

Most interviewees (81%) had childhood dreams. Around one-third (35%) wanted to do business, 15 percent wanted to be professionals, and 12 percent wanted to be rich. More than half of them might not dream of being an entrepreneur but most of them at least knew what they wanted to be. Four out of eight interviewees, who were poor in their childhood, would struggle for better living by dreaming of

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being a businessman, professional or rich, while the rest did not have any dreams at all.

As mentioned earlier, one of the driving forces of starting a business is the need for achievement. More than half of the interviewees (59%) regarded self-achievement as their motivation for starting a business. Only two interviewees considered money as the major motivation at the startup stage. The result is different from that of Redding (1990). In his study, approximately three-quarters of respondents acknowledged money as a significant motivation, even when they were unhappy to admit it. His study was conducted in 1987 when many mainland Chinese were just emerging from poverty. His respondents were mainly the first generation of overseas Chinese who had moved from mainland China. After more than a decade of wealth accumulation, society in general has become wealthier, and the new generation of entrepreneurs mainly came from well-off families. To make more money is no longer a major motivation for starting up a business.

### **Self-Esteem**

Three-quarters of the interviewees thought that they had a high self-esteem level. This is consistent with Robinson, Stimpson, Huefner & Hunt findings (1991) that he perceived self-esteem in business pertaining to self-confidence and the perceived competency of an individual in conjunction with his/her business affairs.

### **Creativity and Innovation**

Begley *et al.* (1997) noted that in the United States people who want to innovate see that starting a business will give them the opportunity to do so, whereas Singaporeans and Indonesians would only be inclined to start a business if they regarded it as a sure thing. Therefore, they would likely start a business in a situation with a low risk of failure. If they wanted to be creative, they would be inclined to do so within the protective walls of a larger company.

In this study, more than half (56%) of the interviews claimed to be innovative and around two-thirds found creativity and innovation important, but their innovation and creativity might not be reflected in their business. Under the influence of Western culture, Hong Kong falls between the United States and Singapore as far as innovation or creativity is concerned. A further examination noted that since more than half of the interviewees have inherited family businesses from parents, they tend to be conservative in doing business since innovation or

creativity more or less involves a certain amount of risk. Furthermore, innovation and creativity were not particularly relevant in some lines of business. For example, interviewees S, T and B worked in OEM manufacturing, which does not require so much innovation. In addition, Hong Kong is better known for marketing innovative products than for innovating itself. Understandably, creativity is not as highly encouraged in Hong Kong as in the United States.

### **Persistence**

As persistence is an important success factor (Hill, 1960), an overwhelming majority (91%) of the interviewees were very persistent people. They would never allow adversity to stop them from completing a chosen project. Their attitudes towards failures were very positive. Interviewee T said: when I experienced failure, I tried to solve the problem instead of feeling down.

### **Ethics**

All the interviewees claimed to be ethical business persons. They saw it as important to be ethical in doing business. This finding contradicts Redding's study (1990), in which respondents claimed that ethics and morals rated very low as far as businessmen were concerned. If they can cheat, they will. In Hong Kong, we owe society nothing. There is no identity. It is a colony, a transient place. You are here to make money. This attitude is understandable, as Redding's study focused on the first generation of Chinese immigrants from China. They regarded Hong Kong as a place to make money rather than as their home. The new generation, however, has developed a sense of belonging, since it has grown up in Hong Kong even if it was not born here. If conflict arises, some will even give up a business opportunity. An interviewee clearly stated:

Under-the-table money is very common in our industry, especially in mainland China. My policy is that there is to be no under-the-table money. My staff knows that.

As Lasker (1978) suggested that since entrepreneurs always possess the greatest degree of authority, it would be reasonable to expect that entrepreneurs as a group would tend to be placed at a higher level of moral development than groups of non-entrepreneurs. Timmons (1989) proposed that ethics is important for entrepreneurs to guard their reputation for integrity and ethical dealing to ensure long-term success. Also, King and Leung (1975) found that the majority of

entrepreneurs regard trust as a crucial factor in the formation of solid business relationships. As one interviewee said trust is very important for a long term business. If you are not a trustworthy person, your network will collapse and nobody will believe in you

### **Recognition of the Importance of Interpersonal Relationship**

Gartner (1985) argued that social support is an important factor. In Redding study (1990), networks, especially clan networks, were extremely important and useful. Personal networks are built in order to control uncertainty in three senses: gathering of information, stabilizing of sources of supply and markets, and the cementing of certain key relationships in the organization. In this study, a great number (90%) of the interviewees recognized interpersonal relationship as one of the most important success factors. Interviewee K stated:

*We need many talents to run a business. Social support is very important. I meet many friends and many of my customers are actually my friends, or people they introduce to me.*

### **Total Commitment and Determination**

Eighty-four percent of the interviewees think that they have a strong personal commitment to their organizations, which is a desirable entrepreneurial behavior trait, according to Timmons study (1989).

### **Integrity and Reliability**

Around four-fifths (81%) of the interviewees regard integrity or trust as one of their success factors. This confirms Timmons (1989) finding that it is vital for entrepreneurs to do what they say they are going to do. It is particularly true in Chinese society, which emphasizes the importance of integrity or trust. Interviewee J stated:

*Trust or integrity is very important,. You may lose business opportunities if you are not a trustworthy person.*

### **Decisiveness**

Coincided with Timmons (1989) findings, three-quarters of the interviewees had strong decisiveness. An interviewee put it nicely: when you have a vision, stick to it and go along with it. Find partners who will share and go along with your vision.

### **Dealing with Failure**

All the interviewees were optimistic while dealing with failure. Forty-one percent of them mentioned that they learned from failures and 38 percent of them would try to solve problems. This agrees with Timmons (1989) argument, who believed that an entrepreneur must be able to use failure as a learning exercise in order to avoid making similar mistakes in future. As interviewee S stated:

*This failure taught me a lesson. I had never had any real difficulty since I started the business. I believed that nothing was impossible, and I would not fail if I worked harder. I was wrong about this.*

### **Team Building and Hero Maker**

Almost every interviewee (97%) found teamwork very important. Timmons (1989) suggested that teamwork could complement one's skills and talents to achieve success. Interviewee J stated:

*Teamwork is very important. Unless you are doing your own things, you must cooperate with your partner/employee to do the job.*

### **High Energy, Health and Emotional Stability**

Aside from work, most interviewees would keep themselves busy during holidays. Forty-one percent of the interviewees claimed that they would play sports; 19 percent would travel; 9.4 percent would keep on working. Half of them regarded working hard as an important success factor and only 15.6 percent considered that they were hot-tempered. All these findings indicate that most of them have high energy, good health and emotional stability. As interviewees C and H mentioned:

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*C: (During holiday) I am very active in other community services and playing sports.*

*H: Now, I will play sports such as tennis or golf. In the 1980s, I organized many social activities such as football, tennis team, etc. Today, I usually play sports with my friends as my children are studying overseas. I also get involved in public service and sports and playground associations, as my father does. Through such activities I have made many friends with many different people, including government officials, and built up my social credibility.*

### **Hard Working**

Half of the interviewees claimed that hard work was one of the most important success factors. This confirms the findings of Timmons (1989) and Redding (1990). An interviewee mentioned, still work almost 10 hours a day. Some would rather give up holidays and keep on working on public holidays. Interviewee R said: am very busy with my business. I have to work from 9am to 7pm and then entertain my customers. Thus, I am fully occupied everyday.

### **Vision and Capacity To Inspire**

Timmons (1989) noted the importance of an entrepreneur vision and capacity to inspire. In this study, 91 percent of the interviewees have got vision or mission as the operation direction of their firms. As mentioned by interviewee P: Vision is my drive to motivate others to do things.

## **THE INFLUENCE OF SPIRITUAL FACTORS AND VALUES**

Apart from the factors identified from the literature review, this research looks at the influence of new perspectives including luck and fate, religion, life philosophy (Mission Value) and ultimate value (Image Value) on success factors of entrepreneurs.

Most interviewees believe that their success was attributable to their own contribution even though there is something designated and unchangeable. The most interesting findings is the obvious change of life philosophies among the interviewees prior to and after their success stages. Their ultimate life values (Image

Value) are to be regarded as a successful entrepreneur, a good person, a devoted person, etc. Rather than desiring to run business successfully or making money, most interviews are now pursuing spiritual satisfaction like satisfying one desire, pursuing a happy, full and balanced life. The new set of success factors that fits the situation of Hong Kong provides a guideline for further studies in the field of entrepreneurship. Please see below for elaboration.

### **Luck and Fate**

All the interviewees agreed that their success was more or less a blessing of luck. But luck alone is not the determined factor as four-fifths (84%) of the interviewees believed that their success were mainly made up by their own contribution. Only 6.6 percent thought that their success were mainly contributed by luck and 9.4 percent thought that both luck and own contribution made up their success in equal weighting.

### **Religion**

Two-thirds (66%) of the interviewees have religious beliefs or are influenced by a certain religion. Among them, 71 percent think that these affect their ethical value in doing business. As interviewee E said: here are some principles from my religion that I always insist upon. If a conflict arises, some will even renounce a potential business opportunity. As interviewee R said, if there is conflict between them, I will stick to the Bible and give up business opportunity

### **Life Philosophy (Mission Value)**

It is interesting to study the life values and philosophy of the successful entrepreneurs to see how it affects their business lives. The ultimate value (Image Value) in this study is defined as how people value her or him, or their image projected on others. Agar (2001) found that the life ethics will have the most profound and immediate implications for our view of our own planet. The intrinsic value associated with life forms the foundation of an environmental ethic, enabling us to recognize nature moral importance.

All the interviewees have more or less similar life philosophies when they first start their business and at the present stage. At the startup stage, 36 percent of them wanted to set up their own business or run business successfully; 26 percent



wanted to satisfy desire; 21 percent wanted to make money; 14 percent pursued self-achievement and 3 percent were willing to contribute themselves to society/industry. Their present life philosophies now show a marked difference to that of the past. Around one-third (34%) of them wanted to satisfy desire; 23 percent pursue a full and happy life; 20 percent wanted to make contribution to the society/industry; 17 percent wanted to pursue self-achievement and only 6 percent wanted to make more money.

It is noted that establishing a business or running a business successfully is no longer the present life philosophy of the interviewees. Having improved living standards, making money becomes a much less significant factor among the interviewees. Upon achieving certain achievements, the number of interviewees who wanted to make a contribution to society or industry is nearly seven times to that of the past, and more and more interviewees wanted to satisfy their desire.

Also, around one-quarter of the interviewees wanted to pursue a happy and full life at present, but nobody did so at the startup stage. All of these marked changes can be explained by the fact that, once people have satisfied their physiological needs, they will pursue an advanced level of need such as making contribution to society, or pursuing their own desires or interests.

### **Ultimate Life Value (Image Value)**

When asked to think about what impression they wanted to give others, half of them claimed that they wanted to impress others as good individuals with pleasant characteristics; around one-third wanted to be regarded as a devoted person who contributed to society, family or industry and a quarter of them wanted to be considered as a successful entrepreneur. As interviewee M mentioned want to be a good businessman, live up to the company mission and contributes myself to society Interviewee K echoed: hope people regard me as a successful entrepreneur and philanthropist. I like to contribute to society. Thus, I am not only a profit-making entrepreneur but also a philanthropist as well. My aim is not simply to earn money.

## **CONCLUSION**

The profile of the common success factors found in this study is slightly different from that of the global entrepreneurs. For example, the unique characteristic of Chinese culture, that is, sons whether they are eldest or not, used

to inherit business from parents makes the difference. The difference can also be attributed to recent rapid changes in Hong Kong. For example, in 1997 Hong Kong returned to Chinese rule, and in 1998 was severely affected by the Asian financial crisis. Some of the environmental factors of the global entrepreneurs conceivably differ from those of local entrepreneurs.

In addition, in Hong Kong, most of the young Chinese entrepreneurs have an international background in terms of exposure and education. They have become a special power group with their own culture and their common values, which may be different from those of the traditional and global entrepreneurs. This group of young Chinese entrepreneurs with international exposure and education makes the demographics and the personality of Hong Kong entrepreneurs different from that of the global entrepreneurs.

On analyzing the change of values of the successful entrepreneurs, we realize that achieving success is the common primary goal of entrepreneurs at their startup stage. But this goal or definition of success will change once an entrepreneur has acquired his or her primary goal of success. Ultimate life value is relatively unconscious and unimportant at the startup stage. Upon achieving success, people will then pursue an advanced stage of success in which happy family, contribution to society, health and rich life, balanced life and enjoyment of life become their prime concerns. Even though these may not be achieved easily, they act as people guiding principle in doing business and hence result in sustainable success. For the sake of high standard set by people and balancing the gap between status quo and their ideal life, they would again measure their present goal with their ultimate goal.

The success of entrepreneurs does depend on a mixture of factors, which may vary from industry to industry, from person to person, from place to place, and from time to time. Generally speaking, no single factor can give birth to an entrepreneur. In other words, successful entrepreneurs do possess many common factors. This study defines a new set of factors in Hong Kong, which may serve as a managerial guideline for the study of the field of entrepreneurship. The new perspective on success factors – spiritual Factors & Values give a new perspective on the influence of values towards success, and also makes a contribution to the academic study of entrepreneurship.

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# ENTERPRISING VOCATION IN EUROPE: THE SPANISH CASE

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## ABSTRACT

*A great number of researchers agree on pointing out that nowadays it is impossible to imagine an advanced society without an emerging and continuously growing business body. Different rates of growth between countries or within periods inside a country are determined by the creation of enterprises.*

*This article shows an X-ray of entrepreneurship in Spain in the period 1999-2002. So, the position Spain is in is analysed in respect to a series of European countries as regards entrepreneurship, by means of the observation of three variables: births, deaths and survivals of enterprises in the market. Afterwards, we analyse the performance of the enterprises created in Spain during the analysed period.*

## INTRODUCTION

A great number of researchers agree when they point out that nowadays it is impossible to imagine an advanced society without an emerging and continuously growing business body (Ayerbe, 1994, Shane, 1996, Cuervo, 1997, García & Marco, 1999, 2002, among others). In that way, the enterprise becomes the principal generator of progress and economic and social development in a country (Schumpeter, 1912, Orr, 1974, Deutsch, 1975, Hause & Du Rietz, 1984, Birley, 1986, 1987, Cooper, Willard & Woo, 1986, Lafuente, 1986, Lafuente & Lecha, 1988, Acs & Audretsch, 1989, Audretsch & Acs, 1994, Carter, Stearns, Reynolds & Miller, 1994, Audresch, 1995, García & Marco, 2002, among others); it becomes the flagship of market economies (Genescá & Veciana, 1984).

This article shows an X-ray of entrepreneurship in Spain in the period 1999-2002. To this end, the article is divided into three sections. The first section analyses the position of entrepreneurship in Europe by means of the observation of three variables: birth, death and survival of enterprises in the market. The second section analyses the performance of the enterprises created in Spain during the analysed period, and to finish with, a third section is given over to conclusions.

### **ENTREPRENEURSHIP IN EUROPE**

In academic circles, there is no unity of criterion on the definition, meaning and scope of entrepreneurship (Veciana, 1999, p. 15). Authors such as Stewart (1991) and Bygrave & Hofer (1991) state that a universal definition of entrepreneurship does not exist, and that it should not exist, and that it must be the researcher, within the framework of his or her research, who decides and explains clearly what they understand by entrepreneurship and by enterprising,

Nevertheless, authors such as Gartner (1985) or Vesper (1983) state that this inability to reach an agreement about a common definition has curbed research progress in this area. As far as they are concerned, Low & McMillan (1988) defend the idea of defining the term entrepreneurship in a global way, trying to include the various proposals of researchers, with the result that research in this area tries to explain and facilitate the role of the new enterprises in boosting economic development.

We agree with authors such as Veciana (1999), Stewart (1991) and Bygrave & Hofer (1991) that the researcher himself/herself must, within his/her research, determine and define what he/she understands by entrepreneurship and enterprising. In the research we are dealing with, we share the definition given by Carland, Hoy, Boulton & Carland (1984), Gartner (1985, 1989), Low & McMillan (1988), Bygrave (1989) and Veciana (1999), who understand entrepreneurship as the creation of new enterprises.

But, what do we understand by a new enterprise? According to the Commission Regulation no. 2700/98 (p. 17) and from a statistical point of view, an enterprise birth is defined as “the creation of a combination of production factors with the restriction that no other enterprises are involved in the event. Births do not include entries into the population due to mergers, break-ups, split-offs or restructuring of a set of enterprises. It does not include entries into a sub-population resulting only from a “change of activity”.



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In order to analyse the situation of entrepreneurship in a country or a certain area, apart from analysing the birth rate of enterprises, it is also necessary to study the death rate of enterprises and the percentage of enterprises that maintain their activity during a given period of time. This brings us to define what is understood by maintenance or survival of an enterprise and by cessation or death.

According to the European Commission Regulation no. 2700/98 (p. 45), the survival rate of an enterprise is calculated, at most, by three years of difference. So, in the year 2004, we can calculate the survival rate of the enterprises that began their activity in 2001, 2002 and 2003. In this way, “an enterprise born in year “t” is considered to have survived in year t+1 if it is active in terms of turnover and/or employment in any part of the year t+1 (otherwise referred to as survival without change). An enterprise is also considered to have survived if the linked legal units have ceased to be active, but their activity has been taken over by a new legal unit set up specifically to take over the factors of production of that enterprise (otherwise referred to as survival by take-over)”.

In the same way, the European Commission Regulation no. 2700/98 (p. 71), defines enterprise death as “a count of the number of deaths of enterprises registered to the population concerned in the business register corrected for errors. A death amounts to the dissolution of a combination of production factors with the restriction that no other enterprises are involved in the event. Deaths do not include exits from the population due to mergers, take-overs, break-ups and restructuring of a set of enterprises. It does not include exits from a sub-population resulting only from a change of activity”. Furthermore, the statistics presented do not consider an enterprise as having died if it undergoes a change of legal form, or if it is reactivated within two calendar years.

Afterwards, the situation of Spain (ES) is analysed compared with nine countries of the European Union –Belgium (BE), Denmark (DK), Italy (IT), Luxembourg (LU), The Netherlands (NL), Portugal (PT), Finland (FI), Sweden (SE), The United Kingdom (UK)- and Norway (NO), on the basis of the three parameters under consideration: enterprise birth, survival and death.

### **ENTERPRISE BIRTH**

If the creation of enterprises is analysed by sectors –industry, building and services-, we observe that it is the services sector that shows the greatest number of business births in all the countries observed and during the period analysed (table 1), the average being 74% of the total of created enterprises.

	Sector	EU(1)	ES	BE	DK	IT	LU	NL	PT	FI	SE	UK	NO
1998	Industry	:	8.3	6.0	7.6	11.6	3.0	:	12.2	11.9	:	8.5	7.7
	Construction	:	15.7	13.2	11.4	15.9	6.8	:	20.7	16.0	:	12.3	12.1
	Services	:	76.0	80.7	81.0	72.5	90.2	:	67.1	72.1	:	79.2	80.2
1999	Industry	9.3	7.8	:	6.8	11.2	2.6	6.9	13.7	10.9	9.4	8.5	8.0
	Construction	16.2	17.1	:	10.7	17.1	5.9	13.2	20.0	17.4	10.2	12.4	11.5
	Services	74.5	75.1	:	82.4	71.7	91.5	79.9	66.4	71.6	80.3	79.1	80.5
2000	Industry	9.0	7.5	5.8	6.9	10.9	2.8	6.4	10.8	11.1	8.8	8.2	6.5
	Construction	16.8	18.2	12.8	12.7	16.9	6.0	15.4	23.5	18.1	11.1	11.8	11.5
	Services	74.2	74.2	81.4	80.4	72.2	91.3	78.2	65.7	70.8	80.1	80.0	82.0
2001	Industry	8.6	7.4	:	6.6	10.1	2.5	6.1	12.5	10.8	8.3	:	5.6
	Construction	16.9	18.9	:	12.2	16.6	5.9	16.4	15.3	17.3	10.8	:	14.8
	Services	74.5	73.7	:	81.2	73.3	91.6	77.5	72.1	71.9	80.8	:	79.6

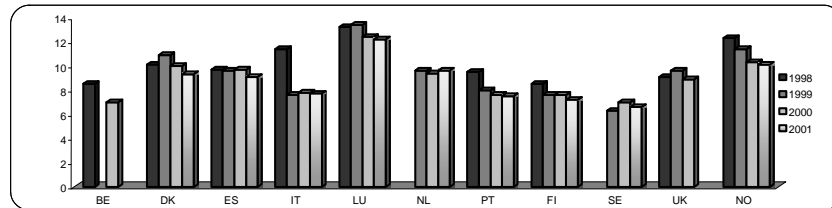
(1) Denmark, Spain, Italy, Luxembourg, The Netherlands, Finland and Sweden only.  
(:) Not available  
Source: European Commission and Eurostat (2004)

Broadly speaking, it can be said that, although all the countries observe a clear tendency towards the creation of new enterprises in the services sector, the countries located in the South of Europe –Spain, Portugal and Italy- have percentages relating to enterprise birth relatively higher than the rest of the countries in the building and industry sectors. On the contrary, the countries located in the North of Europe –Belgium, Denmark, Luxembourg, The Netherlands, Sweden, The United Kingdom and Norway- show a higher percentage of births in the services sector. Finland is an important exception. Luxembourg is the country that has the highest level of enterprise births in the services sector, over 90% in the last four years.

If we analyse the birth rate of enterprises, which is defined as the quotient between the number of enterprises that are created in a year compared with the total number of enterprises that exist in that year, we observe that Spain is in an intermediate position (graph 1). Considering that the European average, calculated on the basis of the data of Denmark, Spain, Italy, Luxembourg, The Netherlands, Finland and Sweden, is around 8% in the four periods analysed, Spain would be above that average with a birth rate of enterprises that varies between 9.1% and 9.7%. Luxembourg and Norway stand out because of their high birth rate of

enterprises as opposed to Sweden, Belgium and Finland, which have the lowest percentages.

**Graph 1: Enterprise birth rates in business economy (%)**



**Source: European Commission and Eurostat (2004)**

If we analyse the birth rate of enterprises by sectors (table 2), we observe that in Spain, just like in countries such as Italy, The Netherlands, Portugal and Finland, the highest rate corresponds to the building sector. The rest of the countries create a higher ratio of enterprises in the services sector. It can be pointed out that, in any case, Spain is above the average regarding the creation of companies in any of the sectors analysed.

**Table 2: Enterprise birth rates by activity sector (%)**

	Sector	EU(1)	ES	BE	DK	IT	LU	NL	PT	FI	SE	UK	NO
Industry	1998	:	7.7	5.4	5.9	8.2	8.1	:	8	6.6	:	6.7	7.7
	1999	6	7.3	:	5.9	5.4	7.4	6.8	7.7	5.5	5	7.2	7.7
	2000	6	7.1	4.4	5.6	5.5	7.5	6.3	5.8	5.4	5.3	6.9	5.8
	2001	5.6	6.6	:	5.1	5.2	6.8	6.3	5.6	5.2	4.7	:	5.3
Construction	1998	:	12.5	7.8	9.6	13.3	10.6	:	11.6	9.7	5.1	8.5	8.8
	1999	10.5	13	6.5	9.7	9.5	9.5	10.4	9.3	9.4	5.7	8.9	8.2
	2000	10.7	13.2	6.2	10.3	9.5	9.1	11.4	10.1	9	6.9	8	7.7
	2001	10.1	12.3	:	9	9	8.9	11.7	10	8.3	6.3	:	9.5
Service	1998	:	9.6	9	10.9	11.7	13.7	:	9.2	8.7	7	9.6	13.9
	1999	8.5	9.3	7.5	11.9	7.7	14.1	9.8	7.7	7.7	6.6	10	12.8
	2000	8.6	9.4	7.5	10.6	7.9	13	9.5	7.3	7.3	7.3	9.4	11.5
	2001	8.4	8.8	:	10	7.9	12.8	9.6	7.5	7.4	6.9	:	10.9

(1) Denmark, Spain, Italy, Luxembourg, The Netherlands, Finland and Sweden only.

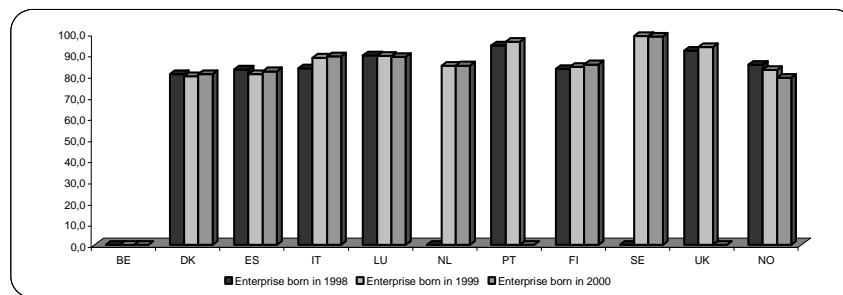
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Source: European Commission and Eurostat (2004)

## SURVIVING ENTERPRISES

The percentage of enterprises that stayed in the market after a year of activity is above 75% in all the countries analysed (graph 2). Spain and Denmark are the countries with the lowest one-year survival rate, which is, for the companies created during the period 1998-2000, between 79.7% and 80.6% for Denmark, and between 80.6% and 82.8% for Spain. At the opposite end of the scale, we find Sweden, with survival rates that vary between 98.3% and 98.7% for the same period. Other countries with very high survival rates, above 90%, are Portugal and the United Kingdom.

**Graph 2: One-year survival rates in business economy (%)**



**Source: European Commission and Eurostat (2004)**

The survival rate of enterprises born in 1998 varies depending on whether we consider one-year, two-year or three-year survival rates. On the whole, Spain and Denmark are the countries that have the lowest survival rates, whereas the United Kingdom and Norway have the highest rates.

If we analyse the one-year survival rate by sectors, the services sector has the highest survival rates in the majority of the countries studied. Only three of the countries analysed have higher rates in sectors different from the services one. So, the one-year survival rates are higher in the building sector in countries such as Spain and Portugal, while the United Kingdom has a higher survival rate in the industrial sector. Nevertheless, the two-year and three-year survival rates present a quite different picture. The highest survival rates are from the industrial sector, followed by the building sector. Denmark behaves strangely. Its services sector is the one that has the highest one-year survival rate as opposed to the other two sectors analysed; the industrial sector has the highest two-year survival rate and

the building sector has the highest three-year survival rate. In Spain, the companies that last longest are those in the industrial sector.

<b>Table 3: Enterprise survival rates born in 1998 (%)</b>											
	ES	BE	DK	IT	LU	NL	PT	FI	SE	UK	NO
<b>Business economy</b>											
One-year survival rates	82.8	:	80.6	83.3	89.4	:	94.1	83.0	:	91.8	85.1
Two-year survival rates	69.3	:	63.8	71.3	77.2	:	71.6	68.4	:	77.8	74.8
Three-year survival rates	61.6	:	53.5	62.3	66.2	:	:	59.2	:	:	66.9
<b>Industry</b>											
One-year survival rates	86.7	:	83.2	83.6	92.5	:	95.0	86.3	:	90.4	85.7
Two-year survival rates	76.5	:	70.0	72.5	83.8	:	77.0	72.8	:	77.2	77.8
Three-year survival rates	69.2	:	60.3	64.5	76.3	:	:	64.3	:	:	65.8
<b>Construction</b>											
One-year survival rates	81.3	:	83.6	84.6	95.1	:	92.3	84.6	97.4	92.4	85.2
Two-year survival rates	68.7	:	69.6	73.8	79.5	:	69.4	70.3	89.6	79.1	72.1
Three-year survival rates	60.9	:	60.6	66.4	69.7	:	:	61.1	80.6	:	64.6
<b>Services</b>											
One-year survival rates	82.7	:	80.0	83.0	88.9	:	94.5	82.1	96.8	91.8	85.0
Two-year survival rates	68.7	:	62.4	70.6	76.9	:	71.3	67.3	86.4	77.7	75.0
Three-year survival rates	61	:	51.9	61.1	65.7	:	:	58.0	76.1	:	67.4
(:) Not available											
Source: European Commission and Eurostat (2004)											

The industrial sector has an one-year survival rate that varies between the 83.2% of Denmark and the 95% of Portugal. Nevertheless, its three-year survival rate doesn't exceed 80% in any country. The country with the highest one, two and three-year survival rate in the industrial sector is Luxembourg, followed by Portugal and the United Kingdom.

The one-year survival rate of the building sector varies between 81.3% in Spain and 97.4% in Sweden. In this sector, the three-year survival rate is lower than in the industrial sector, being below 70%, except for Sweden, whose three-year survival rate exceeds 80%. This country, together with Luxembourg, has the highest survival rates. Spain and Denmark are the countries with the lowest survival rate in this sector.

Lastly, the one-year survival rate of the services enterprises varies between 80% in Denmark and 96.8% in Sweden. The three-year survival rate, just as happened in the building

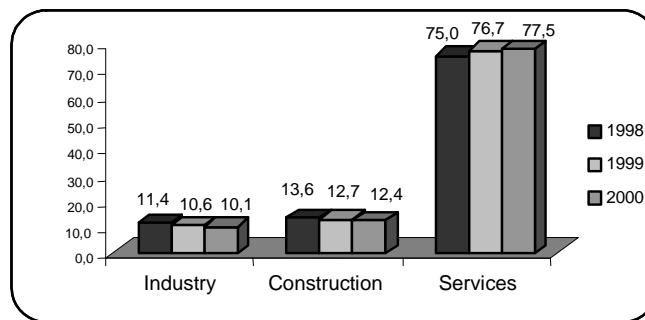
sector, carries on falling and is below 68% in most countries. Sweden is an exception again; its three-year survival rate is 76.1%.

### ENTERPRISE DEATH

From all the deaths of enterprises in the period 1998-2000, it is the services sector that suffers greatest from business closure. Approximately 75% of all the enterprises closed traded in the services sector. The other two sectors analysed have similar percentages of cessations, although the building sector is above the industrial sector (graph 3).

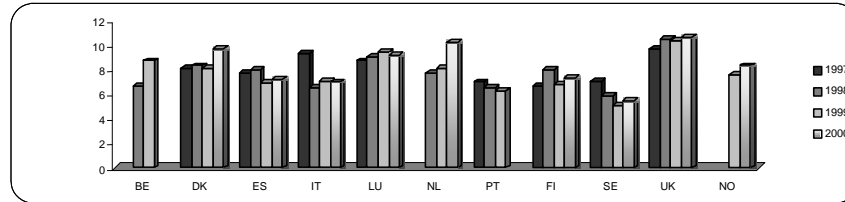
If we compare the cessation of enterprises with the birth of enterprises (table 1), we observe the same tendency. The services sector shows a higher percentage both of enterprise birth and death, being in both cases nearly 75% of all the enterprises created and closed. It is followed, with similar percentages, by the building and industrial sector, both in enterprise birth and death.

**Graph 3: Enterprise death rates by sector (%)**



**Source: European Commission and Eurostat (2004)**

If we analyse the death rate of enterprises, as defined by the quotient between the number of enterprises that cease trading in a year and the total number of active enterprises that year, we observe that the rate in Spain varies between 6.9% and 8% during the period 1997-2000, a percentage similar to the European average, (calculated on the basis of the data of Denmark, Spain, Italy, Luxembourg, the Netherlands, Finland and Sweden) which is about 7% for that period (graph 4). Denmark, Luxembourg, The Netherlands, The United Kingdom and Norway have death rates higher than the European average. This behaviour makes sense because they are the countries that also have the highest birth rates of enterprises. Sweden, Belgium and Portugal have the lowest death rates. Again, this situation is related to the low birth rate that these countries have.

**Graph 4: Enterprise death rates in business economy (%)**

Source: European Commission and Eurostat (2004)

If we analyse enterprise death by sectors (table 4), we observe that the industrial sector has the lowest death rates of the three sectors in the period analysed. The United Kingdom is the country that has the highest death rates in this sector.

The services sector, which had the highest levels of enterprise creation, is in turn the sector most damaged by the enterprise cessation. By countries, the United Kingdom is, together with Luxembourg, the country that has the highest death rates. The building sector holds an intermediate position.

So far, we have compared the situation of entrepreneurship in several European countries (among them Spain). We now analyse the situation of entrepreneurship in Spain at length and in depth, considering different related variables and diverse geographical areas.

**Table 4. Enterprise death rates by activity sector (%)**

	Sector	EU (1)	ES	BE	DK	IT	LU	NL	PT	FI	SE	UK	NO
Industry	1997	:	6.8	:	5.1	7.4	5.2	:	6.2	5.9	5.6	8.9	:
	1998	6.1	7.5	4.9	5.4	5.6	5.8	5.9	6.6	6.6	5.0	9.4	:
	1999	5.7	5.9	6.3	5.2	5.8	6.3	6.0	5.5	5.6	4.3	8.7	6.4
	2000	5.7	6.0	:	6.6	5.4	5.9	7.8	:	6.1	4.7	9.4	8.5
Construction	1997	:	7.5	7.6	5.7	9.1	6.8	:	7.9	6.6	6.7	9.2	:
	1998	7.6	8.4	5.7	6.3	7.7	6.7	5.2	6.4	8.4	5.2	10.3	:
	1999	6.9	6.8	7.3	6.3	7.5	8.4	5.3	6.9	6.6	4.3	9.3	7.7
	2000	6.8	7.2	:	7.5	6.6	6.2	7.5	:	6.9	4.8	9.7	6.7
Service	1997	:	7.8	10.0	8.9	9.8	9.1	:	6.9	7.0	7.3	10.0	:
	1998	7.3	8	7.1	9.1	6.5	9.4	8.2	6.6	8.2	6.1	10.7	:
	1999	7.3	7.1	9.2	8.9	7.4	9.7	8.2	6.2	7.1	5.3	10.9	7.8
	2000	7.7	7.4	:	10.6	7.4	9.7	11.0	:	7.7	5.8	10.9	8.6

(1) Denmark, Spain, Italy, Luxembourg, The Netherlands, Finland and Sweden only.

(: ) Not available

Source: European Commission and Eurostat (2004)

## ENTREPRENEURSHIP IN SPAIN

### Description of the Study and the Variables

The enterprising ability or initiative takes form when a business activity begins, both individually or collectively. In this study, an enterprise birth or death is understood in the terms defined by the European Commission Regulation no. 2700/98.

We distinguish between birth or death of enterprises created by one person alone -sole proprietors- and birth or death of enterprises created under other legal forms.

Once we have analysed the situation of Spain compared with other European countries, we study in depth the situation of entrepreneurship in Spain, on the basis of the data by Autonomous Regions (in future, AR) of the Economic Activities Tax (from now on, EAT) as regards business, individual firms' and corporations' births and deaths, in the period 1998-2002. The data have been provided by the Spanish Tax Authorities (from now on, STA) split up and classified by province and EAT category.

We try to find out the position each AR is in with regard to enterprise creation and cessation in relation to the Spanish average: (AN) Andalusia, (AR) Aragon, (AS) Asturias, (BL) the Balearic Islands, (CN) the Canary Islands, (CB) Cantabria, (CL) Castile and León, (CM) Castile La Mancha, (CT) Catalonia, (CV) Valencian Community, (EX) Extremadura, (GA) Galicia, (MT) Madrid, (MC) Murcia and (RI) Rioja.

The data regarding the Basque Country and Navarra are not controlled by the STA as these ARs control their own EAT, so they are outside the study.

### Analysis by Autonomous Regions

The data are given in numbers of births and deaths per each 1000 inhabitants, the periods considered being from 1998 (the first year of observation) to 2002 (the last year of observation). It has been shown that the tendency continues unaltered in the intermediate years both for the birth variable and the death variable (tables 5 and 6).

	AN	AR	AS	BL	CN	CB	CL	CM	CT	CV	EX	GA	MT	MC	RI
1998	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100
1999	114	150	124	93	100	91	107	107	97	104	124	100	87	102	97
2000	94	146	93	90	96	85	95	105	98	100	102	91	96	98	95
2001	93	115	49	84	93	89	91	95	101	92	220	96	79	101	95
2002	107	123	86	81	91	87	92	123	94	95	95	91	98	100	92

Source: Own preparation from the data of the SATS



Only Asturias and Extremadura show data worthy of note in the year 2001 as regards the previous and following years. Asturias goes down 47% compared with the year 2000 and 50% compared with 1998. As far as Extremadura is concerned, the total number of births increases by 115% compared with the year 2000 and by 120% compared with the year 1998. In neither of these cases, has the STA been able to explain the reason for these outstanding data.

**Table 6: Evolution of the total deaths between 1999 and 2002 (base year 1999)**

	AN	AR	AS	BL	CN	CB	CL	CM	CT	CV	EX	GA	MT	MC	RI
1999	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100
2000	167	247	145	143	154	137	166	156	163	159	209	170	138	152	162
2001	172	246	167	173	177	160	194	223	175	193	125	201	215	168	169
2002	217	308	237	177	194	162	200	163	224	203	157	210	155	197	200

Source: Own elaboration using AEAT data

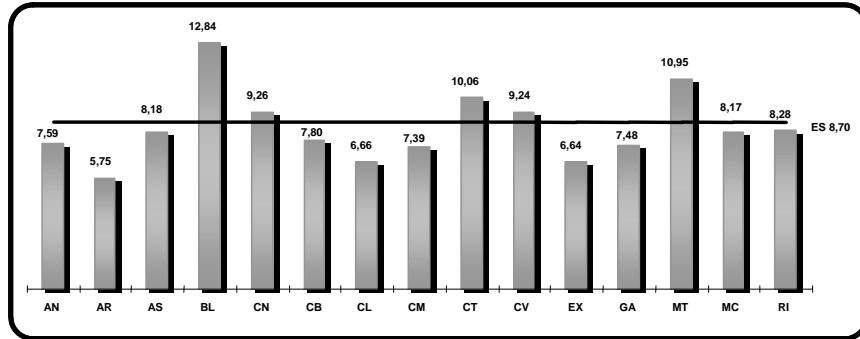
In the case of the death variable, the most outstanding data come from Extremadura and Madrid in the years 2000 and 2001 respectively. In the year 2000, Extremadura increases the deaths by 109% in comparison with 1998. However, the increase in deaths in the year 2001 compared with 1992 is only 25%, so an important decrease in deaths takes place in the year 2001 compared with the previous year. In the case of Madrid, the total number of deaths increases by 115% compared with the year 1998 and 55% compared with the previous year. Nevertheless, just like in Extremadura, the tendency in the following year does not continue as the deaths of enterprises decrease again by 26%.

### **ENTERPRISE BIRTH RATES IN SPAIN**

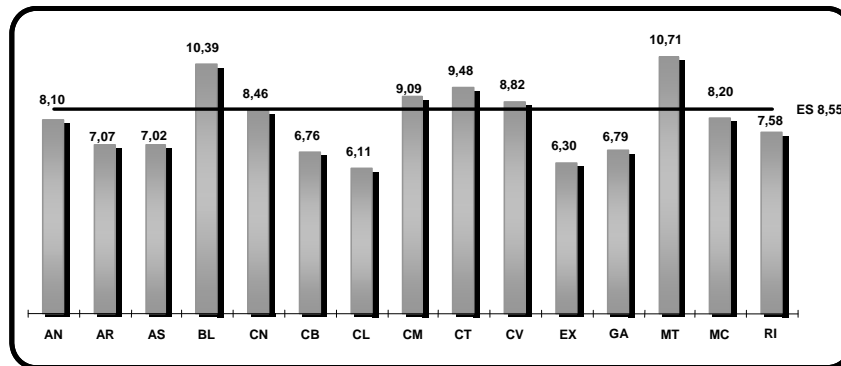
The birth variable, which includes enterprises created by individuals –sole proprietors- and enterprises created under other legal forms, underwent a small drop in the year 2002 compared with the first year of observation, the year 1998. The Spanish average has decreased from 8.70 births per each 1000 inhabitants in 1998 to 8.55 in the year 2002 (graphs 5 and 6), which means a drop of 1.7%. Only three ARs – Andalusia, Aragon and Castile-La Mancha – underwent a slight rise in the

year 2002 compared with 1998. The other regions have followed a downward tendency.

**Graph 5: Enterprise birth rates (Total) (per each 1,000 inhab.) by AR compared with the Spanish average (1998)**



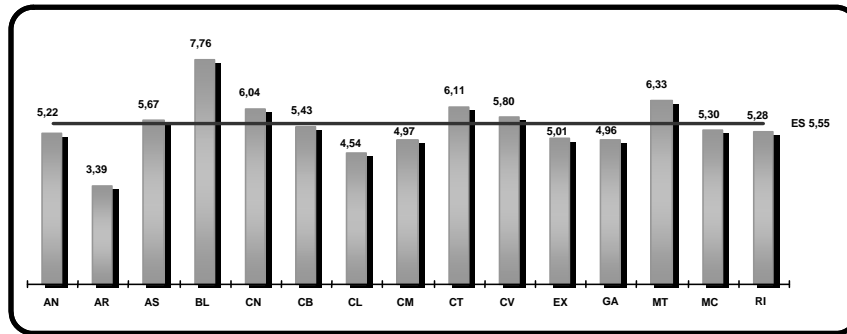
**Graph 6: Enterprise birth rates (Total) (per each 1,000 inhab.) by AR compared with the Spanish average (2002)**



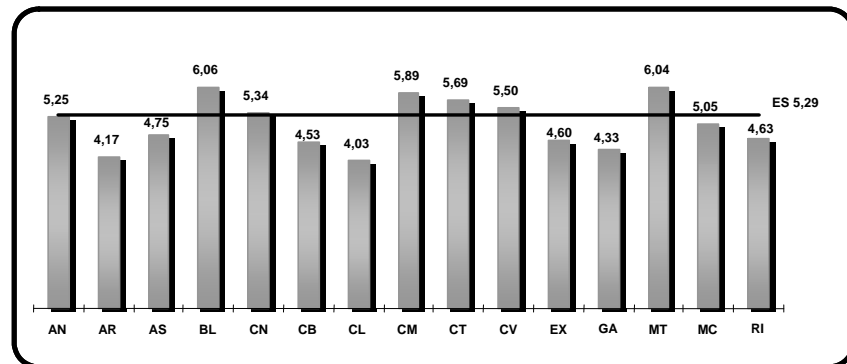
The region that is least enterprising in 1998 is Aragon, while in the year 2002 it is Castile and León, with scarcely 6 births per each 1000 inhabitants. The other ARs follow quite a stable tendency during the time interval considered (table 5).

If the analysis is more detailed, considering enterprises created by individuals –sole proprietors- and enterprises created under other legal forms, we observe that the Spanish average in sole proprietors has decreased in the year 2002 compared with the year 1998 (graphs 7 and 8), while the average number of enterprises created under other legal forms has increased slightly (graphs 9 and 10).

**Graph 7: Enterprise birth rates  
(Sole Proprietors) (per each 1,000 inhab.) by AR  
compared with the Spanish average (1998)**



**Graph 8: Enterprise birth rates (Sole Proprietors) (per each 1,000 inhab.) by AR  
compared with the Spanish average (2002)**



As for the enterprises created by a sole proprietor, in 1998 only six of the fifteen ARs are above the average: Asturias, the Balearic Islands, the Canary Islands, Catalonia, Valencian Community and Madrid. In the year 2002, the situation changes a little. Asturias, which in 1998 is above the average, suffers a small drop which moves it to the group of AR that have a number of enterprises created by a sole proprietor inferior to the average. On the other hand, Castile-La Mancha which, as it has been said, underwent a considerable increase in the number of enterprises

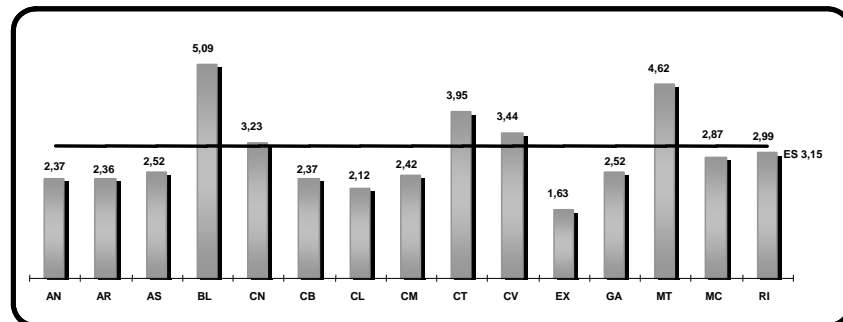
created during the period analysed, joins the group of ARs that have a number of enterprises created by a sole proprietor above the Spanish average.

The Balearic Islands, Madrid and Catalonia are, in this order, the ARs where there has been a higher number of births in 1998, while in the year 2002 the order changes; Catalonia has been supplanted by Castile-La Mancha.

In spite of holding the first position for the last five years, the Balearic Islands have suffered an important drop as regards enterprise creation. One of the reasons that explains this fact may be the growth in population in this region, a growth that hasn't been accompanied by sufficient germination of new enterprises. It isn't the only Autonomous Region that has lowered its ratings of enterprise creation, but without any doubt it is a region that, having increased its population –which means to increase the possibilities of employment creation-, has not increased proportionally the number of new enterprises, but, on the contrary, has reduced.

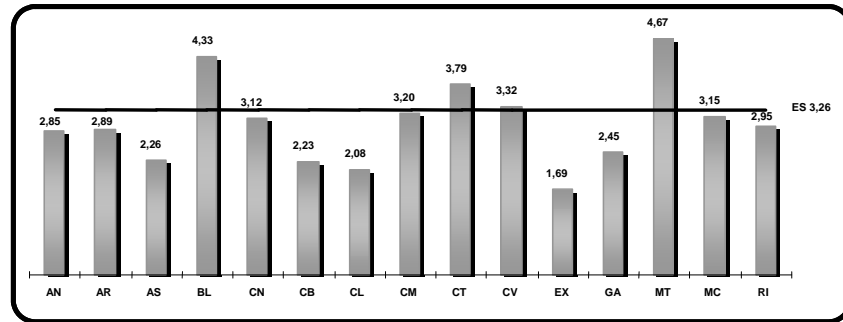
If we analyse the rate of enterprises created under other legal forms per each 1,000 inhabitants (graphs 9 and 10), we observe that they undergo a slight rise in comparison with the average value in the time period analysed.

**Graph 9: Enterprise birth rates (Other Legal Forms) (per each 1,000 inhab.) by AR compared with the Spanish average (1998)**



The Balearic Islands, as in previous cases, is the region with the highest fall in enterprise creation. While in 1998 it was the first Autonomous Region in creation of enterprises under other legal forms different from sole proprietor, in the year 2002 it suffers a very sharp drop and it is in second place, behind Madrid.

**Graph 10: Enterprise birth rates (Other Legal Forms) (per each 1,000 inhab.) by AR compared with the Spanish average (2002)**



In 1998 only five of the fifteen ARs analysed –the Balearic Islands, the Canary Islands, Catalonia, the Valencian Community and Madrid- are above the average. The situation in the year 2002 is slightly worse because regions such as the Canary Islands suffer a drop in the number of births, which places it below the average value, thus increasing the number of ARs that are below the average.

The Autonomous Region that contributes least to enterprise creation is Extremadura, achieving a rating inferior to two births per each thousand inhabitants, both in 1998 and in 2002. If we analyse the joint tendency of the enterprise birth rates (sole proprietor) and enterprise birth rates (other legal forms) in the first period analysed, we observe that, in most of the ARs the enterprise birth rates (sole proprietor) and enterprise birth rates (other legal form) develop in the same direction as regards the average. Only Asturias has a different behaviour, being below the Spanish average as for enterprise birth rates (other juridical forms) and above it as regards the enterprise birth rates (sole proprietor). The year 2002 shows, in this sense, a slightly different picture, the Canary Islands and Castile-La Mancha being the two ARs that are below the Spanish average as regards the enterprise birth rates (other legal forms), and above it as regards the enterprise birth rates (sole proprietor). The other ARs are either above or below the average in both categories.

### ENTERPRISE DEATH RATES IN SPAIN

Unlike the case of the birth variable, the ideal tendency for the death variable is to fall, as this implies the durability of the enterprises. As a general rule, the lower the enterprise death rates is the higher the number of enterprises that survive in the market.

In this case, the first period analysed is the year 1999 and the last 2002. the tendency in the intermediate periods is to rise (table 6).

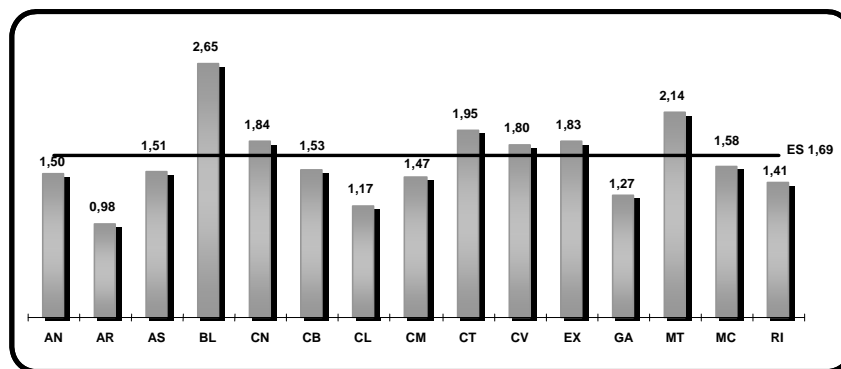
If we analyse the enterprise death rates (total), we observe that the deaths have doubled in the period 1999-2002, as reflected by the Spanish average that goes from 1.69 deregisters for each 1000 inhabitants in 1999 to 3.38 in 2002 (graphs 11 and 12).

The ARs where enterprise deaths have increased the most in the four years studied are Catalonia, Asturias, Aragon and the Balearic Islands, followed closely by the Valencian Community, the Canary Islands and Andalusia. It seems natural that the AR that generate more births are also those that have a higher number of deaths. In this sense, Catalonia has had a spectacular increase in the number of enterprise deaths, going from 1.95 for each 1000 inhabitants in 1999 to 4.35 in the year 2002.

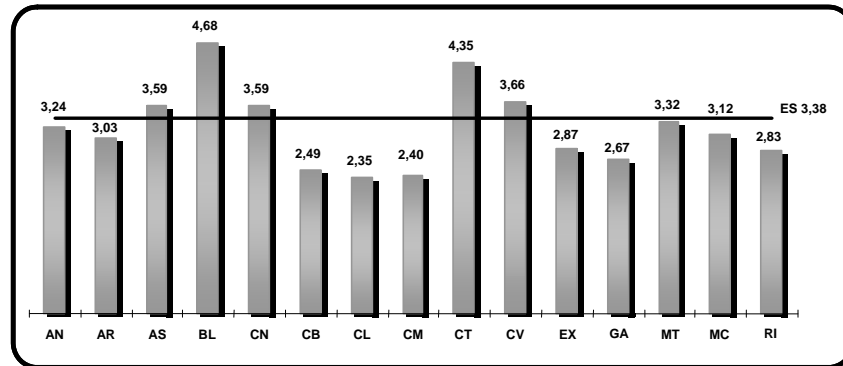
The Balearic Islands is another AR that has suffered a heavy fall in the number of active enterprises. On the one hand, it has shown a strong decrease in the number of enterprise births, and on the other hand, the number of deaths has increased considerably. This means that the net growth (total births minus total deaths) has decreased considerably in the year 2002.

The increase in enterprise deaths has been widespread all over the country in the last four years, although ARs such as Andalusia, Aragon, Cantabria, Castile and León, Castile-La Mancha, Extremadura, Galicia, Madrid, Murcia and La Rioja, are still below the Spanish average in the year 2002.

**Graph 11: Enterprise death rates (Total) (per each 1,000 inhab.) by AR compared with the Spanish average (1999)**



**Graph 12: Enterprise death rates (Total) (per each 1,000 inhab.) by AR compared with the Spanish average (2002)**



It is also worth pointing out that except Castile-La Mancha and Madrid, the other ARs mentioned are those that have fewer enterprise births, which explains to a certain extent their small enterprise death rate.

If we compare the enterprise birth rates (total) to enterprise death rates (total) for the period 2002, we see that the ARs that have more births are: the Balearic Islands, Castile-La Mancha, Catalonia, the Valencian Community and Madrid; while those that have a higher number of enterprise deaths are: Asturias, the Balearic Islands, the Canary Islands, Catalonia and the Valencian Community (graphs 6 and 12).

This leads us to think that the ARs where more enterprises are created are also the ARs where a higher number of business activities are dying. The two exceptions are the Madrid Community and Castile-La Mancha.

The Madrid Community, although it is the AR that has the highest number of enterprise births, is not one of the ARs that suffer the most enterprise deaths, which leads us to think that the enterprises of this community are those that show a higher durability.

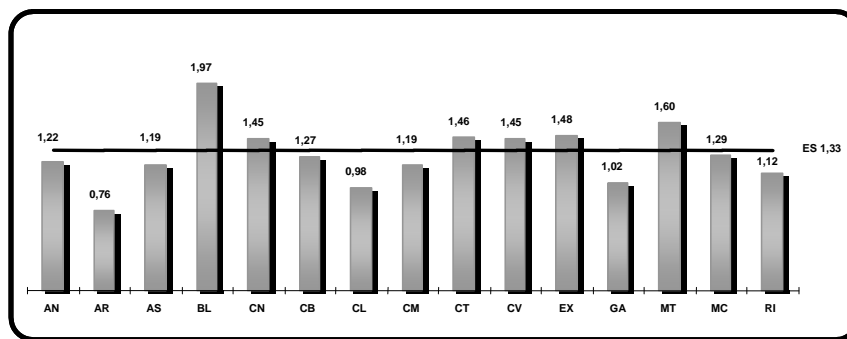
Something similar happens with Castile-La Mancha. While the number of births exceeds the Spanish average, the number of deaths is below it, so this Autonomous Region has the third lowest number of deaths.

If the analysis is more detailed, distinguishing between enterprise death rates (sole proprietor) and enterprise death rates (other legal forms), we observe that the Spanish average has increased in the year 2002 compared with 1999, as regards

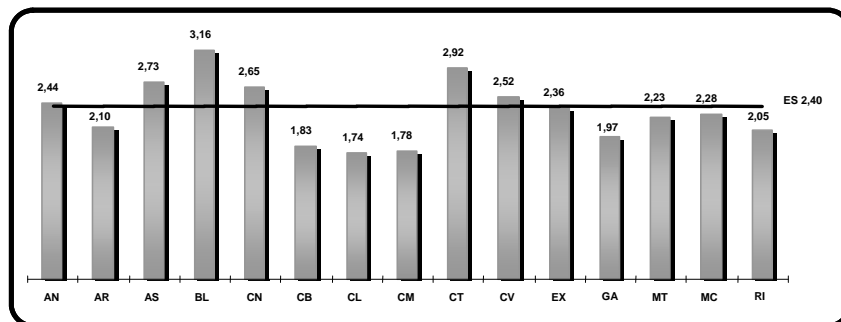
both the enterprise death rates (sole proprietor) (graphs 13 and 14) and the enterprise death rates (other juridical forms) (graphs 15 and 16).

As we observe in graphs 13 and 14, the enterprise death rates (sole proprietor) have increased by 80% in the period 1999-2002, going from 1.33 deaths per each 1000 inhabitants in 1999 to 2.40 in 2002.

**Graph 13: Enterprise death rates (Sole Proprietors) per each 1,000 inhab.) by AR compared with the Spanish average (1999)**



**Graph 14: Enterprise death rates (Sole Proprietors) (per each 1,000 inhab.) by AR compared with the Spanish average (2002)**



The ARs that have had highest enterprise death rates (sole proprietor) in 1999, thus ranking above the average, are the Balearic Islands and Madrid, followed by Extremadura, Catalonia, the Canary Islands and the Valencian Community.



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In the year 2002 the tendency changes substantially, with the Balearic Islands and Catalonia being the ARs with most deaths, followed by Asturias, the Canary Islands, the Valencian Community and Andalucía.

Although Madrid and Extremadura have undergone an increase in enterprise death rates (sole proprietor), this increase has not been so pronounced as that suffered by other ARs (Andalucía, Asturias,...). In this way, both Madrid and Extremadura are below the average in the year 2002.

All the ARs except four – Andalusia, Asturias, Extremadura and Madrid – follow a similar tendency during the period analysed, being either above or below the average in both periods considered.

Andalucía and Asturias show a negative tendency, since, while that they are below the average as regards the enterprise death rate (sole proprietor) in 1999, in the year 2002 this rate increases, being above the average. As far as Madrid and Extremadura are concerned, they show a rising tendency. While in 1999 they have enterprise death rates (sole proprietor) higher than the average, in the year 2002, and in spite of the enterprise death rate (sole proprietor) increasing, they manage to be below the Spanish average.

If we compare the enterprise death rate (sole proprietor) to enterprise birth rate (sole proprietor) for the year 2002, we can see that there is no total coincidence between the ARs that have higher rates of births and deaths (graphs 8 and 14). Madrid and Castile-La Mancha behave in a similar way if the variables to be considered are total births and deaths.

Madrid, while being the region with the second highest number of enterprises created by a sole proprietor in the year 2002, is not among the ARs that suffer the greatest number of deaths, which leads up to think that the individual enterprises or professionals in the Madrid Community show, as has already been mentioned, a higher survival rate.

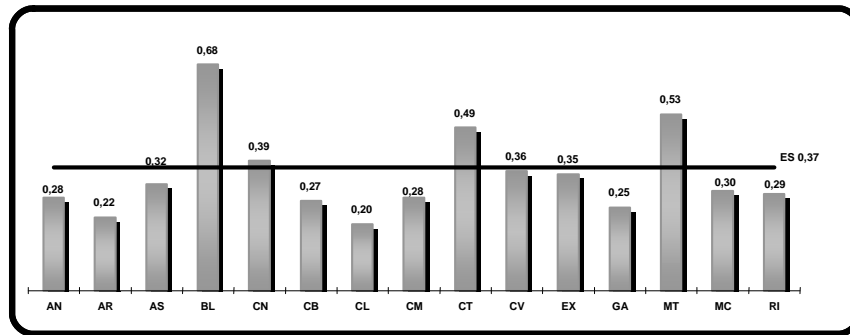
As far as Castile-La Mancha is concerned, it is above the Spanish average as regards enterprise birth rates (sole proprietor) in the year 2002 and below it as regards enterprise death rates (sole proprietor), being the region with the second lowest enterprise death rate (sole proprietor) in that year.

Asturias and Andalusia are above the average as regards enterprise death rates (sole proprietor) and below as regards enterprise birth rates (sole proprietor), so the net growth (enterprise birth minus enterprise death) is very small and the durability of the enterprises is not very high.

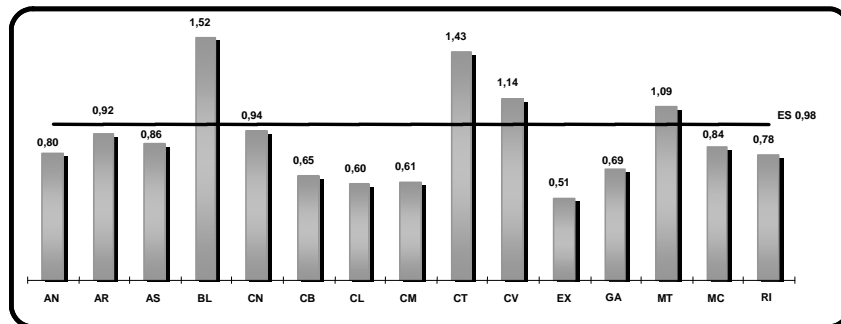
The other ARs follow a similar tendency in the year 2002, being, either above or below the average for the two variables analysed. The Autonomous Region that has the lowest enterprise birth and death rate (sole proprietor) in the year 2002 is Castile and León (graphs 8 and 14).

As far as the enterprise death rates (other legal forms) are concerned, they have also suffered a widespread increase even more pronounced than that suffered by the enterprise death rates (sole proprietor), rising from 0.37 deaths per each 1000 inhabitants in 1999 to 0.98 in 2002, which means a 165% increase (Graphs 15 and 16).

**Graph 15: Enterprise death rates  
(Other Legal Forms) (per each 1,000 inhab.) by AR  
compared with the Spanish average (1999)**



**Graph 16: Enterprise death rates  
(Other Legal Forms) (per each 1,000 inhab.) by AR  
compared with the Spanish average (2002)**



The AR with highest enterprise death rate (other legal forms) in 1999, being above the average, are, in order, the Balearic Islands, Madrid, Catalonia and the Canary Islands. In the year 2002, the situation changes slightly, with the Balearic Islands, Catalonia, the Valencian Community and Madrid being above the average.

Although the Madrid Community and the Canary Islands underwent a strong rise in the enterprise death rate (other juridical forms) in the year 2002 compared with 1999 – 106% and 141%, respectively-, this has not been so strong as the average increase (165%), which allowed both, Madrid and the Canary Islands, to move up and be in a more advantageous position than in 1999.

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All the ARs, except the Valencian Community and the Canary Islands, moved in the same direction during the period analysed, being either above or below the average in both periods. The Valencian Community went against the trend, since, while in 1999 it is below the average, the increase during the period analysed leads it to join the number of ARs that in the year 2002 are above that value.

As far as the Canary Islands is concerned, it follows a positive tendency, although it has also had an important increase in the enterprise death rate (other legal forms). While in 1999 it is above the average –with 0.39 deaths per each 1000 inhabitants- and still being one of the ARs with highest increases, in 2002 it is, however, below the average value.

If we analyse the joint tendency of the enterprise death rates (sole proprietor and other legal forms) in the first period analysed (graphs 13 and 15), we observe that in most of the ARs the rates move in the same direction as the average. Only the Valencian Community and Extremadura show different behaviour, being below the Spanish average as regards enterprise death rates (other legal forms) and, nevertheless, above it as regards enterprise death rates (sole proprietor). The other ARs are, either above or below the average in both variables analysed.

In the year 2002, the situation changes considerably, being four – Andalusia, Asturias, the Canary Islands and Madrid – the ARs that follow different behaviour patterns depending on whether we consider enterprise death rates (sole proprietors) or enterprise death rates (other legal forms) (graphs 14 and 16).

Andalusia, Asturias and the Canary Islands are below the Spanish average as regards enterprise death rates (other legal forms) and above it as regards enterprise death rates (sole proprietor). Nevertheless, Madrid shows the opposite behaviour, being below the average as regards enterprise death rates (sole proprietor) and above it as regards enterprise death rates (other legal forms).

The other ARs are, either above or below the average in both categories. If we compare the data of enterprise death rates (other legal forms) to those of enterprise birth rates (other legal forms) for the year 2002 (graphs 10 and 16), we observe that the ARs that have a higher number of births –Madrid, the Balearic Islands, Catalonia and the Valencian Community- are the same as those that have a higher death rate per each 1000 inhabitants.

The Autonomous Region that has the lowest enterprise birth and death rates (other legal forms) in the year 2002 is Extremadura, followed by Castile and León.

## CONCLUSIONS

The enterprising initiative materializes when a business activity begins, that is to say, when a company is registered. In Europe, Spain is in an intermediate position as for the creation of new enterprises. The rate of enterprise creation in Spain is about 9%, slightly higher than the European average. The sector that has the highest number of enterprises created is the services sector; nevertheless, the building sector has the highest birth rate, which is calculated as the quotient between the number of enterprises created in that sector in the period considered and the number of active enterprises in that sector in that period.

Although the Spanish position is relatively good regarding the creation of enterprises, we can't say the same if we analyse the survival of the enterprise created. Spain is among the countries with the lowest survival rates, with the enterprises located in the industrial sector being those that last longest.

As for the death of enterprises, Spain is again around the European average, and it is the services sector that has the highest the enterprise death rate. Analysing the situation of entrepreneurship inside Spain, we find that inside the Balearic Islands, Madrid and Catalonia are the ARs that have the highest enterprise birth rates (sole proprietor and other legal forms) in the period analysed. Castile-La Mancha has a considerable increase in the number of enterprises created by an individual person in the period 2002, and thus joins the group of ARs that have a highest number of new enterprises with a sole proprietor.

The least enterprising ARs are Extremadura, Aragon, Castile and León and Galicia, whose positions differ depending on whether we consider enterprises created by an individual person or under other legal forms.

Birth is the only variable that has undergone a slight rise in its average value, going from 3.15 births in 1998 to 3.26 in 2002. The other variables have followed a negative tendency in the period analysed.

The death variable has increased strongly in the period analysed, going from 1.69 deaths in 1999 to 3.38 in 2002. This increase has been reflected both in the death of enterprises created by an individual person and under other legal forms, which means that the enterprises created, do not last long in the market.

The ARs that have the highest number of enterprise deaths are the Balearic Islands, Catalonia, Madrid and the Valencian Community, although the position each region holds in the ranking of ARs that have most deaths varies depending on whether we consider deaths of enterprises set up by individuals or set up under other legal forms, and the period analysed. The only region that doesn't change its position is the Balearic Islands, coming first in all the variables in all the periods

analysed. It becomes the AR that has the highest number of enterprise deaths. It should be remembered that it is also the region that has the highest number of births. This may be due to the big tourist boom on the Islands and to the considerable population increase in recent years.

The ARs that have the smallest number of enterprise deaths are Castile and León, Galicia and Cantabria. It should be pointed out that these three ARs are below the Spanish average in the number of births in the period analysed, which explains why they are regions with a low rate of enterprise deaths.

If we analyse the net increase of business activity (births minus deaths), Castile-La Mancha and Madrid are the ARs that have a higher net increase in the year 2002. Both ARs are above the Spanish average as regards the number of births and below it in the number of deaths, which allows us to conclude that the enterprises of these ARs show a greater continuity in time. On the contrary, the ARs that have a smaller net growth in the year 2002 are Asturias and Extremadura.

The next step in this study will be to study in depth the activities with the highest enterprise births and deaths using the EAT codes. We aim to identify the activity areas most representative of the enterprising initiative in each Autonomous Region or province, trying to evaluate the influence that initiative has on the development of certain macroeconomic magnitudes (GDP, employment level,...) as related to each field of action.

It is necessary to encourage the enterprising vocation from the lecture rooms... and beyond them. Anyone can become a successful entrepreneur. He/she only needs enthusiasm, strength, passion and the ability to take risks, all seasoned with the right amount of sacrifice, determination and luck!

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# HUMAN RESOURCE ISSUES AMONG SMES IN EASTERN EUROPE: A 30 MONTH STUDY IN BELARUS, POLAND, AND UKRAINE

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## ABSTRACT

*In the present study we examine the applicability of some traditional human resource management theories to 374 owners of small to medium sized enterprises in border cities of Belarus, Poland, and Ukraine. We examine the relationships between facets of job satisfaction and annual income, and between facets of job satisfaction and performance. It is found that performance and annual incomes were relatively unrelated to facets of job satisfaction with multiple R's in the range of .05 to .34. We also found that within the time period studied that 17.4% of the owners left their businesses for greener pastures. We conclude that many findings based in traditional Western human resource management about the relationships between performance, income, and job satisfaction designed for use with employees do not seem to operate well with business owners in Eastern Europe.*

## 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). Satisfaction with pay satisfaction has been shown to exhibit 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 strength of the relationship between how much an individual is actually paid and that individual's pay satisfaction. This relationship typically has been positive and statistically significant and able to explain around 25% of the variance in pay satisfaction. Interestingly while compensation costs have increased dramatically over the last fifty years, there is solid evidence that employees tend to grossly underestimate the total costs of their pay packages (Convey, 2000; Kerr, 1999). It would appear that instead of perceiving many parts of the packages as an added form of compensation, many employees perceive them as a "right" (Milkovich and Newman, 2002).

Even if an employee undervalues a compensation package, this does not necessarily indicate that he/she will be dissatisfied with his/her compensation. The absolute value of compensation packages can be relatively easily calculated and communicated to employees to remedy the problem of undervaluation; however, establishing levels of satisfaction and the perceived importance of compensation is a more complex issue because they involve perceptual phenomenon (Carragher and Buckley, 1996; Carragher, Buckley, & Carragher, 2002; Lambert, 2000; Sparrow and Cooper, 1998). Assuming that employees consider nonpecuniary outcomes when determining satisfaction (Gomez-Mejia, Balkin, and Cardy, 1995; Lewis, 2000), it is possible that as has been suggested, compensation packages may have the ability to attract and retain employees (Heneman and Berkley, 1999), and perceived dissatisfaction with compensation packages may result in general job dissatisfaction, higher levels of absenteeism, lower levels of performance, and higher turnover rates and intentions (Lee, 2001) and less organizational commitment (Yousef, 2000; 2003). The extent to which this may occur is unknown.

A 2001 state survey of small business owners in New York found that the rising cost of health insurance was their primary concern of doing business. Sixty-three percent of those surveyed cited health insurance costs as the most serious problem facing them (Coons, 2001). Small businesses are competing in a global marketplace for employees and face the difficult task of providing competitive compensation packages to employees in a cost effective manner (DiFiore, 2000; Simmons, 2001) while attracting employees with the needed knowledge, skills, and abilities in order to effectively perform their jobs (Heneman and Berkley, 1999) while still trying to remain profitable. Research with small, medium, and large businesses, alike has found that employee compensation packages can play a strategic role in enhancing organizational performance and profitability for small businesses (Joo, 2000; Mangel and Useem, 2000; Meyer, Mukerjee, and Sestero, 2001). Heneman and Berkley (1999) found that many small businesses were so

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successful with their compensation packages that they had statistically significantly more applicants per vacancy than larger firms.

Does performance lead to satisfaction or does satisfaction lead to performance? Questions such as this have been studied going back at least to the Hawthorne studies (Roethlisberger & Dickson, 1939). The relationship between performance and satisfaction has been described as the “holy Grail” of organizational research (Fisher, 2003; Judge, Thoresen, Bono, & Patton, 2001; Landy, 1989). Judge et al. (2001) examined seven models of the relationship between performance and satisfaction and found an average true correlation of .30 based upon a sample size of 54, 417.

The prior research discussed has focused on typical employees in traditional small, medium, and large organizations. In the current study it is our purpose to explore how well these traditional findings hold up when examining the relationships between job satisfaction and performance, and between job satisfaction and income for groups of business owners of small to medium sized enterprises.

## METHOD

### Measures

#### Job satisfaction

The measures of job satisfaction used in the current research purported to measure general job satisfaction and seven facets of job satisfaction. The seven facets included satisfaction with work, supervision, coworkers, pay, promotion, recognition, and intrinsic job satisfaction with the first five based on the dimensions of the Job Descriptive Index (Smith, Kendall, & Hulin, 1969) and the final two based upon the Minnesota Satisfaction Questionnaire (Weiss, Dawis, England, & Lofquist, 1967). Coefficient alpha reliability estimates for the scales were .74 (work), .78 (supervisor), .82 (coworkers), .70 (pay), .70 (promotion), .78 (recognition), .89 (intrinsic satisfaction), and .81 (general job satisfaction) and the scale unidimensionalities were supported through the use of limited information factor analyses (Sethi & Carraher, 1993). All scales were translated in to Russian, back translated into English, and then retranslated in to Russian in order to provide a check for the accuracy of the meanings of the words in Russian.

### **Income**

Information about income was collected directly from the accounting records of the businesses.

### **Performance**

Performance was measured using assessments from the business owners, their employees, and three trained graduate students utilizing a standardized performance appraisal questionnaire designed for use with retail establishments. The owners and employees were trained to use the rating scales and there was a correlation of .85 between their scores and those of the graduate students indicating a high level of agreement between the raters.

### **Subjects**

Data were collected from 374 owners of small to medium sized retail businesses in Belarus, Poland, and Ukraine. On average they earned \$23,358 (SD = 6578.19) [equivalent to \$115,000 in the US] and were 74.9% female. Their average age was 38 years (SD = 11.46) with 6.9 years of experience as a business owner and 4.81 years at their same location. On average they had 2.1 children with 32% being unmarried, 45% married, and 23% divorced or widowed. In the 30 month period of time in which they were followed 17.4% of the owners closed their businesses and either opened another business in a different field or went to work for another business.

## **ANALYSES AND RESULTS**

Ten sets of multiple regression analysis were performed using performance, income, intrinsic satisfaction, satisfaction with promotions, satisfaction with coworkers, satisfaction with pay, satisfaction with the work itself, satisfaction with ones supervisor, satisfaction with the recognition received, and general job satisfaction. In Table 1 Performance and Income are the dependent variables with the facets of satisfaction as the independent variables. In Table 2 Performance and Income are the independent variables and the facets of satisfaction are the dependent variables.

As can be seen in Table 1 the eight facets of satisfaction were able to explain approximately 7% of the variance in performance and 12% of the variance in

income. The regression equation for performance was significant at the .0834 level while that for income was significant at the .0026 level. None of the facets of job satisfaction contributed a statistically significant portion of variance in performance at the .05 level while for income only satisfaction with promotional opportunities contributed a statistically significant portion of the variance - but the relationship was negative! Thus as satisfaction with promotional opportunities increases the income decreases possibly indicating that those with lower incomes might be looking for greener pastures in other businesses – either owning different businesses or going to work for someone else.

**Table 1 - Regression of Satisfactions on Performance and Income**

	Performance	Income				
Multiple R	.26942	.34643				
R Square	.07258	.12001				
Adjusted R Square	.03182	.08133				
F =	1.78054	3.10270				
Signif F =	.0834	.0026				
Variable	Beta	T	Sig T	Beta	T	Sig T
INTRINSAT	.044347	.581	.5622	.026368	.354	.7234
PROMOTION	.007444	.091	.9277	-.349635	-4.381	.0001
COWORKERS	-.135733	-1.670	.0966	.043738	.553	.5813
PAY	.010790	.137	.8915	.031982	.416	.6782
WORK	.168434	1.718	.0876	.166868	1.747	.0824
SUPERVISR	.136305	1.560	.1204	.071605	.841	.4012
RECOGNIT	.024931	.276	.7832	-.063886	-.725	.4694
GENERAL	.033510	.332	.7406	.030302	.308	.7586

As can be seen in Table 2 income and performance were able to explain between less than .3% to slightly over 8% of the variance in the facets of satisfaction. In the cases of satisfaction with coworkers, satisfaction with pay, satisfaction with recognition and intrinsic satisfaction income and performance were able to explain under 3% of the variance and neither contributed a statistically significant portion of the variance in satisfaction at the .05 level.

Table 2 - Regression of Performance and Income on Facets of Satisfaction									
	Sat. with Work	Sat. with Super- visors	Sat. with Co- workers						
R	.23151	.17350	0.0524						
R <sup>2</sup>	.05360	.03010	0.003						
Adj. R <sup>2</sup>	.04353	.01978	-.00786						
F =	5.32355	2.91738	.25902						
Sig F =	.0056	.0565	.7721						
Vari	Beta	T	Sig T	Beta	T	Sig T	Beta	T	Sig T
INC	0.0965	1.359	.1757	0.03	.417	0.68	0.05	.719	.4728
PERF	.2098	2.957	.0035	.1707	2.376	.0185	0	0	0.98
	Sat. with Pay	Sat. with Promo- tions	Sat. with Recog- nition						
R	.08690	.28311	.14290						
R <sup>2</sup>	.00755	.08015	.02042						
Adj. R <sup>2</sup>	-.00301	.07037	.01000						
F =	.71521	8.19072	1.95941						
Sig F =	.4904	.0004	.1438						
Vari	Beta	T	Sig T	Beta	T	Sig T	Beta	T	Sig T
INC	-.0167	-.230	.8187	-.2661	-3.804	.0002	-.0523	-.725	.4696
PERF	.0854	1.175	.2413	.0986	1.409	.1604	.1333	1.847	.0663
	Intrinsic Satis- faction	General Job Satis- faction							
R	.09697	.17971							
R <sup>2</sup>	.00940	.03230							
Adj. R <sup>2</sup>	-.00114	.02200							
F =	.89229	3.13705							
SigF =	.4114	.0457							
Var	Beta	T	Sig T	Beta	T	Sig T			
INC	.0531	.732	.4651	.0709	.989	.3242			
PERF	.0807	1.112	.2674	.1646	2.295	.0229			

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For general job satisfaction and satisfaction with supervisors income and performance jointly were able to explain approximately 3% of the variance (3.23 and 3.01% respectively) with performance in both cases being the only variable contributing a statistically significant portion of the variance (significance levels of .0229 and .0185, respectively). Income and performance were able to account for 5.36 % of the variance in satisfaction with work and 8.015% of the variance in satisfaction with promotions. Once again income was a statistically significant predictor with satisfaction with promotions [negative once again] and performance was a statistically significant predictor for satisfaction with supervisors – interesting findings as in most cases it might be assumed that the owners of the businesses did not have supervisors or opportunities for promotions. In follow up research over the course of this study it was found that the business owners considered opportunities for promotions to include opening up a new more profitable business, opening up a larger business, or going to work for a larger organization as a manager. The business owners considered the managers of the market areas to be their supervisors or in some cases their spouse to be their supervisor.

### **FUTURE RESEARCH AND CONCLUSIONS**

There are several directions in which future research could develop. It is interesting to note that within this sample satisfaction with pay level and actual pay level are essentially unrelated. This is a rare finding as most studies have found that actual pay level is the best predictor of satisfaction with pay level (Heneman, 1985; Rice et al., 1990) while in this study it is one of the worst. This sample is unique, however, in that only one level of an organization is included while most researchers have failed to control for differences in organizational level (Fiol, 2001; Truss, 2001). Generally as one advances within an organization, not only will salary increase, but so too will intrinsic satisfiers and individual expectations which may result in inflated correlations between salary and salary satisfaction (Jaques, 1961; 1962; 1970; 1996). Additional work should be performed which would examine the relationship between pay and satisfaction with that pay across organizational levels.

While literally thousands of studies have examined the job satisfactions of non-managerial and managerial employees in large, small, and medium sized businesses (Judge et al., 2001), little research has examined the job satisfaction of the owners of businesses within or across cultures and countries. So a second area for future research could be to replicate this type of research with other samples within this and other cultures and countries. A third area for potential research that

could prove fruitful would be to examine the content and construct validities of various facets of job satisfaction for SME owners within the U.S. and across cultures. This should likely begin with qualitative research seeking to examine the underlying content and constructs of job satisfaction for business owners as we sought to do post hoc with the examination of what the business owners considered to be promotions and supervisors. As we previously discussed based upon our post hoc interviews with the SME owners we found that the business owners considered their supervisors to be the managers of the marketplaces in which they operated and/or their spouses. The SME owners additionally considered promotional opportunities to include starting a more profitable business, opening a larger store, or gaining employment working for someone else at a higher rate of pay.

A forth major area for future research based upon these findings could examine differences between SME owners who stay in business versus those who do not stay in business. Are there personality differences between the two groups, leadership style differences, communication style differences, differences in performance or some other external shock (Niederman, 2004) that causes SME owners to seek other employment? Are those more likely to stay in business those who receive the most income from their businesses, those who are task oriented, or those who communicate the best non-verbally?

A fifth area for research could examine reasons that SME owners in developing countries seek self-employment. In some cases it might be because of desired flexibility (Wooden & Warren, 2004) or because of the perception of job instability in the region or country (Bockerman, 2004). Dissatisfaction with per capita income, with the government system in place, or dissatisfaction with previous work experiences (Noorderhaven, Thurik, Wennekers, & Stel, 2004) has also been shown to be related to self-employment in cross-country studies (Bockerman, 2004; Noorderhaven et al., 2004).

So in conclusion, do performance and/or income lead to satisfaction or does satisfaction lead to performance and/or income? It would appear that based upon these findings that neither does. Performance and income do not strongly influence satisfaction nor does satisfaction lead to performance or satisfaction. While previous research has found correlations in the range of .30 to .50 for American samples of employees, we found multiple R's in the range of .05 to .34 for these SME owners in Eastern Europe - with the only overlap in the ranges of values occurring in the regression of income based upon satisfaction levels and yet this could be thought of as comparing apples to oranges as higher multiple R's are certainly generally easier to obtain than large r's. We conclude by suggesting areas for future research examining the satisfaction and income/performance linkages.



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