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# New England Journal of Entrepreneurship, Fall 2003

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Fall 2003 Volume 6 Number 2




College of Business, Sacred Heart University

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# New England Journal of Entrepreneurship

Fall 2003 Volume 6 Number 2

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## Call for Articles

*New England Journal of Entrepreneurship (NEJE),* published twice a year by Sacred Heart University's College of Business, is intended to be an invaluable forum for exchange of scholarly ideas, practices, and policies in the field of entrepreneurship and small business management.

The *Journal* is currently seeking original contributions that have not been published or are under consideration elsewhere. The scope of the articles published in *NEJE* ranges from theoretical/conceptual to empirical research, with maximum relevance to practicing entrepreneurs. The *Journal* tries to appeal to a broad range of audience, so articles submitted should be written in such a manner that those outside of academics would be able to comprehend and appreciate the content of the material.

## Format

Please submit four typed copies of your article, on separate pages, include an abstract of the article (100 words maximum) and a biographical sketch of the author(s). A title page should precede the article and should list the name(s) of the author(s) as well as their full address (including phone and fax numbers and email address). Papers are to be double-spaced with one-inch margins. References should be included on separate pages at the end of the paper. Manuscripts should be no longer than 20 pages of text and 25 pages total, including abstract, text, tables or illustrations, notes and works cited. Please consult APA style guidelines for all formatting details.

## Copyright

The copyright of published articles will belong to the publishers of *NEJE.* Authors will be granted permission to reprint or otherwise use portions of their articles published in the journal upon written request.

## Review Process

All articles will be double blind refereed. Authors will receive reviewers' comments and the editors' publishing decision in approximately 90 days of submission.

All prospective authors are required to include a $20 submission fee with each manuscript sent in for consideration, payable to "NEJE." The fee will be used to cover administrative costs and will also provide the author with a year's subscription to the *Journal.*

## Submission

Authors are encouraged to submit articles for the Fall 2004 issue by April 15, 2004. Papers received after the due date will automatically be considered for future issues of the *Journal.*

All submissions and correspondence should be addressed to:

Editor, *New England Journal of Entrepreneurship*
College of Business
Sacred Heart University
5151 Park Avenue
Fairfield, CT 06825-1000
(203) 371-7854 (phone)
(203) 365-7538 (fax)

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## Sample Copies

Sample copies of the previous issues will be available from the Editor on a first-come, first-served basis.

New England Journal of Entrepreneurship

## From the Editors

In a departure from our usual practice of interviewing one or two entrepreneurs for the *Journal,* we are providing five interviews in this issue. In another departure, these entrepreneurs are not U.S.-based; rather, these business people are all from New Zealand, a spirited country where independent thinking, homegrown solutions, and their own Kiwi take on innovation makes their stories both interesting and varied.

The opportunity to meet and interview a total of nine entrepreneurs representing five different organizations from both the North and South Islands of New Zealand (see map) came about when our Editor spent his Spring 2003 sabbatical touring that country. Over a seven-week period, Laurence Weinstein, starting in Auckland and ending his trip in Christchurch, sought out New Zealanders who had intriguing stories to share with our *Journal's* readers.

- *TeWhau Lodge near Auckland:* Gene O'Neill and Liz Eglinton both left high-paying corporate jobs to start their own upscale lodge on Waiheke Island. Their income is much less than it used to be, but they could not be happier as they now control their own destiny.

- *Raconteur Productions in Christchurch:* William De Friez serves occasionally as the company's director when they are filming documentaries. Veronica McCarthy is the full-time producer. Their views on the how, what, and when's of making these documentaries often clash, but their highly respected productions reflect the value of melding their creative energies and intelligence.

- *Bay House Café in Westport, near Greymouth:* Dudley-Anne Thomson manages this out-of-the-way gourmet restaurant that is a destination for travelers from around the world. Brian Finlayson and Michael Varekamp started the restaurant despite strong local government resistance to their business concept.

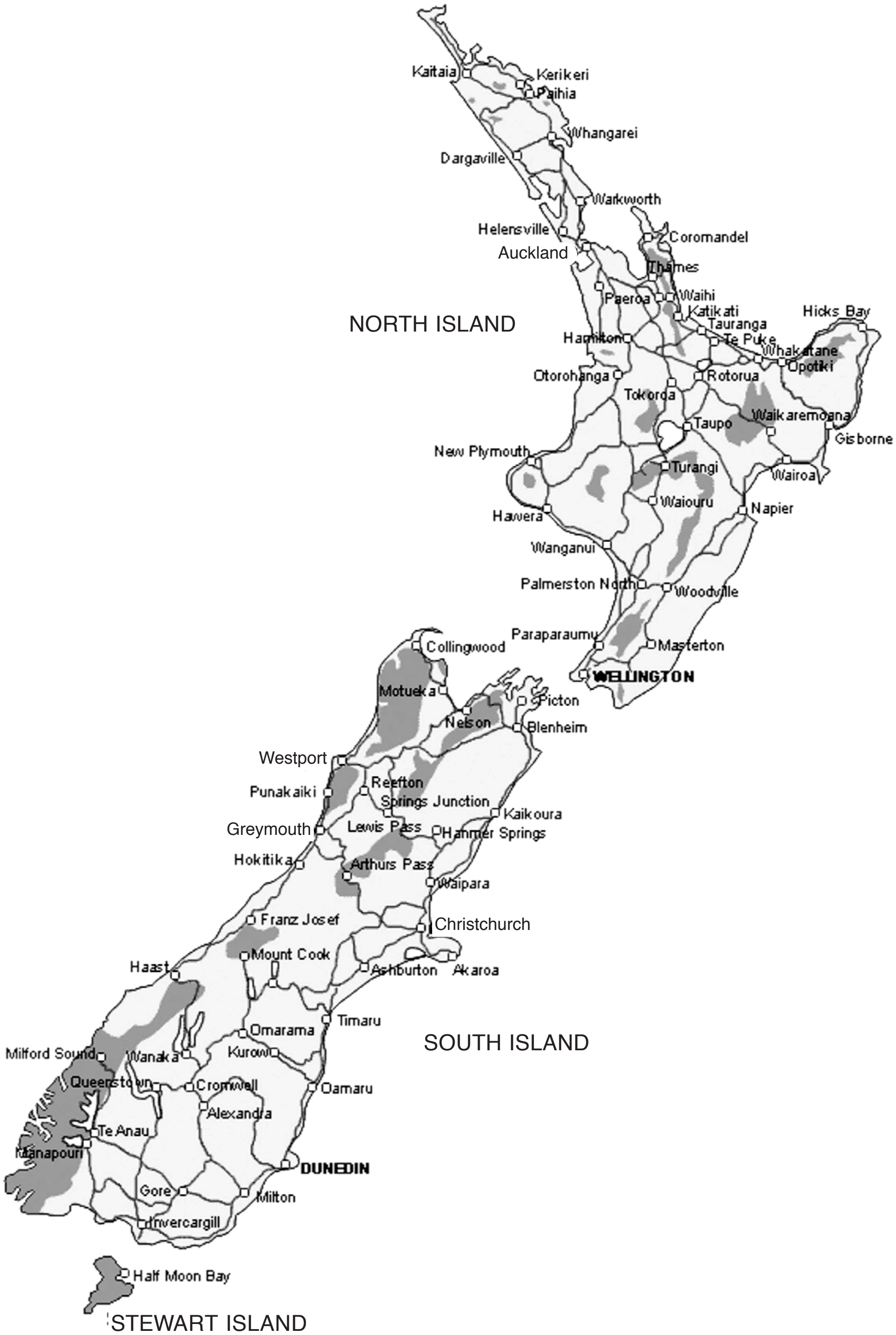
- *Philip King Booksellers in Christchurch:* Philip King started his business in his home as an after-hours hobby and turned his passion for books into a huge pay-off.

- *Jade Software in Christchurch:* Although Sir Gilbert Simpson is considered a software development genius in his own country, Jade Software applications are just now making a splash outside of New Zealand. His goal: "Invade" the United States.

To round out the issue, we are pleased to present, in addition to our regularly peer-reviewed articles, a special "Practitioner's Corner." In this segment, we offer the entrepreneurial musings of Joe Levangie, a very successful venture capitalist for the past twenty-five years.

| | | |
|---|---|---|
| Dr. Laurence Weinstein<br>Editor | Dr. Joshua Shuart<br>Associate Editor | Christopher Sheehan<br>Associate Editor |

# New Zealand

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# From Corporate to Entrepreneurial Life: Risks and Challenges Along the Way

Gene O'Neill, Liz Ellington
Proprietors, TeWhau Lodge, Waiheke Island

*Gene and Liz were married in 1991 and have fulfilled their dream of owning and operating their own business—TeWhau Lodge. The lodge is located on Waiheke Island, a vineyard region just 30 minutes by ferry from downtown Auckland. Guests are provided lodging along with gourmet dinners and breakfasts for New Zealand $495 per night per couple (about U.S. $235).*

***NEJE: Many folks in corporate life dream someday they'll start their own businesses, be their own boss, and set their own hours and financial goals. You seem to be prime examples of that.***
**Gene:** I can't say I started out thinking that way when I joined Air New Zealand. I enjoyed corporate life and stayed with the company for 27 years. At first, I was on the union side but then moved over to management where I had important responsibilities in aircraft engineering and maintenance.

**Liz:** I'm with Gene on that one. I was "all corporate." After university where I majored in fine arts and language, I went into human resources. I worked my way up to HR director working for multinational organizations with thousands of employees based in the United States, Australia, China, Malaysia, and Hong Kong. I had direct responsibility for salary and benefit compensation programs, incentive plans, recruitment, and training and development. Then, I specialized in helping expat managers bring their families and furnishings over to New Zealand. I loved the perks, the excellent salary, and the status of belonging to large companies.

***NEJE: Yet here you are, far from corporate life and living on an island operating a lodge that provides gourmet meals for up to a maximum of eight lodgers a night.***
**Gene:** Yes, it's been quite an adjustment, but one we are both happy we made. The threat of redundancy, losing one's employment to corporate whim and whimsy is not something we wanted to endure. Each of us felt a lack of control over our destinies while in corporate life. Here, at TeWhau, owning our own business at least gives us an "illusion of control."

***NEJE: Why is it an "illusion?" That doesn't sound positive.***
**Gene:** Don't misunderstand. We have control over how we *manage* the lodge, but we still depend on suppliers; we have no influence over the local economy, and non-New Zealanders account for 40 percent of our business. Any terrorist activity that threatens plane travel could impact enormously on us. That's what I mean by "illusion of control." There's a frightening amount of sheer luck that's involved in being successful when one runs this type of operation. There are so many variables out of our direct control.

***NEJE: What about the "24/7" dedication you both need to bring to the lodge? Do you find it's difficult to wake up each day and feel motivated to spend another 14- to 18-hour day preparing meals, welcoming guests, and keeping everything ship-shape?***
**Liz:** No, actually we love this type of life. We were both brought up in small country towns in New Zealand where hard work was valued and expected.

**Gene:** I grew up on a dairy farm and had to milk the family's cows twice a day. I was part of a community back then where everyone supported each other and you learned to get along with all sorts of personalities. We see those early experiences as a real asset. Being in isolation at work or at home doesn't appeal to me. I love being with people, and I really enjoy food preparation. Learning to cook came from my mother, who encouraged me to spend time in the kitchen with her.

***NEJE: Yet operating a lodge seems so removed from corporate life. What sorts of adjustments have you had to make?***
**Gene:** (Laughing) Well, one thing we've had to adjust to

is the loss of our corporate salaries and perks. We aren't going to die rich by any means.

**Liz:** For me, it's always having to be one step ahead of the game. You have to be a lot more nimble as an entrepreneur. There's no such thing as financial security, at least not the kind I felt when I was getting a paycheck from my employer every week. We're only as good as the last person who leaves the lodge every day. We are in the business of pleasing people, of helping them de-stress, seeing that they thoroughly enjoy their stay with us.

We are not unique in what we offer. It's a typical New Zealand experience. Yes, we own 16 acres of land; yes, our lodge is beautifully situated overlooking a bay; but our guests have a lot of similar lodges from which they can choose, and we are very mindful of that. We only have four guestrooms; that is a maximum of eight lodgers per night. Being a small operation, we have to treat visitors royally or else they won't consider coming back.

***NEJE: Why did you choose a small lodge operation versus one that could have accommodated many more visitors at a time?***

**Gene:** If we had made TeWhau Lodge bigger, the whole dynamic of what we wanted to provide here would be very different. We would have lost a lot of customer contact, and the food portions would have had to be created in so much more volume. We consider ourselves restaurateurs and see that as a way to make us different; it's our niche so to speak. We serve our guests around a table where eight people can sit comfortably and make new friendships that often carry over when they return home. Guests don't want to be dominated by their host so we've learned what to provide, how to interact without being intrusive, and then "disappear."

I plan the menu each morning and evening very carefully, but I don't see the lodge as a way to showcase our cuisine. What's important is whether our guests enjoy their social experience around the table; the food we serve is just one part of that memory. How we conduct ourselves, the ambiance we create, the sunsets over Auckland that our guests photograph on the veranda each evening, they're all part of how visitors remember the lodge.

***NEJE: You selected the building site and worked with an architect to design the lodge. Wasn't there a lot more risk in starting from "scratch" rather than purchasing an existing operation?***

**Liz:** But if we had purchased someone else's property, it wouldn't have meant the same to us. We would have bought someone else's dream instead of creating our own.

**Gene:** It was frustrating at first. We looked at other areas but really wanted to build on Waiheke Island. Yet we almost gave up because we couldn't find the right building site. Finally, one day the realtor working with us found out about this property being available and rushed us out here to see it. One look told us this is where we would someday build and run our lodge.

To create your own operation from the ground up involves a lot of detail. However, we felt we were in a better position than most entrepreneurs because we had saved up enough money from our corporate jobs so that we did not have time constraints. Also, Liz continued to work in her corporate job for another 18 months after we opened the lodge as a way to buffer our start-up expenses from depleting our savings. We were focused on what it would take to construct the lodge in a way that would make it look distinctive. We had the money to do it without overleveraging ourselves with the bank. And we had the time so nothing had to be rushed or short-changed.

***NEJE: Did you put together a business plan?***

**Gene:** Absolutely. We both had had exposure to business planning in corporate life so we knew that a strong business plan was essential to our success. Once we slow down after our summer season, around April, we take time out from the business and analyze systemically how we have done versus our original plan. We undertake a complete financial review and update our SWOT analysis.

Last year, we hired a terrific consultant who stayed at the lodge and whom we treated as a regular guest. His stay lasted for 24 hours, and then he wrote a lengthy report on what, in his opinion, we had done right or where we had shown some lapses. It was enormously helpful to get that kind of feedback.

**Liz:** We made sure that financial worries did not drive our decisions. We do not have significant debt to pay back. That means we don't have to worry about how many cars come down the driveway on a daily basis. We focus on customer needs rather than how we are going to meet the mortgage payment. We waited until a later stage in life to start our business. With no young children to raise at this point, we can put all of our energies into growing the business.

It's important to point out that our guests' expectations about their experience at TeWhau Lodge keeps going up. We need to be mindful of what our competition is offering and how to keep ahead of the game. We've heard a new lodge is opening up on the Island, and we've done our initial homework on what type of lodging experience they expect to provide and how that might impact us.

There are other concerns. What if Air New Zealand is not bought out by Qantas Airlines, as has been rumored of late? For Air New Zealand to survive independently, they might cut fares and a price war might ensue. If that happened, Aucklanders who form the backbone of our business might be tempted to vacation in Sydney rather than just take the ferry to local Waiheke Island.

**Gene:** We can't foresee everything that is going to happen around us, but fortunately we can at least choose the route the business will take and not have to go to some committee or distant company CEO to ask for permission to take certain steps to improve the lodge. Not so with corporate life, where you have to seek consensus or constantly ask your supervisor if it's all right to make decisions that carry some risk. We can move quickly and confidently because our corporate "boardroom" is just the two of us.

***NEJE: How did you divide up the responsibilities of running the lodge?***

**Gene:** I take care of buying all of the food provisions, preparing the meals and general maintenance of the lodge.

**Liz:** I handle the inquiries and guest bookings by phone and email and send out proposals when corporations want to use the lodge for conferences and also when, on occasion, we have a couple who wish to be married at the lodge.

***NEJE: Have you ever experienced dissatisfied customers?***

**Liz:** In the four years we've been operating the lodge, we have had perhaps 600 couples come and stay with us. I can remember only one couple who went away unhappy. They were truly beyond our ability to please. It was unfortunate but, thankfully, very rare for us. For the most part, guests are easy to deal with. They're on holiday and they're using discretionary dollars. They want to have a good time; and except for meals, generally they want to be left alone.

**Gene:** We're anxious to provide a "wow" factor to our visitors, and we hope we succeed. I think we do. Big hotels spend millions on decoration, marble, slate, and other design appeal; but they seem to miss the "people factor." Their only interaction with their guests is when someone behind a counter asks for the visitor's credit card.

Here's a specific example. When I was with Air New Zealand, I used to travel quite a lot. I went to the same hotel nearly every week for years; and every time I registered at the front desk, the hotel representative would ask me to fill out the same registration form. It was crazy and I began to resent it, so I changed my lodging to a small, family-run operation. After staying there just once or twice, people working at the hotel would greet me when I came in and say, "Hello and welcome, Mr. O'Neill." That simple way of personalizing my stay and making me feel welcome and special meant a lot to me, and I haven't forgotten that experience. That is exactly what we do here at the lodge when visitors arrive.

***NEJE: What was it like when you first opened up the lodge?***

**Gene:** We decided we didn't want to overreach and become inundated with eight guests every night right from the beginning. So we opened the lodge and "softly" got on our way by taking in one or two couples a night. This made our learning curve less steep and reduced the pressure on us to get everything just right at the start. But I must admit that I tried to take on too much. I thought we could get along without much staff; but I found certain things to be too exhausting, like the grounds maintenance. We had to learn the economics of the lodging business and how many staff to hire for what kinds of tasks.

***NEJE: How has your experience been as employers rather than what you were previously—corporate employees?***

**Gene:** The general employment picture on Waiheke Island has been one of weak demand; so when people find employment they like, they want to hold onto their jobs. Our employees value their positions with us, and we respect their contributions to the lodge. We seek their ideas and suggestions and take them seriously. We work alongside the staff so they see how hard we work and how devoted we are to the business. That almost never happens in corporations where employees never see the leadership. Being an employer has been an experience we've both enjoyed. Fortunately, our staff shares our vision for TeWhau Lodge, and we get along famously.

***NEJE: Does the government provide New Zealanders with incentives to become entrepreneurs?***

**Gene:** We have received no help whatsoever. If anything, the government offers disincentives through their employment policies. For instance, women continue to get paid so they can take time off when they are rearing their young children. If one of our employees has a child, we need to pay for her *and* for her replacement.

The laws are written in favor of large corporations that can afford this type of social policy. It's tough for small operations like ours to take on that kind of added expense.

The amount of paperwork involved in hiring and maintaining a staff is immense. As a country, we are moving away from a socialist economic model so taxation, at least, is no longer confiscatory. The top rate is only 36 percent. And we don't have a system of deductions so the tax form is all of one page. That's all to the good. Although the central government in Wellington likes to promote itself as business-friendly, they heavily favor the large corporations. Most of our politicians were never self-employed. The government is made up of career politicians, lawyers, academics, and trade unionists, not small businessowners. It's tough.

***NEJE: What's your "end game?" What happens when you don't want to dedicate long hours every day to your enterprise?***

**Gene:** I'm not sure yet. I'm 52 years old, and I don't think I'll be able to keep up this pace when I'm 60. We get up at 6 AM, and we're lucky to be back in bed by midnight during our busiest summer months from December through April. I'd like some day to be able to employ a chef, perhaps another person to run the front end; but then our profit would disappear. We'd have to price our lodging much higher, and that would probably discourage the local Auckland demographic from staying with us. We'd be affordable only to international tourists, and that's something we don't want to do. I suppose the trick is to live at the lodge without being so involved in all the day-to-day details.

**Liz:** We don't ever want to run a restaurant. Whatever we do next will have to involve a lot of people contact and have some sort of food element to it. It takes incredible stamina to do what we're doing at TeWhau, and we understand we can't do it forever. It's easy to lose perspective, so we make sure we go away at least three times a year even if it's only for a few days at a time. We feel it's terribly important to keep some balance in our lives.

*(For more information about TeWhau Lodge, visit the website www.tewhaulodge.co.nz.)*

*—L.W.*

# Documentaries: Both Informing and Entertaining New Zealanders

William De Friez, Veronica McCarthy
Raconteur Productions Ltd., Christchurch

*William ("Bill") De Friez and Veronica ("Ronni") McCarthy own and operate Raconteur Film and Television Productions located in downtown Christchurch. Bill serves as part-time director; his full-time position is faculty lecturer in the Film Department of the University of Canterbury. Ronni is the full-time producer for their small business operation that completes an average of three documentaries per year as well as a network children's series and other special projects. She won the prestigious Winston Churchill Fellowship in 1995 to study children's television outside of New Zealand.*

***NEJE: Ronni, you've kept your maiden name, but you and Bill are very much married. Bill occasionally serves as the film director on Raconteur projects, and you're the full-time producer. Don't directors and producers often have antithetical ideas about movie production? How do you balance that along with your marriage day after day and year after year?***
**Ronni:** It's not easy! Bill doesn't always understand that I have to represent the best interests of our clients, keep tight tabs on the budget, and get our documentaries finished on time. It certainly involves a lot of creative tension.

**Bill:** Please! Excuse me, Ronni; but what you really don't like is that directors, to be good at their craft, sometimes have to take creative flights of fantasy to break new ground. That scares you. Admit it.

**Ronni:** Bill, I understand your need for creativity, to get to the core of the idea we are presenting in our work; but you need to appreciate my job and how important it is for us to stay grounded, to understand the constraints that exist in delivering the product on time and within budget.

**Bill:** Believe me, I *do* appreciate what you and other film producers accomplish. However, it shouldn't always be time and money that dictate what we do and how we do it. Our work needs to inform and educate our viewers while entertaining them and keeping them focused on what they are seeing. That's a huge challenge.

***NEJE: How did the two of you meet?***
**Ronni:** We both worked in the television production department of TV New Zealand and started to work on similar projects.

***NEJE: What got you interested in film production in the first place?***
**Bill:** I first got into film with the *Bristol Freighter* documentary in 1984. I had become fascinated with the last flight this famous plane was going to make before it was dismantled. It was a hell of a story, but TV New Zealand did not want to run it. I wanted badly to make it, so we raided the station's film inventory room, found enough unused film to make a short documentary, "borrowed" one of the station's film production trucks, and did the whole thing on a shoestring budget.

***NEJE: Had you studied film in university?***
**Bill:** No, I was an electrician by training and did a lot of work for the forestry service before turning to film. But film was always my passion; I love to make documentaries, and I watch every film I can. It's an amazing creative process.

***NEJE: And you, Ronni?***
**Ronni:** I have been involved in some type of television production from just about my first job out of university. To me, television production, particularly the documentary format, gives me the opportunity to bring new and helpful information to a wide audience. It's the best way I can think of to serve my community meaningfully, and I feel really good about that. What we do gives voice to the average New Zealander. I'm also passionate about creating high quality children's programs. They deserve the best we can do.

***NEJE: What was your first successful documentary?***
**Bill:** We achieved national recognition when we produced a documentary called *Scorched Memories* in 1995 on the 50th anniversary of the infamous Ballantyne retail store fire. I say "infamous" because scores of employees died when a fire started in the basement and quickly moved up to the ground through five floors of the building. It housed the retail floor operation as well as the administrative offices. There were inadequate fire escape exits, and some of the exits were inaccessible as they were blocked by merchandise and office supplies. Worse, the fire alarm was not sounded for more than 10 precious minutes because man-

agers did not want to unduly frighten store customers or employees. Loyal to the core, many employees did not leave their posts until given permission by management. For many, it was too late to save themselves.

We asked to speak to the Ballantyne Executive Board or the Ballantyne family before making the documentary, but they declined to speak to us. We wanted their perspective five decades after the tragedy, but this is a store management that did not formally apologize for its culpability in the loss of life until 1990. There's a strict hierarchy within the store's management, and Ballantyne family members remain firmly in control. No one apparently dares speak out about how the family felt about the fire and what they did internally to correct operations after the fire.

***NEJE: What other documentary topics have you tackled?***
**Ronni:** Recently, we have produced films on topics as diverse as eating disorders, teenage male fathers and how they cope, men and women who have married multiple times, gambling addiction, a behind-the-scenes look at our emergency ambulance services, and a trio of documentaries on body parts.

***NEJE: Body parts? Can you be more specific?***
**Ronni:** Sure. We've produced educational films on the breast, vagina, and penis. The next one to come along, something we're working on right now, is going to be called *The Bum*. We're screening talent right now. Want to be considered?

***NEJE: Ummm . . . no thanks. How have New Zealanders reacted to the body parts series?***
**Bill:** Extremely well. They're the most widely distributed films we've ever produced. Our agent tells us the documentaries are popular as far away as Israel. We didn't make the series to titillate our audience; it was all about educating the public, dispelling myths and celebrating diversity.

***NEJE: What about your work in children's programming?***
**Ronni:** We are currently involved in two quality children's programming, one called *The Big Chair* and the other, *Animation Station*.

***NEJE: How do you receive initial funding for your documentaries?***
**Bill:** The national New Zealand networks provide about 30 percent of the money we need; but most of our funds are derived from "New Zealand on Air," a of government-funded broadcasting commission with a mandate to tell and show New Zealand stories.

**Ronni:** There are different funding groups depending on whether you are seeking seed money for television, radio, or music. We usually approach at least three different funding sources with our concept for a new documentary and see who "bites."

***NEJE: What funding level do you need to produce a documentary?***
**Ronni:** It's an average of $100,000 N.Z. (about U.S. $53,000) for a typical 42-minute documentary. The networks require 18 minutes for advertising and other promotional considerations each broadcast hour.

***NEJE: That's all? It doesn't sound like much money.***
**Bill:** Our staff usually ends up making more money on shooting the documentary than we do as the director and/or producer. No one gets rich making films in New Zealand unless your name is Peter Jackson. He's a great guy and I admire what he's done with *The Lord of the Rings* trilogy, but Peter is the exception. By far. Many producers go bankrupt. Just recently Larry Parr, a well-known filmmaker, had to close his shop. Why? Because after a long and distinguished career, he made one film that didn't sell very well; and the bank cut off funds for his next project, which, by the way, was almost finished. Larry desperately tried to find other sources to back him, but everyone knows funding movie production is a dicey proposition at best. So his operation went under.

Film production in New Zealand is a cottage industry for the most part. Few folks work at it full time. Our country is internationally famous for our short films; however, a lot of people who have worked on those productions in the past were not paid. They hired on at no pay hoping if the movie somehow received international attention they might one day get some compensation.

To Peter Jackson's credit, he sold himself to the executive producers as the best choice for director of *The Lord of the Rings* project. This was based, in part, on several financially successful movies he had made including *Bad Taste* and *The Frighteners*. Peter insisted on New Zealand as the place for the film's setting, and this has really put New Zealand "on the map" in the global film industry. The trilogy took three years to shoot and edit, and Peter's production company employed as many as 2,500 local people at one time. Once the project was finished, however, most of those folks had to find jobs outside of the industry. We just can't sustain that level of activity on a regular basis in such a small country.

I must also point out that the trilogy has been fantastic for tourism. There's a boom going on right now due to the America's Cup race in Auckland and tours to all *The Lord of the Rings*' film locations.

**Ronni:** Unfortunately, most of our films are never seen outside of New Zealand. Occasionally we sell our work to

Australian television, but it often stops there. We dream some day of selling one of our documentaries to the United States. Oh, my, wouldn't that be lovely! The financial remuneration would be considerable.

***NEJE: What would happen if you did reap a large revenue stream?***
**Ronni:** First thing, we would have to pay back the initial seed money to the funding organization. The distributor would take 30 percent off the top; then the funding organization would receive 70 percent of the remaining proceeds until the initial funding level, say $100,000, is paid back. We don't really see much money until after the film distributor and upfront funds are all paid back.

The government helped put together a Film New Zealand public relations effort, and representatives from our local film companies started to attend a lot of international conferences to sell our country as a viable setting for their film production. The goal was to attract three major film productions per year. Currently Tom Cruise is in the country shooting *The Last Samurai*, and Gwenth Paltrow will be working with Peter Jackson on a reshoot of *King Kong*. But that's about it.

**Bill:** Many of the people who work in the film industry are nonunion. This has the film unions in the United States pretty upset. There's a quiet movement going on right now to make sure that when American talent is hired for a New Zealand shoot that they use only union members. I suppose the American unions are hoping this will rub off on us. We'll have to wait and see.

***NEJE: Bill, since you teach film at the local university, do any of your students ever end up working for you?***
**Bill:** Absolutely. I have had the pleasure of working with some top-notch students, and there are times when their paths and mine cross again after they graduate. They often are as passionate as I am about creating an entertaining story and telling it well.

Raconteur is the largest, most successful documentary maker on the South Island. Most film making of this type is done up in Auckland or Wellington on the North Island. An analogy to Americans would be, perhaps, us being situated in Philadelphia whereas most of the documentary production would be occurring in New York City.

People around the Christchurch area *(population 200,000)* depend on us for employment in the film industry, and that includes many of my ex-students. By hiring them and other local people, I feel I'm giving back to the city and to my film community. And I'm not the only one who teaches in the family. Ronni teaches TV production at the Polytechnic University in Christchurch, and she is currently mentoring three graduate students.

**Ronni:** Not a day goes by without someone sending in his or her resume asking whether we are hiring. We are motivated to work hard and press ahead, in part, so we can employ more people who need jobs in the film industry.

In fact, 2002 was our busiest year. We produced four documentaries and several dozen "Animation Station" programs geared for children at the 4:15 PM time slot on our Channel 3. The shows are just seven and a half minutes in length, but putting together five new shows each week takes a lot of coordination. However, it's all been good fun, and we hope to continue this pace for as long as we can.

***NEJE: Bill mentioned mentoring students earlier and getting them involved in current projects. What mentoring work do you do?***
**Ronni:** I'm currently an executive member of the Screen Producers & Developers Association, representing producers and directors in New Zealand. I was a founding member of Screen Canterbury, an organization formed to promote film and television in the greater Canterbury region. I'm also a member of the selection panel for the Screen Innovation Production Fund, which has the responsibility of allocating $230,000 New Zealand (U.S. $122,000) to emerging film makers.

***NEJE: Just like you were 10 years ago.***
**Bill:** Exactly.

*—L.W.*

If you have any questions for Ronni or Bill, you can contact them at Veronica@Raconteur.co.nz.

# The Bay House Café: Against All Odds

Dudley-Anne Thomson,
Brian Finlayson and Michael Varekamp

*Dudley-Anne Thomson is the current manager of the Bay House Café, located10 kilometers from Westport, South Island, New Zealand. She rents the space from Brian Finlayson and Michael Varekam, who both started the Bay House Café eight years ago and then moved on to open restaurants in Sydney, Australia.*

***NEJE: Brian, the Bay House is located five hours driving time from Christchurch, the only major city on the South Island. The west coast of the South Island has a grand total of only 35,000 residents from Karamea in the north to Te Anu in the south. Many of the hundreds of kilometers of coastline are desolate. How did you pick this location?***

**Brian:** I'm from the area originally, and I always thought the town of Westport, even with just 6,000 residents, could use an upscale café. We get an awful lot of tourists coming through from October through March when it's our summer, and I counted on that business as well. We typically closed the restaurant from April to September because we needed a chance to rest from a hectic summer season and to review our menu, promotional efforts, and past business strategies to plan on what we wanted to change.

The veranda we are sitting on and the inside dining area were added on to my batch (beach home) when Michael and I decided to start the café. I bought the batch 25 but decided only fairly recently to open up an upscale restaurant. It seemed like we could make a go of it.

**Michael:** The location, while away from the town, is spectacular. We are right across from a surfing beach, and the sunsets are a great selling point. Across the bay, we have a view of the Seal Colony where tourists by the hundreds walk every day to see the fur seals and their pups lying on the rocks. Can you think of a more beautiful place to eat a gourmet meal while looking out at the Tasman Sea?

***NEJE: However, you have to admit, it must have been tough to attract enough business at first to make a go of it.***

**Brian:** Actually, the tough part was working with the local town council to give us the necessary permits to open the café. It took six months to convince them to give us the go-ahead.

**Michael:** Everyone in town knew Brian, but they didn't know me. Outsiders, people who have not grown up in this area, are considered with great suspicion until the local townspeople feel they can trust you. If you're local, the council will bend the rules and even change the laws to help you out. However, I didn't have that advantage and the council, at first, interpreted the local ordinances in ways that were meant to stymie us.

**Brian:** The legal part took half a year of wrangling, but it took only three months to convert the front part of the batch into a restaurant and then add the deck. Once the Department of Conservation, which owned the land around the restaurant, gave us the final approval to proceed, we moved rapidly to start the café.

***NEJE: It's one thing to get all the local town council approvals and convert the batch into a café, quite another to generate a positive cash flow.***

**Brian:** That's true, but enough locals knew me from when I managed a restaurant in Westport called "Mandala's" to follow us out here. I also spent two years managing a bar/café in town called "Diego's." Originally, I had apprenticed as a pastry chef, then moved on to main courses, then eventually to managing the whole operation. I was ready to open up the "Bay House," and there was a built-in following.

**Michael:** In fact, there were so many people who wanted to come to the café, we were booked solid for three months and even had to turn people away.

***NEJE: It sounds like you started making money right away.***

**Michael:** Actually, everything cost us so much more than we had anticipated that we worked like dogs just to pay off the $40,000 (New Zealand) we needed to borrow to construct the dining area. The second year of business we broke even and had all our debts paid off.

Our location has superb views, but the downside was we were on a dirt road with no electricity and no local water, at least not enough to operate a café. We faced a lot of up-front expenses before we even served our first meal.

**Brian:** We probably would have achieved break-even sooner, but we underpriced ourselves in the marketplace. We weren't charging enough for our lunches and dinners. Breakfast seemed okay, but we were not making sufficient margin on the other meals. We had put together a business plan, this is something I learned how to do because I worked for a U.S. firm as a product manager for several years; but we made some costly errors in the beginning.

***NEJE: How long did you own and manage the café?***
**Michael:** Five years, and we became enormously successful at it. However, I'm from Sydney and I missed the city. I convinced Brian to lease out the restaurant, keep the batch, and move to Sydney. Brian agreed, and we opened up the "Chocolate Dog Café" in the Rocks Section of the city.

***NEJE: After struggling to establish the Bay House Café, you left it to start another venture? Why not just ride your first success and coast for awhile?***
**Brian:** We wanted to challenge ourselves and see if we could establish a successful restaurant in a large, cosmopolitan city like Sydney. "The Chocolate Dog" was open seven days a week. The café was well accepted by the locals as well as tourists, and we did extraordinarily well. I really like to create spaces where I can entertain people and see them enjoying themselves. The experience was very fulfilling. I loved it.

***NEJE: And that's where Dudley-Anne comes in. You sold the business to her.***
**Michael:** Hmmm . . . not exactly. I only wish we had.

**Brian:** What happened was we sold the café to an Australian entrepreneur who made all sorts of noises about all this experience he had and what he could do for the restaurant to expand it and to make it even more profitable. Turns out, he ran up debt all around Westport, never paid it off, and pretty much was an absentee owner from the git-go.

**Michael:** We knew we had a serious problem within 60 days of handing over the café to this guy. Our friends in town called and told us the food quality and service were going down rapidly. The fellow didn't seem to care about the café's image, nor return phone calls about when he was going to pay for the merchandise and services he had purchased.

**Dudley-Anne:** Now that's where I come into the picture. Mark, who at the time three years ago was my boyfriend and business partner, and I were looking to move to the Westport area. Mark, and I'd rather not provide his last name, grew up here and has close family ties around Westport. Neither of us knew much about the Bay House Café. I had grown up in Hastings on the North Island of New Zealand and hadn't traveled much in the South Island. I did have restaurant experience, and that's to the good; but Mark and I did not have a good enough credit rating to borrow the money to buy the Bay House. That's where our financial "angel" came in.

While in the North Island, Mark and I met an American fellow who so took to us that he promised to put up money for a business we might want to buy some day. Well, when we found out the Bay House was up for sale, we called him and told him we were ready to call him on his offer to back us. He was surprised at first that we were ready to take him up on his promise; but he followed through just as he said he would, and we bought the business.

**Brian:** We tried to talk Mark out of buying it, though, because we were ready to throw out the Aussie chap since he wasn't paying the monthly rent to us. We never got a penny from that guy after he purchased the café. Nothing in three months. But Mark wouldn't listen to us and insisted on buying the business outright from the owner who charged him twice what he had paid us. What a waste of money.

**Dudley-Anne:** I didn't know anyone in town except Mark and his family; they lived around the Westport area so I just followed his lead. That proved to be unfortunate. At the beginning, Mark was the chef and I took care of the front operation. It took me two years just to get to know the local market enough to where I was sufficiently confident to start making changes.

But talk about surprises. We went into the café expecting to use the kitchen equipment only to find out that some new equipment included in the sale didn't belong to the seller. They were never paid off, and some people showed up ready to cart them away. It was a tough start.

***NEJE: What changes did you make?***
**Dudley-Anne:** For one, getting rid of the tour buses that would stop off, discharge dozens of passengers who would monopolize the café, order a soda and perhaps a scone, stay for an hour or two to fill out their postcards,

and then move on. The buses were a nuisance, the margins on soda and scones low; and this discouraged local trade from coming out here.

We are not a tea café. We serve gourmet meals at competitive prices, but this means attracting a market that wants excellent food and service and a fairly quiet environment. The buses were ruining that.

Everyone in Westport thought I was crazy; but I had a long-term vision of the business and where I wanted to take it, and the tour buses did not fit into that vision. Mark and I tried to stay open during the winter months here, but after two years we gave up. We were serving too few meals and lost a lot of money because we couldn't meet the overhead. Now, we close from May to August to replenish our energies, conduct needed maintenance, and get ready for the busy summer seasons.

***NEJE: Did you also put together a business plan like Brian and Michael did?***

**Dudley-Anne:** Yes, we did; but it was more to please our financial backer than to guide our everyday activities. Recently, though, we put together a new business plan because it was required by the government as part of our application to win one of the national "Tourism Awards" given out by the New Zealand Tourism Commission. Mark thought the effort wasn't worth it; but I was more sensitive to the marketing value of the award, and so I decided to go after it. We hired a consultant from Christchurch, and he guided us through the planning process.

To our great surprise, considering the commission representatives came to see the café during the winter months when we weren't serving meals, we won "Best Café" for our size for the west coast of the South Island out of 32 entrants. This award, and the other tourism awards we've won since, has given us much greater visibility than we ever had before. We are now attracting an international clientele.

***NEJE: That must have convinced Mark you were right to invest the time and money to apply for the awards.***

**Dudley-Anne:** No, Mark and I ended our personal relationship 18 months ago because we just didn't share the same vision for the café and for our personal lives. We continued to run the business for the next year together, but it became really hard. Mark didn't like sharing the kitchen operation with anyone else; but as we got busier and busier, he couldn't manage it all. We needed other chefs in the kitchen to handle the volume, but he kept worrying about spending more money on additional staff.

Mark saw his job as a "9-to-5" operation, and you can't do that when running a restaurant. It's flat-out 7 days a week, an 18-hours-a-day job. You can't avoid it if you want to be successful. He only wanted to cook at certain times of the day, and that really limited our menu.

Mark left the business for good about four months ago, and I must say, I couldn't have been more relieved. I am happier now than I've ever been; the business is completely mine to run, and I don't have to check in with him any more. No more hassles and fights about how the restaurant should operate. I love it!

The café now has more of a "lady's touch" to it and the restaurant is much more tidy and attractive than it used to be. I really look after the "front of the house," so to speak, and rearrange the lounge every other week to keep things looking new and different to our regular customers. They seem to appreciate that.

I've also increased the number of meals we can serve on any given night by making sure the tables turn at least twice; there's a 6 to 6:30 PM sitting and another one at 8:30 PM. If guests continue to linger at their tables past 8:30, we ask them to take their dessert and coffee to the lounge. That way we keep things moving. We just had the best Saturday night we've ever had this past weekend. The velocity of our business has picked up considerably.

***NEJE: What market research have you conducted? Have you advertised regularly?***

**Dudley-Anne:** We did conduct a survey of local motels about who their clientele was and we asked our diners how they had heard about us. We thought we should provide incentives to the moteliers to send their guests to us, but after a bit, we realized that the motels in the area were getting calls from customers who *first* made dinner reservations with us, *then* called around for a place to stay.

We did not advertise the first two years we were in business; we were depending on word-of-mouth. Now we advertise in local publications, and we're part of the "pure New Zealand" website. We also have our own website (***dine@bayhousecafe.co.nz***).

***NEJE: Do you have trouble keeping staff?***

**Dudley-Anne:** Not at all. We're all pretty close. Communication is key, and I ask my staff on a regular basis to "yarn it out"—to tell me what is bothering them, what concerns they have, and what suggestions they have to increase business. Listening is a skill that every small business owner should have.

***NEJE: How long do you want to continue managing the Bay House?***

**Dudley-Anne:** I've built it up through a ton of hard work, and now it's my baby. It's me. If I leave, what will happen to the Bay House and to my customers? As we've gotten more successful, I've left more and more of the day-to-day operations in the hands of the staff. That gives me more freedom to relax and not feel as much anxiety and tension as I used to. I can travel a bit more during the summer season and that's nice, too.

***NEJE: What keeps you fellows in the restaurant business in Sydney?***

**Brian:** Well, actually right now we're taking a breather. We've sold the "Chocolate Dog Cafe," and we're thinking about what to do next. For me, though, being in my own business means I don't have a boss looking over me. I like to take on the challenge of creating a new business from scratch and seeing if I can make a lot of folks happy by entertaining them and serving good food at the right price.

**Michael:** For me, I like seeing customers enjoy what I've been able to create. I love receiving compliments on what we've designed either from an original concept or from taking an existing business and moving it from "point A" to "point B." The fun is in the process. Once we achieve our goals, I'm ready to move on. I look forward to the next project and the next success. That's what keeps me motivated.

*—L.W.*

# Turning a Hobby into Millions

Philip King
Bookstore Entrepreneur

*Before Philip King sold his five bookstores in Christchurch roughly 10 years ago to Whitcoulls, a large Australian-owned bookstore and office supplies operation, he hardly fancied himself as an entrepreneur. Books were his passion: He loved to read. However, his first job was selling barbeque charcoal to New Zealand's South Island residents.*

***NEJE: Philip, it sounds a bit strange to be talking to such a successful entrepreneur who got his start in selling barbeque charcoal.***
**Philip:** I suppose it does, but it was my father's business, and it was a place for me to start after university. I grew up in Christchurch and loved studying the liberal arts, especially political science and English literature. However, right after graduation, I got married and had to start working for a living; it was easy enough just to go into my family's business.

***NEJE: What came next?***
**Philip:** I started corporate life at the bottom, so to speak, by working for Nabisco in its Sales and Merchandising Department. I spent several years filling supermarket shelves with product. It was humbling compared to what my friends were doing with their university degrees! However, this turned out later to be invaluable experience. I learned all about how to present product to its best advantage on the shelf, what it took to improve market share, and how to compete effectively against other manufacturers.

***NEJE: Is that when you started your own bookstore?***
**Philip:** No, not right away. I decided to leave corporate life and become a teacher. I took a position in a small town with just 20,000 residents. I was put in charge of 30 youngsters who were disciplinary problems; many of them could not read or write at a functional level. It was an enormous challenge.

Several years into it, I found that my hobby of collecting books was getting a bit out of hand since our home could only hold so many. I decided to set up a bookshop where I could share my passion for reading and collecting books with others. I took a punt and borrowed all the money I needed to get the store going. It seemed like quite a risk at the time. In fact, the first time I approached the local bank for $400 (New Zealand) for start-up money, they turned me down because I hadn't put anything in writing. With some coaching, I learned how to put together a business plan; and it was then that the bank gave me the money.

***NEJE: Apparently your bookstore did quite well.***
**Philip:** My very first effort was a modest success, but I realized I could never make much money in such a lightly populated area. I sold the bookstore; and we moved to Auckland, North Island, the largest commercial city in the country. I found the equivalent of 4,000 square feet of commercial space, gutted the area, hired an architect, and came up with a new look to selling books.

Borrowing from what I had learned by working at Nabisco, I knew that the way I presented my books and used every available meter of wall space would be paramount to my success. Movable flat tables were used to highlight best-selling authors and to move bargain lots. Signage, which was typically poor in many bookshops, was another opportunity to do something different. Fixtures were also critical. Everything was rethought, from the floor to the ceiling. I wanted my store to be user-friendly, bright, and very welcoming.

The first year we generated $286,000 (New Zealand) in sales. By the third year, we topped $1 million. My theories about how books could be better merchandised paid off. We were growing exponentially. That's not to say everything in the store reflected just my concepts. I visited hundreds of bookstores throughout the world, and I always looked to take back the best ideas I came across.

***NEJE: Just out of curiosity, what do you consider to be the best bookstores? Borders Books? Barnes & Noble?***
**Philip:** No, it would be Waterstones in the United Kingdom and Powell's in the United States. I am especially impressed with the Powell's website.

***NEJE: When did you open the second store?***
**Philip:** Not in Auckland. In fact, the family missed being in Christchurch so much that I sold the Auckland store, and we all moved back to my hometown in the South

Island during 1985. I started my first store there under the name of "Paper Plus." It was part of a robust association group of 80 independent booksellers with a strong combined buying power that one individual could never hope to match.

***NEJE: "Paper Plus?" What happened to the bookstore?***
**Philip:** Oh, it *was* a bookstore, but you have to understand, in relatively low population density areas, you need to sell stationery as well as books. It's not like in the United States.

***NEJE: That's when you opened a second store.***
**Philip:** Yes, in 1987, but it was in Dunedin, several hundred kilometers to the south. Dunedin is a big university town. I knew I couldn't effectively manage both locations, so I decided to hire someone whom I could trust and delegate much of the managerial functions. It was a great decision all around. In our first year, we generated $2.3 million (New Zealand) in sales, and we never looked back.

***NEJE: You eventually opened a total of five different bookstore locations.***
**Philip:** Yes. In 1988, we opened a third "Paper Plus" in a new Christchurch mall. We no longer needed bank loans; our cash flow was so good we were able to fund our expansions internally. By then I had learned how to read a balance sheet with great care, and I always randomly checked on vendor invoices to make sure we were being treated fairly.

I wasn't enthusiastic about the mall location. I only considered it because one of my staff members was so enthusiastic about the location. In fact, my feelings were that bookstores should be freestanding buildings with as much walk-by traffic as you can muster. At first, I rejected the mall developer's offer and walked away. Three hours later, the developer called me back and put a much better offer on the table.

By 1989, we had four stores operating in the Christchurch area and the one in Dunedin. By growing to this level, we finally had the merchandising and advertising synergy I had always wanted. Things really started to click. I left the "Paper Plus" association umbrella and renamed the stores "Philip King Booksellers." It was uncomfortable at first to see my name on the stores and in our advertising. I am not by nature a person who is self-promoting, but it seemed to be a good idea because it was time to break away from the association. Putting my name on the business gave us credibility both with our suppliers and with the buying public.

By 1993, we had a staff of 100 employees, and we were selling in the neighborhood of $10 million (New Zealand) annually.

***NEJE: With all this success, with the rapid growth and company expansion, you could have sat back and just watched the dollars roll in. But you decided to cash it all in. How come?***
**Philip:** Sometimes there are business offers you simply cannot say "no" to. But let me provide the context for my decision to sell.

Christchurch may be the renowned jumping-off point for ships and planes to explore Antarctica, but the city actually has a temperate climate because it lies between the Southern Alps to the west of the city and the Pacific Ocean to the east. Snow, while not rare, is usually light and melts the next day.

In 1993, I was leaving on a business trip; but everything closed down, including the airport, for two days because we had the equivalent of a four-inch snowfall. Four inches! That's nothing to many Americans, but to folks in Christchurch it was practically a blizzard.

The newspapers made a big deal of this two-day city-wide shutdown, and I was intrigued with the idea that somehow there was a book in all this. Imagine the number of people who took photographs those two days and the memories everyone had! So I called up the local newspaper publisher and suggested that he should take all of his staff's photos and make it into a book.

He turned me down. He said he was in the newspaper business, not the book business. So I called the business page editor and got the same results. No way.

I wouldn't let go of the idea. I put an advertisement in the newspaper for local folks to send in their photos, promising to publish the best 100 or so of those submitted. We received thousands of photos in response to that one display ad. We were so overwhelmed with them all that I had to set up an editorial team with the directive to pick enough snapshots to fill up a 60-page book. Each person who sent in a photo we published received $100 (New Zealand) and two free copies of the book. The rest of the photos were returned.

We called the book *The Big Snow*, and the editorial team turned the project around in five weeks. We saved a lot of time by having the books printed locally even though it was more expensive. Timing was critical. I went way out on a limb and authorized a run of 7,500 copies.

***NEJE: The book must have been very popular.***
**Philip:** Sure was. Word spread like wildfire. We sold out all of our copies in one week. Eventually, sales totaled

28,500 copies. That's huge for Christchurch; our total population is only 200,000. Everyone who sent in a photo that was included in the book must have purchased at least 10 books each to send to family and friends. It was the talk of the town.

It was only natural that some of the book's customers would attempt to buy the book at Whitcoulls, our biggest competitor. An N.Z. entrepreneur owns them and they are much, much larger in New Zealand than we ever were. When one of their staff called over to us to order books, I refused to sell them *The Big Snow*. We considered it an exclusive since we had published the book on our own and I had sole selling rights.

Word got back to Whitcoulls management, and they were furious. They threatened to sue.

***NEJE: Wasn't that intimidating?***
**Philip:** Absolutely not. In fact, I ended up begging the owner to sue us. Can you imagine the newspaper headlines?

"BIG NEW ZEALAND BOOKSELLER SUES PHILIP KING STORES OVER RIGHTS TO SELL KING'S BOOK."

The publicity would have been priceless, and I doubt they had a legal right to force us to sell them the book anyway. The fellow hung up on me; he was angry at my hurting the credibility of his bookstores. Can you imagine what happened in all the Whitcoulls around Christchurch? Every time folks came in to buy *The Big Snow*, the staff had to admit they didn't have the book; and they either sent them to us or made believe they didn't know where the book was being sold!

Let me tell you, it was one beautiful feeling. We went on to publish other books about the Canterbury region, Auckland, Wellington, and the Otago Peninsula.

Not long afterward, the Whitcoulls owner called and said he wanted to meet with me. I had no idea what he wanted. We met in Auckland and that's when he offered to buy me out.

***NEJE: You didn't have to sell.***
**Philip:** They made me a generous offer.

***NEJE: Yet weren't the bookstores all about following your passion and enjoying going to work every day?***
**Philip:** After nearly eight years working what seemed 'round the clock, I was tired. I needed a sabbatical. I enjoyed mentoring my staff and watching employees grow into their positions and gradually take over more and more responsibility, but I also felt it was time to travel for pleasure and not just for business. I bought a 2,200-acre farm with some of the money, and I've enjoyed the good life.

***NEJE: What happened to the bookstores?***
**Philip:** They changed the name to "Books & More." The stores seem to be doing just fine.

***NEJE: And you?***
**Philip:** I'm having fun "working" 10 months a year as the University of Canterbury's bookstore manager. I don't need the money. But they called me last year and said they were desperate to improve the store's operation. I came by, and I was aghast at how poorly everything was being merchandised and presented. So I took this job on as a hobby. We changed the bookstore around completely, and now sales revenue has shot up.

***NEJE: How long will you stay here at the university bookstore?***
**Philip:** It's hard to say. I'm thinking of subdividing the farm and possibly developing parts of it for upmarket housing. Who knows? I'll find something to keep me busy.

*—L.W.*

# Jade Software: Getting Ready to Tackle America

Sir Gilbert Simpson
Founder and CEO

*Sir Gil Simpson is one of New Zealand's pioneers in software development, having started in the field in 1967. He holds steadfast to his dream that one day his approach to software programming will take hold around the world. Simpson has just opened up the company's first office in the United States; he expects his first significant foray into this country will be a successful one.*

***NEJE: It must be daunting to be in the same competitive arena with companies like Microsoft, Linux, Oracle, and Sun Microsystems.***
**Sir Gil:** It certainly is and, I must say, a bit frustrating because very little progress has been made within the software industry in the past 30 years.

***NEJE: That sounds a bit like hyperbole. Computers seem to be able to do more and more with far smaller hardware components and at ever increasing speeds.***
**Sir Gil:** Yes, your perceptions are accurate, but it is in the hardware end of the business where the gains have been made, not the language that computers use to "speak" to one another. The pace of computer language development has languished compared to the breakthroughs in hardware. Not much new has been developed and made available since around 1965.

***NEJE: Why is that?***
**Sir Gil:** I don't want to lay this all at Microsoft's door; but suffice it to say, a distinct lack of competition in many areas of software development explains most of the situation. Once commercial and individual users get used to an operating system, they tend to stay with it even if the system itself is inefficient or has serious limitations.

I've been aware of this situation since 1973 when software packages were just being developed in large volume as commercial use of computers started to soar. I believed then, as I do now, that programming languages were fundamentally flawed and much too difficult for the average person to understand or to use comfortably. It seemed there had to be a better approach, and that's why I started my own software company.

Our competitors are entrenched, but I think we can best them. I would estimate that only 2 percent of Microsoft's entire staff is made up of program engineers. The rest are in new product development, marketing, sales, production, and finance. With just 370 on our payroll, we don't compete at the same level; but we have a lot of extraordinarily bright folks who are well trained as engineers and can perform competitively against anyone else in terms of product performance.

***NEJE: What makes Jade Software so much better?***
**Sir Gil:** Our software gives the user the ability to adapt it to his or her own business needs. In a way, we are genetically related to Excel. Excel is a financial spreadsheet package that you program to sort, calculate, and present data for your specific needs. It's a transitional system. Operators first learn how to relate it to their business, then they program our platform accordingly. Once this is accomplished they have pretty much customized the software to do whatever the requirements dictate.

For instance, Peoplesoft is a popular student enrollment program used by many colleges and universities. However, it is someone else's idea of how you should run your business. There's little to no flexibility built into the program language. In contrast, Jade Software provides users with enormous flexibility and opportunities to customize our programs to their specific needs. All operators have to do is provide a few simple statements in answer to the program's queries, and they are ready to go.

***NEJE: Well, if your software is good, how come . . . ?***
**Sir Gil:** . . . we haven't knocked the socks off everyone?

***NEJE: Yes, exactly.***
**Sir Gil:** Changing an industry that is so resistant to new ideas is an awfully big challenge. We have taken on that challenge; and, hopefully, we will succeed. We've just entered the U.S. market by opening up our first marketing and sales office in Atlanta in May 2002. I think that once customers see how competitive our products are to Linux, Unix, and Macintosh that we will do very, very well.

***NEJE: Why did you wait so long?***
**Sir Gil:** We've worked closely with several U.S. companies for some time now, but we needed to build enough

momentum behind our products to rationalize having a physical presence in America. We now have that presence, and things should really start moving ahead rapidly for Jade. Don't forget, compared to Microsoft and Oracle, we are small potatoes. Opening up a branch office in Atlanta is a big step for us.

***NEJE: Are your sales mostly in New Zealand?***
**Sir Gil:** No, for the year just completed in 2002, our overseas revenue was greater than domestic revenue. We are making great strides in the United Kingdom where we have had enormous success recently with the country's railroad system. I don't know if you've been following transportation news in England, but part of its commercial rail system was a shambles. On-time performance had slipped precipitously, particularly in the electrical generating industry that depends so much on fossil fuel plants that burn coal. Power outages were becoming a real threat, and the electric utility owners were desperately trying to find a way to get coal in the right amounts to the right plants at the right time. It was a logistical nightmare for them.

After considerable efforts using other systems, the electrical utility managers came to us and challenged Jade to provide solutions to their myriad problems. We came in, beat the time they gave us to get on top of the learning curve, and within the first full operating month using our software, the utility companies' management saw a 40 percent increase in operating efficiencies. Why? Because each fossil fuel plant manager could decide for himself or herself how much coal was needed, when it was needed, then order the coal from the mine provider, authorize the rail shipments, and finally track these shipments from the time they left the mine to the time they reached the electrical generating facility. Our software provided total information at all times with complete transparency.

We have had other successes in fields as diverse as healthcare management, container terminal operations, payroll management, and student enrollment management. We're confident we can duplicate those positive developments in many other arenas.

***NEJE: Are companies that sell Linux, Unix, and other software programs aware of you? Or will Jade Software be a big surprise?***
**Sir Gil:** No, we won't be able to use surprise as a tactical tool. We've had a history of coming up against Linux and Unix users for some 20 years and having to prove, time and time again, why our system is better. It's like getting an elephant to move. It takes a lot of hard work and energy at the beginning; but once you get the elephant moving, it can build up a lot of forward momentum. The U.S. software market is just like that elephant; only many times larger in terms of the energy required to get it to start moving in our direction. We're ready now to put the energy and money necessary to do what we need to in order to be successful.

***NEJE: It sounds risky.***
**Sir Gil:** It absolutely is. I'm personally putting a lot on the line financially, but it's been my life-long dream to change the industry. I can't do that from New Zealand. I have to do it in the United States.

***NEJE: Are you planning to do this alone?***
**Sir Gil:** It probably is unrealistic; we'll need to find a U.S. partner. If we can find the right fit with an American company, we can put our plan into motion.

*—L.W.*

***Addendum***
The writer attempted to communicate numerous times with Sir Simpson after the interview was completed, but no response has been forthcoming. According to a local Christchurch newspaper, *The Press*, the company has been hit hard by the recent downdraft in Information Technology spending. About 25 percent of the worldwide workforce of 373 lost their positions with the company in August 2003. Further, several Jade corporate properties around Christchurch have been put up for sale to help raise between $10 to $25 million N.Z. (roughly $6 to $15 million U.S.) in order to maintain a positive cash flow for the company. Further investment from current shareholders is also being sought.

# The Region and the Smaller Enterprise: A Discussion of Appropriate Investigative Methodologies

Ian Pownall

*Regional policy instruments are typically driven by economic rationales, from either a firm or industrial perspective. Yet too often, these rationales are taken as ex ante to the contexts within which firms and industries compete. Recent regional development research has urged a better link be developed between the individual, the firm, and their context, so as to understand the role of regions in supporting effective competitiveness of organizations. In this article, recent research themes are explored that may shed light on the nature of this relationship and that can be developed into an investigative methodology that could aid policy practitioners in generating policy instruments that reflect differing societal constructions of SME reality.*

This article reviews the nature of the relationship between a region and a small enterprise. In particular, it examines recent approaches to regional development theory that address this relationship that have as their common focus an interest in the shape of knowledge used competitively by smaller organizations. Despite the desirability of regional economic development to governments, there is no simple linear relationship between support for small enterprises (in whatever resource form) and the outcome of development for the region itself. Instead the relationship is one of a complex interplay between technology, economy, society, and polity (Skolnikoff 1993). To better understand this relationship, the article takes as its starting point, the argument outlined by Anderson (2000), that knowledge in a region maintained and used by individuals and small enterprises (as collections of individuals) is not an object–subject relationship, but a subject–subject one defined in practice. It is similarly reflected in current debates within geography, where discussion on the nature of competitive knowledge focuses on the interplay between culture and economy (Simonsen 2000). In this latter case, it is a clash between determining the dominance of a regional culture or the regional economy that also drives this article to use Simonsen's (2000) theme of connecting the two concerns through a social ontology. Hence, this article posits that regional knowledge used by small organizations is viewed as socially constructed and highly localized. A key focus for this research is, therefore, reviewing current methodologies that seek to develop this subject–subject relationship and the ways they may aid the development of policy instruments.

The article has four major sections. In the first section, the nature of knowledge and regional development is discussed, with a focus on changing research interests and methods. The second part narrows the focus to consider the nature of the relationship between organizations and their context from a social interaction and cohesion basis. From this discussion emerges the concept of a cultural province to describe a coherent agreement and collection of small business practices and values. The third section seeks to bring these arguments together under the banner of a modified participant research methodology and derive a series of potential research questions and themes to explore the location of cultural provinces and differences in the perceptions of small business managers and their staff to their environments. The final section presents the conclusions derived from the research.

## Knowledge and Regional Development

Following Skolnikoff (1993), the relationship between technology and knowledge is often confused, but technology in its broadest sense can be defined as the development and application of improved technical knowledge and procedures (Holmén and Jacobsson 1998). The effective use of knowledge, codified, tacit, and applied in this sense, by individuals and small enterprises is partly a function of the extent to which they locate, identify with, and can use such knowledge forms from their environment. In this sense the development of the economy and the context of that economy as often viewed by policymakers cannot be effectively separated and developed into specific policy arenas (Simonsen 2000).

Recognition of the importance of understanding the relationship between knowledge development and use in both national and regional development policies has become a focus in both policy and academic circles. Yet the causality between the two activities remains poorly understood. There are certain interests that have been more developed in policy circles, such as high technology investment, training and provision, which have attracted the lion's share of research and funding interest (Oakey 1995; Scott and Storper 1986). They do so precisely because of perceived externality benefits to the environment and supply chain that such investments bring (Fontes and Coombs 1997). They are also those that Lash and Urry (1994) cited by Simonsen (2000) claim would be the activities most likely to see blurred boundaries between a regional economy and its culture by virtue of the increased level of communication and transmission of information, knowledge, and associated meanings as business practices in these knowledge-rich policy instruments. Yet it can be equally argued these investments tend to be in specific narrow technological arenas that only have limited relevance to a large number of regions with less specific technological and knowledge-intensive endowments.

On the other hand, there is evidence that suggests that rural firms exhibit higher employment growth levels than their urban counterparts in the UK (Smallbone and North 1994). They also tend to maintain higher levels of innovative activity (Keeble 1997). Technological and knowledge intensity in a region does not, therefore, seemingly preclude successful regional development opportunities, although we should be wary of reading too much into these observations. For example, measures of employment growth could simply refer to the labor intensity of the good/service being manufactured/delivered in a region, while innovative activity can arguably also be spurred by the lack of a supportive environment, necessitating greater reliance on internal firm resources and local environmental factors.

However, there does seem to be evidence for both regional development driven in what are both normally termed as classically advantaged and disadvantaged environments. Perhaps this should not be a surprise given Cox's (1989) observation on the nature of the production system and power within it as being fundamentally based on the social relations constructing that system. Advantaged and disadvantaged environments can then be viewed in terms of social relations and power structures in those regions. As a result, research methodologies that consider the relationship between the small firm and their environment have embraced this social relations argument, viewing small firm development as both an instituted and socially embedded activity. Methodologies of investigation have become quite eclectic and shaken off the shackles of the limited dialogue of nature vs. nurture or push vs. pull arguments (see Stokes 1995 for a summary of those arguments). Grégoire, Dery, and Bechard (2001), in their review of trends in entrepreneurship research from 1981 through 1999, identified five themes that have underpinned research into small firms:

1. Personal characteristics of the entrepreneur
2. Factors affecting new venture performance
3. Venture capitalists' practices and their impact on entrepreneurship
4. Influence of social networks
5. Resource base of the enterprise

Tilley and Tonge (2003), however, criticize such approaches, as they seek to either itemize important factors or focus on one aspect of small firm development. They do not therefore, offer a broad enough canvas to consider the heterogeneity of small enterprises and their activities such as including the two polarized examples of small firm success in advantaged and disadvantaged areas, described earlier. The development of an appropriate integrative model that can pull together the strands listed above is a goal (Tilley and Tonge 2003), but it is apparent that a more effective understanding of the relationship between regions and small firms will aid understanding of causality in regional development policies, by helping to provide linkages between some of the disparate five themes listed. For example, some of the more relevant "new regionalist" research methods derived from a social networks and resource-based perspective have included:

- semiotic (Hill 2002 citing Feldman1995), metaphorical (Koirenan 1995; Nonaka 1996 cited by Hill, 2002), and pragmatics analysis (Thomas 1995) derived from a focus on language, dialects, and social construction in different environments;
- focus on the "cogito" fit of employees or their mutual identification with their varied environmental context (Garrick and Rhodes 2002);
- addressing the impact of particular critical events in the lives of individual's that reshape their interpretation of the environment (Chetty 1997, Chell 1998, Anderson 2000);
- consideration of the role and function of social and egocentric networks for the continuing performance of established high-technology ventures (Bakstran and Cross 2001);
- examining the historical trends behind knowledge development in a localized region, as important factors shaping the perception and openness of entrepreneurs of their environment (Jørgensen 1999);
- reviewing the entrepreneurs' personal histories and their identification with varying regional narratives (Beattie 1999); and
- examining the psychophysiological responses of entrepreneurs to business opportunities (Craig and Lindsay 2001).

One particularly strong driving impetus for developing integrative approaches between the range of investigative methodologies was made in 1988 and has continued to remain a key focus for analytical methods. This was the statement that what is important is "what the individual/organization does" rather than what it is (Gartner 1988). Gartner's call was instrumental in altering the focus of the debate to behavior of entrepreneurs and small organizations and their social context. However, while authors such as Wickham (1998) have stressed the process dimension as an integrative bridge between the classical and more "new regionalist" methodologies, contextual factors have been somewhat neglected in this capacity (Cooney et al. 2001). It is, therefore, somewhat paradoxical that these are also the factors that have been argued to be most important in shaping the long-term competitiveness and longevity of small organizations (Nooteboom 1999; Bierly III, Daly, and Wigginton 2001). Phrasing this more succinctly: "… research is done *with* people not *on* them" (Rigg, Trehan, and Ram 2002, p.363; *italics* in original).

In essence, such research methods embrace the importance of knowing from experience, rather than knowing without reference to experience. These methods reject the classical Cartesian view of the subject as a unitary being comprised of disparate and separable parts. Along with other methods of social inquiry, therefore, the subject is derived in practice (Simonsen 2000). Business is conducted by individuals and firms without recourse to a text of how to conduct business, it is their activities that constitute the practice of business. Simonsen (2000) described this viewpoint by using Bourdieu's phrase of firms "having a sense of the game." We could also borrow Benzon's (1996) terms and suggest that the "schemas" of business activity vary because of their societal construction. He further suggests that schemas compete with one another according to their capacity to satisfy intrinsic individual needs—in this case effective small business operations in a given market arena that may reflect different individual goals.

Competitive knowledge is then more likely to be sourced from the spatial context and proximity rather than from codified sources such as journals or trade literature. Central to this discussion is the belief that only by addressing the knowledge of how and why small firms operate in their contextual and social resources environment will an understanding emerge about how to construct more appropriate policy instruments that actively consider this broad resource base of the smaller enterprise. In doing so, the environment would not be treated as a passive resource but one that can actively support a firm's competitive positioning.

## *Enterprise and Context*

In an attempt to develop a broader investigative model for inquiry, a more primary perspective is required. Simonsen (2000) reaches a similar conclusion in his paper, that by simply "adding" culture as another variable into a classical analysis does not encompass the ontological nature of an individual's and firm's environment, that transcends the distinction between subject and object. The "new regionalist" methodologies discussed above move the debate forward toward a more encompassing analytical position but in of themselves pursue distinctive concerns. How, for example, would understanding of an entrepreneur's personal history aid the policy-maker in framing more appropriate policy instruments for other entrepreneurs in a given region?

One place to start to consider this question is with Tilley and Tonge (2003) who, for example, in their broad introductory review of competitive advantage in SMEs, comment that because of the heterogeneity of the SME sector the first step in developing a more universal understanding of how SMEs compete is to examine what sustains the competitive advantage of smaller businesses in a more individualistic manner described in both classical and "new-regionalist" based research. Banks, Elliot, and Owen (2003) argue that creativity in smaller organizations exists as an array of contextual and unique company resources and relationships. In their view, creativity can have both behavioral and social and communication aspects. A fruitful place to start to answer the question we have set ourselves is to adopt Jørgensen's (1999) and Simonsen's (2000) methodological position. Jørgensen, from a largely economic perspective, and Simonsen, from a geographic perspective, both suggest an appropriate starting point for an answer is through a consideration of the recognized meanings and practices in a given region.

Jørgensen suggests a geneological approach that does not attempt to develop metanarratives of knowledge development and propagation but is instead focused on the issues, practices, and knowledge that are taken for granted in a region. It is a surface focused approach to understanding the environment, cogniscent that the outcome of such a research approach is dependent on the historical investigative depth pursued. For Simonsen, the firm is a set of overlapping practices, where a joint understanding and a shared body of knowledge are the both the prerequisite and precursor for firm activity. For smaller firms with fewer individuals, it can be argued that a smaller set of known and agreed practices will be maintained through the activities of the firm. Recalling our earlier question then, by knowing for example about an entrepreneur's personal history, a researcher will have an insight into the likely dominant form of accepted routines employed by the smaller firm. These views are, therefore, in keeping with the observations of Banks, et al. (2003), who from a resource-based perspective, argues that creativity and competitive advantage are routines of activity that are emergent, involve many other actors, and reflect tacit knowledge.

For a policy-maker though, constraints of action need to be recognized. Policy instruments span information to regulatory activities, dependent on the objectives and ideologies of the policy-makers. Typically there may also be a spatial or sectoral constraint to consider. What can be said of how a region is understood for policy terms, if we adopt Jørgensen's (1999) position? With a surface approach examining mutually acceptable business practices as the focus, this could give rise to particular regions, the interest of which lies on the mechanisms of cohesion among individuals in a given environment, which then define the region. It can be expected that there may also be mereological contributing factors that shape both the spatial and societal boundaries of regions (Smith and Mark 1998). As an example, Popper and Popper (1999) in their research on the economic development of the Great Plains of North America identified the utility of matching policy support initiatives to a common regional destiny through the use of unifying narratives. In this case they used the banner of "Buffalo Commons" to both identify and bind disparate subcultural contexts and peoples within one large regional context.

This focus on cohesion and performance of activities is a common thread in research that addresses regionality and actor identification through a view of social ontology. Mackinnon and Phelps (2001), for example, stress the importance of "geographic closeness" of actors in a region, while Jones (2002) cites the importance of individuals considering themselves as "belonging" to a particular lifestyle or even that regions can promote themselves with one voice by offering the "authentic" to consumers in search of an identity they can recognize. More evidence comes from Dyer (1997), who emphasized the importance of a shared institutional participation in regional development by individuals that also reinforces a regional consciousness. Jenkins (2000), citing Smith (1990), similarly also refers to the role of developing a common destiny to increase collective energies involved in economic development, while MacLeod (1998), citing Paasi (1997), refers to the role of regional "naming" as important in shaping the intensity of interaction and the learning acquired by those actors (as learning by localizing). Finally, from a firm competitiveness perspective, Maskell (2001) and Desrochers (2001) focus on the agglomeration economies derived from geographical proximity as a competitive benefit for transmitting certain kinds of knowledge between organizations.

Overall, therefore, investigative techniques have approached the relationship between regions and small firms through a focus on constructed knowledge based on variations of the "talk of the individuals in small business" (Cohen and Musson 2000; Koirenan 1995), oral histories of regional pioneers (Neth 2001), the impact of particular critical events in the lives of individuals that reshape their interpretation of the environment (Chell 1998), or the entrepreneurs' personal histories and their identification with environmental narratives (Beattie 1999). There is a complex creation of norms, values, and schemas that are both dynamic and processual.

Given this constantly emergent knowledge focus, it is not a surprise that a regional binding theme has appeared in several regional development methodologies. Nielsen (2002) and MacLeod and Goodwin (1999), for example, cite different approaches to understanding contemporary local development, which have as their focus social interaction that creates emotional and identity attachments between individuals and organizations.

Talalay, Tooze, and Farrands (1997) have also focused on a similar argument by examining the role and function of technology in society. They suggest that it is technological factors that bind communities and regions together where technological change and progress reflect the ideas, values, and language of a given society. Where a uniformity in regional value and ideas is apparent, a particular aspect of technological change will be reflected and embraced by that society. Social constructionists would point to the development of a regional "narrative" (Burr 1998). This narrative helps maintain and propagate the dominant social ties, language, and awareness that will structure the actors' capacities in that region to engage in public debates and developmental activities.

In support of the value of such regional narratives, Popper and Popper (1999) suggest that narratives and regional metaphors are primary tools for understanding and creating alternative futures for regions. The identification of such a set of practices and meanings can engage regional people who share those identities in developmental tasks that then influence policy making. Such narratives are open-ended, multifaceted, and ambiguous. Thus subregional units develop and fix onto different locally defined interpretations of the narrative. In entrepreneurship studies for example by Koirenan (1995), there is a similar focus on shifts in the use of metaphors to account for different interpretations of entrepreneurship in Northern Europe establishing an agreed narrative for enterprise discourse in those subregions. In periods of change and uncertainty, typical of entrepreneurial and innovative activities, the use of a narrative through the development of several metaphors can arguably create a focus and explain meaning behind transformations occurring in regions.

Holmén and Jacobsson (1998) and Maskell (2001) also offer evidence of the benefits of a focus on regional narratives and potential subregional units. They suggest that regionally focused SME clusters comprised of regional firms with neo-market ties will disproportionately benefit from spillovers due to the tacit nature of knowledge, the local nature of labor markets, and the local evolution of specific institutions. In other words, a shared regional narrative supports trust and an exchange of resources by virtue of recognized meanings and identities. Policy attempts to improve the economic conditions of a region, should not, therefore, be solely focused on economic policy instruments but must implicitly address the issue of the space to which they are aimed. They are part of a larger context that needs explicit and, at the same time, ambiguous recognition.

As noted by Popper and Popper (1999, p.5), ambiguity "… draws attention to the characteristics of a region, yet allows a wide range of responses…."

## Narrowing the Definition of a Region: A Cultural Province

With this interpretation of a region based around a coherent and mutually identified collection of groups and individuals, similarities with the concept of a cultural province can be made. This can replace the cumbersome phrase of "subregional units" mentioned above. It is one approach to quantifying the gestaltic bindings of a local context within a greater spatial form (Steve 1996). For example, in a discussion about the identity of the County of Yorkshire and its Ridings, Neave (1998) suggests that broad stroke use of the term *region* remains both inappropriate and unhelpful in identifying coherent parts of that environment, which have common practices and shared constructed knowledge. In her case, concern was raised between the different territories covered by county administration on the one hand and differing political and economic activities on the other. Instead of using a holistic and encompassing term like *region*, an outlined alternative was to develop a "cultural provinces" perspective, where each province has a "… set of distinguishing cultural traits, not the least of which will be a shared susceptibility to the same outside influences…." (Neave quoting Phythian-Adams 1998, p.184).

The interpretation of a region now, as perhaps a combination of cultural provinces, is focused on a cohesive and shared identity with ideally, self-defined, and mutually supportive social and institutional agencies that maintain both a high level of embedded and external social relations.

Cultural provinces can be expected to have narrative communities. By definition such communities are individuals or groups that self-consciously regard themselves as members of a single community defined by believing a particular story or interpretation of society (Shalizi 2000). We could also look for schemas or routines, which impose a form on perceptions, grammar, language, and individual interpretation (Benzon 1996). This would aid the structuring of both the global and the local in context.

For Popper and Popper's (1999) work, their story focused on how different groups identified with the Buffalo, via conservation, spiritual terms, or via economical necessity. This approach negates the singular and internally integrated concerns geographers such as Simonsen (2000) may have with an explicit connection between space and the idea of a culturally distinctive unit. It does so because there is also a focus on what binds such provinces across broader degrees of space. There is a recognition on the one hand, of the artificiality of such boundaries (although mereological boundaries may rationalize this), yet also a pragmatic realization that policy instruments themselves are bounded (as noted earlier). However, this province approach seeks to associate the boundaries of policy instruments to the dominant collections of practice that can be identified within a space of operation and is, therefore, not a metalevel approach to this understanding. For the case of small firm policy support, for example, the stories of individuals who span various provinces and propagate modified or unmodified values and preferred practices about the appropriate form of social relations to adopt within the provinces they serve could also be a policy focus. Civil servants, journalists, university lecturers, business support staff, small business bank advisers, accountants, and so forth would be such important individuals within cultural provinces.

Neave (1998) also suggests that the location of important institutions in a province helps identify with the development of a regional consciousness. Such institutions would include administrative operations, jails and courts of justice, newspapers, workers associations, rotarian and horticultural societies, ecclesiatical boundaries, and police forces. An examination of the location of such institutions would also help indicate the diversity of cultural provinces in regions. The outcome would be a virtuous circle for the development of a cultural province, with regional consciousness developing and being supported by narrative communities that themselves are further embedded by locating administrative offices and authority within that province.

It has already been argued that positioning this article within a social methodological line of inquiry necessarily requires some historical review and context although, as Jørgensen (1999) suggests, this should be limited and stated at the outset of the investigation. This is especially important, given the youth of the small business support service in the UK in general (from a standing 1978 start). Small businesses, despite their economic significance, have been politically difficult to capitalize on and hence have been neglected both as economic and political actors (Tilley and Tonge 2003).

From a surface level interest, it can be noted that an "enterprise culture" was the label given to the particular articulation of a diverse group of politicians toward the value and status of self-employment during the 1980s in the UK. The associated activities used to establish this collection of interests identified the preferred practice of policy-makers and hence a means of shaping the environment in which individuals sought employment.

The implementation of these preferred economic activities relied on the creation of specific concepts and terms. The use of the terms "small and medium-sized enterprise" (SME) and "clusters," for example, surround and stratified these policy preferences creating knowledge applied to cultural provinces and regions. This stratification is continually reflected and reconstructed in academic papers and theories and governmental initiatives (Cohen and Musson 2000). No particular thought, however, was attached to the contextuality of the SME. Such applied knowledge constrains some policy actors who are not recognized as being associated with such socioeconomic labels and actions, yet who may be intrinsic to the development and growth of SMEs in a region or cultural province. Such broad labels may also allow other dominant actors to tell the "story" of the policy problem and just how to view the SME, their needs, and performance requirements (Howlett and Ramesh 1995). The creation of such an enterprise culture, is not just a political activity but one that extends beyond this sphere, to the "… wider world outside, where its meanings further multiply in number, and fragment in effect…." Cohen and Musson 2000, p.32, citing Ritchie 1991).

The enterprise culture is a discourse, portraying one understanding of the ways of thinking and producing meaning in a society (Lenk 1996 , p.108). In this case it has been predominately state focused. When an individual's or firm's activities are viewed as an outcome of social relations, it is relying on certain knowledge attributes (which encompass beliefs, practices, ideologies, and perceptions; from Jørgensen 1999). These are not permanently fixed but subject to change. As an example, Anderson and Jack (1999), through their studies of entrepreneurs in the Highlands of Scotland, are keen to emphasize that one function of social relations in such coherent environments is to establish cultural province knowledge attributes. They argued from this provincial focus that the dominant practices were local prestige and influence, which were more important motivating factors than profit.

It may not, of course, always be the case that small organizations will be comprised of mutually supportive individuals, and Nooteboom (1999) has developed the term of "cognitive distance" to describe the variance between the objectives of individuals in an organization. In terms of how knowledge is being used competitively by those individuals, the concept could be adapted to also account for the varying extent to which members in a small firm share similar values and meanings (and have small cognitive distances) or have divergent values and meanings (and have large cognitive distances). As suggested previously, it can be hypothesized that small firms that exhibit small cognitive distances between the objectives of individuals in those organizations would come from the same/similar cultural provinces. Such organizations would have significant knowledge redundancy, through an overlap of complimentary capabilities that are mutually understood by members of the small firm (Nooteboom 1999). Policy instruments that seek to build on cultural provinces shared business practices would be concerned with firms that have small cognitive distances.

Overall, as Neth (2001) states, giving meaning to a region is an act of translation between past and present. This association between regions, knowledge, and individuals, is largely the reason why attempts to simply transpose the success of metaphors such as "Silicon Valley" or "Route 128" to other regions and nations have failed. They lacked a focus on this province—knowledge association did not recognize the importance of local market demand pull for such activities and most importantly failed to identify meaning with the narratives underlying the choice of policy activities.

## Developing a Provincial Methodology

In this section, some practical observations are made based on the conceptual arguments presented so far. In particular, this discussion addresses the statement that a focus on behaviors and social processes, rather than market share or organizational structure, can inform the practical identification of cultural provinces and cognitive distances in smaller organizations.

May (2001) describes the complete participant approach to research as one in which the researcher fully engages in the activities of the individual or organization under investigation. This is an action research agenda, in which the researcher is working with research participants on matters of genuine concern to them (Rigg et al. 2002). A key problem with this intensive form of observation is the time required for the researcher to become an accepted part of the context within which observations take place and hence ensure the collected data has validity. The increased access to the rich social data though is viewed as a worthwhile compromise and is often a balanced compromise in small firm research (Curran and Blackburn 2001).

Lesser levels of organizational immersion, such as observer as participant and complete observer, are also outlined by May (2001) as viable ethnographic approaches to collecting data, although their outcomes depend on the depth to which the investigation proceeds and the researchers' goals with the investigation (following Jørgensen 1999; Rigg et al. 2002). As was suggested previously, this depth of analysis requires a clear stated conceptual position, especially when our concern is with values and practices in a cultural province where the researcher may not be able to directly identify or intuit the value of a given observation for the competitiveness of the smaller organization. An appropriate methodology, therefore, is not pure action research driven (Rigg et al. 2002) but is concerned with adopting a participant observer position. This seems a reasonable compromise to extract meaningful and relevant contextual data within the practical constraints of fieldwork in this sector of the economy. Rigg, et al. (2002) further cite Lewin's (1946) original action research cycle and the Chicago School's view, to outline changes in the knowledge of a social system—as part of a cycle of action and reflection. However, the surface focus of this methodology is only concerned, therefore, with steps 1 through 3 of the 6 original research action steps, which helps maintain an ambiguity in constraining the location and shape of the province :

1. ***Problem statement***
2. ***Diagnosing the problem***
3. ***Devising actions for the problem***
4. Taking actions to resolve the problem
5. Evaluating the outcomes of the problem
6. Redefining the problem

If we recap on the discussion so far, the key reason discussed for the eclectic development of investigative methodologies into small firm research is that they represent a highly heterogeneous collection of human activities, either individually or in groups, where formalized procedures and activities from the more familiar large enterprise have little immediate benefit to bring to our understanding. It is no surprise, therefore, for Hill (2002) to state that there is no such thing as a "typical" small firm. The phrase "business as usual," which could be argued as the driving focus behind small firm operations, both hides the nature of contextual practices and explains them, which are typically problem and survival oriented for the small and micro business (Hill 2002; Pownall and Skinner 2003). So while The Chicago School tradition of action research suggests that social relations between individuals in organizations and in the region may and do differ, they also take forms that display similarities, which have been argued here to form cultural provinces.

A second key reason for the development of a range of investigative approaches to researching small firms not discussed earlier lies with the level and degree of access the researcher has to the individuals that constitute the small firm. Hill (2002), citing Easterby-Smith, Thorpe, and Lowe (1993), acknowledges that often there is a compromise between maintaining academic rigor while facilitating access to rich data sourced from multitasking individuals in small firms. Rigg, et al. (2002), for example, offer ample evidence of how they had to balance this compromise when working with second-generation Asian entrepreneurs who were keen to use the external "consultancy" of the researchers, in preference to the academic "twaddle" of the proposed research. Both Rigg, et al. (2002) and Hill (2002) state that flexibility in the chosen methodology is a key requirement of a successful small firm research strategy. This is an issue that May (2001) argues is also a key strength of longitudinally based ethnographic data collection, in which the length of time over which data is collected, allows the research to be flexible in its approach and context, especially when documentary evidence can be very hard to locate and when the research questions driving the analysis may themselves initially be vague or unclear.

Research investigations that are short, repetitive, and do not interfere with organizational direction and pace provide a solid basis for collecting rich data and differentiating between similar and dissimilar practices in small organizations that establish cognitive distances and the location of a cultural province. An important analytical point from May's (2001) discussion that can be incorporated into this emergent methodology, is to focus the research questions on the collections of social meanings. These collections of social meanings rest on observed practices and meanings and their rules of propagation. The collections of meanings approach considers observations that encompass the social relations and resource based perspectives discussed previously. As a methodology, we can use the themes discussed in May's (2001):

- ***Meanings focused*—**Identify cultural norms. What are people's definitions of the situation and variations in the scope of rules at work in the social context?
- ***Practice focused***—What are the recurrent categories of talk and action that are apparently significant in the current context (but aware of the reflexivity of the researchers choices)? How, for example, are differences dealt with inside the organization (cognitive distance)?
- ***Episode focused*—**What are the collections of activity that are out of the ordinary and unexpected events in the individual and organizational environment? This can include illness, marriage, business acquisitions, or significant changes in the environment for example.
- ***Encounter focused*—**These describe social patterns and rules of behavior that emerge as individuals work together, either formally or informally, to achieve a mutually satisfactory goal.

In the earlier discussion, May's (2001) themes would constitute the schemas of business practice within SME provincial business operations. Within these four collections of social meanings evidence of cognitive distance and cultural provinces can be identified. May also then describes the different levels at which these collections of meanings arise. It is a perspective that is very similar to that of Johanisson and Dandridge's (1995) dynamical systems approach but instead focuses at one level beneath the interest of their model to consider the inputs into the individual, the organization, and an organization as a collection of individuals. Thus, the construction of tacit knowledge of an individual is the context within which meanings, practice, episode, and encounter focused observations are made. These four social meanings of a cultural province reflect

- ***Roles*—**These are the labels used by people and organizations to undertake their own activities and describe those of others. They are a form of the symbolic character of social capital.
- ***Relationships*—**Changes in the form of the interaction of people over time.
- ***Groups*—**Individuals who have mutually recognized themselves as a social entity with hierarchies, cliques, and mutually supportive mechanisms.
- ***Organizations*—**Are one step beyond groups and reflect what was discussed as the provincial affiliation of individuals to a particular group set of values, practices, and norms that they then sustain and practice. They constitute an important element of the individual's habitus.
- ***Settlements*—**Are typically groups and organizations that exist and operate within a defined geographic territory.

Some research questions that can then be derived from these themes and be asked of small business managers and their employees are shown in Table 1.

The list of themes and questions discussed above represent a first attempt to qualify the concepts (schemas, cognitive distance, routines, and cultural provinces) discussed earlier in this article. It is, therefore, far from an exhaustive list; and given the nature of the methodology, it can be expected that additional questions would arise. Answers to these questions, would allow the researcher to interrogate policy instruments and determine their cultural fitness, cognitive relevance, and distance and their appropriateness for the region and cultural province under analysis.

## Conclusions

This article has explored the literature on the relationship between the firm, the individual, and its contextual environment. It is a desirable goal especially for policy practitioners and the development of an integrative model of small firm development but one that necessarily involves a multiplicity of factors and interests; for example, where the competitive interpretation of areas are termed advantaged or disadvantaged is too broad to fully describe the potential for regional development. Indeed, it has been argued that contextualized and localized knowledge, is an important source of competitive advantage for the smaller enterprise. Similarly, the argument in this article preferred to adopt the concept of cultural provinces as a narrower and more effective term to describe particularly cohesive areas, which share business values, knowledge, and practices.

This was the key methodological argument of Jørgensen's (1999) discussion of avoiding meta-narratives to account for different levels of practice in knowledge development. Instead, only surface observations derived from conceptual positions are viewed as acceptable to understand knowledge development and propagation. The conceptual position of this article has argued that surface observations are narrowly defined to cohesive areas—cultural provinces—and these are the source of narrative

**Table 1**
**Research Questions Derived from Identified Themes**

| Theme | Participant–Observer Goal | Research Questions Arising from Four Social Meanings Themes |
|---|---|---|
| Source, definition and meaning of cultural province and textual artifacts. | Meanings focused | A. How is the region defined by self-identified entrepreneurs? (RELATIONSHIP). Are these component(s) reflected in the targeted policy instruments ?<br>B. What is the role of towns and cities in these definitions by the self-identified entrepreneurs? (SETTLEMENTS). Is there a symmetry with the location of the service provider? Is this identified with by the entrepreneurs? |
| Identification of regional narratives in cultural provinces. | Practice focused | C. What are the operative regional narratives articulated by identified and self-identified entrepreneurs and regional actors? How do these differ/reflect those constructing the targeted policy instruments? (SETTLEMENTS and SOCIAL WORLDS)<br>D. What is the physical evidence supporting textual forms of regional knowledge? How are "stories" reported in local press? What is the relationship between different levels of regional/provincial administration? (GROUPS and ORGANIZATIONS)<br>E. What are the apparent themes and their periodicity in the textual evidence (e.g., newspaper stories, court reports, minutes of Parish Councils, and so forth)? What is the construction of that information? To what extent do targeted policy instruments embrace those themes? |
| Construction of regional narratives in cultural provinces. | Meanings focused<br>Practice focused<br>Encounter focused<br>Episode focused | F. To what extent are self-identified entrepreneurs open to "new" knowledge flows? What is their provincial status, access, and scope of personal contacts? What are their impressions of alternative routines and business practices? (RELATIONSHIPS and GROUPS)<br>G. What are the given rationales for involvement with other self-identified entrepreneurs/actors in the region? What are the key motivators shaping the formation of business schemas? (RELATIONSHIPS and GROUPS)<br>H. What is the level and scope of technology used by self-identified entrepreneurs? Is this use contingent or externally sourced (outside any province)? (RELATIONSHIPS and GROUPS)<br>I. What are the processes employed to identify opportunities and what key (re)sources are utilized? To what extent is this OR process a cognitive/schema based activity? (RELATIONSHIPS and GROUPS)<br>J. What are the meanings given to self-identified significant events in the histories of the actors concerned? Is this shared by other members of a small firm? (RELATIONSHIPS and GROUPS)<br>K. What is the level of awareness of the self-identified entrepreneurs of the strategic impact of their environment on their activities? (RELATIONSHIPS and GROUPS)<br>L. What is the evidence of a desire/need for the creation of supportive socioeconomic infrastructures both at the individual and institutional levels? (SETTLEMENTS and SOCIAL WORLDS)<br>M. Is there evidence of a balanced culture of self-belief and self-reliance for the self-identified entrepreneurs? What are the boundary support points for this balance? (RELATIONSHIPS and GROUPS)<br>N. How effective is the perceived imagery of the statistical/administrative region, as a supportive context for technology-based entrepreneurs? (RELATIONSHIPS and GROUPS)<br>O. How are entrepreneurial failures handled in the environment? (RELATIONSHIPS and GROUPS and SETTLEMENTS and SOCIAL WORLDS). What are the processes involved and arising perceptions?<br>P. What is the level of vertical integration of business support activities in the region? To what extent does this hierarchy dilute societal constructions for targeted regions/provinces? (ORGANIZATIONS and SETTLEMENTS)<br>Q. What is the cognitive distance between policy determination, relevance, and promotion of small firm policy instruments and the small firm/entrepreneur? (ORGANIZATIONS and SETTLEMENTS)<br>R. What is the perception of known policy instruments addressing the competitiveness of small firms? (RELATIONSHIP)<br>S. What is the representativeness and openness of local governance to challenges from its community? (SETTLEMENTS and SOCIAL WORLD) |

communities, which generate localized learning and sustainable and idiosyncratic competitive advantage for smaller enterprises.

While it has been argued that narrative communities in cultural provinces will generate and sustain a level of mutual conformity on agreed business practices, the idea that there will still be different opinions and attitudes between owner managers and staff in smaller organizations was focused in the concept of cognitive distance. Arguably, smaller enterprises, which maintained smaller cognitive distances, would be more likely to reflect a distinctive cultural province.

To bring these ideas and concepts together into a methodology that might help in identifying particular groups and clusters on cultural provinces in regions, elements from action research methodology were developed. This was viewed as an appropriate vehicle to develop a methodology as at one level of participant research; it does address surface observations and social processes. It also will include the potential heterogeneity of the small firm sector and be reliant on the observations, rather than imposing a particular framework of understanding on the data. The emergent methodology, therefore, drew heavily on the idea of looking for collections of social meanings in a region that would allow the identification of cognitive distance in organizations and, as a consequence, the location and development of cultural provinces in a region. A series of suggested research questions were finally identified from this methodology that the researcher could develop and use to explore the relationship between the individual, the smaller firm, and its context and, as stated at the start of this conclusion, support the development of more appropriate policy instruments. It is possible that such emergent improvements could include

- different use of language in policy publications;
- different formats of dissemination of policy instruments;
- the location of service providers; and
- the roles of service providers in the province/-region targeted.

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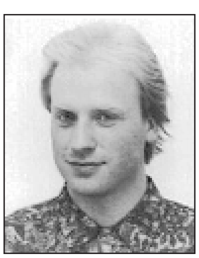


**About the Author**

IAN POWNALL (i.pownall@hull.ac.uk) is a lecturer in the Business School of Hull University and the Regional Business Development Subject Group. Dr. Pownall's main research interests are in small firm policy analysis and development, small firm growth in peripheral regions, and the biotechnology industry. His research has appeared in the *Encyclopaedia of Life Support Systems, Electronic Journal of Biotechnology, Public Administration and Management: An Interactive Journal, Biotechnology and International Relations*, and *Science and Public Policy.*

# Collective Entrepreneurship in Family Firms: The Influence of Leader Attitudes and Behaviors

Jun Yan
Ritch L. Sorenson

*Collective entrepreneurship is the synergism that emerges from a collective and that propels it beyond the current state by seizing opportunities without regard to resources under its control (Stevenson and Jarrillo 1990). This study provides a conceptual model of collective entrepreneurship and its relationship with leadership and team dynamics in the context of a small family business. It proposes two types of prerequisites for collective entrepreneurship: attitudinal and behavioral. The attitudinal prerequisite is family business members' commitment to the family business. The behavioral prerequisite includes collaboration and task conflict among family business members. Further, the article argues that leadership behaviors directly affect the attitudinal and behavioral prerequisites, and indirectly affect collective entrepreneurship. Specifically, relations-oriented and participative leadership have positive, indirect effects on collective entrepreneurship. Task-oriented leadership has both positive and negative, indirect effects on collective entrepreneurship. An empirical study of 271 small family businesses in the United States confirmed most of the hypotheses.*

A very important concern of family businesses is to sustain entrepreneurial capability (Hoy and Verser 1994). However, practitioners and researchers seem constrained by the following individualistic assumptions about entrepreneurship: The entrepreneurial competence of the firm is equated with that of the owner (Miller 1983; Man, Lau, and Chan 2002), and the owner is the only source of a firm's entrepreneurial competence (Slevin and Covin 1995; Stoner 1987).

An individualistic view of entrepreneurship (Reich 1987; Tiessen 1997) fails to recognize that in many cases entrepreneurship is a collective effort. Missing from most literature is the important role of collective entrepreneurship—the collective entrepreneurial capability to innovate and create (Reich 1987; Stewart 1989). Collective entrepreneurship may be especially important to sustain the continuity and growth of family firms. Owners who develop a culture that promotes collective entrepreneurship may instill an entrepreneurial spirit that enables them to achieve the hope for a firm that lasts for generations.

This study examines the contribution of owners' leadership to the collective entrepreneurial capability of small family firms. Here, we view owners as being potential "organizing geniuses" (Bennis and Biederman 1998) who transform their family firms into "great teams" that are highly and collectively entrepreneurial.

Entrepreneurship is a process in which entrepreneurs pursue opportunities without regard to resource currently under control (Stevenson and Jarrilo 1990). Two core components of this process are recognition/identification of opportunities and getting use of the resources needed to exploit these opportunities (Block and MacMillan 1993; Kilby 1971; Stevenson and Gumpert 1985). Recognition of opportunities includes such activities as scanning both external and internal environments for new markets, unmet needs, existing problems in work process, and new product ideas (Sandberg 1991; Sayles and Stewart 1995). Obtaining resources includes such activities as leveraging resources through "running hot," creating collective synergism, fostering and using collective creativity (Stewart 1989), borrowing or coopting resources (Jarrilo 1988, 1989), designing and implementing strategies (Stevenson and Jarrilo 1990; Tiessen 1997).

Here, we define collective entrepreneurship as synergism that emerges from a collective and that propels it beyond the current state by seizing opportunities without regard to resources under its control (Stevenson and Jarrilo 1990); the collective capability of both identifying and responding to opportunities are important components of collective entrepreneurship. Collective entrepreneurship may exist in *teams* (Reich 1987; Stewart 1989), *organizations* in the form organization-wide "Kaizen" (continuous improvement involving all members of an organization; Imai 1986), and *networks of organizations* (Nonaka 1988; Mourdoukoutas 1999).

The focus of this study is small family businesses, which have made great contributions to the U.S. economy (e.g., Duman 1992; Kets de Vries 1993; Hershon 1975). However, relatively little research attention has been given to the nature and function of these family firms (McCann, Leon-Guerrero, and Haley 2001; Morris, Williams, and Avila 1997).

Hoy and Verser (1994) viewed leadership as the number one issue for future research in the interaction between family business and entrepreneurship. However, leadership research has given disproportionate focus to the role of the founder/entrepreneur in the process of transition or succession (Handler 1994). Some researchers have addressed the impact of owner leadership styles on both family-related and business-related outcomes (e.g., Dyer 1986; Sorenson 2000), but almost no attempt has been made to study the relationship between the owner's leadership styles and family firm's entrepreneurial capability.

Hoy and Verser (1994) advocate studying the implications of team leadership in family business. Moreover, studies indicate that small family businesses function like work teams (Riordan and Riordan 1993). An advantage of treating small family firms as work teams is that much research attention has already been given to teams (Cohn and Bailey 1997). For example, Stewart (1989) studied entrepreneurship in a work team environment, which he called "team entrepreneurship" and which we refer to here as collective entrepreneurship. Researchers suggest that collective entrepreneurship is a source of competitive advantage not only for teams (Reich 1987; Slevin and Covin 1992) but also for other types of organizations (Imai 1986; Jelinek and Litterer 1995; Nonaka 1988; Mourdoukoutas 1999).

Based on previous research in small family businesses, work teams, collective entrepreneurship, and leadership, we propose and test a model of collective entrepreneurship for small family businesses, businesses that are family-owned and that have no more than 20 employees. Such firms are likely to function like a work team (Cohn and Bailey 1997; Riordan and Riordan 1993 ) and potentially to engage in collective entrepreneurship.

## Collective Entrepreneurship and Small Family Business

Today more and more successful organizations draw their competitive advantages not from the major initiatives of CEOs and mavericks but from continuous, incremental innovation and refinement of ideas by teams in the form of collective entrepreneurship (Reich 1987). Collective entrepreneurship draws on everyone's talent, creativity (Stewart 1989), knowledge, and experience, which is diffused throughout the team, to create a whole that is greater than the sum of individual contributions (Reich 1987, p. 78). The entrepreneurship in small family firms likely results from countless small innovative ideas that help members to "stretch past their previous abilities" to meet the demands of customers, which Stewart (1989) calls "running hot."

Below, based on previous studies (Haskins, et al. 1998, Slevin and Covin 1992, and Stewart 1989 provide an extensive discussion), we propose (1) an attitudinal followed by (2) a behavioral prerequisite for collective entrepreneurship (see Figure 1). The attitude prerequisite provides the energy, and the behavior prerequisite transfers the energy into synergistic outcomes (Hackman 1987); like the engine, transmission, and wheels for a car, attitude and behavior are the "energy" and "essential mechanisms" that result in collective entrepreneurship. We argue that both of these prerequisites are influenced by the nature of leadership in the family firm.

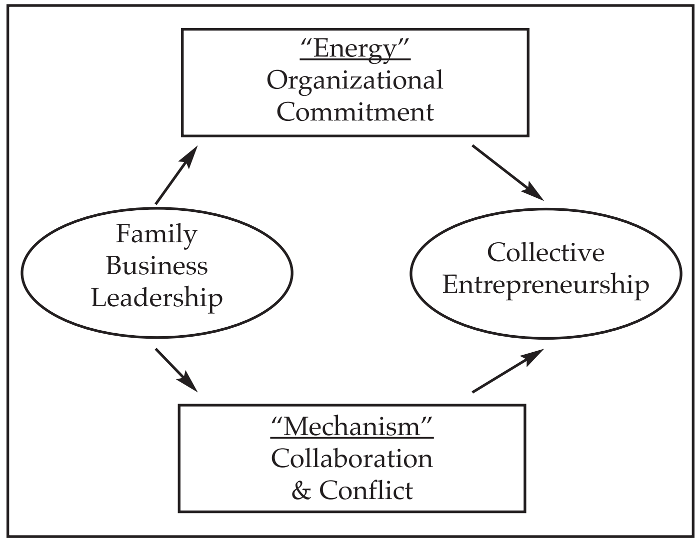



**Figure 1. Leadership, "Energy," and "Mechanisms" Underlying Collective Entrepreneurship**

## An Essential Attitudinal Prerequisite for Collective Entrepreneurship: Organizational Commitment

Organizational commitment is a collection of feelings and beliefs within organizational members (Mowday, Porter, and Steers 1982) that consists of belief in the organization, a sense of pride, and a feeling of loyalty that provides a sense of conscientiousness and stewardship (Haskins et al. 1998). Committed organizational members are likely to act above and beyond the call of duty and are less likely to quit (Mathieu and Zajac 1990). As a result, they should devote effort to detecting and diagnosing organizational problems, identifying defects and weaknesses in current work, and searching for better ways to do their work and to serve the organization. We argue that family business members' commitment to the family business is an essential attitudinal prerequisite to the collective entrepreneurship of a small family business. To test the effect of collective entrepreneurship, we offer the following hypothesis.

**Hypothesis 1: Family business members' commitment to the family business is positively associated with its collective entrepreneurship.**

## Essential Behavioral Prerequisites for Collective Entrepreneurship: Collaboration and Conflict Management

In collective entrepreneurship, skills, intelligence, and experiences of individual family business members are integrated, forming a strong collective capacity to create and innovate. Over time, as family business members work through various problems, they learn how to help one another perform, what each can contribute, how best to take advantage of other's experience, and when and how to make mutual adjustments. However, we believe that, without effective collaboration and conflict management, collective synergy will not occur.

### *Collaboration Among Family Business Members*

Collaboration is an internal process that is positively related to business performance and effectiveness (e.g., Sorenson 1999, 2000). We believe that collaboration may be the most important mechanism that transfers the "energy" of attitude into interaction that produces collective synergy.

Collaboration is most extensively studied in conflict management research (e.g., Sorenson, Moore, and Savage 1999) as a process that fully satisfies the concerns of involved parties and creates integrative solutions (Eiseman 1977). Effective collaboration reflects the ability of people to work together for their mutual benefit (Scott 1999). In collaboration, individuals strive to understand the talents, thoughts, and emotions of one another; such interpersonal understanding is the wellspring of the creation, preservation, and enhancement of collective excellence (Haskins et al. 1998). Stewart (1989) uses the analogy of soccer team members working together to score to explain the importance of mutual understanding and collaboration among team members to produce collective outcomes. Similarly, we argue that collaboration enables family businesses to engage in collective entrepreneurship. Thus, we offer the following hypothesis.

**Hypothesis 2a: Collaboration among family business members is positively associated with the collective entrepreneurship of the family business.**

### *Conflict Among Family Business Members*

Conflict management has long been an important research subject in organizational studies (e.g., Sorenson 1999; Thomas 1992; Wall and Callister 1995). How conflicts are managed directly impacts organizational performance and outcomes (Amason 1996; Jehn 1995). Appropriate conflict management can help to reduce unnecessary consumption of resources, increase synergy, and build relational resources (Stevenson and Gumpert 1985). Family firms should effectively manage two types of conflict. The first is *task* or *functional conflict*, which consists of disagreement among organizational members about task content; the second is *relationship* or *dysfunctional conflict*, which refers to interpersonal incompatibilities, tension, animosity, and annoyance (e.g., Amason 1996; Jehn 1995; Priem and Price 1991).

Studies show that task conflicts are beneficial to organizational and team performance, adding to creativity and decision quality (Amason 1996; Jehn 1995). Task conflict contributes to an organization's cognitive diversity, which has been found to be related to innovativeness and ability to solve complex and nonroutine problems (Bantel and Jackson 1989; Murry 1989).

However, relationship conflicts are divisive and detrimental to performance (Amason 1996; Jehn 1995), resulting in poor relationships, limiting synergy, and if not solved, destroying collective entrepreneurship (Stewart 1989). Thus, we argue that task conflict should promote and relationship conflict should hinder collective entrepreneurship.

**Hypothesis 2b: Task conflict among family business members is positively associated with the collective entrepreneurship of the family business.**

**Hypothesis 2c: Relationship conflict among family business members is negatively associated with the collective entrepreneurship of the family business.**

## Essential Leadership Characteristics Underlying Team Entrepreneurship: The Effect of Leadership on Attitude and Behavior

Collective entrepreneurship does not eliminate the need for leadership in family business. Leaders help cultivate both the attitudes and behaviors that create a favorable context for collective entrepreneurship.

To illustrate the potential impact of leader influence, we discuss three types of leadership styles (Bryman 1996) or behaviors (Likert 1961, 1967) and their impact on the attitudes and behaviors of family business members. In this article, we use leadership styles and behaviors interchangeably. The three leadership styles are (1) relations-oriented, (2) participative, and (3) task-oriented (Bass 1990; Yukl 1998).

### *Relations-Oriented Leadership*

Studies show that relations-oriented leaders (e.g., Bowers and Seashore 1966; Likert 1961, 1967; Sorenson 2000) are concerned about people and relationships, which tends to increase collaboration, teamwork, and subordinate identification with the organization or team. Key component behaviors of relations-oriented leadership include supporting, developing, recognizing, and consulting with individuals (Yukl 1998).

By showing consideration, acceptance, and concern for the needs and feelings of their subordinates, family business leaders help build and maintain effective interpersonal relationships and help subordinates reduce and cope with stress, which can help to reduce unnecessary interpersonal conflicts, especially relationship conflicts that may damage collective entrepreneurship (Amason 1996; Jehn 1995). In addition, subordinates may imitate their leaders' supportive behaviors (Weiss 1977) to further support positive interaction and working relationships, very likely leading to creative collaboration (Haskins et al. 1998).

The tendency of relations-oriented leaders to develop, recognize, and reward subordinates increases the likelihood that subordinates will be committed to the family business. Therefore, we offer the following hypotheses.

**Hypothesis 3a: Relations-oriented leadership is positively associated with family business members' commitment to the family business.**

**Hypothesis 3b: Relations-oriented leadership is positively associated with the collaboration among family business members.**

**Hypothesis 3c: Relations-oriented leadership is negatively associated with relationship conflict among family business members.**

Thus, in our model, relations-oriented leadership should have indirect positive impact on the collective entrepreneurship of a small family business.

### *Task-Oriented Leadership*

Studies show that task-oriented leaders do not spend time working with their subordinates. Instead, they concentrate on task-oriented functions such as planning and scheduling work, coordinating subordinate activities, and providing supplies, equipment, and technical assistance. Task-oriented leaders define and structure their own roles and the roles of their subordinates. They closely supervise subordinates in setting and achieving formal performance goals (e.g., Likert 1961, 1967). This helps to reduce task conflicts among subordinates.

Task-oriented leaders coordinate the activities of their subordinates instead of helping subordinates to coordinate among themselves. Task-oriented leaders can help subordinates collaborate by designing work, coordinating, and managing interaction. However, collective entrepreneurship will be limited to those interactions directed by the leader, resulting in minimal synergy.

Based on the previous discussion, we offer the following hypotheses.

**Hypothesis 4a: Task-oriented leadership is positively associated with the collaboration among family business members.**

**Hypothesis 4b: Task-oriented leadership is negatively associated with the task conflict among family business members.**

Because task-oriented leadership potentially has both a positive and negative influence, we suggested that the total effect of task-oriented leadership on collective entrepreneurship is at best indeterminate.

### *Participative Leadership*

Participative leaders encourage and facilitate involvement of subordinates in making decisions. Involving subordinates promotes approval and commitment. The highest level of participative leadership is delegation of decision-making or encouraging subordinates to assume responsibility for their own work. Thus, participative leadership includes power sharing, empowerment, and reciprocal influence processes (e.g., Vroom and Yetton 1973).

Participative leaders increase interpersonal interaction, mutual obligation, and accountability, making the family firm more "groupy" (McGrath 1984). In meetings, participative leaders encourage diverse ideas and opinions from team members, which may promote task conflict.

We assume that, similar to relations-oriented leaders, participative leaders will influence family business members to be open to one another's opinion, ideas, and suggestions (Wiess 1977). A family business leader who opens the domain of decision authority to the entire family business team may also encourage them to open their domain of work to others, making the entire business more integrated and holistic. Similarly, power sharing by a leader may also encourage team members to share power (Leavitt 1975; McGrath 1984). Participative leaders clearly have the potential to positively influence family business members to have constructive attitudes toward their job, the family business, and their leaders. Thus, we suggest the following relationships:

**Hypothesis 5a: Participative leadership is positively associated with family business members' commitment to the family business.**

**Hypothesis 5b: Participative leadership is positively associated with the collaboration among family business members.**

**Hypothesis 5c: Participative leadership is positively associated with the task conflict among family business members.**

**Hypothesis 5d: Participative leadership is negatively associated with the relationship conflict among family business members.**

Similar to relations-oriented leaders, participative leaders should have a positive impact on building cooperative interpersonal and working relationships, which will help collective entrepreneurship to grow in a small family business.

## Methodology

### *Data Collection*

To examine the collective entrepreneurship of small family firms, we use secondary data from the "Survey of Family Business," collected by the Center for Entrepreneurship and Family Business at a Southwestern University between 1997 and 1999. The "Survey of Family Business" is a 199-item questionnaire, which asks respondents about a wide variety of activities, practices, and values/policies in family businesses. All of the respondents were members of the owning family. Since all of these businesses had 20 or fewer employees and most business decisions were kept in the family, family members exerted considerable influence. Most of the respondents (77%) listed themselves as the owner, CEO, president, or administrator of the business. Some (17%) indicated they were vice presidents or managers. Others (6%) listed a variety of roles, the predominant of which was secretary/treasurer.

Riordan and Riordan (1993) found that small family businesses with 20 or fewer employees function like workgroups or teams. Thus, we treat each small family business as an independent work team. This study limited the sample to businesses with from 3 to 20 employees, resulting in a sample size of 271 family firms.

Responses to the "Survey of Family Business" questionnaire were gathered in two ways. First, a national sample was obtained by identifying the Chambers of Commerce in various communities in the United States from their sites on the Internet. Membership directories were accessed and businesses were randomly selected to be a part of the study. Owners of those businesses selected were called and asked if their company was a family business and, if so, whether they were willing to participate in the study. Of the questionnaires that were sent, 20 percent were completed and returned ($n$ = 158). Second, students at Texas Tech University were invited to ask family business owners to complete surveys. These surveys primarily were obtained from businesses in Texas ($n$ = 113). The response rate for this data collection was more than 70 percent. Background characteristics of selected small family businesses used in this study are summarized in Table 1. Multivariate analysis showed that there was no significant difference between samples.

**Table 1**
**Numbers of Small Family Businesses Located in Different Regions in the United States**

| Region | I | II | III | IV | V | VI | VII |
|---|---|---|---|---|---|---|---|
| Number | 26 | 34 | 18 | 69 | 44 | 48 | 24 |

*Notes:*
1. I: WA, OR, ID, MT, WY
   II: CA, NV, UT, AZ
   III: ND, SD, MN, CO, NE, KA, OK, MO, IA, IL, WI
   IV: West TX, NM
   V: East TX
   VI: MI, IN, KT, OH, PA, WV, VA, NY, MD, MA, ME, NY
   VII: AR, LA, TN, MS, AL, GA, NC, SC, FL
2. The regions of 8 companies are not identifiable.

### *Measures*

***Task-oriented Leadership Style (TL).*** The measure for this construct consisted of three items measured on a scale from 1 (strongly disagree) to 7 (strongly agree). The items were "Top-level leadership in our organization…" (1) "maintains clear control over the business," (2) "is very directive," and (3) "retains the authority to make almost all decisions."

***Relations-oriented Leadership Style (RL).*** This construct was measured on a scale from 1 (strongly disagree) to 7 (strongly agree) by two items that were *reverse scored*. These items were "Top-level leadership in our organization…" (1) "sometimes strongly persuades/manipulates employees" and (2) "is very dominating."

***Participative Leadership Style (PL).*** Four items were used to measure this construct. The scale ranged from 1 (strongly disagree) to 7 (strongly agree); the items were adapted from the Michigan Organizational Assessment Questionnaire (Cammann, et al. 1983). These items were "Top-level leadership in our organization…" (1) "encourages subordinates to participate in important decisions," (2) "keeps informed about the way subordinates think and feel about things," (3) "encourages subordinates to speak up when they disagree with a decision," and (4) "provides goals and gives employees freedom to achieve them."

***Organizational Commitment (OC).*** The three items for the measure of team commitment were adapted from Camman, et al. (1983) and were answered on a scale of 1 (strongly disagree) to 7 (strongly agree). The items were "In general, employees in this business…" (1) "like working here," (2) "feel like they are really a part of this business," and (3) "are satisfied with their role in the business."

***Collaboration (CL).*** Five items were used to assess collaboration. Possible responses varied from (1) strongly disagree to (5) strongly agree. Three of the items were from a conflict measure developed by Rahim (1983). The items read as follows: (1) "We try to bring all our concerns out in the open so that the issues can be resolved in the best possible way," (2) "We try to exchange accurate information to solve the problem together," (3) "We try to ensure that all the employees have access to more information than the minimum required to perform their job," (4) "We try to work with one another for a proper understanding of the problem," and (5) "We try to meet the expectations of one another."

***Task Conflict (TC).*** Task conflict was measured with three items on different scales: (1) "How many different solutions do members of your organization consider when making decisions" was measured on a scale from 1 (none) to 5 (a great deal); (2) "We encourage diversity in people and ideas within our organization" was measured on a scale from 0 (not at all) to 5 (very great extent); and (3) "The following statements describe types of operating philosophies and beliefs which may or may not exist in your business…participation, open discussion" was measured on a scale from 1 (minimally valued and used) to 7 (extensively valued and used).

***Relationship Conflict (RC).*** This measure used three items developed by Amason (1996), and they were measured on a scale from 1 (none) to 5 (a great deal): (1) "How much tension is there over different ideas in your business?" (2) "How much anger is there in your business during disagreements?" and (3) "How much personal friction is there between members of your organization during disagreements?"

***Collective Entrepreneurship (CE).*** Three items were used to measure collective entrepreneurship, and they were measured on a scale from 0 (not at all) to 5 (very great extent). However, due to the constraint of the available data in this study, we could measure only one of the most important aspects of collective entrepreneurship—the collective capability in identifying external opportunities and internal working and processes for improvement. Opportunity identification (Christensen, Masden, and Peterson 1989; Hills and Shrader 1997; Long and McMullan 1984) is considered one of the most important entrepreneurial activities and capabilities. The items used to measure collective entrepreneurship were: (1) "We are good at scanning the external environment for opportunities and potential problems"; (2) "We are good at scanning the internal workings and processes of this organization for areas which may be improved upon"; and (3) "We try to uncover and communicate all relevant facts, not just those that are politically acceptable."

## Analysis and Results

Structural equation modeling (SEM) was used for analyses. SEM was appropriate for this study because multiple and interrelated dependence relationships involving unobservable concepts were simultaneously investigated.

The model was assessed with several statistics to examine its fit with the data. First, a $c^2$ test was used to assess the goodness-of-fit between the reproduced and observed covariance matrices, an index that measures the absolute fit of the overall model. As sample size increases, this measure has a greater tendency to indicate significant differences for equivalent models. However, when the ratio of the $c^2$ value to degree of freedom is smaller than 2, the model is considered to have an acceptable fit. Another index that attempted to correct for the tendency of the $c^2$ statistic to reject any specified model with a sufficiently large sample was the root mean square error of approximation (RMSEA). Two other indices, which compare the proposed model to a baseline model, often referred to as the null model, which in most cases is a single-construct model with all indicators perfectly measuring the construct, were also used. Two such indices were the adjusted goodness-of-fit index (AGFI) and the comparative fit index (CFI).

The initial model included 25 items intended to measure 8 variables. The $c^2$ statistic was 499.13 with a degree of freedom of 271 ($p = 0.00$). The ratio is smaller than 2.0. RMSEA was 0.056. AGFI was 0.85, and CFI was 0.92. Thus, the measurement model had an acceptable fit. The composite reliabilities of each variable are shown in the diagonal of Table 2. All values were above 0.60, which reflected an acceptable degree of construct reliability.

Convergent and discriminant validity were examined with the significance of loadings to each variable (Table 3) and the correlations among included variables (Table 2). All the loadings were significant statistically and no correlation was above 0.80. The model had achieved an acceptable degree of convergent and discriminant validity (Hair, et al. 1998). The means, standard deviations, and skewness are reported in Table 4.

**Table 2**
**Lisrel Estimates (Maximum Estimation Likelihood) of PHI of the SME Model**

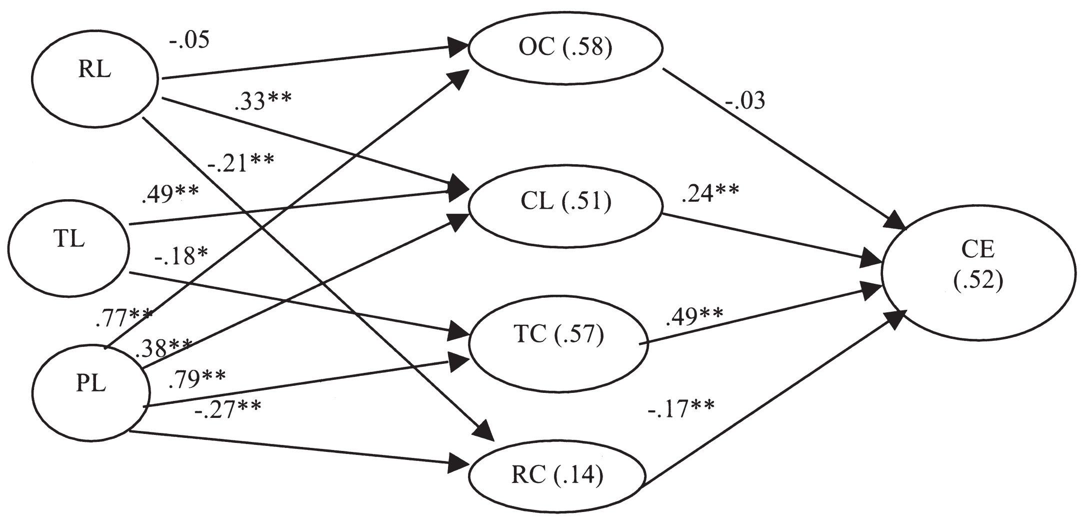
| | TC | RC | CE | CL | PL | TL | RL | OC |
|---|---|---|---|---|---|---|---|---|
| TC | (.68) | | | | | | | |
| RC | -.14 | (.86) | | | | | | |
| CE | .71** | -.34** | (.80) | | | | | |
| CL | .58** | -.37** | .57** | (.82) | | | | |
| PL | .76** | -.32** | .47** | .60** | (.74) | | | |
| TL | .06 | -.12 | .30** | .48** | .32** | (.63) | | |
| RL | .23** | -.29** | .07 | .18* | .16 | -.52** | (.64) | |
| OC | .57** | -.38** | .47** | .63** | .75** | .32** | .06 | (.92) |

TC = Task Conflict, RC = Relationship Conflict,
CE = Collective Entrepreneurship,
OC = Organizational Commitment, PL = Participative Leadership,
TL = Task-oriented Leadership, RL = Relations-oriented Leadership,
CL = Collaboration.
*.05 level of significance
**.01 level of significance

The same sets of goodness-of-fit indices used to evaluate the structural model were also used to assess the measurement model. The $c^2$ statistic was 523.07 with a degree of freedom of 279 ($p = 0.00$). The ratio of the $c^2$ value to the degree of freedom was less than 2.0. RMSEA was 0.057, within the range of acceptance. CFI was 0.92, above the suggested acceptable level; and AGFI was 0.85, which was considered acceptable. In general, the model showed acceptable fit to the data.

The standardized path coefficients for each hypothesized relationship in the theoretical structural model are displayed in Figure 2. The first hypothesis (hypothesis 1) was not supported. Family business members' commitment to the family business (OC) was not significantly related to the family business's collective entrepreneurship (CE) (*Beta* = -.03, *t* = -.38). Hypothesis 2a was supported. Collaboration (CL) was positively and significantly related to collective entrepreneurship (*Beta* = .24, *t* = 2.53). Hypotheses 2b and 2c were also supported. Results showed that positive and significant relationships existed between task conflict (TC) and collective entrepreneurship (*Beta* = .49, *t* = 4.85), and a negative and significant relationship existed between relationship conflict (RC) and collective entrepreneurship (*Beta* = -.17, *t* = -2.62).

Regarding leadership styles and family business members' commitment and interactive behaviors (CL, TC, and RC), most hypotheses were supported. Participative leadership style (PL) was found to be positively and significantly related to family business members' commitment (*Beta* = .77, *t* = 8.16), to collaboration (*Beta* = .38, *t* = 3.66), and to task conflict (*Beta* = .79, *t* = 7.21).




TC = Task Conflict, RC = Relationship Conflict, CE = Collective Entrepreneurship,
OC = Organizational Commitment, PL = Participative Leadership,
TL = Task-oriented Leadership, RL = Relations-oriented Leadership, CL = Collaboration.
*.05 level of significance
**.01 level of significance

**Figure 2. Results of SEM Analysis of the Hypothesized Path Diagram**

**Table 3**
**Properties of the Measurement Model**

| Constructs and Indicators | Standardized Loading | *t*-value[a] | Reliability | Variance Extracted Estimate |
|---|---|---|---|---|
| Task Conflict (TC) | | | 0.68[b] | 0.42 |
| (1)[c] | 0.48 | 7.20 | 0.23 | |
| (2) | 0.72 | 12.37 | 0.52 | |
| (3) | 0.72 | 12.44 | 0.52 | |
| Relationship Conflict (RC) | | | 0.86[b] | 0.68 |
| (1) | 0.82 | 15.50 | 0.67 | |
| (2) | 0.80 | 14.88 | 0.64 | |
| (3) | 0.85 | 16.08 | 0.72 | |
| Collective Entrepreneurship (CE) | | | 0.80[b] | 0.58 |
| (1) | 0.67 | 11.52 | 0.45 | |
| (2) | 0.85 | 15.76 | 0.73 | |
| (3) | 0.75 | 13.26 | 0.56 | |
| Collaboration (CL) | | | 0.82[b] | 0.47 |
| (2) | 0.52 | 8.58 | 0.27 | |
| (1) | 0.74 | 13.39 | 0.55 | |
| (3) | 0.68 | 12.03 | 0.47 | |
| (4) | 0.66 | 11.46 | 0.43 | |
| (5) | 0.80 | 15.07 | 0.65 | |
| Organizational Commitment (OC) | | | 0.92[b] | 0.75 |
| (1) | 0.86 | 17.56 | 0.75 | |
| (2) | 0.83 | 16.50 | 0.69 | |
| (3) | 0.88 | 10.21 | 0.78 | |
| Participative Leadership (PL) | | | 0.74[b] | 0.42 |
| (1) | 0.60 | 9.89 | 0.36 | |
| (2) | 0.71 | 12.20 | 0.50 | |
| (3) | 0.66 | 11.30 | 0.44 | |
| (4) | 0.64 | 10.77 | 0.41 | |
| Task-Oriented Leadership (TL) | | | 0.63[b] | 0.39 |
| (1) | 0.46 | 6.92 | 0.21 | |
| (2) | 0.60 | 9.17 | 0.36 | |
| (3) | 0.73 | 11.17 | 0.53 | |
| Relationship-Oriented Leadership (RL) | | | 0.64[b] | 0.49 |
| (1) | 0.50 | 7.12 | 0.25 | |
| (2) | 0.85 | 9.91 | 0.71 | |

[a] All t-tests were significant at p <.001.
[b] Denotes composite reliability.
[c] The numbers for each item correspond with item numbers provided in the text

**Table 4**
**Means, Standard Deviations, and Skewness**

| Constructs and Indicators | Mean | S.D. | Skewness |
|---|---|---|---|
| Task Conflict (TC) | | | |
| (1)[a] | 5.37 | 1.43 | -0.89 |
| (2) | 3.50 | 1.17 | -0.82 |
| (3) | 3.43 | 0.92 | -0.42 |
| Relationship Conflict (RC) | | | |
| (1) | 2.82 | 0.98 | 0.39 |
| (2) | 2.38 | 0.93 | 0.59 |
| (3) | 2.40 | 0.96 | 0.72 |
| Collective Entrepreneurship (CE) | | | |
| (1) | 3.26 | 1.17 | -0.70 |
| (2) | 3.31 | 1.12 | -0.62 |
| (3) | 3.46 | 1.27 | -1.00 |
| Collaboration (CL) | | | |
| (2) | 3.79 | 1.04 | -1.10 |
| (1) | 4.23 | 0.80 | -1.29 |
| (3) | 4.09 | 0.85 | -0.91 |
| (4) | 4.02 | 0.78 | 0.63 |
| (5) | 4.19 | 0.77 | -0.82 |
| Organizational Commitment (OC) | | | |
| (1) | 5.62 | 1.11 | -1.29 |
| (2) | 5.68 | 1.15 | -1.32 |
| (3) | 5.87 | 1.02 | -1.32 |
| Participative Leadership (PL) | | | |
| (1) | 5.25 | 1.39 | -1.03 |
| (2) | 5.41 | 1.25 | -0.79 |
| (3) | 5.58 | 1.36 | -1.34 |
| (4) | 5.58 | 1.27 | -1.29 |
| Task-Oriented Leadership (TL) | | | |
| (1) | 5.96 | 1.22 | -2.00 |
| (2) | 6.16 | 1.05 | -2.00 |
| (3) | 5.20 | 1.36 | -0.08 |
| Relationship-Oriented Leadership (RL) | | | |
| (1) | 3.86 | 1.84 | -0.84 |
| (2) | 4.13 | 1.91 | -0.19 |

[a] The numbers for each item correspond with item numbers provided in the text.

A negative and significant relationship was also found between participative leadership style and relationship conflict (*Beta* = -.27, *t* = -3.56). Thus, hypotheses 5a, 5b, 5c, and 5d were supported.

Task-oriented leadership style (TL) was found to be positively and significantly related to collaboration (*Beta* = .49, *t* = 3.51); thus hypothesis 4a was supported. The relationship between task-oriented leadership style and task conflict was negative and significant as was hypothesized (*Beta* = -.18, *t* = -2.17). Therefore hypothesis 4b was also supported.

The relations-oriented leadership style (RL) was found to be positively and significantly related to collaboration (*Beta* = .33, *t* = 3.10), so hypothesis 3b was supported. A negative and significant relationship was also found between relations-oriented leadership style and relationship conflict (*Beta* = -.21, *t* = -2.83), thus hypothesis 3c was supported. However, no significant relationship was found between relations-oriented leadership style and family business members' commitment (*Beta* = -.07, *t* = -0.95). Thus, hypothesis 3a was not supported.

## Discussion

Overall, the proposed model of relationships among leadership, attitude, behavior, and collective entrepreneurship was supported.

### *Contribution of Attitude and Behaviors to Collective Entrepreneurship*

All the "mechanisms" (collaboration, task conflict, and relationship conflict) tested in this study were found to contribute to the collective entrepreneurship of small family businesses. Collaboration was a very important contributor to collective entrepreneurship. This finding confirms the arguments of researchers (e.g., Haskins et al. 1998; Bennis and Bierderman 1998) that collaboration contributes greatly to group creativity, collective excellence, and organizational success.

Task conflict positively impacted collective entrepreneurship. Task conflicts promote diverse opinions and ideas regarding a work team's tasks (Amazon 1996; Jehn 1995; Thomas 1992). Importantly, task conflicts also contribute to expression of group or organizational cognitive diversity (Amazon 1996).

Relationship conflict was significantly and negatively related to collective entrepreneurship. Thus, just as it has been found to negatively affect team's decision-making quality, affective acceptance among team members (Amazon 1996), and team performance (Jehn 1995), relationship conflict can damage the collective entrepreneurship of a small family business.

The study failed to find a significant relationship between family business members' commitment and collective entrepreneurship. Results indicated that organizational commitment did not directly contribute to the collective entrepreneurship, even though a positive and significant correlation existed between them (*r* = .47, *p* < . 01). This finding is not consistent with the views of other researchers (Bennis and Beirderman 1998; Stewart 1989).

One possible explanation is that organizational commitment does not directly contribute to collective entrepreneurship. Mediating factors may exist between family business members' commitment and collective entrepreneurship. As previously discussed, commitment was found to lead to organizational citizenship behaviors (George and Brief 1992), which may contribute directly to collective entrepreneurship.

Our results indicated that a positive and significant correlation existed between commitment and collaboration (*r* = .63, *p* < .01) and between commitment and task conflict (*r* = .57, *p* < .01) and that a negative and significant correlation existed between commitment and relationship conflict (*r* = -.38, *p* < .01). These findings suggest that commitment may directly and positively affect task conflict and collaboration among family business members, directly reduce relationship conflicts among them, and then indirectly contribute to a small family business's collective entrepreneurial capability. Moreover, without the behavioral "mechanisms" of collaboration and task conflict, the "energy" of commitment alone will not promote the collective synergistic entrepreneurial capability.

### *Contributions of Leadership to Collective Entrepreneurship*

Almost all hypotheses about leadership styles were supported. Participative leadership positively affected collaboration among family business members, had a positive impact on their commitment, promoted task conflict, and reduced relationship conflicts.

Results indicate that participative leadership helps foster collective entrepreneurship through at least three channels—high collaboration, high task conflict, and low relationship conflict. Participative leadership had the highest joint and indirect effect on collective entrepreneurship (*Beta* = .51, *t* = 5.60).

Task-oriented leadership contributed to collective entrepreneurship through its positive impact on collaboration. However, such collaboration may be highly dependent on the leader's coordination and initiation. Haskins and associates (1998) call this type of collaboration "transactional collaboration" because it is not voluntary nor initiated by team members but is initiated, directed, and controlled by the leader. In contrast, relational collaboration, which is initiated by family business members and embedded in the culture of the family firm, is not dependent on a leader's task-oriented behaviors (Haskins, et al. 1998).

Overall results also indicated that the joint and indirect impact of task-oriented leadership on collective entrepreneurship was insignificant (*Beta* = .03, *t* = .44). Considering its indirect negative impact on collective entrepreneurship, high levels of task-oriented leadership, especially without accompanying relational leadership, is not a good choice for leaders who want to create collectively entrepreneurial family firms.

Results revealed that relations-oriented leadership promotes collaboration and reduces relationship conflicts. Its joint and indirect effect on collective entrepreneurship is positive and significant (*Beta* = .12, *t* = 2.60) but weaker than that of participative leadership. Like participative leadership, relations-oriented leadership is likely to promote "relational collaboration" among family business members instead of "transactional collaboration" (Haskins, et al. 1998), contributing to the family firm's collective entrepreneurial capability.

Inconsistent with the findings of other studies (Bass 1990; Yukl 1998), relations-oriented leaders were not found to positively influence organizational commitment. The measure used in this study may explain these findings. The measurement of relations-oriented leadership, which was based on the reverse scaling of leadership manipulation and domination, failed to reflect such important aspects of this leadership style as developing, rewarding, and recognizing (Yukl 1998), which are often found to be positively related to subordinates' attitudes (Bass 1990).

However, the measure of relations-oriented leadership used here also has its own unique contribution in that it captured a major characteristic of entrepreneurs. As indicated above, the measure was the reverse scaling of the degree to which a leader maintains dominance and manipulates employees. Researchers have found individual entrepreneurs to be dominating and manipulative (e.g., Hornaday and Aboud 1971; Mitton 1989), especially with subordinates and successors (e.g., Handler 1994). This study shows that entrepreneurs with such characteristics, even though they may personally contribute to the business (e.g., Miller 1983), may ultimately hurt the entire organization's collective entrepreneurial capability (Reich 1987). Thus it may be difficult for a family business leader to maintain a high degree of *individual* entrepreneurship and, at the same time, for the entire family business to maintain a high degree of collective entrepreneurship.

### *Limitations*

The static nature of the data made this research at best a snapshot study of a very complex and dynamic multilevel phenomenon. Plans for future studies of collective entrepreneurship should include longitudinal field and systemic studies. Research methods could include experimental and computer simulations that could help better understand the pattern of the development of collective entrepreneurship and its interaction with lower- and higher-level dynamics.

Reliance on a single self-reporting source for each measure in this study could lead to two possible problems. The first is the "key informant" (Mitchell 1994) methodology used in this research. However, efforts were made to minimize negative effects by obtaining respondents who held similar or identical positions in small family business, which helped to reduce problems associated with lack of standardization. A second problem is a possible percept-percept inflation due to the single self-reporting source for each measure. In this research, factor analyses revealed variables prone to the impact of percept-percept impact—commitment and some leadership behaviors—did not load on the same factor, which suggests that the common method was not a serious problem in this study (Podsakoff and Organ 1986).

The tendency of respondents to provide socially desirable answers could contaminate the data for this study, which may suppress and obscure relationships among variables and produce artificial relationships among independent and dependent variables (King and Bruner 2000). In future studies, statistical control techniques should be included in the questionnaire design to reduce the effects of social-desirability bias.

Caution should be taken when generalizing the results to organizations other than small family businesses. We studied family businesses with no more than 20 members, which have unique characteristics (Sorenson, 1999; 2000). Furthermore, due to the constraints of the data, we tested only the collective capability of a small family business to identify opportunities, not to act on them.

## Conclusions and Implications

This study provides evidence that family business leaders have an indirect impact on the collective entrepreneurship of small family businesses. Different from other studies that focused mainly on interfirm or interinstitutional relationships (Nonaka 1988; Mourdoukoutas 1999), this study reveals the complexity of the concept and the mechanism underlying its formation and accumulation inside small family firms. Many individual and collective factors play a role in the formation of collective entrepreneurship. The study also reveals that three behavioral factors, or "mechanisms"—collaboration, task conflict, and relationship conflict—all have positive influence on the collective entrepreneurial capability of small family businesses.

Because it positively impacts family business members' attitudes, collaborative behaviors, and task conflicts, participative leadership is the most effective of the styles in promoting collective entrepreneurship. Relations-oriented leadership also contributes to collective entrepreneurship. However, task-oriented leadership does not significantly contribute to collective entrepreneurship and is the least recommended to practitioners among the three types of leadership.

Another important implication of this study is that in some respects there seems to be irreconcilable conflict between individual entrepreneurship and collective entrepreneurship. This is because individual entrepreneurs are often identified with characteristics (Hornaday and Aboud 1971; Mitton 1989) that may not help to build, and may even destroy, a favorable environment for collective entrepreneurship.

Unlike individual entrepreneurship that emerges from a single "maverick," collective entrepreneurship may possess more staying power since it does not rely on a single person. This is especially important to researchers and practitioners of family businesses because most family businesses rely on the entrepreneurship of founders for their success (e.g., Hoy and Verser, 1994; Miller 1983).

Two directions for future research are very important to a holistic understanding of this collective phenomenon. First, we suggest a systemic approach to study collective entrepreneurship in which collective entrepreneurship is viewed as a system-level or global property that emerges from the dynamic operation (often involving nonlinear interactions) of microlevel variables (McGrath 1997). This study addresses some of those dynamics, such as attitudes, leadership, and interactive behaviors, within the business system. Future research may consider more global and microlevel factors from the family system, such as power sharing, affection, and conflict among family members on a microlevel, and types of family systems on a global level (Constantine 1986; Kantor and Lehr 1975). The interaction between the "family system" and the "business system" (Davis and Tagiuri 1981; Hoy and Verser 1994; Riordan and Riordan 1992) should also be considered to better understand the dynamics and underlying mechanisms of family business's collective entrepreneurial capability.

Second, we suggest more longitudinal studies to examine the effect of collective entrepreneurship on the durability of firms. In addition, longitudinal studies may reveal the difference between the role of family business leaders as individualistic entrepreneurs and as "organizing geniuses" (Bennis and Bierdman 1998) in that they promote enduring collective entrepreneurship within the family firm.

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**About the Authors**

**Jun Yan** (jyan@csulb.edu) is an assistant professor of management at California State University, Long Beach. He received his Ph.D. in management from Texas Tech University. Dr. Yan's areas of research include entrepreneurship, family business, and international management.

**Ritch L. Sorenson** (ritch.sorenson@ttu.edu) is professor and area coordinator of management in the Rawls College of Business at Texas Tech University. Dr. Sorenson received his Ph.D. from Purdue University. He has published articles in a variety of journals including *Group and Organization Studies, Family Business Review*, and *The Leadership Quarterly*. His current research interests include family business, entrepreneurship, conflict management, and leadership.

# Propensity to Trust, Purchase Experience, and Trusting Beliefs of Unfamiliar E-Commerce Ventures

Gregory B. Murphy

*Trust has become a major issue among online shoppers. This underresearched subject will predictably determine the success or failure of e-commerce vendors. The lack of face-to-face interaction, the inability to inspect goods and services prior to purchase, and the asynchronous exchange of goods and money all contribute to the perceived risk of purchasing online and the resulting need for trust. Trust is particularly critical for small and new Internet ventures confronted by the liability of newness (Stinchcombe 1965). Lacking, among other things, a name that is readily recognized in the marketplace, entrepreneurial Internet ventures require trust if they are to succeed. The research presented in this article addresses this issue by building on the work of McKnight and colleagues and considering the effects of propensity to trust on trusting beliefs. Specifically, the author predicts that propensity to trust will significantly affect perceived ability, benevolence, and integrity but only for those individuals with limited direct experience. Based on a sample of web survey participants, the author found that propensity to trust significantly impacted perceived ability and benevolence for individuals with limited direct experience only. No statistically significant results were found for the effects of propensity to trust on perceived integrity.*

Trust has been argued to be "the most significant long-term barrier for realizing the potential of e-commerce to consumers" (Grabner-Kraeuter 2002, 43). This underresearched subject (Cheung and Lee 2001; McCole 2002) will predictably be a "key differentiator that will determine the success or failure of many Web companies" (Urban, Sultan, and Qualls 2000). Hoffman, Novak, and Peralta (1999) noted that many would-be customers lack the trust in e-commerce vendors to go ahead and click the purchase button. Trust is particularly important for e-commerce ventures since, first, customers are usually not able to personally inspect the quality of goods and services or the venture's professionalism (McKnight and Chervany 2001; Torkzadeh and Dhillon 1999) and, secondly, Internet purchases are typically viewed as being more risky (Lee and Turban 2001) since the exchange of goods and money are not simultaneous (Grabner-Kraeuter 2002; Warrington, Abgrab, and Caldwell 2000; Yoon 2002). The lack of face-to-face interaction between salesperson and customer further inhibits the development of trust in online markets (Chadwick 2001; Papadopoulou, Andreou, Kanellis, and Markatos 2001; Yoon 2002). This lack of trust is particularly important for entrepreneurial ventures online as they strive to overcome the liability of newness (Stinchcombe 1965), lacking, among other things, a name that is readily recognized in the marketplace (Murphy and Smart 2000). Previous research has shown that brick-and-mortar establishments with strong brand identification enjoy a considerable advantage when establishing an online store (Cheskin Research/Studio Archetype 1999). The online business is seen as legitimate and trustworthy as a result of the previously established brand name awareness and reputation (Yoon 2002). Entrepreneurial online ventures, however, tend to have little or no name recognition even if the business has a corresponding brick-and-mortar establishment (Murphy and Smart 2000).

Gaining legitimacy and trust is important for the nascent online ventures success and survival as it facilitates the venture's ability to attain needed resources (Murphy and Smart 2000; Zimmerman and Zeitz 2002). The digital economy does allow small entrepreneurial ventures to quickly and inexpensively compete side-by-side with industry titans (Joshi and Yermish 2000). Although entry barriers are low in the digital economy, trust is desperately needed for the small entrepreneurial venture to generate sales sufficient to sustain and grow the venture (Murphy and Smart 2000).

Recent research has begun to address this issue by offering (Cheung and Lee 2001; Gefen 2002; Grabner-Kraeuter 2002; Javenpaa, Tractinsky, and Vitale 2000; Kimery and McCord 2002; Lee and Turban 2001; McKnight and Chervany 2001; Murphy and Smart 2000) and testing (Gefen 2002; Kimery and McCord 2002; Lee and Turban 2001; McKnight, Choudhury, and Kacmar 2002a; McKnight, Choudhury, and Kacmar 2002b; McKnight, Kacmar, and Choudhury 2003; Murphy and Blessinger 2003) models of online trust development. Only Lee and Turban (2001), however, tested the relationship between propensity to trust and trusting beliefs. Specifically, Lee and Turban (2001) found that propensity to trust moderated the relationship between perceived integrity (a trusting belief) and consumer trust in Internet shopping. McKnight and Chervany (2001) proposed propensity to trust as an antecedent of trusting beliefs for online shoppers but did not empirically test the relationship. This study seeks to extend this line of research by investigating the effects of propensity to trust on the basic trusting beliefs of perceived ability, benevolence, and integrity (Mayer, Davis, and Schoorman 1995; McKnight, Cummings, and Chervany 1998). Information gained from this study may be useful to e-commerce ventures in building a level of trust necessary to encourage online shoppers to click the purchase button, an action clearly necessary to survive and succeed as an online vendor.

McKnight, Cummings, and Chervany (1998) noted that initial trust formation is based on either the individual's propensity to trust or on information cues that promote trust in the absence of experience. Murphy and Smart (2000) and Murphy and Blessinger (2003) consider the effects of information cues but do not consider the effects of disposition or propensity to trust. Rotter (1971) stated that the impact of generalized expectancies (propensity to trust) should vary from situation to situation, depending on the novelty of the situation. Context and experience are, as a result, important when considering the effects of propensity to trust.

## Trust

Trust is a complex construct and the definition of trust is not widely agreed upon (McKnight and Chervany 2001). McKnight and Chervany (2001) note that trust is a subject of interest to several major disciplines (psychology, economics, sociology, and social psychology) and that functional orientations logically lead scholars in different fields to adopt different definitions. There are, however, some common elements of major trust definitions. Specifically, there is a willingness to make oneself vulnerable under the general conditions of risk and uncertainty (McKnight and Chervany 2001; Rousseau, Stikin, Burt, and Camerer 1998). The need for trust increases as individuals have less information and experience in dealing with each other (Aldrich and Fiol 1994) and is considered to be a critical element needed to facilitate most exchange relationships (Mayer, Davis, and Schoorman 1995; Ring 1996; Rousseau, Sitkin, Burt, and Camerer 1998) including Internet transactions (Gefen 2002).

Different disciplines tend to focus on different trust relationships. Much of the management literature dealing with the subject of trust tends to focus on trust within organizations (Mayer, Davis, and Schoorman 1995; Rousseau, Sitkin, Burt, and Camerer 1998) while other parts of the literature focus on trust between persons and organizations (McKnight and Chervany 2001; McKnight, Choudhury, and Kacmar, 2002a; McKnight, Cummings, and Chervany 1998). The focus of this study is person-to-organization trust. The within organization trust literature will be used, however, to the extent that the concepts logically extend to person-to-organization trust.

## Trusting Beliefs

Mayer, Davis, and Schoorman (1995) offered what they termed factors of trust. McKnight and colleagues (McKnight and Chervany 2001; McKnight, Choudhury, and Kacmar 2002a and b; and McKnight, Cummings, and Chervany 1998) referred to these same factors as trusting beliefs. Both Mayer, Davis, and Schoorman (1995) and McKnight and colleagues extensively reviewed the trust literature and identified common and important trusting beliefs. Specifically, the authors identified ability, benevolence, and integrity as factors of trust or trusting beliefs. Mayer, Davis, and Schoorman (1995, 717) noted that these factors are "not trust per se," but they "help build the foundation for the development of trust." McKnight, Cummings, and Chrevany (1998) and McKnight and Chervany (2001) are also careful to state that these trusting beliefs are part of a broader trust typology. These trusting beliefs are extremely important, however, because they are posited to directly affect trusting intentions (McKnight, Cummings, and Chervany 1998; McKnight and Chervany 2001) and trust itself (Lee and Turban 2001; Mayer, Davis, and Schoorman 1995).

Mayer, Davis, and Schoorman (1995) defined ability as "that group of skills, competencies, and characteristics that enable a party to have influence within some specific domain" (717). They stress the specificity of the domain of influence given the contextual applicability of specific skills, competencies, and characteristics. McKnight and Chervany (2001, 49) add that "in the case of the Internet relationship, the consumer would believe that the vendor can provide goods and services in a proper and convenient way." Benevolence was defined as "the extent to which a trustee is believed to want to do good to the trustor, aside from an egocentric profit motive" (Mayer, Davis, and Schoorman 1995, 718). "Benevolence is the perception of a positive orientation of the trustee toward the trustor" (719). In the context of e-commerce, McKnight and Chervany (2001, 49) add that "a benevolent Internet vendor would not be perceived to act opportunistically by taking advantage of the trustor." Integrity is defined as the "trustor's perception that the trustee adheres to a set of principles that the trustor finds acceptable" (Mayer, Davis, and Schoorman 1995, 719). In this particular context, the consumer believes that the Internet vendor will fulfill its ethical obligations (McKnight and Chervany 2001, 49). It is important to note that these trusting beliefs—ability, benevolence, and integrity—are all perceptions of the trustor about the trustee. McKnight and Chervany (2001, 46) commented that "trusting beliefs means that one believes that the other party has one or more characteristics beneficial to oneself. In terms of characteristics, the consumer wants the e-vendor to be willing and able to act in the consumer's interest, honest in transactions, and both capable of, and predictable at, delivering as promised."

Mayer, Davis, and Schoorman (1995) conclude that ability, benevolence, and integrity are related but separable and that together they explain much of the variance in trustworthiness while maintaining parsimony. Gefen's (2002) study empirically supports the validity of ability, benevolence, and integrity as trusting beliefs. Principal component analysis revealed clean factor loadings, and confirmatory factor analysis using LISREL confirmed the validity of using ability, benevolence, and integrity as important and distinct trusting beliefs, using two different samples of MBA students. Goodness of fit indexes strongly supported the model. Likewise, McKnight, Choudhury, and Kacmar (2002a) examined the factor structure of the three trusting beliefs and found strong convergent and discriminant validity.

Much of the literature on trust assumes the presence of a prior relationship (Bigley and Pearce 1998; Garbarino and Johnson 1999; Gulati 1995; Harrison, Dibben, and Mason 1997; Nooteboom, Berger, and Noorderhaven 1997). However, there is evidence that trust can be present, and in some cases strong, in the absence of a prior relationship (McKnight, Cummings, and Chervany 1998). McKnight, Cummings and Chervany (1998, 474–475) note that initial trust is not based on experience or prior knowledge but rather on "an individual's disposition to trust or on institutional cues that enable one person to trust another without firsthand knowledge." Building initial trust is precisely the dilemma faced by aspiring entrepreneurial Internet ventures (Murphy and Smart 2000). Lacking name recognition and exposure in the marketplace, new and/or small Internet ventures are likely very dependent on the consumer's disposition or propensity to trust.

## Propensity to Trust

Rotter (1971, 444) defined what he called interpersonal trust as "an expectancy held by an individual or a group that the word, promise, verbal, or written statement of another individual or group can be relied on." Rotter (1971) adds that such expectancies are generalized and constitute a relatively stable personality characteristic. More recently, trust researchers have referred to these same generalized expectancies as propensity to trust or disposition to trust (Mayer, Davis, and Schoorman 1995; Bigley and Pearce 1998; Kimery and McCord 2002; Lee, and Turban 2001; McKnight and Chervany 2001; McKnight, Cummings, and Chervany 1998; Cheung and Lee 2001). Mayer, Davis, and Schoorman (1995, 715) defined propensity to trust as "a stable within party factor that will affect the likelihood the party will trust." Consistent with other definitions of propensity to trust, Bigley and Pearce (1998, 410) comment that "factors exist within individuals that predispose them to trust or distrust others, whom they do not know." Mayer, Davis, and Schoorman (1995) note that at the extremes some people are willing to grant total blind trust while others will not trust regardless of the circumstances that make it relevant to trust. This individual characteristic is said to be something akin to a personality trait (Mayer, Davis, and Schoorman 1995) that is the product of early life socialization experiences (Bigley and Pearce 1998; McKnight, Cummings, and Chervany 1998).

In their reviews of the literature, Mayer, Davis, and Schoorman (1995) note that propensity to trust has been found to be significantly related to important organizational outcomes in different contexts. Lee and Turban (2001, 77) comment that "a consideration of consumer trust in Internet shopping that did not examine trust propensity, a personality trait of the concerned consumers, would be quite inadequate." Mayer, Davis, and Schoorman (1995) and McKnight and colleagues (McKnight and Chervany 2001; McKnight, Cummings, and Chervany 1998) also suggest that propensity to trust should be significantly related to trusting beliefs. However, McKnight, Cummings, and Chervany (1998) report mixed empirical findings and conclude that any link has yet to be adequately proven. Bigley and Pearce (1998) comment on the empirical literature and note that many of the studies that have failed to find significant results did not consider the novelty of the situation in determining the salience of propensity to trust. In support of Bigley and Pearce (1998), Rotter (1971, 445) does comment that "the more novel the situation, the greater weight generalized expectancies have." Rotter (1971, 445) adds that "the situation partially determines the response, and the theory predicts that situations of considerable familiarity are less predictable from a generalized tendency than those involving more novelty." McKnight and Chervany (2001, 45) add that "disposition to trust will affect trust in a specific other (interpersonal trust), but only when novel situations arise in which the other and the situation are unfamiliar."

The effects of propensity to trust should be strongest in the absence of previous experience. For the Internet shopper in particular, a lack of online experience creates a novel and unfamiliar situation that should promote the importance of propensity to trust on trusting beliefs (McKnight and Chervany 2001). Since a potential Internet customer is unlikely to have previously encountered the website of a given new and/or small Internet venture, the effects of propensity to trust are particularly salient. Given such a novel environment, one's disposition or propensity to trust may be the only basis for trusting or not trusting (Johnson-George and Swap 1982).

Linking the previous literatures on propensity to trust and trusting beliefs, we posit that propensity to trust will significantly affect evaluations of an e-commerce vendor's perceived ability, benevolence, integrity, and trustworthiness—but only for individuals with low Internet purchasing experience. Experienced online shoppers are likely much less affected by trusting propensities. In such cases, previous experiences tend to dominate perceptions of trustworthiness (McKnight, Cummings, and Chervany 1998).

**Hypothesis 1: Propensity to trust will be significantly related to perceived ability, but only for respondents with low experience.**

**Hypothesis 2: Propensity to trust will be significantly related to perceived benevolence, but only for respondents with low experience.**

**Hypothesis 3: Propensity to trust will be significantly related to perceived integrity, but only for respondents with low experience.**

The theoretical model is presented in Figure 1. The hypotheses add the effects of direct experience to the model developed by McKnight and Chervany (2001). The model presented by McKnight and Chervany (2001) was chosen since it has been previously adopted for research on trust in e-commerce (McKnight and Chervany 2002; McKnight, Choudhury, and Kacmar 2002a; McKnight, Choudhury, and Kacmar, 2002b; McKnight, Kacmar, and Choudhury 2002). Although McKnight and Chervany (2001) did not explicitly include experience in their model, they did comment in their paper that disposition to trust will only affect trust when novel, unfamiliar situations are encountered. The model is different from that presented by Lee and Turban (2001) and Mayer, Davis, and Schoorman (1995) in that, first, propensity to trust is treated in this study as an antecedent of trusting beliefs, consistent with prior research by McKnight and colleagues (McKnight and Chervany 2002; McKnight, Choudhury, and Kacmar 2002a; McKnight, Choudhury, and Kacmar 2002b; McKnight, Cummings, and Chervany 1998; McKnight, Kacmar, and Choudhury 2002) rather than as a moderating variable between trusting beliefs and trust; and second, the effects of experience are considered in this study. Although Internet shopping experience was not included in Lee and Turban's (2001) model, they did report that 95 percent of the respondents in their sample of 405 business school undergraduates majoring in management information systems at the City University of Hong Kong had no Internet shopping experience. Lee and Turban (2001), did, however, assess the effects of trusting beliefs on perceived trustworthiness. These relationships, consistent with the model developed by McKnight and Chervany (2001) are depicted in Figure 1 with dashed lines since they will not be tested in this study.

## Instrument, Sample, Methodology, and Results

### *Instrument*

A web survey was prepared for this study. The survey presented a series of mock e-commerce web pages. All of the mock web pages were identical except for the information cue. Information cues are used by Internet vendors to try to communicate their trustworthiness (Grabner-Kraeuter 2002; Murphy and Smart 2000; Warrington, Abgrab, and Caldwell 2000) and are particularly relevant for inexperienced Internet shoppers (Murphy and Smart 2000). The pages depicted a fictional e-commerce business named "Collectibles

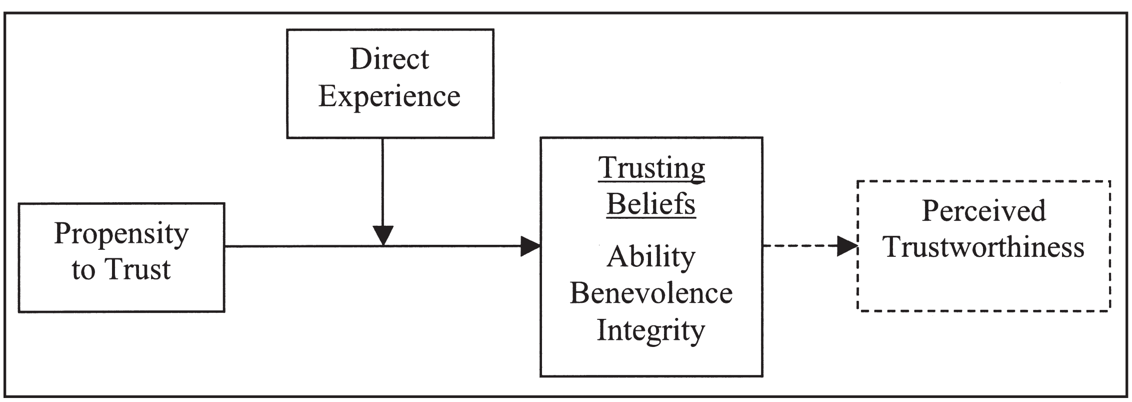


**Figure 1**
**Model of Propensity to Trust, Direct Experience, and Trusting Beliefs**

Inc." and included a subheading ("Your one-stop shop for collectibles") and six pictures of collectible items (antique furniture, Elvis Presley postage stamp, old comic book, print of a classic painting, bell bottom jeans, and Yogi Bear slippers). The collectibles industry was chosen because it presents a relatively high risk of opportunistic behavior and, as such, emphasizes the importance of trust and trustworthiness.[1] Doney and Cannon (1997) note that some level of risk is needed for trust to be operative. Sheppard and Sherman (1998) add that benevolence is only relevant in the presence of considerable risks. Kimery and McCord (2002) add that trust has the effects of reducing risk perceptions and increasing risk-taking behavior.

Each of the 16 mock pages contained a different information cue.[2] The specific cues used are listed in Table 1. The use of information cues is consistent with McKnight and Chervany (2001) and others (McCole 2002) in positing that web vendor interventions that are appropriately communicated to potential e-commerce customers (Chadwick 2001) have the potential to impact trusting beliefs. The specific information cues used (from Murphy and Blessinger 2003) and the specific intervention or trust-building strategy they are intended to measure are presented in Table 1. Murphy and Blessinger (2003) developed their cues from the work of Murphy and Smart (2000) and focus specifically on the case of new and small entrepreneurial Internet ventures that have yet to establish a strong, readily recognizable brand name. The developed cues focus on new and/or small businesses' ability to communicate similarity to trusted forms (isomorphism) as well as their ability to strategically communicate transference or identification; competency, value, and goal congruence; the presence of structural assurances; and a history of fulfillment with other customers (Murphy and Blessinger 2003; Murphy and Smart 2000). While communicating a history of successful fulfillment with other customers is not possible for completely new ventures, it is possible and likely an important cue for a small business seeking to expand its geographic reach by venturing online (Murphy and Blessinger 2003; Murphy and Smart 2000).

Respondents were asked to indicate their perceptions of the mock vendor's ability, benevolence, and integrity using a 5-point Likert scale (1 = strongly disagree, 2 = disagree, 3 = neither agree nor disagree, 4= agree, 5 = strongly disagree) on the bottom of each of the 16 pages. Respondents were asked in the introduction to the survey and on each page of the survey to consider only the information available on the immediate page in answering the questions.

To measure perceived ability, respondents were asked to rate their agreement with the following statement: "I believe this e-commerce vendor has the ability to deliver goods as promised." To measure perceived benevolence, respondents were asked to rate their agreement with the following statement: "I believe this e-commerce vendor has my best interests in mind." To measure perceived integrity, respondents were asked to rate their agreement with the following statement: "I believe this e-commerce vendor follows acceptable business practices." Each of

**Table 1**
**Communicated Cues and Their Respective Strategies**

| Cue | Strategy Communicated |
|---|---|
| Certified compliance with all legal and regulatory agencies | Legal and regulatory compliance |
| Questions? Please call our showroom at 1-800-579-6548 | Conforming to common expectations |
| Highest rating by MySimon.com | Endorsement (trust broker) |
| "We put our trust in Collectibles Inc." —Mark and Mary Thompson | Testimonial |
| Member of the Chamber of Commerce and the Web Merchants Association | Business alliances |
| Over 30 years experience | Business and professional experience |
| We employ only the best trained and educated web technicians | Technical competency |
| Payment security assured | Payment security |
| We promise to keep your personal information confidential | Information security |
| Your money back if not fully satisfied | Product and/or service guarantee |
| All orders promptly delivered by two-day delivery. Order tracking available | Fulfillment process clarity |
| Over 10,000 orders have been successfully filled | Fulfillment |
| Make a purchase and a portion of the proceeds will go to the charity of your choice | General value and goal congruence |
| We offer superior quality and service at competitive prices | Clarifying value added |
| Hello, I'm the owner, Cathy. Please e-mail me with your comments | Personalization |
| Share your comments and read what other customers have said | Information sharing |

these statements was developed to reflect the definitions of ability, benevolence, and integrity offered by Mayer, Davis, and Schoorman (1995). The responses to the different information cues were combined for this study. The coefficient alphas for the ability, benevolence, and integrity variables were .93, .94, and .92 respectively.

A pilot study was conducted using approximately 30 undergraduate students as subjects. The subjects completed a pencil and paper version of the web survey. Immediately after the surveys were completed, a feedback session was conducted to ensure that each information cue and question was interpreted as intended. Responses indicated good matches between the subjects' interpretation and understanding of each question and the corresponding theoretical and methodological underpinnings of each question.

The propensity to trust scale developed by Schoorman, Mayer, and Davis (1996) was used for this study. The propensity to trust scale was also administered online. Data for the scale were collected before the respondents viewed and reacted to the 16 trust-building information cues. Mayer and Davis (1999) used the same scale and found the coefficient alphas for the two waves of their study to be .55 and .66. This study found the coefficient alpha for the scale to be .63. Nunnally (1978) recommends a threshold of .70 in establishing reasonable scale reliability. Accordingly, the eight items in the scale were factor analyzed to further investigate the relationships among the items. Results of the factor analysis using Varimax rotation are presented in Table 2. Table 2 also presents the exact wording of each item.

Two distinct factors with eigenvalues greater than one were found in the analysis. The two factors appear to reflect two different propensities: a propensity to trust and a propensity to distrust. This finding is consistent with the work of authors who contend that trust and distrust are different dimensions (Bigley and Pearce 1998; Koehn 2003; Lewicki, McAllister, and Bies 1998; McKnight, Kacmar, and Choudhury 2003). Given the poor scale reliability and the strong match between the factor analysis results and existing theory, the two factors (propensity to trust and propensity to distrust) were retained and used in the remainder of the study.

Internet purchase frequency was used as an indicator of experience and was measured by asking respondents to indicate the number of Internet purchases they had made over the preceding 12 months. One control variable was used in the study: trust in the Internet. This was deemed appropriate given the possibility that trust in the Internet in general may impact the more specific trust in a busi-

**Table 2**
**Factor Analysis Using Varimax Rotation of Propensity to Trust Items**

| | Propensity to Trust | Propensity to Distrust |
|---|---|---|
| Most experts tell the truth about the limits of their knowledge. | **.67** | .03 |
| Most people can be counted on to do what they say they will do. | **.64** | .24 |
| Most adults are competent at their jobs. | **.61** | -.10 |
| Most salespeople are honest in describing their products. | **.59** | .19 |
| Most people answer public opinion polls honestly. | **.58** | .06 |
| These days, you must be alert or someone is likely to take advantage of you. | -.03 | **.81** |
| One should be very cautious with strangers. | .04 | **.75** |
| Most repair people will not overcharge people who are ignorant of their specialty. | .33 | **.47** |
| Eigenvalue | 2.02 | 1.54 |
| Percent of variance explained | 25.29 | 19.26 |

ness-to-consumer e-commerce vendor. Respondents were asked, "In general, do you trust or distrust the Internet?" Possible responses ranged from "trust the Internet a great deal" to "distrust the Internet a great deal."

### *Sample*

A sample of potential e-commerce customers was sought for this study. Initially, a two-stage process was used to identify a sample. To begin, an equal number of male and female names (100 each) were chosen from the Pregnancy Today Random Baby Namer website located at http://www.pregnancytoday.com/names. Each time the page is updated, the site returns 10 randomly selected male names and 10 randomly selected female names. The site purports to contain more than 12,000 names in its database reflecting all "flavors, colors and origins." Each name was then searched for in the World Email Directory located at http://www.worldemail.com. The search was limited to individuals in the United States to reduce language and/or cultural differences. Lee and Turban (2001) note that propensity to trust may be heavily influenced by culture. Although there is cultural diversity within the United States, there is no doubt increased cultural diversity when respondents are sought from additional counties. The World Email Directory reports to have more than 18 million e-mail addresses worldwide in its database and claims to be the "fastest growing search engine for people, businesses and organizations." This process resulted in 548 nonduplicate, individual entries with verifiable[3] e-mail addresses.

Dillman's (2000) recommended procedures for conducting a web and/or Internet survey were followed. Each subject received a presurvey notice and three subsequent mailings (e-mails) prompting participation. Each of the three subsequent mailings contained a link to the web survey, which was hosted on a server at the researcher's institution. Contacts were organized into distribution lists and invitation messages were sent out via blind carbon copy (bcc) to increase efficiency and to avoid the presentation of multiple entries on the "to" line (Dillman 2000). A total of 216 usable responses were obtained from this process (39.4% response rate).

To supplement the responses, approximately 65 senior-level undergraduate students were asked to participate and to invite their contacts to participate.[4] Although the exact number of persons contacted via this method is unknown, an impressive 258 usable responses were obtained from this process. Since this process was decidedly less random and less controlled than the initial collection method, analyses were initially run on the two samples separately. And, since the analyses yielded comparable and consistent results, the two samples were subsequently combined into one sample.

Approximately 60 percent of the respondents were male, and the average age of the respondents was approximately 27 years old (range of 18–80). The average number of hours a week spent online was 14.89 (median of 8), and the average number of Internet purchases over the 12 months prior to the survey was 6.1 (median of 2). When asked, "In general, do you trust or distrust the Internet ?" 3.1 percent indicated that they trust the Internet a great deal; 38.8 percent noted that they trust the Internet; 33.7 percent responded that they neither trust not distrust the Internet, 11.8 percent reported that they distrust the Internet, and 2.2 percent stated that they distrust the Internet a great deal.

### *Methodology*

To test the hypotheses that propensity to trust significantly affects perceived ability, benevolence, and integrity in the absence of experience, the sample was divided into three subgroups based on the frequency of Internet purchases over the prior 12 months. The first group (low experience) purchased goods or services over the Internet no more than once during the prior 12 months. The second group (medium experience) purchased goods or services over the Internet between two and five times during the prior 12 months while the third group (high experience) purchased goods or services over the Internet more than six times during the prior 12 months. The hypotheses were then tested by regressing the control variable, trust in the Internet, and the two propensity factors on perceived ability, benevolence, and integrity for each of the three groups. Support for the hypotheses will be found if significant relationships are found only for the low experience group.

### *Results*

Results of the analysis are presented in Table 3. Support is found for hypotheses one and two. Propensity to trust was found to be positively related to perceived ability for the low experience group only, providing support for hypothesis one. For this sample, inexperienced individuals with a general tendency to trust gave higher evaluations of vendor ability than those with greater relative experience. Propensity to distrust was found to be negatively related to perceived benevolence for the low experience group only, providing support for hypothesis two. This finding indicates that inexperienced individuals with a general tendency to distrust gave lower evaluations of vendor benevolence than those with more experience. Regarding hypothesis three, no statistically significant relationships were found for any of the three experience groups. This

**Table 3**
**Regression of Propensity to Trust Factors on Perceived Ability, Benevolence, Integrity, and Trustworthiness for Low, Medium, and High Internet Purchase Frequency Groups**

| | Ability | Benevolence | Integrity |
|---|---|---|---|
| Low frequency group (N=175) | | | |
| Trust in the Internet | .14 | .10 | .09 |
| Propensity to trust | **.26 | .12 | .04 |
| Propensity to distrust | -.07 | *-.21 | -.15 |
| Medium frequency group (N=134) | | | |
| Trust in the Internet | -.10 | -.03 | -.14 |
| Propensity to trust | -.10 | -.08 | -.08 |
| Propensity to distrust | .08 | .02 | .04 |
| High frequency group (N=96) | | | |
| Trust in the Internet | .01 | .05 | .03 |
| Propensity to trust | .08 | -.16 | -.01 |
| Propensity to distrust | -.03 | .07 | .07 |

Standardized regression coefficients reported
*p<.05, ** p<.01

suggests that propensity to trust and propensity to distrust may not significantly affect perceptions of integrity and that differences in experience level may not be relevant in clarifying the relationship.

Results of this study provide some support for the proposition that propensity to trust will be most salient in the absence of prior experience (Rotter 1971; Mayer, Davis, and Schoorman 1995; McKnight and Chervany 2001; McKnight, Cummings, and Chervany 1998). No statistically significant relationships were found for the medium and high frequency purchase groups. This finding suggests that propensity to trust is likely much more important for new and/or small Internet ventures than it is for well-established Internet ventures that consumers are more likely to have experienced.

The findings of this study add to the work of McKnight, Kacmar, and Choudhury (2003). The authors examined the effects of disposition to trust and disposition to distrust on institution-based trust (perceptions of the structural assurances of the Web), perceived web site quality, willingness to explore a web site, and trusting intentions in the web site. McKnight, Kacmar, and Choudhury (2003) found that disposition to trust was positively related to structural assurance perceptions, perceived site quality, and willingness to explore, while disposition to distrust was significantly related to perceptions of deficient structural assurances and negatively related to trusting intentions. This study also found disposition to trust and disposition to distrust to be distinct and important to the cause of Internet vendors. This study adds to the work of McKnight, Kacmar, and Choudhury (2003) by including the important variables of trusting beliefs (McKnight and Chervany 2001) and by specifying the circumstances under which disposition to trust and distrust are most salient (low experience). McKnight, Kacmar, and Choudhury (2003) identify a contribution of their paper as showing that disposition to distrust is stronger than disposition to trust in predicting high-risk behaviors. This paper supports that finding by showing that while propensity to trust was significantly related to perceived ability, propensity to distrust was found to be significantly related to perceived benevolence. Perceived benevolence, the perception that the trustee is considerate of and acts in the best interests of the trustor, is likely viewed as being more risky than perceived ability, which only requires that the trustor view the trustee as being capable of performing the required tasks. To believe that another is capable of delivering as promised is not the same as believing that the other will necessarily do so.

Two of the trust-building cues taken from Murphy and Blessinger (2003) and used in this study ("over 10,000 orders have been successfully filled" and "over 30 years experience"), although possibly appropriate for ventures expanding their existing business over the Internet, are likely not appropriate for entirely new ventures. To assess the generalizability of the results of this study to entirely new ventures, the analysis was repeated without the two cues that require business experience. The significant relationships were unchanged. Propensity to trust was found to be positively related to perceived ability for the low experience group only and propensity to distrust was found to be negatively related to perceived benevolence for the low experience group only. No other relationships were statistically significant. These findings suggest that the results of this study are generalizable to entirely new ventures as well as to existing ventures expanding by using the Internet.

## Discussion

There has arguably never been more pressure on e-commerce businesses to gain the trust of Internet users. "When it comes to using the Internet for business transactions, gaining the trust of users has been a challenge" (Chapko 1999, 29). Despite the Internet's rapid growth, there are still millions of dollars lost everyday from Internet users abandoning their "shopping carts." Many web surfers simply lack the trust necessary to go ahead and click the purchase button (Hoffman, Novak, and Peralta 1999). Problems that inhibit trust in e-commerce, such as the inability to inspect goods and services before purchase and the lack of simultaneous exchange, are partially overcome by third-party information providers (Ba, Whinston, and Zhang 2003; Kimery and McCord 2002; Siyal and Barkat 2002). MySimon, for example, provides ratings of Internet stores that market products on their web site. However, problems in establishing trust remain. Kimery and McCord (2002) found, for example, that frequently used third-party assurance providers did not significantly influence respondents' perceptions of web vendor trustworthiness. Koehn (2003) commented that while third-party information providers can help build trust, a favorable certification from a third party will not necessarily cause the web vendor to be seen as trustworthy by consumers.

This article has sought to improve our understanding of trust in business-to-consumer e-commerce by examining the effects of propensity to trust on consumer perceptions of e-commerce vendor ability, benevolence, and integrity. As Rotter (1971) noted, context matters when considering the effects of propensity to trust. Richness and theoretical grounding are further added to the study by including factors of trust or trusting beliefs (perceived ability, benevolence, and integrity). A contribution is also made to the literature by supporting Rotter's (1971) position that propensity to trust is most salient when experience is low. Although trust is likely strongest when prior experience is high (Doney and Cannon 1997; Garbarino and Johnson 1999), the effects of disposition or propensity to trust on trusting beliefs are strongest when experience is low. Insight has also been gained on the dimensionality of propensity to trust by finding factors that suggest a propensity to trust and a propensity to distrust.

For the practitioner, the results of this study suggest that, when trying to attract new customers, business-to-consumer e-commerce vendors should focus more effort on promoting perceived ability than perceived benevolence or integrity. Conversely, this study suggests that a relative focus on promoting perceived ability may not be needed when dealing with experienced customers.

Using mock web pages placed the study more in context and hopefully increased the realism of the study relative to conventional survey methods. The use of mock web pages also allowed for greater experimental control. By using mock web pages, the researcher was able to carefully control what the respondents were seeing and reacting to. Although a strength of the study, the use of mock web pages also has its limitations. Specifically, we were not able to simulate free navigation flow through different web pages. Also, by controlling the content, the mock sites no doubt lacked the complexity of typical business-to-consumer web sites.

Some recommendations for future research are suggested. A study of the effects of propensity to trust using real business-to-consumer web sites would be interesting. Such a study would add further contextual richness and possibly increase the realism of the study. Considering different industries may also influence study results and may be another point for investigation. It is possible that different industries present different real and/or perceived risks in type and intensity. Differences in risk may consequently affect a potential online consumer's willingness to trust. This study found that experience matters in determining the effects of propensity to trust. However, the rate in which experience supplants the effects of propensity to trust has not, in this context, been adequately explored. Finally, Murphy and Blessinger (2003) found that trust-building information cues significantly improved trusting beliefs and perceptions of overall trustworthiness. Further research may find it useful to consider the combined effects of information cues and propensity to trust.

## Endnotes

1. A pretest confirmed the perceived relative risk of purchasing collectibles online. Respondents indicated greater perceived risk when buying collectibles online relative to buying t-shirts online.
2. Applets were used to speed the loading of what appeared to the respondent as successive pages.
3. Addresses that did not return a user unknown undeliverable message.
4. Although the use of student samples is often a questionable practice, it should be noted that college students are, on average, relatively very heavy Internet users (Anderson 2001). According to Anderson (2001), 28 percent of all Internet users are full-time students and the typical Internet-using student is on the Internet for 100 minutes a day.

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**About the Author**

**Gregory B. Murphy** (GBMurphy@usi.edu) is an assistant professor of management at the University of Southern Indiana. He received his Ph.D. in business administration from the University of Houston. His research interests are in the areas of entrepreneurship and electronic commerce. He has previously published in the *Journal of Business Venturing, Journal of Business Research, Journal of High Technology Management Research,* and *New England Journal of Entrepreneurship*

# Musings of a Serial Entrepreneur—Reconciling Theory with Practice

Joseph E. Levangie

*To reminisce about my entrepreneurial career with appropriate self-importance, I might note that I have helped create companies and jobs. This contributes in a small way to economic growth. Economic growth is, however, an often illusive concept to characterize. Job growth is an essential component of a dynamic, innovative process. In the late 1970s jobs growth research suggested that the vast majority of new jobs are created by small business formation. Such empirical research is difficult to support with theoretical constructs. Classic macroeconomics analysis discounts size-of-firm as irrelevant. Entrepreneurial contribution is therefore difficult to assess.*

If we cannot divine satisfaction from arcane macroeconomic treatises (e.g., the "creative destruction theory" of shifting market structure crafted in the 1930s by Joseph Schumpeter), perhaps we can understand, from a bottom-up perspective, how these storied champions of small business formation really think and operate: the entrepreneurs.

If the so-called "science" of economics seems difficult to nail down, so too are the fundamentals and psychology of the venturing process. The intrinsic entrepreneurial success it occasionally spawns, from this practitioner's vantage point, represents a true mélange of conflicting views, often mysterious in its very nature. Accordingly, I choose to study this curious entrepreneurship process as a set of *mysteries!*

## The Seven Mysteries of Venturing

Let me address the following seven entrepreneurial mysteries:

1. Are entrepreneurs made or born?
2. Does new venturing represent high risk or "measured" risk?
3. Is the business plan a selling document or an integrated and detailed guide?
4. Should entrepreneurs be fast-moving and act with intuition or employ MBA-like analytical tools?
5. Should emerging companies stay clear of large entrenched companies or try to work with them?
6. Should entrepreneurs focus on personal equity control of their company or relinquish control in exchange for adequate resources?
7. Is the ultimate raise-up of seed and growth capital a logical fall-out of the entrepreneurship process or a serendipitous miracle?

I will apply the lessons of my own successes and failures of the last three decades to interpret these dilemmas.

### *Mystery #1—Born Entrepreneurs*

*Are entrepreneurs made or born?*

Entrepreneurship can involve mind-numbing risk taking and produce brain chemical rushes that defy description. The very nature of analyzing entrepreneurs can be like trying to interpret the lifestyles of fuzzy, crawly alien life. An integrating principle is often lacking. The "venturing addiction" can also produce anecdotal tales of entrepreneurs snatching defeat from the jaws of victory:

- I had an enraged entrepreneur throw an ash-filled trash can at me (he missed) in London when he stubbornly refused to share, with other venture team members, a meeting with institutional investors. I persisted. The "team" prevailed. We executed a successful London IPO.
- I was sued by an entrepreneur advisee who was emotionally dismayed that I would not endorse the use of either his wife's name or image on a box of biodegradable diapers.
- I was chastised by a "born again" Christian entrepreneur who challenged my very morality for not endorsing a ("born-again" logo) venture for which he intellectually or psychologically could not even craft a sensible business plan . The lack of this critical document caused all his "born again" investors to walk.

Born or made? My own venturing proclivity is best described as an acquired quirk, not a genetic or glamorous gift. I have met just a few life-long, inveterate entrepreneurs. Almost idiot savants, they have been gifted lateral thinkers in strategic thinking, market interpretation, product development, financial "engineering," and the like, while often lacking practical social skills such as tact, flexibility, open communications, team building, and operations savvy. But they're certainly not idiots. I took the more traditional route, acquiring academic and business credentials to establish both an economic safe haven and a knowledge base so I could eventually figure out what I wanted to be when I grew up. My entrepreneurial learning process is unending, and my own "idiot" issue remains unresolved.

Given that we're trying to reconcile certain theories about entrepreneurship with the practical aspects of competing in the deal-making trenches, the notion of who is attracted to small growth businesses—with what motivation, and what characteristics, and what external environmental influences—is an excellent trigger point to understanding what skill sets become manifest in the entrepreneurial world.

Perhaps a little historic context of regional venture activity would help. The New England region has long been a hot bed for entrepreneurs. As Sobel (1974) notes, the region can boast the early 19th-century factory systems guru Francis Cabot Lowell. His namesake city on the Merrimac River once had 11 robust textile mills, using the Jacquard loom invented in 1801. The use of punched cards to control the new technology set the stage for later application to the computer industry. Ultimately over the span of two centuries, all the textile mills were recycled to commercial high tech. Our region has transformed from dependence on textiles to aerospace/defense, to minicomputers, to biotech, to artificial intelligence, to genomics. Pumped with ideas from MIT, Harvard and a hundred other colleges and universities, our regional economy thrives on brainpower (and precious few state-sponsored economic incentives!).

Entrepreneurs provide the requisite lubricant. Royal Little ignored his uncle (Arthur D. Little), dropped out of Harvard with his own entrepreneurial notion on textile company roll-ups, and learned entrepreneurial finance (find high margin companies with tax losses and modest debt and low stock price; leverage the balance sheet to borrow the bulk of purchase price; sell off nonperforming assets; and repay loan). Textron, one of the region's biggest employers, was thus born of a guiding consolidation principle and entrepreneurial devotion to execution of plan.

By the late 1960s, entrepreneurship in New England was vibrant, but relatively much simpler than today. General Georges Doriot was the reigning VC guru. A Harvard Business School professor, he put his American Research & Development (AR&D) firm in the VC Hall of Fame for parlaying a $70,000 investment in Digital Equipment into almost $500 million in less than a decade. (Of course, the B-School case study revealed in the appendix that AR&D had a negative 9 percent return on the remainder of its portfolio.) The net PR effect to young, aspiring entrepreneurs like myself was addictively alluring. Building exciting new companies that create important customer-satisfying product offerings was a possible career choice. I caught the venture bug, big time, and wanted someday to be an entrepreneur.

The high profile academic who then (and now is chairman of the MIT Entrepreneurship Center) analyzed venture dynamics was Ed Roberts at MIT's Sloan School. He penned a classic *Harvard Business Review* article (Roberts, circa 1965) on venture spin-offs, showing how hi-tech firms like Raytheon, Avco, Itek, and others created hundreds of start-ups along Route 128. He ventured across the Charles River to visit our HBS class (the Management of New Enterprises—MNE) and interacted with us snotty B-schoolers. Perhaps given that his own father was an owner of a retail oil business in Chelsea, Massachusetts, a major premise of Roberts' research was an "environmental" profile of successful entrepreneurs, wherein he portrayed the probability of success to correlate with one coming from a "small business owner" family. Since my auto mechanic dad was only an employee, I appeared to be entrepreneurially-challenged coming out of the box. Professor Roberts took my rantings well, noting that my persistence (read "obnoxiousness") and analytical comments, peppered with objections to his research structure, significant sample size, and loose correlation fits more than offset my presumed environmental shortcomings for small business. I wrote my second-year HBS paper on entrepreneurial pursuits in oceanography. (I have yet to dip my big toe into that marketplace!)

Counterbalancing the traditional business research approach to entrepreneurship has been the provocative theories of the *psychoanalytical thinkers.* Abraham Zaleznik (circa 1965) and Harry Levinson (1970) attempted to analyze the internal wiring of managers and entrepreneurs. Zaleznik is a neo-Freudian who smokes big Churchills and has a symbolic leather couch in his office. As students, we watched psycho-drama movies in his class (e.g., *The Caine Mutiny* and *Twelve Angry Men*). We read Freud and learned about the meaning of Dora's dreams. Zaleznik focused on how individuals mobilize and use power derived from position, competence, and personality. Assumed harmony between position and competence he viewed as naïve, because entrepreneurial position controls the flow of rewards. Disharmonies between an entrepreneur's designated authority and his actual competence can engender psychological conflicts with his venture team.

Levinson points to venturing decision-making evolving out of issues of fear and concern for obsolescence. He analyses the impulsive motives, manipulation, and control and disillusionment of the CEO (entrepreneur).

Manfred Kets de Vries (1985), an HBS classmate, joined the psychoanalytic camp in the 1970s. He views typical good entrepreneurs as

- achievement-oriented;
- taking responsibility for decisions;
- disliking repetitive routine work;
- having high levels of energy, perseverance, and imagination;
- willing to take calculated risks; and
- gifted in instilling contagious enthusiasm.

He also addresses the "dark side" of entrepreneurship. The distinctive attributes of entrepreneurs seem to produce derived negatives in terms of less glamorous personality quirks:

- generating action for action's sake; thoughtless decision-making;
- difficulty taking direction or advice from board of directors;
- personality idiosyncrasies—"misfit" behavior;
- need for total control;
- suspicious, almost paranoid, tendencies—perhaps derived from inner voices of inferiority;
- need for applause;
- hyperactivity; and
- feelings of suffocation.

Where do I come down on the "good" entrepreneur? Table 1 lists my desired attributes for myself, for my partner(s), or for my mentee (s). I undoubtedly overanalyze entrepreneurs, but I can only pursue two to three deals a year.

A word of caution. Don't overly glamorize the entrepreneur. We did it with the American cowboy. Mostly, the American cowboy was an illiterate, dusty grunt. The entrepreneur is generally quite literate and often cleaner.

**Table 1**
**The Good Entrepreneur**

1. Drive and energy
2. Long-term commitment
3. Self-confident
4. Experienced and successful
5. Hungry
6. Persistent problem solver
7. Plans and sets goals
8. Intelligent risk taker
9. Learns from mistakes
10. Accepts criticism
11. Is Creative, takes initiative, makes things happen
12. Good at using available resources
13. Desires to win
14. Integrity
15. Superman (woman)

Just as the recognition, applause, and euphoria of receiving a fancy parchment diploma from a prestigious university only shrouds the years of tedious, occasionally hopeless, toil preceding the glamour of the academic milestone, so too is the notoriety attached to a successful entrepreneurial effort. It's real hard work. Only less difficult than such impossible challenges as finding a cure for the common cold, giving birth to a baby, or being a member of Red Sox Nation. It's 2 percent inspiration and 98 percent perspiration. The former is extolled. The latter soon evaporates from memory.

The successful entrepreneur can and should be viewed favorably. MIT's Edward Schou noted, "Champions of new invention display persistence and courage of heroic quality."

## Mystery #2—Venturing Risk

*Does new venturing represent high risk or "measured risk?"*

Like many of the best entrepreneurs I have known, I firmly adhere to the adage "It is far better to be lucky than smart, any time, every time!" We certainly acknowledge the rigors of the Darwinian, survival-of-the-fittest law of the jungle. But if you bump into a free lunch, enjoy the free lunch! As a 23-year-old, fresh out of B-School, I was assigned to take an analytical look at a modular housing venture. Fortuitously, *Business Week* had that very week published a 46-page cover story on the housing industry that allowed me to quickly assemble a 60-page presentation and champion the opportunity, ultimately letting me secure corporate backing in just seven weeks. How good is that kind of good luck?

Why look for good luck? Because being an entrepreneur in a dynamic, competitive market environment is so difficult. So many variables are in play. Some (independent) variables, you may be able to control. Most (dependent) variables, you hope you can influence your way. Like USAF test pilots or barnstorming daredevils, entrepreneurs want to measure, control, and minimize risk while getting the job done—successful small business growth.

Churchill and Lewis (1983) provide a framework for the five stages of small business growth:

1. Existence
2. Survival
3. Success
4. Take-off
5. Resource maturity

Uncertainty is highest in the early stages. If lucky and if the entrepreneur manages risk well, risk should diminish across stages. But the nature of the numbers problem persists:

- 1 of 19 new products will succeed.
- Less than 10 percent of all new industrial products will return a profit.

- As much as 50 percent of present revenues in most major industrial companies are accounted for by products not in existence five years ago.

The first 98 percent of product development is relatively easy. The last 2 percent is very hard. So imagine how risky the marketplace is for a raw start-up with no long-term customer base and no infrastructure! Short-term venture sales are, therefore, critical. Revenues cover a variety of venture sins. Cash flow is helped. Validation of the venture begins.

And the entrepreneur may have no resources! Arthur Rock (1987), an experienced venture capitalist, reports his experience. Rock looks at more than 300 business plan proposals a year. At the end of the year, he has invested in only one or two companies. Entrepreneurs can spend more than half their time during stage one (existence) looking for seed capital. And the odds are that they will come up dry.

What due diligence is required to vet the entrepreneur? What questions do I ask myself, my partners, my advisers? Table 2 lists my typical sequence.

If—that's a big "IF"—suitable answers are provided, risk can be assessed and managed. And IF I don't lie to myself (the far too prevalent "self-deception"), and IF my partners or venture incubators don't lie to me. Due diligence really means finding the right answer to these questions.

**Table 2**
**Ten Questions to Ask a Small Business**

1. Is the company in an area of emerging technology?
2. Is there a market for the technology or product?
3. Why didn't an established company decide to exploit and market the product?
4. Is there a natural product line or follow-on technology?
5. Does management have corporate experience?
6. What are management's goals?
7. Does management have a 10-year objective and 5-year plan?
8. Does management understand:
   - Research & Development?
   - Product Development?
   - Manufacturing?
   - Finance?
   - Accounting?
   - Legal?
   - Marketing & Sales?
   - Other?
9. Does management understand the nature and use of money?
10. Does management have a competent, recognized leader and decisionmaker?

**Table 3**
**The Business Plan**

1. Executive Summary
2. Description of Business & Industry
3. Features & Advantages of Products or Services
   - Descriptions, Proprietary Position, Potential
4. Market Analysis
   - Customers - Market Size and Trends
   - Competition
   - Estimated Market Share and Sales
5. Marketing Plan
   - Marketing plan - Pricing
   - Sales Tactics - Service and Warranty Policies
   - Advertising, Public Relations, and Promotion
6. Product Development Plan
   - Development Status and Tasks
   - Difficulties and Risk - Costs
7. Operations Plan
   - Geographic Location - Facilities & Improvements
   - Strategy and Plans - Labor Force
8. Management Team
   - Organization - Key Management Personnel
   - Management Compensation & Ownership
   - Board of Directors
   - Management Assistance and Training Needs
   - Supporting Professional Services
   - Public Accounting Firm - Legal Counsel
9. Overall Schedule
   - Incorporate Venture
   - Completion of Product Development
   - Sales Representation
   - Dates of Displays at Trade Shows
   - Build-up of Inventory - Start of Operation
   - Receipt of First Orders - First Sales and Deliveries
   - Payment of First AIR (Cash "in")

   Also:
   - Number of Management Personnel
   - Number of Operations Personnel
   - Additions to Plant or Equipment
10. Critical Risks and Problems
    - Price Cutting - Bad Inventory Trends
    - Overruns in Product Development
    - Overruns in Operating Costs
    - Low Orders - Schedule Delays
    - Long Lead Times in Procurement
    - Credit Line - New Equity
    - Lack of Availability of Trained Labor
11. The Financial Plan
    - Income Statement - Balance Sheet
    - Cash Flow - Key Ratios - Assumptions
12. Proposed Company Offering
    - Desired Financing - Capitalization - Use of Funds

Truth be told, no new venture at outset has a probability of success much above 3 to 5 percent. Why? If you take the inherent uncertainty of each of the 6 to 10 functional areas (e.g., finance, R&D, product development, sales, production, distribution, etc.), and lay out the sequence of a simple decision tree, you generate hundreds of milestones (events and decision points) that must be resolved in stages to reduce the band of uncertainty. Intelligent execution of the daily plan is critical. Two friends/colleagues—Baty (1974, 1990) and Brown (1980)—address execution. God is in the details. Incremental progress against agreed-upon milestones reduces risk. A successful journey through the venture minefield results in the eventual reduction of risk.

The entrepreneur, however intuitive, must remember to show constant vigilance regarding those pesky land mines. Managing that risk is something I highly endorse. Perhaps the entrepreneur should consider the *Serenity Prayer*: God grant me the *serenity* to accept the things I cannot change, the *courage* to change the things I can, and the *wisdom* to know the difference.

## Mystery #3– Role of the Business plan

*Is the Business plan a selling document or an integrated and detailed guide?*

Many of us, or our kids, invest considerable time and energy playing fantasy baseball or fantasy football. It's fun but not real. So, too, goes the game of fantasy business plan. The only certainty with a really comprehensive business plan is that what really eventuates will be substantially different from the scenarios presented in the plan's glossy pages. As the wag noted, "Forecasting is always difficult, particularly when it's about the future!"

The business plan is an integrated document that embodies narrative and numbers. Long-winded, incoherent, poorly-written plans are common. Clear, well-written, and *concise* plans that insightfully crystallize the crux of the business concept are quite rare. My personal business plan outline is listed in Table 3. One customizes the content appropriate to the company's business.

Business plans must be

- concise,
- complete,
- consistent,
- powerful,
- easy-to-understand, and
- obvious as to how the application of funds reduce venture risk.

My personal prejudice toward business plans is built upon 35 years of being in their midst. Familiarity breeds contempt. I would estimate that I've personally written 650 to 700 plans and reviewed, in depth, 2,200 to 2,500. I have seen all kinds of attempts to communicate (or obfuscate in the case of a bunch of dot.coms). As with most entrepreneur-investors, I've really been there; don't try to BS a BS-er!

***Theory v. Practice.*** White and Graham (1978) provide a model for spotting technological winners. They identify 4 "merits":

1. Inventiveness
2. Embodiment (e.g., miniaturization)
3. Operational
4. Market

These merit assessments lead to a sense of *technological potency* and *business advantage*, which may then translate into *innovative success.* I have found this theory helpful as a checklist to dissecting the plan. My ultimate test is taking that great Internet-induced buzzword—"business model"—and applying common sense:

- Perform extensive sensitivity analysis on the spreadsheet projections;
- Test the assumptions for consistency, accuracy, and completeness;
- Ask the really important questions:
  - Who is the customer and what does he or she want?
  - What value is provided?
  - What is the competition?
  - How does the company actually make money?

***Business Models; Case Examples.*** Magretta (2002) cites two examples of business models. In 1892, American Express introduced the travelers' check. The advantage? Customers paid for the checks up front. It worked on float! Great concept. Sound premise. In contrast, Disney opened European amusement parks with a glaring error in one assumption on restaurant utilization. Americans eat in park restaurants all day long. Europeans have precise, set eating schedules. Disney lost millions before fine-tuning an acceptable solution. Understand what makes the business model really work.

***Opportunity for Change in Direction.*** I use the business plan more as a validation and communication device, than as a management control tool. The plan can help change strategic direction. On two major deals, I actually convinced the venture team to change the end market:

1. *Color-matching case example.* Instead of the dental market (enamel color matching) where dentists are hard to access and nearly impossible to sell, we switched over to the retail paint market where 40,000 retail paint dealers could be accessed through 40 paint manufacturers.

2. *DC to AC Electric conversion case example.* Instead of attacking the residential solar electric market and competing with large utilities, we convinced the team to become an uninterruptible power source (UPS) supplier for the then-emerging personal computer market. Having the right business concept resulted in *billions* of dollars of created market value.

***Depth of Analysis.*** Clopton's law states: "For every credibility gap, there is a gullibility fill." With business plans, you risk sudden death using this premise. Assume all facts will be checked and assumptions questioned by investors. Practical suggestions include looking at

- Customer purchase orders (POs) and letters of intent (LOIs)
- Bill of materials authenticated by vendors
- Banking facilities showing working capital availability
- Useful comparative ratio information from recognized sources:
  - Dun & Bradstreet
  - Standard & Poors Corporation
  - Robert Morris Associates
  - Value Line
  - Various trade associations

On the color-matching "Greenfield" IPO placement on the London Stock Exchange, my spreadsheet was actually *audited* cell-by-cell by a then-Big 7 firm. I did everything but put my first-born male in escrow! Assumptions were cross correlated to the aforementioned documents (POs, LOIs). By doing it "right" and completely, we successfully raised $2.8 million in a precedent-setting deal.

***Basis of Due Diligence.*** The business plan allows potential investors to initiate due diligence. As an entrepreneur, you want this to happen well and efficiently in order to attract the desired investment.

Linde and Prasad (2000) wrote the MIT Entrepreneurship Center study on Angel Investors. While some angels act intuitively, some conduct detailed due diligence. They

- Read through the business plan.
- Speak extensively with the entrepreneur and the management team.
- Check the references and background of the team.
- Phone current and prospective customers.
- Discuss and introduce the company to prospective customers and strategic partners to gain a better understanding of market interest.
- Ask technology experts to evaluate the technology.
- Discuss the deal with targeted industry business associates.
- Understand product-specific market issues by talking with industry consultants and investment bankers.
- Ask other angel investors or venture capitalists familiar with the industry to look at the deal.

A good business plan sets you on the right track.

## *Mystery #4—Intuition v. Analysis*

*Should entrepreneurs be fast-moving and act with intuition or employ MBA-like analytical tools?*

In a sense, this mystery in some circumstances is almost a nonissue. With truly experienced, competent entrepreneurs, their extensive knowledge base, intellect, and personal insight from past successes and failures imbue them with an analytical sixth sense that seems hard-wired into their DNA.

***Perceptions of Analysis.*** Sixth-sense intuition may seem nonanalytical to some casual observers. Many investors, in fact, are critical of stubborn entrepreneurs who might deem requests for supporting management analysis (reports, forecasts, budgets, schedules, ratio analysis) to be interfering and a "useless crutch." Their board of directors and investors (many with MBAs) may well view such requested analytical oversight as "management religion" that needs appropriate devotion.

I have mediated this debate for years. The flip side extreme, of course, was our MIT ScD CEO who, having sold just his first three black boxes (UPS), wrote his own customized inventory control system that could have helped to run all of General Motors! It was overkill! We substituted a $30 software package.

Three important points to the analytically-reluctant entrepreneur

1. The board of directors and investors are really your "customers." If they want an analytical measure of XYZ, they probably should get it. This marketing approach eliminates a potential negative.
2. Creative use of analytical tools can create valuable respect and trust. For example, Admiral Hyman Rickover, father of the U.S. Nuclear Submarine program, gained unprecedented independence from his DoD bosses by adopting Program Evaluation and Reporting Technique (PERT) controls for the management of the program. This preemptive approach creates a positive.
3. An ability to apply concepts like game theory (win-win, win-lose, lose-lose) helps in all phases of growing a company. Win-win outcomes create a bigger pie from which all players can share.

***Need for Better Analysis.*** Sometimes, beyond issues of perception, the entrepreneur actually *needs* the help of MBA-like tools. Consider two examples:

1. *Defensive:* Investors, bankers, and auditors tend to be analytical. Armed with their assessments, they can kill the entrepreneur's pet project as too risky.

Hodder and Riggs (1985) report that under many circumstances, the traditional risk assessments overstate risk:

- Improper treatment of inflation effects
- Excessive downward ROI (DCF) adjustments for risk, even when risk actually decreases in later stages of the project
- Failure to acknowledge how management can proactively influence the reduction of risk

2. *Offensive:* In one of our young public companies, we closed on an $11.5 million secondary offering only because we could schedule an M&A transaction in 75 days rather than the expected 120 days. The secret? We used PERT to fast-track the closing of the transaction. Without this analytical tool, there would be no deal. The market capitalization increased 150 percent!

| Table 4<br>Warning Signals |
|---|
| • Financials and ratios ignored: Margin, market, debt, capital, people |
| • Excuses: Lame and repetitive |
| • Inadequate control and information systems |
| • Projects delayed, over cost, behind on milestones |
| • Morale suddenly low |

***Consequences.*** Despite good intentions, ventures can turn sour. Table 4 lists warning signs that repeat themselves all too often. Table 5 lists internal problems. Entrepreneurs, self-styled as invincible, often ignore these warnings. Compliant BODs become unwitting enablers. Disaster looms.

Hamm (2002) addresses the classic shortcoming of entrepreneurs' ability to scale up operations. Entrepreneurs who can scale must take deliberate steps to confront their shortcomings and become the leaders their organizations need them to be. What barriers do many entrepreneurs subconsciously introduce to thwart their own efforts? Consider these negatives:

- Undue loyalty to comrades.
- Task orientation rather than goal-orientation.
- Single-mindedness and insensitivity to others.
- Diffidently working in isolation.

The consequences to the entrepreneur of not adapting to the needs of his or her growing company can be dire. Consider

- I have led the firing of five CEOs of public companies we have founded or cofounded.
- I have been fired three times.
- I have fired myself twice.

| Table 5<br>Internal Problems |
|---|
| • Management factor |
| - Inadequate depth |
| - Limited experience |
| - One-person rule |
| - Inbred bureaucracy |
| • Weak finance function |
| - Lack of operating controls |
| • Nonparticipative board |

Not all relationships last forever, even with the companies we start up ourselves. MBA tools can and should help the venture relationship to be more robust and last longer. But not always. Certainly not when other, stronger egos are in conflict. In the end, the analytical approach to entrepreneurship can help the evolving small business immeasurably, as long as it isn't preempted by the darker psychological underbelly of the entrepreneur.

## *Mystery #5—Dancing with the Big Guys*

*Should emerging companies stay clear of large entrenched companies or try to work with them?*

***Tales of Odd Couples.*** Even the most optimistic dealmaker acknowledges that the notion of a small venture approaching a megacompany for a discussion or potential strategic alliance is truly incongruous. The two entrepreneurs might typically sit in the oversized conference room that comfortably seats 250, waiting for a battalion of 25 to 30 MBAs, PhDs, CPAs, and BMOCs to troop in. Their corporate staff of 2,700 oversees their 310,000 employees. "What do you guys want to do?" they ask. They view this interruption as an "aggravation meeting" that must be dealt with politely, but quickly. In contrast, the entrepreneurs aggressively approach the "big opportunity" like a flea climbing the elephant's leg with intent to rape. The circus act begins.

Occasionally, an alliance agreement with a Big Guy is actually secured. For example:

- Our waste tire recycling company allied with a $1 billion liquid nitrogen vendor (vendor and equity agreements). Also, the company allied with a $3 billion waste management company (which led to the $6 million acquisition of their tire-related assets).
- Our medical laser company allied with Massachusetts General Hospital and funded (and received licensing rights to) contract research for world-class medical technology.
- London investors actually loved that our color-matching company had a seven-year office lease with a large international can company; they liked the long-term

security (and the presumed third-party endorsement from a well-known company). We, of course, disliked the lease's long-term financial commitment.

- Our online investment bank/brokerage operation allied with a $500 billion European bank. The snail-like Europeans picked our brains for a year, then invested more than $60 million in equity. They promised to deliver one million "accredited investor" accounts to our electronic platform over 12 months. Their bureaucratic in-fighting over project control delayed all milestone achievements and resulted in their ultimate acquisition of our assets. The Big Bank killed us with slow love.

***Guiding Principles for Strategic Alliances.*** What does practice suggest about theory in this partnering mystery? Kuhn (1988) discusses negotiating skills and secrets that can be applied to the strategic alliance deal-making process. Relevant tests include

- *Consistency Test:* Do major variables hang together (goals, cash flow, milestones)?
- *Importance Test:* Relevance, benefits?
- *Structure Test:* Are we biting the right bait?
- *Smell Test:* Is negotiation obstinate, disruptive, honest?

Many negotiating games are played: Big firms train their representatives to low ball, high ball, bluff, bait-'n'-switch, sandbag, sting (lie, drop out), and refer to "unknown, uncontrollable authorities." Perhaps during these stressful, direction-turning times, we need to recall the psychoanalytical teachings of Zaleznik (circa 1965), Levinson (1970) and Kets de Vries (1985). I'd be crazy not to.

Tables 6 and 7 summarize my views on important conditions to ensure success and well-structured alliances. The a priori conditions for success *must* be built into the deal structure.

Strategic alliances can represent wonderful access to markets, technology, and resources. Investors absolutely adore the implied third-party endorsement of "an important player." If one can get through the mating dance, due diligence (ideally, give them your IPO registration material!), and big company smugness (throw your MBA back at them!), then all that is left is the 98 percent effort to execute the alliance. The land mines start appearing.

**Table 6**
**Joint Ventures: Important Conditions to Ensure Success**

| | |
|---|---|
| 1. | Style of operations |
| 2. | Time perspectives |
| 3. | Financial goals |
| 4. | Collaborative decision-making |
| 5. | Balanced strengths |
| 6. | Past work relationship |
| 7. | No takeover threats |
| 8. | Top echelon visibility and access |

**Table 7**
**Well-structured Alliances**

| | |
|---|---|
| 1. | Strategic synergy |
| 2. | Positioning opportunity |
| 3 | Limited resource availability |
| 4. | Less risk |
| 5. | Cooperative spirit |
| 6. | Clarity of purpose |
| 7. | WIN-WIN |
| 8. | Positive third-party endorsement for investors |

What can go wrong dealing with the Big Guys? "I thought my partner was responsible for that?" is a typical lament of a failing strategic alliance!

## *Mystery #6—Control v. Funding*

*Should entrepreneurs focus on personal equity control of their company or relinquish control in exchange for adequate resources?*

This is the easiest mystery to figure out. Cash is king. Initially, most entrepreneurs answer incorrectly.

***Reality Check for Control.***

- In practice, entrepreneurs psychologically view the venture as a "child." Often they're ignoring their own family life, so the notion of being loyal to the venture offspring has supreme import. Giving away control of the child is often deemed to be total anathema to them. The reaction is remarkably visceral.
- In theory, the entrepreneur needs adequate funds to fuel company growth. Accepting funding dilutes the entrepreneur's percentage ownership. The more funds raised at initially low company valuation, the more severe the dilution impact.
- The balancing act is a tradeoff. One "optimizes" the coupling of resources with venture need; it is *not* a "maximization" effort. Too much capital raise-up too early causes unnecessary dilution at low valuations.
- The bottom line: Careful financial planning can be effective. Many venture team members with 1 to 5 percent ownership stakes at IPO time can become financially well-off. A sliver of a big juicy pie can be a lot. Conversely, 100 percent of very little is very little.

***Complexities of Equity Ownership.*** An analysis of the resource-equity control mystery is a nontrivial exercise in the trade-off of many variables. Several key variables influence the assessment:

- Cash needs/timing
  - Sales growth and working capital requirements
  - Profit margins
  - Investment requirements
  - Working capital line of credit availability
- Perceived valuation by sophisticated investors (pre- v. post- money) at important milestones
- Source of funds; different investors have selective ROI criteria
- Impact (fully dilutive) of employee stock options (at particular exercise prices).

Ronstadt (1988) devotes an entire text to entrepreneurial finance, wherein he articulates the end game as being neither *under-* nor *over*capitalized in fund-raising at any point in time. The trick is to find a threshold band of capitalization at critical points in the venture's growth cycle to determine funding requirements. He emphasizes, rationally, comprehensive, exhaustive interaction of spreadsheet values, conditioned by severe questioning of key assumptions, and heeding key industry ratio values. He advocates worst, likely, and best case scenario analysis.

Hoffman and Blaky (1987) explain how to negotiate terms with investors:

- Understand weighted v. full-ratcheted antidilution provisions.
- Offset equity forfeiture for poor performance with bonus options for good performance.
- Define employment control—severance values.
- Address shareholder control—voting-rights issues.
- Assure an ability to cash-out personally.

***Simplifying Model of Dilution and Ownership.*** Years of heated discussions with emotional entrepreneurs have forced me to devise a simple, generic, integrated model to accommodate the iterative aspects of this otherwise overly-complicated equity-bleed process.

Table 8 shows, with illustrative values, how the CEO-entrepreneur can be diluted down to 27 percent ownership and still make him or her worth (on paper until he or she cashes out) more than $16 million. Hand-holding for the entrepreneur, the venture team, and the investors is still required. This interactive model helps with all these stakeholders.

## *Mystery #7—Funding: Logic or Miracle?*

*Is the ultimate raise-up of seed and growth capital a logical fallout of the entrepreneurship process, or a serendipitous miracle?*

***Views on Money.***

"Go where the money is."

—Willie Sutton (Brink's Bank robber)

"Money is the resource to gain market share."

—Japanese saying

"Money is *not* the goal; just the best measure of success."

—Entrepreneurial saying

"Money *is* the goal; just ask the stockholders!"

—Investor saying

***Financing Process.*** Siegel (1990) presents a synopsis (see Table 9) that summarizes the financing process.

Timmons and Sander (1986) remind us of everything the entrepreneur *doesn't* want to know about raising capital; the process can take up to half the founder's time over the first six to nine months. He may have to guarantee loans personally. The entrepreneur can get fired. His stock can be appropriated. Control of the BOD can be wrested from him. He can lose his "child!"

***Resolution to Capital Raise-up.***

- Persistence in selling the venture to investors is key. The entrepreneur must work the capital raise-up 18 hours a day. Case example: Use reverse psychology. In the tire recycling venture, most of the seed and bridge capital came from people whom I initially insisted couldn't be in the deal. The more I resisted, the more they wanted *"in."* At IPO time, we submitted in sequence seven different registration statements to the SEC, with *four* different underwriters. Desperate, driven people simply don't give up. They push until there is no more "push" left! We wore everyone out. The professional support people (lawyers, auditors, etc.) needed the deal to close so they could get paid!
- Demonstrate the magic of the cap chart (Table 8) to investors. They are looking for a 4-bagger or an 8-bagger on their money. The brilliance is to show these investors how they get their "vig" while keeping the deal terms favorable to the venture.
- The harder you work, the luckier you get. Excruciating detail to investor follow-up, investor group meetings with management, weekly updates, daily calls—all create investor interest.
- In truth, this money-raising *mystery* is still pretty much a mystery to me. Work the logical financing process and gleefully accept good luck when it presents itself. The Law of Large Numbers generally is at work. The more financial raise-up action that is in play, the higher the probability of success. The higher the probability that you will get lucky!

***Conclusions to a Magical Mystery Tour***

- Entrepreneurship is not for most (read: 99.9%) people.
  - Erratic income; minimum fringe benefits
  - Highly cycling net worth
  - Excessive work tension, pressure, impact on family life
  - Long gaps before enjoying positive feedback
  - 2 percent inspiration, 98 percent perspiration

- Benefits are worth it to the truly addicted.
- For me, measures of success have outweighed the costs:
  - personal financial gain
  - helped create more than 5,000 jobs
  - helped to create about 7 dozen millionaires—2 dozen (first time); 5 dozen (already there)
  - helped create several dozen companies with products serving thousands of satisfied customers
- Issues of entrepreneurial theory v. practice; intuition v. analysis; risk v. reward; individual drive v. team building efforts—all *can* be *reconciled*. But only if you work so very hard enough to get *lucky*.

## Table 8
## Simple Equity Model

[Co. Valuations in $000's]

| | Scenario / Stage | | Initial | Angel #1 | Employee Options Plan #1 | VC or Pvt. Placement # 1 | Employee Options Plan #2 | IPO @ $ Valuation |
|---|---|---|---|---|---|---|---|---|
| Without Stock Options Dilution | Pre-Money Value | | $3,500 | $6,500 | $8,000 | $12,000 | $15,500 | $45,000 |
| | Additional Investment | | n/a | $1,500 | n/a | $3,500 | n/a | $15,000 |
| | Pre-Money Stock Price | | $3.50 | $6.50 | $6.50 | $9.75 | $9.75 | $28.31 |
| | New Investment Stock Price | | n/a | $6.50 | n/a | $9.75 | n/a | $28.31 |
| | Post-Money Blended Stock Price | | $3.50 | $6.50 | $6.50 | $9.75 | $9.75 | $28.31 |
| | Pre-Money No. of Shares [ I/O ] | | 1,000,000 | 1,000,000 | 1,230,769 | 1,230,769 | 1,589,744 | 1,589,744 |
| | Additional No. of Shares [ I/O ] | | 0 | 230,769 | 0 | 358,974 | 0 | 529,915 |
| | Post-Money No. of Shares [ I/O ] | | 1,000,000 | 1,230,769 | 1,230,769 | 1,589,744 | 1,589,744 | 2,119,658 |
| | Post-Money Value | | $3,500 | $8,000 | $8,000 | $15,500 | $15,500 | $60,000 |
| Accounting for Stock Options Dilution | Issue of Employee Stock Options [ as % of I/O ] | | | | 10% | | 10% | |
| | No. of Stock Options Issued | | | | 123,077 | | 158,974 | |
| | Exercise Price [ @ 80% of Pre-money Stock price ] | | | | $5.20 | | $7.80 | |
| | Fully Diluted No. of Shares | | | 1,230,769 | 1,353,846 | 1,712,821 | 1,871,795 | 2,401,709 |
| | Fully Diluted Post-Money Value | | | $8,000 | $8,640 | $16,140 | $17,380 | $61,880 |
| | Fully Diluted Blended Stock Price | | | $6.50 | $6.38 | $9.42 | $9.29 | $25.76 |
| | **Fully Diluted Holdings: %'s, Nos. of Shares, & Values** | | | | | | | |
| | CEO | F. D. % | 65.0% | 52.8% | 48.0% | 37.9% | 34.7% | 27.1% |
| | | F. D. # Holding | 650,000 | 650,000 | 650,000 | 650,000 | 650,000 | 650,000 |
| | | F. D. $ Holding | $2,275 | $4,225 | $4,148 | $6,125 | $6,035 | $16,747 |
| | SVP | F. D. % | 35.0% | 28.4% | 25.9% | 20.4% | 18.7% | 14.6% |
| | | F. D. # Holding | 350,000 | 350,000 | 350,000 | 350,000 | 350,000 | 350,000 |
| | | F. D. $ Holding | $1,225 | $2,275 | $2,234 | $3,298 | $3,250 | $9,018 |
| | Angel #1 | F. D. % | 0.0% | 18.8% | 17.0% | 13.5% | 12.3% | 9.6% |
| | | F. D. # Holding | 0 | 230,769 | 230,769 | 230,769 | 230,769 | 230,769 |
| | | F. D. $ Holding | $0 | $1,500 | $1,473 | $2,175 | $2,143 | $5,946 |
| | VC / PP #1 | F. D. % | 0.0% | 0.0% | 0.0% | 21.0% | 19.2% | 14.9% |
| | | F. D. # Holding | 0 | 0 | 0 | 358,974 | 358,974 | 358,974 |
| | | F. D. $ Holding | $0 | $0 | $0 | $3,383 | $3,333 | $9,249 |
| | Total Employees | F. D. % | 0.0% | 0.0% | 9.1% | 7.2% | 15.1% | 11.7% |
| | | F. D. # Holding | 0 | 0 | 123,077 | 123,077 | 282,051 | 282,051 |
| | | F. D. $ Holding | $0 | $0 | $785 | $1,160 | $2,619 | $7,267 |
| | Public Investors | F. D. % | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% | 22.1% |
| | | F. D. # Holding | 0 | 0 | 0 | 0 | 0 | 529,915 |
| | | F. D. $ Holding | $0 | $0 | $0 | $0 | $0 | $13,653 |
| | All Investors & Employees | F. D. % | 100.0% | 100.0% | 100.0% | 100.0% | 100.0% | 100.0% |
| | | F. D. # Holding | 1,000,000 | 1,230,769 | 1,353,846 | 1,712,821 | 1,871,795 | 2,401,709 |
| | | F. D. $ Holding | $3,500 | $8,000 | $8,640 | $16,140 | $17,380 | $61,880 |

**Note:** **Inputs are highlighted, like this.**

**Table 9**
**Financing Process**

A. Preparing for a Financing Transaction
1. Identify your goals and financing requirements
2. Business plan
3. Management team
4. Professional advisors

B. Sources of Financing
1. Start with sources of capital known to the company
2. Seed capital
3. Venture capital
4. Institutional investors
5. Government sponsored/subsidized financing
6. Strategic or corporate partners

C. Risk V. Reward
1. Debt
2. Equity
3. Pledge of corporate assets/stock
4. Personal guaranties
5. Technology rights
6. Management and control

D. Financing Process
1. Timetable
2. Due diligence
3. Clean-up of corporate records and insider transactions
4. Disclosure/offering documents
5. Director and stockholder approval

E. Securities Laws
1. Federal laws
   - Registration of securities
   - Exemptions from registration
   - "Safe harbors" - Regulation D
   - Accredited investors
2. State ("Blue Sky") laws
   - Registration of securities
   - Exemptions from registration
   - Limited offering exemptions
3. Use of sales and advertising literature
4. Brokers, dealers, and finders

F. Equity Financing Terms and Conditions
1. Investment agreements
2. Representation and warranties
3. Restrictions on transfer
4. Preemptive rights
5. Registration rights
6. Antidilution rights
7. Conversion rights
8. Puts, calls, and mandatory redemptions

G. Tax Considerations
1. Subchapter S
2. Section 1244 stock
3. Stock for services - Section 83(b)

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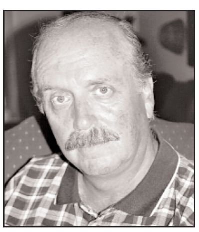

**About the Author**

**Joe Levangie** (jelevangie@covad.net) is a Boston-area investor, adviser, and entrepreneur. Over the last quarter century, he has helped launch several dozen new business enterprises—first from a large company platform, then from a not-for-profit incubator, and later as an venture adviser, as an independent entrepreneur, as an active investor, and as a passive "angel." His companies have competed in a wide array of industries: financial services; renewable energy; uninterruptible power sources; biotech; computer hardware, flex circuits, and software; medical lasers; electronic retail color-matching systems; radioactive medical implants; food technology; modular housing; semiconductor equipment; specialty materials; and waste tire recycling. The number of Levangie's ventures successfully completing an IPO has now reached double figures. He has served on the board of directors of dozens of private and public companies and has been a guest reviewer at business plan contests at MIT and Harvard Business School. Levangie is an active alumnus of both institutions. He currently is vice chairman of Ardour Capital, a New York City investment banking firm.

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