

**The Dialectic Process of Firm Growth: An Empirical Study of
Growth of HR service SMEs in Guangzhou City, the People's Republic of China**

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**Thesis submitted to the University of London
for the degree of the Doctor of Philosophy in Management Studies**

August, 2011

Declaration of Authorship

I (Hanmin Huang) hereby declare that this thesis and the work presented in it is entirely my own. Where I have consulted the work of others, this is always clearly stated.

Signed: 

Date: August 18, 2011

Abstract

How to best understand and facilitate growth of SMEs has been an important and long-standing subject for academics and management practitioners in China and abroad. This dissertation joins this effort, reporting an empirical study on the growth of HR service firms (SMEs) in Guangzhou City, China, which have been playing an increasingly important role in fast economic development of the country. The study aims to gain a better understanding on how and why these service firms were able to grow so as to identify ways to facilitate their growth.

To achieve the objectives, this study first reviewed the theories of the growth of the firm, in particular, theory of Penrose (1959), from which research gaps were identified and research questions were raised. Next, using multiple-case (embedded) design, the researcher of the study carried out two phases of empirical research on growth of the HR service SMEs in Guangzhou City. Findings from the research were then thoroughly discussed in view of extant literature on firm growth and conclusions were drawn on the research questions as to how and why these firms in the city were able to grow.

Based on the findings, it is concluded in this dissertation that HR service SMEs studied were in dialectical relation with their market (mainly their customers and competitors), with market constantly challenging these SMEs which in turn, continuously taking up and quite often overcoming these market challenges; it is this dialectical process of continuous forming and resolving conflicts between firm capabilities and market demands that led to spiral growth of these SMEs; thus, it could be said that causes of growth were the increase in market demands and the development of firm capabilities;

both forces interacted constantly in a dialectical manner to produce forces driving firm growth.

Acknowledgement

This dissertation is the summation of my PhD study in the School of Management, *Royal Holloway, University of London*. I am indebted to all the teaching, guidance and help which I have got from the staff of the School as well as those of the Library and other sections in the University of London. Here I would like to express my thanks to Royal Holloway, University of London for providing me with full scholarship which has funded my PhD project and studies. Without such funding, it would not be possible for me to make such accomplishment as it is today.

Above all, I want to express my deepest appreciation to my supervisor Professor Chris Smith for the confidence, trust, and encouragement which he has lavished on me throughout my study. In addition, I also want to thank him for his deep theoretical insights, his scholarly guidance and his practical help for me when I developed the proposal for this thesis, when I did my fieldwork research and when I did the writing of the current dissertation. Without strong support and guidance from Professor Smith, I would not have been able to complete this dissertation. Here I would also like to extend my full appreciation to my advisor Dr. Chin-Ju Tsai, who has given me not only encouragement but also detailed practical instructions on my research and writing, particularly on my use of research methods for data collection and analysis. Finally, I would like to thank Professor Jeffrey Unerman and Professor Christopher Napier. Both of them have been, in succession, the chairman of my PhD supervisory panel and have given me valuable comments and advice.

I am also very grateful for the constructive comments on my thesis from Professor Paul Edwards, Professor Paul Adler and other participants in the 27th EGOS conference, which was held in July of 2011 by ‘Organization Studies’ in the University of Gothenburg, Sweden. In addition, I would like to extend my thanks to my examiners, Dr. Christos N. Pitelis, Director of Centre for International Business and Management, Judge Business School, University of Cambridge, and Dr. Robert Fitzgerald, Reader of Management, University of London, for their valuable comments and suggestions on my dissertation.

Special thanks go to IBM partners, Mr. Zijian Cang, and Mr. Yonghua Xu, both work for IBM China Strategy and Change Consulting Group. They have given me much support during my PhD study and research. Furthermore, they have given me valuable guidance on, and much convenience for, the completion of this dissertation.

Lastly, I would like to extend my gratitude to my family, particularly to my wife Ms Xiaoyan Song, who accompanied me during my time in the U.K. and in China to complete PhD study, including this dissertation. Without their understanding and support, I would not have been able to make these achievements, which had always been my dream.

All mistakes in this dissertation, if any, are of my own.

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Abbreviation, definition and research scope

Abbreviations in the dissertation:

SMEs: small and medium-size enterprises

MNCs: multinational corporations

Definitions in this dissertation:

Firm capability: *ability of a firm to successfully deliver products or services to market, including ability of product innovation, marketing and sales, production and services.*

Market demands: *client requirements and competition pressure.*

Firm growth: *development in firm capability and, increase in firm size and value.*

Growth process: *a series of activities which impact firm growth.*

Growth mechanism or generative mechanism of growth (causal mechanism of growth): *a cycle of self-reinforcing activities which result in firm growth.*

Productive opportunity: *a business opportunity an entrepreneurs can see and take advantage of.*

Growth model: *a systems dynamics model consisting of interacting processes which facilitate firm growth and processes which constrain firm growth.*

Causes of growth: *forces generating firm growth.*

Rate of growth: *speed of firm capability development and firm value increase which may be expressed in firm size expansion or employment increase.*

Risk control ability: *ability of the firms to control its business risk.*

Firm adaptability: *ability of the firm to adapt to the changed market condition.*

Research scope:

The current research is concerned only with growth of HR service SMEs in Guangzhou City, China. It assumes that these firms wanted to grow (in interview, owners of each case firm confirmed that they wanted to grow in some way). Firms which did not want to grow were not in the scope of the current research. The current research concerns only with the questions how and why some of these firms have been able to grow while others could not, given that these firms all wanted to grow.

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Chapter One: Introduction to the current Research

This chapter presents a short introduction to the current research and a summary of the dissertation. The purpose is to clearly lay out the research background, research problem, research objectives and dissertation structure so that the arguments of the dissertation can be read and understood easily and thoroughly. To achieve this purpose, first, the chapter provides an overview of research background and gives a short statement of the research problem and then sums up existing literature on the problem, and reveals research gaps concerning the research problem, gaps which call for further research. The chapter then introduces the current research objectives, research questions, research methodology, research process and significance of the research. Finally, the chapter describes structure of the dissertation which is written to report the current research and the arguments thereof.

1.1 Background for the current research

This section gives an overview of the background for the current research. This research is on growth of small and medium-size enterprises providing human resource services (hereafter HR service SMEs) in Guangzhou City, the People's Republic of China. Economy of the city has been growing fast for the past three decades, with GDP growing at an average annual rate of over ten percent; SMEs, in particular, HR service SMEs as a type of professional service firms (PSFs), have been playing an increasing

important role in economic development of the city. HR service SMEs in the city were born out of market need for employee recruitment and training when MNCs first entered the city in early 1980s. Since then, they have been growing along with the development of the city's economy. Over the decades, these SMEs have been providing services in employee recruitment, skill training and social welfare administration. By such services, these firms have been acting successfully as channels to assist the flow of labour, knowledge and technology, which has greatly enhanced economic development of the city. In turn, economic development and social change of the city and the region has been facilitating growth of these HR service firms. Over the years since 1990, as market need for human resource services rose rapidly, a number of HR service SMEs have been growing fast, which has formed a unique service sector of its own. Entry barriers to the sector have always been very low and as a result, competitors are numerous and competition is becoming open and fierce. Under such circumstance, HR service SMEs have to continuously develop their services and business models to achieve market differentiation which allows them to survive competition. For these SMEs, growth in ability and size has become an imperative for survival and prosperity, because continuous growth is a sign of success and of reliability, in a market which is immature and not immediately transparent. In an immature market with weak institutional support, growth of HR service SMEs in the city is still problematic, as is the case with many other Chinese SMEs in their development (NDCR, 2007). HR service SMEs in Guangzhou City have been fighting hard for growth. Some of them have a very successful growth history while others do not. It is interesting and important to find out why there is such a difference, which may inform ways to facilitate growth

of these important professional service firms in the city.

1.2 Statement of the research problems

Although Guangzhou City's HR service SMEs have been playing an increasingly important role in economic development of the city, they have faced many difficulties in their growth, receiving little support from the government and facing an immature market with poor institutions. Some have been growing continuously but others could not. Why is it so? What caused the difference? What are the most critical actions for these service SMEs to take in order to achieve fast growth? These are the important management problems calling for further research that may shed lights on ways to facilitate growth of these SMEs.

1.3 Research gaps on the problems

The management problems for research as listed above are easier stated than solved, because solving these problems necessitates in-depth exploration of processes underlying growth of these SMEs and yet, there is a lack of theories and past research on growth process of SMEs which could guide the current research (Davidsson and Wiklund, 2000; Mckelvie and Wiklund, 2010). According to Zingales (2000), research on growth of SMEs has not got sufficient attention from researchers because scholars

were overwhelmed with their research on big firms. Recently, there has been recognition of this deficiency and more research has been done on growth of SMEs. However, existing research on growth of SMEs has been carried out mainly in cross-sectional surveys to identify factors facilitating or hindering growth of these firms. It remains a fact that few research projects have been conducted to understand processes of dynamic growth of SMEs and there remains a lack of proper theoretical frameworks or theories on growth of firms, particularly on growth of SMEs (Artman *et al.*, 2001; Garnsey, 2002; Mckelvie and Wiklund, 2010; Leitch *et al.*, 2010).

Review of the literature on professional service firms (PSFs), to which the subjects for the current study (HR service SMEs) belong, also confirms that there is a lack of a proper theory to explain growth of professional service firms; such firms are featured by high knowledge intensity, low capital requirement and professional work force; they are very different from industrial firms and existing theories which were mostly built on industrial firms may not be applicable to these firms (Carman and Langeard, 1980; Bryson *et al.*, 1997; Lewendahl, 1997; Greenwood *et al.*, 2005; Muller and Doloreux, 2009). This calls for profound research on growth process of PSFs; but research on professional service firms is still at a very primitive stage (Bryson *et al.*, 1997; Lewendahl, 1997; Lowe, 2004; Greenwood *et al.*, 2005; Greenwood and Suddaby, 2006; Nordenflycht, 2010). It concerns mostly with classification of professional service firms, factors important for their success, as well as their business models and their competitive strategies. Although such research is useful for understanding professional service firms as a unique type of business entities, it is not very helpful in understanding

growth of these firms, for such research projects did not explore growth process to expose causes of their growth.

Under this circumstance, to complete the current research, one could only borrow theories built from research on growth of industrial firms, seeking out relevant concepts while discarding the irrelevant ones. Among these theories, the most applicable work seems to be the one written by Penrose (1959) entitled '*The theory of the Growth of the Firm*'. This work has been hailed as one of the most authoritative economics and management works on growth of firm (Kor and Mahoney, 2000; Pitelis, 2002). It explores growth process and growth causes of industrial firms. It argues that managers constantly interact with firm resources such as human resources, which enhances their knowledge (experience) of utilizing these resources for profit-making—an assumed managerial motive that drives firm growth; as knowledge increases, more productive opportunities open up for the firms, which leads to expansion; each expansion will leave some resources underutilized, which induce the firms to further expand; firm growth is both facilitated and constrained by growth of managerial resources which embodied firm knowledge and capability. This thesis of Penrose (1959) has offered a reference framework for the current research. Some of her arguments may not be relevant for the current research which focused on growth of knowledge-intensive HR service SMEs, for example, her argument that knowledge can increase automatically within the firms and that growth of managerial service may act as a limit on growth of firms was not supported by the empirical data of the current study; however, her idea that knowledge leads to innovation and then to firm growth is highly relevant; also, her insight on how

firm growth happened is largely relevant to the current study and her concept that growth induces growth is also true.

1.4 Research objectives and research questions for the current research

Given the lack of theories and research on process and causes of growth of SMEs, including HR service SMEs, which makes it difficult to understand the growth of these firms, there is a necessity to conduct research to correct this deficiency. The current research is carried out on HR service SMEs in Guangzhou City to explore process and causes of their growth. It has the following objectives:

- ◆ to gain a better understanding of how HR service SMEs in Guangzhou City grew by exploring their growth process and growth mechanism
- ◆ to identify causes of growth of these HR service SMEs and to develop a theory to better explain their growth which sheds light on ways to facilitate their growth
- ◆ to come up with recommendations to improve management practices to facilitate growth of these SMEs

These research objectives can be met by finding answers to the intellectual questions of how and why HR service SMEs were able to grow. These formed the two central research questions for the current research and were broken down into four sub-questions which were then used to guide research activities throughout the current research project:

- ◆ how did the growth of these firms happen?
- ◆ why were they able to grow (what were the causes of their growth)?
- ◆ why were some of HR service SMEs able to grow faster than others?
- ◆ why have some of these firms been able to grow continuously while others could not, given the same external environment?

1.5 Research methodology and research process: an overview

Given that the research questions for the current research were exploratory in nature, quantitative research approach such as survey research was not considered appropriate for the research. Qualitative research approach was regarded as more suitable for such research, because the approach allows in-depth examination and wide contextualization of a social process, which is the case for the current empirical study. After research methods relevant to such in-depth examination were compared, a case study approach utilizing qualitative research methods has been chosen as the methodology for the current research; and multiple embedded case study has been chosen as its research design, as explained in Chapter Four. This research approach fits well with the suggestion of Van de Ven (1992) that retrospective case histories can be used to study strategic process. Data collection mainly relied on semi-structured interviews, supported by archival research. Data analysis consisted of within-case analysis and cross-case analysis which used table and figure to display data for comparison and contrast purposes. Analysis has been conducted at two levels: growth of a firm as unit of

analysis and growth of service lines and growth scenarios as sub-unit of analysis. Multiple level analysis has allowed the researcher to see more thoroughly the growth process and growth dynamo of these service SMEs.

The current empirical study on growth of HR service SMEs in Guangzhou City followed the tradition of ‘grounded theory’ logic (Glaser and Strauss, 1967); thus, it was divided into two phases. The researcher believes that as in all procedural research projects on firm growth, one must first discover activities which formed a process leading to growth before he could find among these activities critical drivers for the growth; only then, one could safely identify causes of growth from these critical drivers and the ways these causes led to growth. Accordingly, the current research was divided into Phase One Study which explored the processes of firm growth and Phase Two Study which focused on identifying causes leading to firm growth. Based on the result of these two phases of empirical study, a new theory was then developed to explain growth of the case firms. The process of the current research is an iterative journey between theory and data, as shown in Figure 4.4.3.3b in Chapter Four. The process started from research problems calling for research and then moved to literature review which identified gaps in answering the research problems; it then moved on to development of research objectives and research questions; the next step in the process were data collection and data analysis; findings emerged from data analysis were compared and examined in light of existing literature, particularly ‘*The Theory of the Growth of the Firm*’ by Penrose (1959); the final step in the research process was drawing conclusions from the research and writing up dissertation to report the research.

However, when some points in the theorizing process, which intended to find answer to the research questions, did not match with existing data, the researcher went back to field notes to validate the points or to re-collect extra data. This iterative journey between theory and data continued until the time when theory matched data, which has ensured the validity of analysis and argumentation of the current research.

1.6 Significance of the research

The most obvious significance of the current research is that it has facilitated a better understanding of growth of HR service SMEs in Guangzhou City, which has been playing an increasingly important role in the fast economic development of the city. Prior to the current research, little had been known on growth of these firms, which had made it difficult to identify ways to facilitate their growth. The current research has made up for this research deficiency and it has added general knowledge to the understanding of growth of HR service SMEs in the city; in this way, the current research has shed light on important management practices which can facilitate growth of these firms. In a wider scope, the current research has added new knowledge to research on dynamic process of growth of professional service SMEs; before the current research was done, hardly any research had been conducted to enhance understanding of process and causes of growth of professional service SMEs. Through its discovery of processes and causes of growth of HR service SMEs which were a type of professional service firms (PSFs), the current research has made significant contribution to

knowledge on process and causes of growth of PSFs. Finally, the current research has resulted in a theory to explain growth of HR service SMEs in Guangzhou City, which may be important for future research attempting to develop theories to explain growth of professional service SMEs. By this, the current research has made new contribution to theorizing SMEs' growth which is still very much underdeveloped, according to scholars (Garnsey, 2002; Mckelvie and Wiklund, 2010).

1.7 Structure of the dissertation

This dissertation consists of eight chapters; content of each chapter is briefly explained here. Chapter One: this chapter gives an overview of the current research, providing information on research background, research problems, research objectives and research question, research methodology and structure of the dissertation. The purpose is to make it easy to read the dissertation and to understand its arguments.

Chapter Two: this chapter presents a focused literature review on the research problems, which centred on '*The Theory of the Growth of the Firm*' by Penrose (1959). The purpose is to identify how well existing literature has addressed the research problems and what gaps still need to be filled so that the problems can be properly addressed.

Chapter Three: this chapter provides a context for the research, aiming to familiarize the reader with subject matter for this research, that is, professional service firms (PSFs).

There are two questions in this chapter to be answered: what are the subjects for this research and what is the context in which they grew. The chapter presents information on professional service firms to which the subjects for this research, HR service SMEs, belong; and it also gives information on socioeconomic development of Guangzhou City. Moreover, information on development of HR sector is provided in **Appendix IV**.

The information was developed to contextualize the current research.

Chapter Four: this chapter presents the methodology adopted for the current research—case study approach. Multiple embedded case study was adopted as the research design. This chapter presents methods used for the data collection and data analysis; it also presents the research process. The methodology was developed to ensure the reliability and validity of the current research, which allows empirical audit and replication of the research in similar contexts.

Chapter Five: this chapters presents within case data analysis and cross-case data analysis of Phase One Study which is an exploratory study (descriptive research) intending to find out the process of growth of HR service SMEs in Guangzhou and to see how existing theories on growth of the firm can explain their growth. The discussion of the major findings is also presented; the discussion leads to the finding that existing theories which were built on industrial firms seem inadequate for explaining growth of service SMEs and dialectic theory may be more suitable for the purpose.

Chapter Six: this chapters presents within case data analysis and cross-case data

analysis of Phase Two Study which was carried out to identify causes of growth of HR service SMEs in Guangzhou. The theoretical perspective used is that of a dialectic theory. Short discussion is also presented on the major findings from data analysis of this phase of study.

Chapter Seven: this chapter sums up and discusses the research findings. The findings are interpreted, interrogated and assessed against existing literature reviewed in Chapter Two; this reveals the merit of the findings which have either confirmed existing knowledge or have added new knowledge on growth of firms. Based on the discussion, a systems dynamics model reflecting the dynamics of the process of firm growth among the HR service SMEs studied was developed; the model was developed based on the growth theory of Penrose (1959), following Garnsey (1998), as interpreted and conceptualized in Chapter Two, also in a systems dynamics model; the model is further rooted in cause and effect analysis of systems dynamics (Forrester, 1961; Checkland, 1981; Senge, 1990). Finally, in addition to the growth process model, the general argument (thesis) of the dissertation was put forward in the form of a new process theory, advancing knowledge on growth of relation-based professional service firms such as HR service SMEs under the study.

Chapter Eight: this chapter concludes the research, answering the research questions. It concludes that according to the findings of the current study, growth of HR service SMEs studied seems to be the result of constant dialectical interaction between these firms and market actors (mainly clients and competitors).

In summary, this chapter provides an introduction to the current research. The chapter first presents in brief the research background, the research problems, the literature review, the research objectives and the research questions. The research methodology and the structure of the current dissertation are also summarized in this chapter. Most important of all, this chapter clarifies the objective of the current research: to improve understanding of growth process and growth causes of the HR service SMEs studied so as to identify ways facilitating their growth. It is hoped that the introduction makes it easy to read and understand the dissertation reporting the current research on growth of HR service SMEs in Guangzhou City which have been playing an increasingly role in economic development of the city.

Chapter Two: Review of literature on firm growth

This chapter critically reviews ‘*The Theory of the Growth of the Firm*’ published in 1959 by Edith Penrose (1914-1996), which is ‘one of the most influential books on the second half of the twentieth century bridging economics and management’(Kor and Mahoney, 2000, p.109) focusing on the growth of firms and a ‘revolutionary work’(Ghoshal *et. al.*, 2002, p. 288). Its increasing worldwide influence, as predicted by Marris (1961) in his review of the work, has eventually come to pass. In this chapter, Penrose’s arguments and theoretical synthesis are assessed in the context of literature on growth of firms; the aim is to identify a sound theoretical foundation for the current research in explaining growth of HR service SMEs in Guangzhou City. The chapter begins with a brief explanation on why ‘*The Theory of the Growth of the Firm*’ (Penrose, 1959) is chosen as the focus for this review. Then, the work is introduced. The main part of this chapter reviews key arguments of the work in relation to research themes on firm growth; and based on the review, an attempt is made at synthesizing her position into what she calls ‘a single argument’ on firm growth (Penrose 1959, p. xxiii). Key arguments from the literature on firm growth are used as a framework of reference (a basis for critique) to show the merits and missing links of Penrose (1959) on the topic of firm growth, making this review a focused, yet broad, examination of major conceptualizations and theories on the topic.

2.1 Who is Edith Penrose? Why is ‘*The Theory of the Growth of the Firm*’ chosen as focus of Literature review on firm growth?

Edith Penrose (1914-1996) was a scholar famous for her theory on the growth of the firm. The following description of her life is mainly based on Pitelis (2002). Edith Penrose was born as Edith Elura Tilton on November 29, 1914, on Sunset Boulevard in Los Angeles. She earned a BA in economics from University of California at Berkeley in 1936. Her first husband, David Denhardt, died in a hunting trip when Edith was four months’ pregnant. She later married E F Penrose, thus named Edith Penrose. One of her important development was her study in Johns Hopkins University for her master and PhD in economics. She completed her PhD in 1951, under the supervision of Fritz Machlup, a strong champion of neoclassical economics. This is interesting because it is Machlup who asked her to join a research project in the University from which Penrose wrote her nontraditional work ‘*The Theory of the Growth of the Firm*’. The work is ‘nontraditional’ because the work does not follow the traditional thoughts of neoclassical economics flourishing at the time. Penrose later recalled, according to her interview with David King in the British edition of Parkin and King’s economic textbook (Pitelis, 2009, p.6):

‘I had no special interest in firms, but a Professor there [Johns Hopkins] had a large grant to do studies of the growth of firms, and he asked a group of us to participate. I didn’t mind what I specialized in, but I had to earn some money and the growth of firms seemed interesting. So I elected to work on the theory of the growth of the firm and it took me nine months of reading and especially

thinking before I realized that the traditional theory of the firm, in which I, like other economists, had been trained, was not relevant to the problem of the growth of firms.’

To find a theory of the growth of the firm, Edith did her field work in Herculer Powder Company as a Fellow under the College-Business Exchange Programme; and this work eventually led to the birth of ‘*The Theory of the Growth of the Firm*’. The work was published 1959, with little impact on the academy which was then dominated by neoclassical theories. After that, Edith, together with her husband Pen, began her mobile work abroad in Australia, Iraq and the UK. She taught in many universities, including the University College of Arts and Sciences in Baghdad, The University of London and INSEAD. In 1964, she took the first Chair of Economics with Special Reference to Asia in SOAS, University of London which she held until 1978 (Pitelis, 2009). She then retired from the University and took up Professorship of Political Economy in INSEAD which lasted till 1984 when her husband Pen died. His death was a serious blow to Edith and upon his death, she retired from INSEAD and lived in Waterbeach, near Cambridge, close to her sons. She died there in 1996, shortly before her 82nd birthday.

After she retired, recognition of her early works, particularly ‘*The Theory of the Growth of the Firm*’, began to accelerate and a stream of visitors visited her in Waterbeach. Edith enjoyed her belated recognition and picked up the thinking on theories of the growth of the firm. Her work ‘*The Theory of the Growth of the Firm*’ was reprinted by Oxford University Press in 1995, with her revised Preface attached. Edith lived in the

goodness of the people and ‘was not ambitious for herself’; and she ‘had little interest in academic politics’; ‘it seemed as though she was unaware of her achievement’ (Pitelis, 2009, p.10), although the influence of her work, in particular, ‘*The Theory of the Growth of the Firm*’, was monumental (Pitelis, 2009).

The work ‘*The Theory of the Growth of the Firm*’ has been generally recognized as seminal work of Resources-Based View (RBV), although some scholars such as Foss (2002) question this kind of association. As Edith claims (Pitelis, 2009), neoclassical economics is not relevant to the theories of the growth of the firm; she and many her followers have ventured into a new field of thought, RBV, in order to secure a sound explanation of firm growth. 50 years have passed since the publication of ‘*The Theory of the Growth of the Firm*’. To date, it seems that few works on the topic of firm growth, if any, have surpassed ‘*The Theory of the Growth of the Firm*’ in its insight into the inner process of growth, in its comprehensive treatment of the topic on firm growth and in its theoretical depth of arguments. McKelvie and Wilund (2010, p.271) says that ‘[h]er work appears to be the main, or at least most highly used, theory of growth.’

Owing to the monumental impact it has on research on the growth of firms (Foss, 2002 and Kay, 2002), ‘*The Theory of the Growth of the Firm*’ has been chosen as the focus work for review in this chapter, which intend to come up with a Penrosean theoretical framework for later application in the current research to explain growth of HR service SMEs in Guangzhou City. The following section gives an overview of the work.

2.2 ‘The Theory of the Growth of the Firm’ : an overview of the book

This section gives an overview of Edith Penrose’s work ‘*The Theory of the Growth of the Firm*’, which is the ‘most cited work’ in the research field of firm growth (Foss, 1998, p.2); this is done to prepare for the review of her major arguments and theoretical synthesis that are to come in later sections. The book is introduced as it is, with little criticism. Published in 1959 and reprinted in 1995, ‘*The Theory of the Growth of the Firm*’ is a thin book of eleven chapters in two hundred seventy two pages (excluding the forward and preface written by Edith Penrose). In her 1995 forward, Edith Penrose states:

‘In undertaking an analysis of the growth of firms in the 1950s, the question I wanted to answer was whether there was something inherent in the very nature of any firm that both promoted its growth and necessarily limited its rate of growth.’(Penrose, 1995, p. xi)

This is the central research question which links the chapters of the book. In order to find this question’s answer which forms the theory of firm growth, in the book, Edith selects industrial firms as subjects of her study. In 1950s when Penrose (1959) wrote her work, in these US industrial firms, ‘managerial employees both controlled the allocation of the resources and embodied the accumulation of capabilities and they dominated the industrial organizations of the capitalist economies’ (Lazonick, 2002, p. 266-267). In her work, she defines a firm as:

“[A] collection of resources bound together in an administrative framework, the boundaries of which are determined by the ‘area of administrative coordination’ and ‘authoritative communication’.”(Penrose, 1995, p. xi)

This definition is what she called a ‘managerial firm’. Apart from this definition, in order to carry forward her argument, Edith Penrose makes the following assumption:

‘[A managerial] firm [is] run by a management assumed to be committed to the long-run interest of the firm, the function of shareholders being simply to ensure the supply of equity capital. Dividends need only be sufficient to induce investment in the firm’s share’ (Penrose, 1995, p. xii)

Although inadequate in today’s business context as Edith acknowledges in her 1995 forward, this assumption is the one which provided the basis for her arguments in the book. Based on this assumption, in the book, Edith provides an answer to her central question:

‘The firm’s existing human resources [predominantly meant ‘managerial resources’ by Edith] provide both an inducement to expand and a limit to the rate of expansion.’ (Penrose, 1995, p. xii)

Chapter by chapter, Penrose builds up her arguments to finally land on the above answer

for her central research question. Her arguments, however, are not developed in a linear straightforward manner, as most academic papers do. Her book is packed with ideas (Marris, 1961) which are difficult to be synthesized into a single argument. Nonetheless, she warns in her 1959 forward that '[t]he entire study is essentially a single argument no step of which can be omitted without the risk of misunderstanding later conclusions' (Penrose, 1995, p. xxii). The following is a summary of the chapters of the book:

Chapter I of the book provides an introduction to the book, presenting the purpose of the study and the nature of the argument. Chapter II provides a Penrosean definition of a firm, as shown above, which is different from the definition of the firm in economics' 'the theory of the firm'. Chapter III and Chapter IV proceeds to examine the forces inherent in the nature of firms which promote growth but at the same time limit rate of growth. Chapter V discusses the direction of firm expansion, which Edith argues is determined by 'inherited resources. Chapter VI deals with the size of firms which is a heated topic in economics regarding firm growth. In this chapter, she advances a new concept of economy of growth, which is useful for explaining motivation for firm growth. Chapter VII discusses the economics of diversification. Chapter VIII discusses the topic of expansion through acquisition and merger. Chapter IX deals with rate of growth of firms through time, again, a central topic in economics. Edith argues that rate of growth is limited by managerial services but size of firm is not. Chapter X presents the positions of large and small firms in a growing economy, which argues that there is room for small firms to grow due to 'interstices' in a growing economy; these 'interstices' are left over by the big firms because the big firms are too preoccupied with

their fast growth to take care of them. Chapter XI presents growing firms in a growing economy, which describes process of industrial concentration and the pattern of dominance; in this chapter, Edith provides strong support for growth of big firms.

2.3 ‘*The Theory of the Growth of the Firm*’: a critical review of its major arguments

This section presents a focused critical review on major arguments of ‘*The Theory of the Growth of the Firm*’ which are relevant to the current research on growth of HR service SMEs whose aim was to find out causal mechanism of growth of these SMEs. Arguments in the book which are irrelevant to the current research are not reviewed, for example, her arguments on diversification, merger and acquisition as well as industrial concentration process. Since the book is packed with ideas which are hard to untangled and rearranged into a simple linear argument on firm growth, its major arguments are reviewed following the logical flow of major research themes on firm growth: what is a firm, why firms want to grow, why firms are able to grow, how firm growth happens, what are the major determinants of firm growth and why some firms can grow continuously. Review of Penrosean arguments on each of these research themes is conducted in this sequence: presentation of concept and theories of the research theme other than that of Penrose (1959) if any, presentation of Penrose’s arguments on the research theme, critique of Penrose’s argument on the research theme drawing on existing literature on the same topic. It is hoped that Penrose’s argument on a specific research theme can become a focus point to draw and criticize various relevant thoughts in literature on the same topic; in this way, this review can be turned into a focused and

yet comprehensive, literature review on research themes on firm growth that are relevant to the current research.

2.3.1 What is a firm: conceptualization of a firm by Penrose (1959)

What is a firm? This is the first question every researcher on the theory of the firm and the theory of the growth of the firm has to answer before he or she can proceed to research into causal mechanism of the growth of the firm. Coase (1937, p.386) emphasizes the importance of defining a firm:

‘Since there is apparently a trend in economic theory towards starting analysis with the individual firm and not with the industry, it is all the more necessary not only that a clear definition of the word " firm " should be given but that its difference from a firm in the " real world," if it exists, should be made clear.’

Penrose shares the same view. She devotes a whole chapter of the book ‘*The Theory of the Growth of the Firm*’ to seeking a definition of a firm that is suitable for her research purpose. The following paragraphs review her arguments on what is a firm. First, the context of her argument is provided; then, her definition and argument behind it are presented and finally, her argument is critiqued.

As Penrose observes, a firm has always been in an important place in economics analysis, because essentially an economy is run through operations of various firms.

However, a firm is a very complex institution, influencing many aspects of the society. Due to its complex nature, a firm can be analyzed in many perspectives: sociology, economics, and organizational theory (Ravix, 2002), just to cite a few. Therefore, different researchers define a firm in different manners, leading to a variety of definitions of a firm and quite naturally, some confusion therefrom. There are several major definitions of a firm which are relevant to conceptualization of a firm by Penrose and thus, are reviewed in following paragraph.

The first of such concepts of a firm is defined by neoclassical economics and it is often found in the ‘theory of the firm’. To neoclassical economists, the firm is a production function used for modelling price and output in equilibrium-based economics theories. These scholars care little about what is going on inside the firm—‘a black box’ as it is often called, because their only interest is resource allocation and efficiency of market; they do not want to find out the mechanism of wealth creation as classical economists such as Adam Smith did. Coase (1937) regards the firm as a hierarchical mechanism allocating resource which can substitute price mechanism in the market; he explains that firms exist because they are more efficient than market in resource allocation and their boundary is determined by transaction cost; Coase’s (1937) idea was taken up by Williamson (1985) who further developed the transaction-cost theory of the firm. The firm as defined by neoclassical economics is a model to develop theories of price and output which totally ignores people in it; such conceptualization of the firm has nothing to do with what businessmen call ‘firms’ (Penrose, 1959). Nevertheless, the construct has been widely used and still dominates today’s economic analysis. By contrast, in

sociological perspective, a firm is a social organization in which all social actions play out. Sociologists are interested in finding out how people interact and what impacts their interaction brings about. A behavioural theory of the firm holds that a firm is a social stage on which managers build their social status and prestige (Greve, 2008). In management studies, Resources-Based View (RBV) define a firm as bundle of resources to gain competitive advantage while competence-based view regards a firm as an institution where core capabilities or dynamic capabilities (Teece, 2007; Augier and Teece, 2009) can be built up to gain competitive advantage. In organizational learning theory, a firm is a generic organization which permits interaction of people, development of collective knowledge and facilitating workplace learning (Turvani, 2002). These constructs of a firm are not in themselves wrong or right. They are developed to suitable different research purposes and thus, are all justifiable (Machlup, 1967). The relevance of them to the current review of conceptualization of a firm by Penrose (1959) is that definition of the firm by neoclassical places a contrasting role, offering a target for critique from which she builds her different concept of a firm. The other three concepts of a firm offer her either sources with which she develop her own definition of a firm or confirmation of her definition of a firm.

Before advancing her definition of a firm, Penrose (1959) critiques the concept of the firm in the theory of the firm. The theory of the firm only concerns with price and output, without looking inside the firm, it is not suitable for research on other aspects of firms such as growth. Such definition of the firm is irrelevant to her study which set out to examine the process of growth. Besides, according to the theory of the firm, there is a

limit to size of the firm when it is optimally efficient, due to the curve of cost and to the fact that market limits the size of the firm tying to a specific product. This argument does not hold, Penrose (1959) insists, because firms are free to add or change their product lines or even change market. Penrose (1959) concludes her critique of the concept of the firm in neoclassical economics by saying that the 'Firm' [in the theory of the firm] is not a firm, meaning that the neoclassical conceptualization is not suitable for studying firms in the real world:

'Difficulties arise when an attempt is made to acclimatize the theory [of the firm] to an alien environment and, in particular, to adapt it to the analysis of the expansion of the innovating, multi-product, 'flesh-and-blood' organization that businessmen call firms.' (Penrose, 1959, p. 130)

She proceeds to argue that the primary economic function of industrial firms, which is her only concern, is to 'use productive resources for the purpose of supplying goods and services to the economy in accordance with a plan developed and put into effect within the firm itself' (Penrose, 1959, p.15). From this, Penrose (1959) reasons that a firm is the administrative organization which plans, coordinates and executes economic activities. Managerial services are thus vital to the operation and expansion of firms. The size of the firm is defined by the boundary of the administrative co-ordination and authoritative communication. Besides, she argues, a firm is 'more than an administrative unit; it is also a collection of productive resources' (Penrose, 1959, p.24), the disposal of which is determined by administrative decision. From these arguments, it could be inferred what an industrial firm is in Penrose (1959), which is set out in later forward

written by Penrose in 1995. A firm is a

‘collection of resources bound together in an administrative framework, the boundaries of which are determined by the ‘area of administrative coordination’ and ‘authoritative communication’(Penrose, 1995, p.xi).

In the theory of organization learning, according to Foss (1998), the firm in Penrose (1959) is an institution which best produces, stores and manages knowledge (experience) learned from expansions. This definition is a very important concept for her to develop her famous theory of the growth of the firm. As Penrose (1959) observes, ‘[t]he theorist is free to adopt the technique most suited to his problem’ (this is the view of Machlup, her PhD supervisor). She develops this concept of a firm to suit her problem of researching growth of firms. There are several points in the conceptualization from which she develops her theory of the growth of the firm. One important concept is bound resources. Resources are fungible, could be integrated and reconfigured to become heterogeneous productive services of the firm, which is the source of competitive advantage. Knowledge is one of the important resources which can be increased and managerial resource is another which has the will and the power to bundle, or rather, to reconfigure firm resources for producing different productive services; and when productive services are combined with external growth opportunities, the firm can have productive opportunity set. Besides the concept of bound services, another important concept is administrative framework. By this concept, Penrose is able to set out the nature of the firm and the boundary of the firm, both of which depends on

administrative coordination and authoritative communication, that is, managerial services (Pitelis, 2002). Expansion (growth) of the boundary of the firm is therefore, logically, limited by managerial services.

Arguments of Penrose (1959) on what is a firm have successfully opened the black-box firm of neoclassical economics. These arguments put human agents inside the firm and make the firm a purposive institution in economy. The conceptualization reflects firms in real world which are run by businessmen. This is very appropriate for Penrose (1959) who wants to research into the process of the growth of firms. Yet, her definition has a fundamental problem. The construct of a firm as administrative framework which emphasizes managerial services could be invalid. Not all firms are complex, for example, SMEs are often simple in management structure and routines, not to mention one-man firm in service industry. In such firms, to grow, managerial services may not be as important as other activities; and managerial resources may not be always as critical as other resources (Pitelis, 2002).

2.3.2 Why firms want to grow: A Penrosean argument

2.3.2.1 Theories on why firms want to grow excluding that of Penrose (1959)

The motivation for firms to grow is a prominent research theme in literature on firm growth, maybe because it is important to understand the motives behind firm growth if effective incentive measures are to be taken to drive growth. In this regard, there are quite number of theories. Classical economists such as Marshall (1920) believe that

firms exist to create wealth, which can be done by maximizing production volume and minimizing production cost. Expansion can achieve these two purposes and hence, maximizing profit. Maximizing profit is the motivation for firms to grow. This argument gives rise to the lateral expansion of firms in order to achieve economy of scale. Different from this view, Coase (1937), in his famous essay '*The Nature of the Firm*', argues that firms expand for economic benefits by reducing transaction cost, resulting in the substitution of firms for market. Williamson (1985) later further developed the transaction cost concept. If some activities can be done more efficiently in the firm than in market, these activities will be transferred inside the firm. His argument explains the phenomenon of vertical integration of firms. Coase (1937) may over-emphasize market transaction to the point of ignoring internal production function in firms. It is argued that given the same market transaction, increase in internal production efficiency can also expand the boundary of firms, that is, to grow the firms (Alchian, 1950). These economic views are criticized for their neglect of non-economic motives behind firm growth such as power perspective by Perrow (1979). In addition, they seem to suggest that any firm can grow automatically, as if driven by an innate natural law, because the motivations for growth which these economists provide appear to exist in all firms. This could be one of the weaknesses of these theories.

Different from these economic scholars, other scholars found other motives behind firm growth. Starbuck (1971) found that various motives are behind firm growth. While some firms grow to gain economy of scale or economy of scope, others firms grow to fend off competition (Bain, 1956; Pitelis, 2002) or to satisfy the ambitions of

entrepreneurs and managers for power and social status. Sometimes, growth is desirable and even necessary for survival (Stanworth and Curran, 1976). Perrow (1979) believes that firms grow to dominate markets by excluding their competitors. Thus, firms grow for monopoly or near-monopoly market power. In contrast with the theories described above, a radical theory (evolutionary theory) holds that firms grow as time passes, just as any living organism, if they are selected by environment to survive and grow; this seems to suggest that firm growth is a natural phenomenon with its own law. This view is held by scholars making firm growth analogous to biological evolution (Hannan and Freeman 1977; Gartner, 1985; Henderson, 1989). The view is criticized by Penrose (1952) for not considering the voluntaristic nature of the firms which are, after all, human organizations.

2.3.2.2 The argument of Penrose (1959) on why firms want to grow

Penrose (1959) limits her research on growth of industrial firms. She has put an agent into her firm, which is contrast to the firm in the theory of the firm in neoclassical economics that has no human face. This is very wise and critical for explaining why firms want to grow. In order to explain why firms want to grow, Penrose (1959, p.26-28) now can make several assumptions:

- ◆ ‘Firms act for a purpose’ and ‘Firms are management controlled’
- ◆ ‘...[Increase] in income and wealth have personal advantages for the individual which will spur him to obtain what he reasonably can.’

- ◆ ‘..[F]irms, or more accurately the managers of a firm, always want to make more profits
- ◆ Profit is the cheapest capital for expansion and managers want to retain profit for expansion; long-run profit is favourable for growth and growth is a means to obtain long-run profit.
- ◆ Managers can ‘gain prestige, personal satisfaction in the successful growth of the firm’ which gives them better paid positions and wider scope for their ambition. All of these, however, come from long-run profit.

Unlike neoclassical economists who can only explain that firms want to grow for maximizing economic benefits, Penrose (1959) delves deeply and indeed, successfully at the real root of motivation for firms to grow. For her, a firm is a managerial firm and managers want to grow for long-run profit to realize their own life and career dreams. In addition, Penrose (1959) points out several important inducements for a firm to growth: market demand, competition pressure and slack of resources inside the firm. She does not expand her argument on why firms want to grow by contributing motivation to external sources such as market demand and competition; instead, she contributes motivation for firm to grow to the firm. An increase in knowledge inside the firms opens up eyes of managers to more growth opportunities which induce them to take actions to grow. In addition, there are some resources such as human resources that have in them the nature of economy of growth. The more expansions the firm undertake, the more they learn, and the more profit they can make. Firms do not necessary expand for economy of size and scope although these are valid; they can expand for economy of

growth and for some resources which can be used only for this purpose. Finally, Penrose (1959) argues, each expansion of the firm will leave over some slack resources (which have already been paid for and can be used at low marginal cost); underutilization of these slack resources means loss of money for the firm, indeed, particularly, managerial resources released from the prior expansion. The firm always wants to make the most of these unused resources for profit making. Thus, each expansion induces the next. As she observes, '[u]nused productive resources are, for enterprising firm, at the same time, a challenge to innovate, an incentive to expand, and a source of competitive advantage' (Penrose, 1959, p.85). Many theories have been built on this important construct.

The argument of Penrose (1959) on why firms want to grow appears logical and very realistic. However, her argument may not always hold true. The assumption that managers are interested in long-run profit as shareholders may not be valid today when managers are moving quickly from one firm to another (Lazonick, 2002). As Marris (2002, p.70) comments, 18 months may mean 'long term' in the eyes of today's top management of a firm. In particular in dynamic economy such as that of China, for a manager to stay in a firm too long may be seen as incompetence in professional job market. Managers thus have the incentives to work for short-term gains. If a firm has unused productive resources, its managers may not use them to expand; rather, they may sell or shed them for short-termed benefits, as it happened to US corporations in 1980s and 1990s (Lazonick, 2002; Kay, 2002). That is why firms often use "gold cuffs" to retain their key staff. In this light, the argument of Penrose (1959) that the firms grow in order to make the best use of slack resources in the firm appears weak in today's

changed business environment (Pitelis, 2002). Indeed, in her 1995 forward, Penrose acknowledge this discrepancy of her assumption. The second assumption of Penrose (1959) that growth of a firm can always bring profit in the long run is not always true (Marris, 2002). In fact, growth of many high-tech firms today often brings loss to the firms, which could last for many years. These firms grow to give a signal to the capital market that they are successful so that they can continue to be funded. Other firms are well aware that growth may not always be profitable and are cautious on expansion. Finally, vertical integration is not done to make the best use of existing resources. Instead, it is done to 'ensure security, quality and continuity of supplies' (Kay, 2002, p.92). In this sense, the theory of Penrose (1959) can not explain well the motive for vertical integration which can not use prior learning (managerial services) (Kay, 2002).

The 'profit motive' (Penrose, 1959, p.27) does not appear to explain growth of some other firms such as SMEs operating in a buyer market in which survival is more important than profit; for them, growth may be forced upon them by external environment and they have to do it with or without profit. As Stanword and Curran (1976) explain, firms have an immediate need over the other motives to grow for survival; this is particularly true for small firms in buyer market. Firms could only exist when they add value to their customers or clients; in this sense, for them, survival and growth have priority over other growth motives; only when a firm survives and operates, can it make money for its shareholders.

It seems that the theory of Penrose on why firms want to grow could be complemented

by other theories. Growing for profit may be one motive, but not all the motives, for firms to go for expansion. Indeed, there may be several motives for a firm to go for expansion; these motives may be compatible. To expand for gaining market power, for example, is not in any way contradictory to the motive of growing for profit maximizing. Consequently, instead of criticizing other theories on firms' motivation for growth, in search of firms' motives for growth, it is more appropriate to identify major motivations and to prioritize them, so as to understand the main forces driving the growth of a firm.

2.3.3 Why firms are able to grow: A Penrosean argument

2.3.3.1 Theories on why firms are able to grow except that of Penrose (1959)

Given that firms have motivation to grow, regardless of motivations, why are firms able to grow? Many researchers work on this question in order to understand the generative mechanism of firm growth. Again, there are many explanations, because, like other research themes on firm growth, this research theme can be approached from many perspectives. It is very difficult to have a neat and clean summary of so many different approaches explaining generative mechanism of development and growth (Van de Ven and Poole, 1995). Nevertheless, the following paragraphs attempt to put forwards a limited number of key views in extant literature on the theme why firms are able to grow.

Adam Smith (1723-1790) could be one of the first persons attempting to explain why firms can grow. He does not explicitly explain why firms can grow. Yet, from the

famous pin factory story in his '*An Enquiry into the Causes and Consequences of the Wealth of Nations*' (Smith, 1776), it is still possible to infer his view on this research theme. He believes that specialization of labour gives rise to efficiency (Loasby, 2002) and this economy allows much bigger volume of production to follow. To Adam Smith, specialization of labour fosters increasing return includes the 'improvement of art' (Best, 2002, p.185); it is the generative mechanism of economic growth, because 'division of labour is...organizing the development of skills and also of different kinds of knowledge, thereby generating the possibility of novel production sets' (Loasby, 2002).

Schumpeter (1942) believes that innovation, particularly 'creative destruction', is the cause of business growth and growth of economy in general. Innovation can bring better products or services to the market which in turn rewards the innovative entrepreneurs. The entrepreneurs have more resources to complete yet more innovation, which leads to more and better products for market and hence, the growth of their firms. As Lazonick (2002, p. 254) observes, 'what enables firms to grow over time is [the] continual ability of the enterprise to utilize pool of resources to generate new products developed in the past, while building on this existing pool of resources to generate new unique capabilities'. Although simplified here, this virtuous self-reinforcing cycle of innovation and expansion is another generative mechanism of firm growth and economic development. In fact, Schumpeter's idea of innovation as an engine for growth later is taken up by many scholars in research on entrepreneur and growth of SMEs (Hoskisson, et al., 2011)..

Resources-based view (RBV) believes that a firm can gain competitive advantages from its unique and heterogeneous resources, which implies that it can have better business in the market and thus, a better chance to expand. In other words, due to their heterogeneous resources, firms can gain competitive advantages which enable them to expand. Capability-based view extends this concept of RBV. It explains that a firm can develop its core competency or dynamic capability which differentiates it from the rest in the market, giving it clear competitive advantages; and competitive advantages increase chances of winning in the market, which most likely leads to firm growth.

Chandler (1990, 1992), through his work tracing development and growth of British, American, German and Japanese corporations, advances the point that development in organization capabilities shapes growth of corporation. No other theory other than organizational capability development, either Neoclassical economics, Agency Theory, Transactional Theory or Evolutionary theory of economics, can explain the growth of firms. As firms develop stronger and stronger organization capability, they are becoming more and more competitive in the market and thus, gain more resource and better recognition. In turn, firms have better chance to grow.

Managerial theories of the firm (Baumol 1959, 1962 and Marris, 1964) and later many organizational theories point to another concept: organizational learning and development in the firm as the engine for firm renovation and growth. Organizational learning brings about new ways of thinking and new knowledge about the business of the firms. This increase in knowledge helps to develop capabilities of the firms,

minimizing cost and raising return from the assets. Economy and new strength from organizational learning leads to favourable position in the market, which gives a better chance for firms to grow.

Different from the above view focusing on internal mechanism for firm growth, Porter (1980) looks to external causes for firm growth. He believes that the source of firm growth is from the favourable position a firm can secure and defend in its industry. According to Porter (1980), there are five major forces in the market which a firm must fight against in order to have a favourable position to gain profit and to sustain growth. The firm must get to know well its industry and its own strength and weakness; and based on this knowledge, the firm need to develop a strategy of action to influence the industry for its favour. 'The key to growth - even survival –is to stake out a position that is less vulnerable to attack from' its opponents and 'less vulnerable to erosion from the direction of buyers, suppliers and substitute goods' (Porter, 1980, p.50). The theory of Porter (1980) and others cited in this section, it can be concluded, although different, are all attempting to explain why firms are able to grow from a one-sided view: firms are able to grow either due to firm capability development or due to firm's successful market exploitation.

2.3.3.2 Penrose (1959) on why firms are able to grow

Penrose (1959) is one of the forerunners on the generative mechanism of firm growth. On this topic, she does not seem to base her arguments solely on specialization of labour,

as Adam Smith does. She does, however, agree with Schumpeter (1942) on entrepreneurship and innovation as an engine of growth (Foss, 1998; Lazonick, 2002; Cantwell, 2002). Penrose (1959) believes that innovation creates new value for firms in the long run and technological progress brings new value to the existing income stream in an industry. She is not interested in theory of competition which orthodox economists such as Porter (1980) embrace, because competition can only let firms maximize a firm's profit from existing pool of income, adding no new value to it. Furthermore, she believes that 'examples of growth over long periods which can be attributed *exclusively* to such protection [market power] are rare'. (Penrose,1959, p.113) and firm growth comes only from development of firm capabilities. Thus, accidentally, she comes to the same view as Chandler (1990, 1992) on organizational capability as engine of firm growth, although her research approach is different from that of Chandler (1990,1992). Essentially, she argues that increase in knowledge in the firm leads to firm growth.

Knowledge comes in two forms: 'objective knowledge' and 'tacit knowledge' (Penrose, 1959, p.53). Objective knowledge can be easily transmitted because it is coded, whereas tacit knowledge, or rather, experience, is difficult to separate from the person and context and to transmit. In the period of time when Penrose (1959) wrote her theory, managers embodied capability of the firm and they dominated the firm (Lazonick, 2002). Thus, Penrose (1959) argues, as managers learn more about the resources of the firm and external world, they increase their knowledge on productive services of their resources, which open up more productive opportunities, which Penrose (1959, p.31) define as 'the productive possibilities that [a firm's] 'entrepreneurs' see and can take

advantage of'. This conceptualization is somewhat subjective (cognitive). Thus, due to learning of resources, managers can have productive opportunities for a firm to grow (Foss, 1998), even if the external world has not changed; external 'environment is not an objective fact discovered before the event' (Penrose, 1959, p.41); it is after all, an 'image' in the entrepreneur's mind (Penrose, 1959, p. 5) and productive opportunities always exist for those enterprising minds actively seeking for growth opportunity, which Penrose (1959) believes requires intuition and imagination.

In short, Penrose (1959) argues for 'the growth of the firm as the development of knowledge in the firm' (Turvani, 2002, p. 210). She claims that as managers of a firm increase their learning and experiences, particularly on their resources, they see and can take advantage of more and more productive opportunities to grow their firm. Increase in knowledge within the firm is the generative mechanism for firm growth. It is here that one can appreciate the fact why she put human agents into her definition of firm. By doing so, Penrose (1959) focuses on actors inside the firm which increase knowledge which in turn generates growth, a logic absent from the theory of the firm by neoclassical economists who have no human face in their concept of the firm; orthodox economists are not interested in explaining growth of firm (value creation); instead, they are interested only in explaining optimal size of the firm which can be gained through market power maximizing monopolistic profit. Penrose (1959) returns to wealth creation through increasing knowledge, as championed by Adam Smith and Marshall; and she has thereby made a great contribution to the theory of the growth of the firm.

The argument that increase in knowledge within the firm leads to firm growth, however, could be over simplified, without any specificity, as most RBV constructs are. After all, it is ‘the actual application in production, and not the mere possession, of resources [knowledge]... that create revenue’ (Spender, 1994 in Foss, 1998). Increase in knowledge may open up wider possibilities of expansion. Yet, this is good for planning expansion only, which is what Penrose (1959) focuses on (Ravix, 2002). There is a long distance between planning and achieving firm growth, which can make or break expansion plan. There are many details in between. Increase in knowledge may need to effect improvement in firm capability, which in turn need to lead to innovation and innovation may still need to secure competitive advantage. Simply put, increase in knowledge within the firm does not always generate firm growth, although possible. Nevertheless, argument of Penrose (1959) that increase in knowledge within firm leads to firm growth is very logical and highly relevant to the current knowledge economy. In fact, many current schools of thoughts on generative mechanism of growth, such as organizational learning theory, all seem to benefit from Penrose (1959).

2.3.4 How firm growth happen: A Penrosean conceptualization of process of firm growth

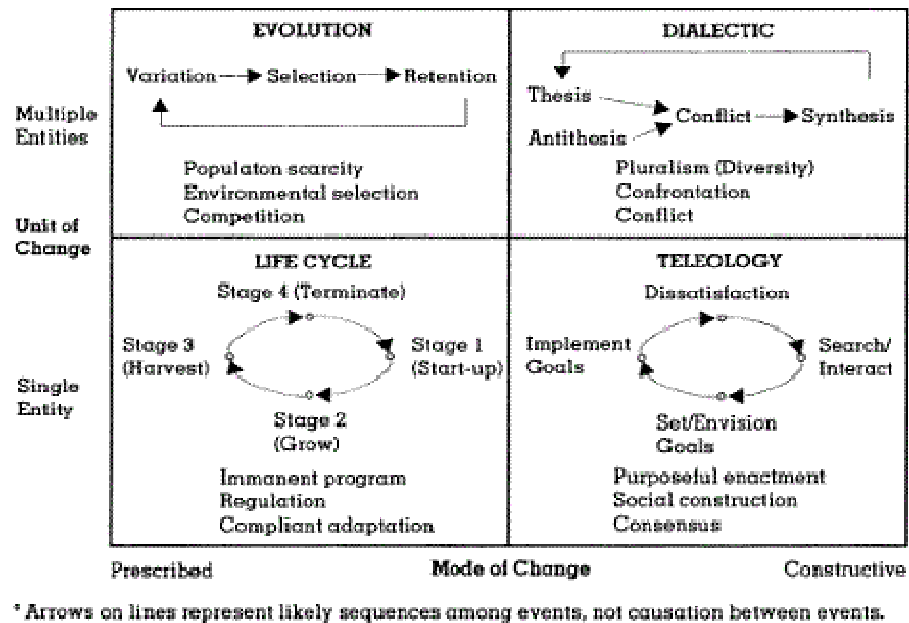
2.3.4.1 Theories on process of firm growth except that of Penrose (1959)

How does firm growth happen? Or what is the process of firm growth? This theme is less researched (Leitch *et al.*, 2010; Mckelvie and Wiklund, 2010). In words of Langley (1999, p.706), ‘there are constant calls in the scholarly literature for more in-depth

process research that will enable us to understand organizational phenomena at more than a superficial level'. Unfortunately, most economists except Edith Penrose are interested in substantial enquiries into nature, existence, boundary and size of the firm, but not procedural enquiries into the behaviours of firms governed by behaviour theories. Still, there are a number of theories developed to account for such a process. The paragraphs in the following first of all set out a typology of organization development invented by Van de Ven and Poole (1995); it is a good framework of reference for understanding growth process of firms. Based on the typology, key process theories on firm growth are presented and discussed.

Process theories on organization development (firm growth) can be generally categorized into four types, as shown by the typology of Van de Ven and Poole (1995), which comes from 'Explaining Development and Change in Organizations', an article published in 1995 in *The Academy of Management Review*. The figure below shows the typology.

Figure 2.3.4.1: Typology of Van de Ven and Poole (1995, p.520) on process theories



The first theory is ‘*life-cycle theory*’. This theory stipulates that change is imminent. An organization has within it a pre-programmed code that ‘regulates the process of change and moves the entity from a given point of departure toward a subsequent end that is prefigured in the present stage’ (Van de Ven and Poole, p. 515,1995). ‘Historical forces... shape the future growth of organization’ (Greiner, p. 166, 1972). Life-cycle theory of organizational entities often takes institutional rules as codes which prefigure the sequence of organization development and change. ‘*Teleological theory*’ is the second process theory on organization development and change. It has as its root in the philosophical doctrine that the final goal can guide movement of an organization entity: the entity constructs an envisioned end state, takes action to reach it, and monitors the progress. According to ‘*Teleological theory*’ in Van de Ven and Poole (1995), organization development process is a repetitive sequence of goal formulation,

implementation, evaluation and modification based on what is learned and intended by the entity. This process theory stresses the purposefulness of the actor or unit as motor for change but it also recognizes limits on action. The third process theory on organization development and change is the '*dialectical theory*'. It believes that the internal dialectical conflict is the engine for development and the process of organization development is a spiraling process of moving the organization from one equilibrium state to another higher equilibrium state. The fourth process theory on organization development and change is '*evolution theory*'. It holds that as in biological change, organizations go through a continuous cycle of variation, selection, and retention. The generative mechanisms are population scarcity, competition and commensalism.

These four ideal-type process theories represent most of the process theories on organization development and change, and thus, when combined, they can produce many composite process theories explaining the phenomena of organization development and change. Van de Ven and Poole (1995) suggest an array of sixteen composite process theories of development and change, which focus mainly on generative mechanism (motor) of change. They believe that the complexity of organization development and change can be analyzed as the interplay among these primitive motors.

While firm growth may embody organizational change and development of the firms, it is beyond internal organizational change and development of the firms. Firm growth

needs to involve many stakeholders in the market such as customers, competitors and suppliers. The interaction is thus much wider and more complex than that in organizational change and development. The research question what goes on within the firm while it is growing is never easy to answer and except Penrose (1959), few have produced a satisfactory answer (McKelvie and Wiklund, 2010). The reason may be that firm growth can be secured in many ways and each of them required different process of activities. In organic growth, growth of a firm from product innovation is carried out differently from growth of a firm from marketing promotion. The course of actions taken for growth using merger and acquisition approach is even more different (McKelvie and Wiklund, 2010). It is hard, if not possible, to generalize heterogeneous empirical growth data into a clean and parsimonious process theory of firm growth unless these empirical data are to be distilled into a certain abstract level (Penrose, 1959). With this in consideration and based on the typology of organizational change and development as developed by Van de Ven and Poole (1995), the following paragraphs review existing schools of thought on process theories of firm growth, except that of Penrose (1959) which is to be reviewed later in more intensity.

Teleological process theory on firm growth is closely related to growth process of managerial firm (Greve, 2008). Managers have social aspiration; they want to grow their firm for higher social status and bigger job reward (Penrose, 1959; Starbuck, 1971). Managers interact with their counterparts in market and form an aspiration level for size through social comparison (Greve, 2008). When they are dissatisfied with the size of their firms, they set goals and vision to expand the size of their firm. This vision guides

actions of the firm. Managers develop strategy and year-on-year action plan to realize their vision. They implement the action plan, monitors the progress. The process of setting goal, implementing action plan, appraising and revising action plan is repeated on a yearly basis until the firm grow to match the vision of its managers. This teleological process theory explains well day to day course of actions in many firms which expand rapidly. The bigger the gap between reality and aspiration regarding size of the firm, the more firms grow (Greve, 2008). Teleological process theory, however, tells little on activities underlying the process, for example, activities behind vision setting. It looks more like a management process than a growth process which embody many more activities than mere management actions of goal setting, implementing actions and evaluating actions.

Life-cycle process theory on firm growth is very popular, particularly in research on growth of entrepreneurial firms. According to this school, firms, like organisms in nature, have a life cycle. They have pre-programmed instructions within themselves which move them from one stage of development to another higher stage. Growth of a firm is imminent and inevitable. These points form the assumptions for research in this area. However, scholars differ over how many stages and what stages firms have. As a result, many papers have been written on this topic, assigning different stages to corporate development. This can be illustrated in the table below (Moy and Luk, 2003, p.202):

Table 2.3.4.1: Different stages and associated problems in firm growth

Author	Growth stages	Problems types (affected stages)
Dodge and Robbin (1992)	<ol style="list-style-type: none"> 1. Formation 2. Early growth 3. Later growth 4. Stability 	Marketing (stage 1) Management (stage 4) Finance (stage 1)
Kazanjian (1988)	<ol style="list-style-type: none"> 1. Conception and development 2. Commercialization 3. Growth 4. Stability 	Organization system (stage 3&4) Sales/marketing(stage 3) People (all stage) Strategy positions (stages 1&4) External relations (stage 1&2)

In addition to the discussion on a number of stages in life-cycle of firm growth, scholars in this school are also interested in find out what move a firm from one stage to another and what typical problems or barriers firms often encounter in certain stages of firm growth (which is more or less influenced by Greiner,1972). Although life-cycle theory applying to explaining growth of firm is so popular, particularly among practitioners of management, it has met many criticisms. The theory is heavily criticized for its assumption of life-cycle for firms being analogous to a living organism, because, and most importantly, firm growth is result of a purposive course of actions by human; firms do not have a pre-programmed life-cycle and can never grow by themselves, as organism does (Penrose, 1952). The theory is also criticized for inflexible sequencing of growth stages: firms seldom go rigidly in linear through these stages in life cycle; some firms skip certain stages and jump to other stages, while others repeatedly going through some stages; or, firms can exhibit attributes of more than one stage in growth, due to its composition of business entities. Besides, life-cycle process theory inform little regarding the processes underlying growth within certain stage and course of

activities going on when firms moving from a lower stage into a higher one; in other words, life-cycle theory shows more the path of firm growth rather than the process of firm growth.

Evolutionary theory on firm growth is also based on the assumption that firms grow as organism do. There have been constant debates on the appropriateness of analogies drawn from biological evolution to shed light on social development process (Penrose, 1952). Nevertheless, this happens in economics, in management studies and other social disciplines. The stochastic evolutionary process of variation, selection and retention is used to study the changes of population of organization (firms) at industry level, rather than changes in individual firms at firm level. Hannan and Freeman (1977, 1989) have conducted such analysis and coin the word 'population ecology'. These studies have little direct relevance to the growth of an individual firm which is the concern of the current study. It by no means answers the research question of what are going on while a firm is growing.

However, the principle of evolution can be borrowed for examining the internal 'evolutionary process' which is responsible for a stream of productive knowledge leading to firm growth (Penrose, 1959). What is more, it shed lights on several important aspects regarding growth process: growth as emergent and indeterminate, growth as cumulative and path-dependent and human agency in growth process (Blundel, 2002). Evolutionary analogizing seeks to explain change as the result of a largely unintended process of emergence, rather than the result of planning and design

(Blundel, 2002). Evolutionary process works against modernist assumptions of linearity. Firm growth may be planned, as argued in teleological process theory; yet, the outcome of such plan is indeterminate; firm growth is more a kind of emergent phenomenon. Furthermore, according to evolutionary theory, firm growth is a cumulative process and very much depends on the history of the firm (Penrose, 1959). This adds a note of caution against the concept that firm growth is solely human intervention. However, human agency does play the major role in such event. Firms are social organizations; unlike biological entity which contains biological DNA, firms are purposive a human invention to serve human purpose (Penrose, 1959). While social structure may work against human agency, human actors have the will and the power to change the social structure to fit their purposes (Giddens, 1986). In short, evolutionary theory on firm growth does not inform much on human activities leading to firm growth, but rather, the important role of firm history and external environment in firm growth.

Dialectical analysis on process studies (De Rond and Bouchikhi, 2004), in particular, on firm growth, has seldom been explored. This theory emphasizes that internal conflict is the generative mechanism of firm growth. Inside the firm there must be thesis and antithesis; these two forces work against each other until synthesis, or rather, new equilibrium, appears. Although this process theory is useful for describing process of organizational change and development which is the outcome of conflict between two internal forces (thesis and antithesis), it is not easily applicable to firm growth; it is difficult to imagine that a conflict within a firm can lead to firm growth unless this conflict is between the firm and market, as Adam Smith observes. He acknowledges an

interactive dynamic between the emerging opportunities in market and evolving activities of production (Best, 2002). As the extent of the market increases, the subdivision of activities multiples; more and more activities in the firm must be specialized and from this, return increase. As a result, the firm grows. Theory inferred from Smith on firm growth goes beyond internal organizational change and development in a firm, involving market forces. This line of theorizing has not been picked up in modern management literature; for example, Porter (1980) takes only external forces and Penrose (1959) takes internal forces, as causes for corporate development, although both of them acknowledge interaction between internal and external forces. Dialectic analysis on growth process may offer a potential route of analysis leading to discovering of the dynamics and mechanism of firm growth.

2.3.4.2 The conceptualization of process of firm growth by Penrose (1959).

In the introduction to '*The Theory of the Growth of the Firm*', Penrose (1959) makes clear that she aims to develop 'a general theory of the growth of firms', or more specifically, the theory of the process of growth, which no economists have done. On this, Lazonick (2002, p.270) quotes Pitelis and Wahl (1998) saying that 'Penrose dared to explore the internal working of the industrial corporation... Yet such an inquiry is an intellectual venture that economics as a professional discipline has been and remains loathe to undertake'. After going through all her arguments on what is a firm, why firms want to grow and why firms are able to grow, she does not explicitly give any black and white description of how growth of firms happen in a process. Nonetheless, her

arguments distributed in the book betray such a theory.

Overall, Penrose (1959) believes that growth of a firm is an evolutionary process consisting of many planned expansions (Pitelis, 2002); this concept of growth is different from that of Schumpeterian integration (Ghoshal *et. al.*, 2002). In the word of Penrose (1959, p.xiii), '[growth] is essentially an evolutionary process and based on the cumulative growth of collective knowledge, in the context of a purposive firm' and 'the very process of operation and expansion are intimately associated with the process by which knowledge is increased (Penrose, 1995, p.56). Growth process begins with desire of enterprising managers to constantly seek opportunity for profitable growth. Motivated by such a desire, managers learn about resources of their firm and how to work with each other. Interaction between man and material resources automatically increases knowledge in the firm. Penrose (1959, p.78) observes:

'[Both] an automatic increase in knowledge and an incentive to search for new knowledge are, as it were, "built" into the very nature of firms possessing entrepreneurial resources of even average initiative.The two [material and human resources] create the special productive opportunity of a particular firm. ... in so far as they [potentials for growth] are realized, growth will take place. The process is one by which new productive services [managerial resources] are continually becoming available to a firm ... even in the absence of changes in the external world, there is a continuous impelling pressure to expand, arising up from the continuous opening up of new areas of profitable

expansion.’

Penrose (1959) theory on process of firm growth may be summed up as: learning about resources leads to an increase in knowledge which leads to discovery of productive services of the resources in the firm that in turn leads to productive opportunity for growth (Foss, 1998) or ‘it is eventually the process of knowledge that leads to the expansion of the firm’ (Ravix, 2002, p.175). When potentials of growth can be realized, new managerial services are created and more resources and learning come to the firm; in addition, each expansion leaves some underutilized resources which induce further expansion; new knowledge, new resources and left-over resources lead to more productive services and to the urge for further expansion; thus, the cycle of growth begins again.

There are some problems with Penrosean growth. This type of growth is mostly related diversification, expansion rooted in knowledge and technology cumulated in the past (Kay, 2002); it is drastically different from Schumpeterian process of creative destruction (Ghoshal *et al.*, 2002). Obviously, the process theory of Penrose (1959) on firm growth is evolutionary in nature and cannot explain firm growth due to technological or management breakthrough or ‘creative destruction’, whose examples can often be found in high-tech industries such as IT sector. On this type of growth, Marris (2002, p.69) comments that ‘I have to concede that in the contemporary IT industry the steady-state model of the growth of the firm is peculiarly unrealistic.’

The success of process of firm growth as presented and defended by Penrose (1959) hinges on the increase in knowledge within the firm, which, she argues, is built into the very nature of the firm and is thus automatic. But this can be contended. To her, something in the nature of the firms automatically drives the firm to grow continuously. All firms will grow unless they are limited by something such as lack of managerial services. Penrose (1959, p.3) knows that her 'theory on the process of growth' is 'susceptible to empirical testing against the experience of individual firm. Whether such an argument can stand empirical test remains a question and may probably remain so for some time to come, since few researchers venture to conduct research and build theory on process of growth in firms (Langley,1999; Leitch *et al.*, 2010; Mckelvie and Wilund, 2010). Questions can be raised as to whether learning in firms are automatic, self-driven, or as Penrose (1959) claims, built in the nature of the firm, and whether increase in knowledge (experience) naturally leads to productive opportunities, without involving external world and whether this process theory of growth is valid for other types of firms besides industrial firms.

Regardless of all these doubts, the process theory of growth as suggested by Penrose (1959) has opened the 'black box' of firm growth process (Ghoshal *et. al.*, 2002), which is impossible with the theory of the firms in neoclassical economics. This is a great contribution towards development of a theory on the growth of firms. Indeed, Penrose (1959) has pioneered the road towards empirical and theoretical research on process of firm growth which has been taken up by some enterprising scholars such as Garnsey (1998) in Cambridge who has made an attempt to develop a theory of the early growth

of the firm.

2.3.5 What are the major determinants of firm growth: a Penrosean argument

2.3.5.1 Theories on major determinants of firm growth except that of Penrose (1959)

What drives firm growth has been under debate for decades. Some scholars believe that societal environment determines the survival and growth of firms (Hannan and Freeman 1977; Gartner, 1985) while others insist that managers can secure survival and growth for their firms (Penrose, 1959). The situation is noted by Hendrickson (1992) and Johson and Scholes (1997). Hendrickson (1992, p.18) labels it as ‘nature or nurture’ dichotomous debate. In this section, the nature school of thoughts is reviewed first before the nurture school of thoughts on firm survival and growth is explained and critiqued.

2.3.5.1.1 Key theories on external factors affecting firm growth

Firms could be understood in the concept of an open system. Environmental factors can have great impact on firm growth. Based on the open system view of organization, it is possible to identify several theories useful for explaining the environmental impacts on firm growth: institutional theory, industrial dynamics, market theory and network theory.

Institutional theory has been developed by scholars such as Selznick (1949), DiMaggio and Powell (1991) and Scott (1995) to explain how social behaviours are determined by

social structure. North (1990) believes that it is the interaction between institutions and organizations that shapes economic activities. Whitley (1992) and Warner (2003), too, consider a business system something embedded in a societal context including various legal, social, political and economic institutions. Market exists within rules and regulations which provide structure for transaction and therefore, the growth of a firm is greatly impacted by institutions. Institutions create historically rooted trajectories of growth (Peng and Heath, 1996). Institutional theory has met strong criticism. It seems that institutional theory advocates environmental determinism, ignoring the voluntaristic nature of the firms (Child, 1972; Giddens 1986). Nonetheless, for the current research, the theory is helpful in explaining some institutional factors influencing firm growth. Any analysis of firm behaviours such as firm growth, as Peng and Heath (1996, p.500) point out, ‘must take into account the nature of the institutional framework’.

In neoclassical economics, it is believed that the structure of an industry determines the conduct of firms operating in it, which in turn determines the performance of the firms (or sector performance); this is the well-known structure-conduct-performance Paradigm (SCPP) noted by Scherer and Ross (1990 in Foss, 2002). The view that conduct of the firm is conditioned by the sector in which it operates is shared by many scholars (Chamberlin 1937; Mason 1939; Bain, 1968; Caves, 1977; Child and Smith, 1987). According to this view, firm organizational change, sector performance and hence, firm growth, is greatly impacted by the structure of the industry. This structure-conduct-performance is essentially static (Foss, 2002) and to a large extent benefits from the neoclassic paradigm that firms can not influence the structural

characteristics of an industry (Antonelli, 1997). For example, although Porter (1998) acknowledges the ability of firms to influence industrial structure, he believes that a firm's performance is largely depending on its position in its industry. Hence, the best for a firm to do is to position itself well to capture the rent of the sector as much as possible (Porter, 1998; Ghoshal *et. al.*, 2002). This industrial determinism is not without criticism. Holding that it is largely the industrial structure which determines firm profitability and hence, growth potentials, industrial determinism is contrary to firm determinism held by other scholars such as Penrose (1959), Demsetz (1973) and Rumelt (1991) who put firms over industrial structure as factors responsible for firm performance and growth.

In manner similar to the influence of institutions and industrial dynamics, market theories argue that various markets such as capital market and labour market exert great influence on the firms operating in these markets. First of all, these markets set the boundary for a firm, according to Coase (1937). Market transaction carries a cost and when this cost exceeds the cost of coordination within the firm for the same production function, firms internalize market transactions and they become substitutes for market. This means that the market can determine the boundary of firms. In addition, information asymmetry of these markets impacts firm growth. Market is not perfect and information for sellers and buyers is asymmetric (Coase, 1937). Firms are complex organizations operating in situations of uncertainty (or limited information). Therefore, firms need to constantly search, negotiate and contract with other firms or entities to get these resources. According to signaling equilibrium theory (Spence, 1973, 2002), firms

must show strong competence and credit in order to defeat competitors and successfully secure these resources from markets. In this sense, markets and firms interact with one another and the outcome of their interactions often determine what resources and how much resource firms can get from the market. The more competence and credit a firm shows, the more space it could have for growth. It is also true vice versa. Finally, various markets, such as labour market, product markets and resource market, interact and their interaction impacts firm growth. Unfortunately, not much research has been carried out on this, although the interaction of these markets could have great impact on firm growth. It seems that these markets are reinforcing each other, which drives firm to grow or decline.

Besides institutions, industrial dynamics and markets, another external factor impacting the growth of firms is the network in which these firms operate. A firm is only a node in a social network of enterprises. Richardson (1972, p.883) sees industry as ‘dense network of cooperation and affiliation by which firms are inter-related’. This view is supported by Best (2002) who expounds on open-system networking and believes that firm growth and regional growth are two-way interactive dynamics. Firms need to depend on other enterprises in the same network for survival and growth; or in the words of Best (2002), ‘the firm exists within a large system of inter-firm relations and dynamics which condition its opportunities’. Cooperation between firms and their customers to create unique value can form a new source of competitive advantages for these firms (Prahalad and Ramaswamy, 2004). Network becomes either facilitator or constraint on firm growth. Porter (1991) believes that network (cluster) gives firm

competitive advantages and his argument is later supported by studies of scholars such as Lechner *et al.* (2003). However, his argument is not supported by a study by Harnes and Senneth (2001) which reveals that network is positive to market extension but not others such as employment and sales revenue.

To sum up, various theories on the external factors affecting (facilitating or limiting) firm growth have one thing in common, that is, environmental determinism. This may be true, to certain degree, in the case of SMEs. Environmental factors do often hold sway on their growth. However, organizations can select the environment in which to operate (Child, 1972). In other cases, even though environment may have a powerful impact on firms, firms can react against it in some ways if they are more powerful than, or at least as powerful as, the market in which they operate. Firms can and do proactively interact with the other external actors to create an environment favourable for their growth (Child, 1972; Lazonick, 1991; Porter, 1991; Murray and Gorman, 1994); in 'the US economy, the corporation grows by controlling market forces, rather than being controlled by them (Lazonick, 2002, p.278). For instance, Microsoft has monopoly power on office software and so in this market segment, Microsoft directs market trend. Therefore, it could be argued that environmental determinism is not always true. Another argument against environmental determinism is that given the same environment, firms in the same sector have quite different performance. It appears that only internal factors can account for these differences.

2.3.5.1.2 Key theories on internal factors affecting growth of individual firms

The growth of firms in most of the time has to do with the function of their internal factors (Penrose 1959). One of the best research evidences to support this view was provided by Rumelt (1991) who states that up to forty seven percent of profitability is due to firm internal factors. Even Michael Porter, who traditionally advocates that industry factors determine firm performance, acknowledges the importance of firm actions in determining firm success. He admits by his own study that firm factors can account for thirty-one per cent of firm profitability, in comparison with only nineteen per cent of firm profitability being explained by industrial factors (McGahn and Porter, 1997). Baden-Fuller and Stopford (1992) believes that success [of performance and growth] was the result of the strategies pursued by firms. It is suggested by Cosh and Huges (1998) who carried out a substantial research regarding constraints on SMEs growth that the sources of growth are within the firms. This is in line with Penrose (1959). To explain how these internal factors affect the growth of firms, there have been many theories proposed. Among them the most prominent ones are the resources based view of the firm (RBV), the competence-based view of the firm, the organizational learning theories, the organizational change theories and entrepreneurship theory. In the following paragraphs, these prominent theories are reviewed and evaluated in relation to firm growth.

The resource-based view (RBV) holds that a firm is a bundle of resources (Penrose, 1959) and firms can gain a competitive advantage by applying the bundle of valuable resources at the firm's disposal (Wernerfelt, 1984). Barney (1991) states that firm resources which are valuable, rare, not substitutable, imperfectly imitable and not completely mobile can bring about sustainable competitive advantages for the firm (thus,

a sustainable growth for a firm). This specification of resource characteristics necessary for a sustainable competitive advantage delineated by Barney (1991) is seminal in making RBV popular in strategy literature. RBV is widely quoted in strategic management. Still, RBV has also met some severe criticism since its birth. Porter (1991) believes that RBV is circular which is supported by Priem and Butler (2001) who point out that there are two problems with RBV. One is that RBV is at the risk of tautology: the resource characteristics (or capabilities) leading to competitive advantage are those that are valuable and rare. Yet, competitive advantage is defined in term of value and rarity. This problem is also noted by Williamson (1999). Secondly, there is the lack of specificity in RBV (Porter, 1991; Foss, 1998). Resources and capabilities mean little without being specific about the activities and processes that comprise them. In addition to the above two problems, scholars raise question on the construct of bound resources; bound resources are not appropriate and beneficial for firms in today's fast changing market; resources too tightly bundled may lead to rigidity and competitive disadvantages in high-velocity markets (Eisenhardt and Martin, 2000). Also, Foss (2002, p.158) says, the RBV 'has neglected the actual process of coordinating and deploying resources to alternative uses... forgetting that it is the actual application in production, not the mere possession, of resources that create value'. Finally, RBV is criticized for not exploring sufficiently how product markets impact firm growth. Nevertheless, in contrast to environmental models of strategic management such as that established by Porter (1979, p.516), RBV does succeed in pointing out that sources of firms' sustainable competitiveness may lie in the internal factors of the firms.

Richardson (1972) observes that capabilities are determinants of the boundary of the firm. The competence-based view of the firm is used here to mean two points of view: core-competence of the firm (Prahalad and Hamel, 1990) and dynamic capabilities of the firms (Teece *et al.*, 1997; Teece, 2007; Augier and Teece, 2009). These two constructs have profound impact on strategic management. Both of them attempt to explain from inside out the source of competitive advantages, in contrast to Porter (1980). In the theory of core competence, the idea is that core competence leads to core products, which are used to build a variety of end products. The construct of core competence has the meaning of discrete business-level processes fundamental to running the business which give an advantage over competitors. The theory of core competence of the corporate has also met criticism. It runs the risk of being inward looking (Porter, 1998); this is problematic because it ignores the impact of external factors on growth. Moreover, the concept is static in nature and core competence sometimes can make firms rigid in the changing world and is accountable for failures due to inability to catch up with the development (Khanna *et al.*, 2005; Kay, 2006).

The construct of *dynamic capabilities* attempts to correct the static nature of RBV and core competence. Teece *et al.* (1997, p.516) define dynamic capabilities as ‘the ability to integrate, build, and reconfigure internal and external competence to address rapidly-changing environments’. The construct arises from correcting the shortcoming of RBV. RBV holds that the competitive advantages lie in the unique firm resources, ignoring factors surrounding the resources. RBV has not fully explored how resources are developed, how they are integrated within the firm and how they are released.

Dynamic capabilities attempt to fill this gap. Dynamic capabilities (Teece, 2007) view holds that competence and resources are necessary but not sufficient for sustainable advantages in a changing environment (Foss, 2002). Competitors can replicate the competence of a firm or market may shift, which makes the existing competence of a firm less and less valuable (Eisenhardt and Martin, 2002). Dynamic capabilities put emphasis on the organizational capabilities of a firm to reconfigure the resources and competence as a response to the changing market conditions, which allows firms to sustain their advantage in a fast changing market (Teece, 2007). It is this ability to adapt and to extend the competence which makes the construct of dynamic capabilities different from core competence. The abilities to sense the change in the market and to reconfigure existing firm resources and competence to capitalize on such changes are at the core of a firm ability to survive and to grow. In this sense, dynamic capabilities are most relevant to the current research. It may be assumed that firms with stronger dynamic capabilities can grow faster.

According to RBV and competence-based view of the firm, a firm's unique resources and competence are the source of competitive advantage for the firm. Firm growth is the results of accumulating knowledge (Penrose, 1959), broadening of firm competence and coordinating resources. How a firm builds up its stock of knowledge and competence is then the key question to be answered in research on firm growth; this question is neglected by RBV (Foss, 1998). In this circumstance, the organization learning theories and the organizational change theories are particularly illuminating in explaining the growth of firms.

Organizational learning is an area of organizational theory examining how organizations learn and adapt to new circumstances. For the current research, how firms learn is not the focus. Rather, it is important to note how organizational learning facilitates firm growth. As Lazonick (2002) puts it, organizational learning is at the core of the theory of Penrose (1959). In this respect, many studies have been carried out (Teece *et al.*, 1997). It seems that path to growth starts with organizational learning, which accumulates organizational knowledge, that in turn builds up competence of the firms, particularly firm dynamic capabilities (Winter, 2003; Teece, 2007). Increase in competence then broadens business opportunities for growth. Hence, organizational learning is important for building firm competence for growth. An organization can not improve what it cannot understand (Teece and Pisano, 1994). To a certain degree, as Peng and Heath (1996, p.517) agree with Nelson and Winter (1982), ‘the boundaries of a growing firm are constrained by the firm’s ability to codify its routines and transmit this information to its members’. Firm growth can be propelled by the ability of firms to assimilate imported expertise (Peng and Heath, 1996; Turvani, 2002).

Organizational learning accumulates knowledge, which leads to firm growth (Penrose, 1959). However, the accumulation of knowledge alone may not be enough for a firm to grow (Foss, 2002; Richardson, 2002). Before organizational knowledge can be turned into firm competence and dynamic capabilities, firms need to reconfigure its organizational structure and managerial processes or routines which embody firm capabilities (Teece and Pisano, 1994; Nonaka and Takeuchi, 1995; Ghoshal *et al.*,

2002). Organizational culture and award system need to be changed too. Organizational change, sometimes even Schumpeterian integration (Ghoshal *et.al.*, 2002), is necessary for firms to acquire competence needed (Teece and Pisano, 1994). Organizational learning and organizational change must work together harmoniously in order to gain a specific new firm competence that drives firm growth. Indeed, firm growth always entails organizational change (Greiner, 1972), whether gradually or dramatically. But again, the adaptability of firms thanks to learning and change could be a necessary but not sufficient condition for firm growth. The implication for the current research is that firm growth may be affected not only by its organizational learning but its organizational adaptability.

Another important internal factor affecting firm growth among SMEs is entrepreneurship. In its basic sense, entrepreneurship means creating and running a new business. It can be seen as a process of exploiting opportunities that exist in the environment. It turns creative ideas into economic opportunities and creating value through innovation. Entrepreneurship is widely believed to be one of the most important internal factors accountable for firm growth, particularly the growth of SMEs. Marshall (1920) gives credit to entrepreneurs, who, he believes, drive firm growth. To him, entrepreneurs who are innovative, diligent and skilful in organizing are necessary to dramatically increase sales volume and increase the internal economy. Only those entrepreneurs who thoroughly understand their industrial sector can drive firm growth. Schumpeter (1942) further develops this view of Marshall (1920) on entrepreneurs. He believes that an entrepreneur is the force which drives innovation--what he terms as

‘creative destruction’. Innovation leads to continuous firm growth. Penrose (1959) agrees with this Schumpeterian view. Child (1972) argues that strategic choice of firm owners and managers greatly affect firm organizational structure and performance. Storey (1994) also acknowledges entrepreneurs as a critical factor for firm growth. He believes that the growth of SMEs is determined by many features of entrepreneurs, including personal profile factors such as their motivation, family background, previous managerial and functional experience and experiences in the industry sector in which the firm operates. Given the small size of SMEs, entrepreneurs often hold sway on the fate of their firms. Scholars more or less agree, both in theories and empirical research that entrepreneurs can drive firm growth by their ambition, their market insight, their innovative capabilities, their social networking capabilities, their willingness to take risk and in particular, their experiences (Georgiadis and Pitelis, 2011).

However, it is questionable if entrepreneurship alone can drive firm growth, because it can impact on firm growth mostly at the stage when growth opportunities are to be identified and business plan is to be made. Yet, firm growth goes far beyond identifying growth opportunities and having creative business idea and plan. It requires vigorous execution of the vision set by entrepreneurs. Quite a number of entrepreneurs had very innovative business ideas (good business men) but they failed to turn these into firm growth. The identification and realization of firm growth opportunity requires different skill set (Teece *et al.* 1997). The execution of growth has to do with the will and skill of the workforce more than the ‘creative destruction’ of entrepreneurship in Schumpeterian sense.

2.3.5.2 Penrosean argument on what facilitate and limit growth of firms

Penrose (1959) was not interested in answering the question on what determine growth of a particular firm; she says that ‘I am not asking what determines whether a particular firm can grow’ (Penrose, 1959, p. 7). Penrose (1959) is interested in finding out what limits rate of firm growth. She takes up three classes of explanation on why there may be a limit to the growth of firms—managerial ability, product or factor markets, and uncertainty and risk. In her theory, although she acknowledge the inducement of market demand and competitive pressure for a firm to expand, Penrose (1959, p.43) rules out the external barriers to expansion by taking up two assumptions below:

‘First, that the supply to the firm of capital, labour, or management is not absolutely fixed—that there is not an effective limit to the amount of any kind of productive resources that the firm can obtain at a price; second, that there are opportunities for profitable investment open somewhere in the economy at existing prices and interest rates. These assumptions are fairly reasonable for many firms.’

To Penrose (1959), there is no optimal size of a firm as neoclassic economists claim, if the firm can always adapt its management to larger operation (Lazonick, 2002). Obviously, like Schumpeter (1934), Penrose (1959) purposefully focuses on the inside of a firm to look for what limit its growth. In her 1995 foreword to *The Theory of the*

Growth of the Firm', Penrose (1995, p.xi) states that at the time she did the research, she set out to discover '...whether there was something inherent in the very nature of any firm both promoted its growth and necessarily limited the rate of its growth.' After defining an industrial firm as a collection bound resources in an administrative framework whose boundary is set by administrative coordination and authoritative communication, Penrose (1959) logically comes to the point that managerial resources, or rather, managerial services are the most important resources for firm growth; from there, she moves on to argue that size of the firm has no limit, as often claimed in neoclassical economics, but the rate of the growth has a limit. She argues that rate of firm growth is limited by growth of managerial resources which can only be done by the firm and need some time to complete. Since managerial services, which embody tacit knowledge, of a firm at any one time are limited, rate of its growth is limited. Thus, it can be concluded that growth of a firm is facilitated by growth of its managers and boundary of a firm at any one time is limited by how much its managers can carry out administrative coordination and authoritative communication (Turvani, 2002); furthermore, rate of its growth is limited by its managerial services at the time. She argues that

'[an] Individual with experience within a given group cannot be hired from outside the group, and it takes time for them to achieve requisite experience. It follows, therefore, that if a firm deliberately or inadvertently expands its organization more rapidly than the individuals in the expanding organization can obtain the experience with each other and with the firm that is necessary

for the effective operation of the group, the efficiency of the firm will suffer...'(Penrose, 1959, p.47).

This is the famous 'Penrose curve', or Penrose effect (Foss, 1998): human resources, in particular, managerial resources, 'provide both an inducement to expand and a limit to the rate of expansion' (Penrose, 1995, p. xii). Since managerial resources are the embodiment of knowledge (Lazonick, 2002), according to Penrose (19159), rate of firm growth is limited by growth of knowledge within it' (Penrose, 1995, p.xvi). By this famous observation, Edith Penrose anticipated 'the capabilities theory of the boundary of the firm (Foss, 1998, p.25).

Regarding the effect of uncertainty and risk on expansion of a firm, traditional view is that they limit expansion of a firm. However, Penrose (1959) argues that entrepreneurs are not passive receiver of uncertainty and risk; they use managerial service to mitigate uncertainty and risk. Only when managerial resources are not fully used, can one identify uncertainty and risk as the only factor limit expansion of a firm; if managerial resources are fully used, it is impossible to contribute limit to growth of the firm to uncertainty and risk since managerial resources are themselves a limit to the expansion.

As evident from the above, Penrose (1959) seems to focus more on limits to rate of growth than on factors driving firm growth. Nonetheless, it is possible to infer from her work other factors as drivers of firm growth, as Kor and Mahoney (2000) do. Kor and Mahoney (2000) provide a comprehensive and critical review of Penrose (1959) and

sum up her main arguments. Among these arguments, 'Idea 7' states that excess capacity of productive services of resources [is] driver of firm growth. Penrose (1959) does in her book '*The Theory of the Growth of the Firm*' argues for 'Idea 7' as Kor and Mahoney (2000) sum up. In addition, however, if one follows Penrose (1959) in her reasoning, an even more critical factor which drives firm growth is the capability of a firm to learn and increase its knowledge (experience), particularly knowledge about the productive service of its resources (Foss, 1998).

Arguments of Penrose (1959) on what facilitate and limit firm growth may be valid if her assumptions on the external environment are taken into account. However, her work reflected and was limited by social conditions for firms in 1959 (Lazonick, 2002); after fifty years, some of her assumptions can hardly stand. Profitable opportunities to grow in markets which are saturated by products are hard to find and financial commitment is not always there for firms (Lazonick, 2002), even in a growing economy. Moreover, factor markets have great influence on growth of a firm, which have become the focus point for many economists. External institutions also impact greatly on growth of firms. Consequently, external barriers to firm growth have been a hot topic in papers on growth of firms, in particular, growth of SMEs. If her assumptions have changed so much, the relevancy of her theory to the current business world is questionable. Expansions of firms today may not be driven from the need for internal economy (Foss, 1998), as Penrose (1959) always emphasizes following the tradition of economics. Instead, many such expansions come from strategic need to cater to the pressure from capital market, product market or even from institutional pressure. A firm may grow just

for survival purpose in highly competitive market, for example. External strategic needs of the firm, not its economy, can and do drive firm growth. Such reality makes Penrosean theory less adequate for explaining growth of firms today. In addition, her emphasis on knowledge and managerial services as facilitators and limits for growth of firms may be inappropriate and unnecessary for explaining growth of firms other than industrial firms (Pitelis, 2009), for example, labour-intensive SMEs in service. In these firms, managerial services may not be the most critical service for their expansion; but the services of their first-line labour are. Similarly, increase in knowledge may have minimum impact on growth of these types of firms. One has to be careful in applying her theory to explain growth of these firms. Indeed, as Porter (1998, p.xvi) warns in his forward to the 1998 re-print of '*Competitive Strategy*' (Porter, 1980), 'concentrating only on resources/competences and ignoring competitive position runs the risk of becoming inward looking'; this inward looking is not helpful in identifying determinants of growth.

2.3.6 Why some firms can grow continuously: a Penrosean argument

2.3.6.1 Theories on sustainability of corporate development except that of Penrose (1959)

Some firms seem to enjoy sustainable growth over decades but others can not. The research question why some firms can enjoy sustainable growth is interesting, not only for practitioners of management, but also for researchers. Sustainability of development including sustainable corporate development (firm growth) is the popular word for the world today. For this research question, there seems to be no easy answer; or rather,

there may be no simple answer at all, as to what firms should do to maintain continuous growth, because there are so many explanations for sustainable growth. They all seem to converge on the idea that firms take actions to achieve sustainable competitive advantage (Penrose, 1959; Porter, 1980) or a series of temporary competitive advantages (D' Aveni, 1994), a condition which enables them to appropriate as much as possible of the value that accrues from [the] economic rent-sustaining barriers (Ghoshal *et.al.*, 2002) and hence, to enjoy continuous growth. Firm actions, competitive advantage and firm growth reinforce each other, forming a virtuous cycle which leads to continuous firm growth.

Literature, however, differs very much on what are firm actions which lead to competitive advantage and how these actions can lead to sustainable competitive advantage or a series of temporary competitive advantage (D' Aveni, 1994). Porter (1980) believes that sustainable competitive advantage of a firm can be gained from a favourable and profitable position in its industrial value chain which it can stake out and defend, using a strategy compatible with resources of the firm. This theory of Porter (1980), in philosophical doctrine, is close to teleological process theory. It is criticized by RBV proponents for being overemphasizing external industrial factors' influence on performance of a firm. According to RBV, sources of competitive advantage lie in resources of the firm, not in the industrial value chain (Rumelt *et al.*, 1991); thus, sustainable growth is tied to unique resources of the firm. RBV is criticized by scholars of competence-based view who believes that competitive advantage lies in competence of a firm, not its resources. Prahalad and Hamel (1990) argue that firms need to develop

core competence in order to gain unique competitive advantage (which is a condition leading to firm growth). However, their view is criticized for being static calling for firms to stick to a few capabilities, which is rather dangerous in the current fast changing market. Rather, Teece *et al.* (1997) and Eisenhardt and Martin (2000) argue, to gain sustainable competitive advantage in moderately dynamic markets or a series of temporary competitive advantages in high-velocity markets, firms should develop their dynamic capabilities. Dynamic capabilities also create new resources (Eisenhardt and Martin, 2000). By developing and deploying dynamic capabilities, a firm can gain competitive advantages for long in stable market and a series of temporary competitive advantage in fast-moving markets, which in turn leads to continuous firm growth.

2.3.6.2 Argument of Penrose (1959) on sustainability of firm growth

Penrose (1959) holds that there is no limit to the size of a firm, which implies that it can grow endlessly. However, Penrose (1959, p.113) agrees that there is no sustainable advantage for a particular technological innovation,

‘Examples of growth over long periods of which can be attributed exclusively to such protection are rare (note: protection from patents, for example)’....

‘For many, if not for most firms, the more efficient long run protection...lies in the firm’s ability to anticipate, or at least to match, threatening innovations in processes, products, and marketing techniques’.

Penrose (1959) comes back to her argument on growth process, when talking about sustainable growth: ability of firms, not the products or resources, is critical to continuous growth. Many of her followers in RBV tradition argues that the heterogeneity of resources is the basis for competitive advantage which allow firms to grow, presumably, endlessly. Penrose (1959) does not specifically argue on the topic of sustainable growth. She simply assumes that. To her, firm growth is an accumulated, evolutionary trajectory consisting of one expansion followed by another. Market shifts; boundary of a firm depends on its managerial services which could be unlimited. Therefore, as far as the firm continues to learn, to increase its knowledge and to create new productive services of their resources and as far as its managerial services continue to grow (which lead to the receding of managerial limit), the firm can grow indefinitely. It follows that some firms do well in this process and consequently, they enjoy continuous grow; other firms fail to do well in this process and as result, they fail to continuously grow.

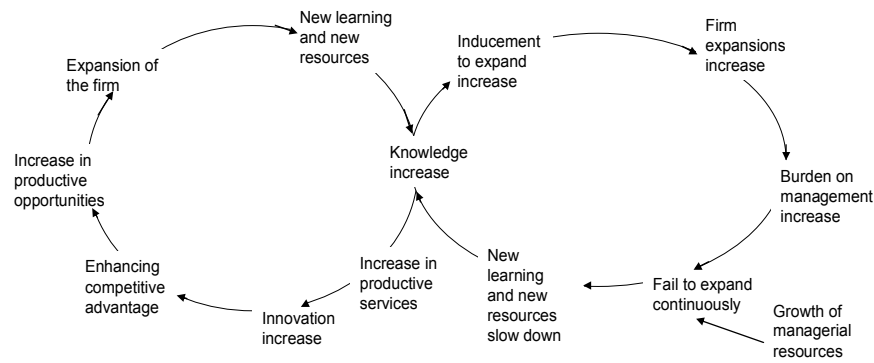
The argument of Penrose (1959) on why firms are able to continuously grow is not explicit in her work '*The Theory of the Growth of the Firm*'. The above is inferred from her work, based on her arguments on process of firm growth. In her view, the generative mechanism for firm continuous growth is the increase of knowledge (experience) within the firm (Foss, 1998) which is automatic unless limited by managerial services; on this, Penrose (1959, p.137) comments that

‘the profitability, survival and growth does not depend much on efficiency as it

does on the ability of the firm to establish one or more wide and relatively impregnable “base” from which it can adapt and extend its operations in an uncertain and competitive world.’

Increase in knowledge (experience) leads to increase in innovation which in turn leads to growth of the firm. Thus, to keep a firm growing continuously is to promote organizational learning and knowledge improvement (Foss, 1998; Ghoshal *et. al.* 2002), while developing managerial resources to provide sufficient managerial services for expansion of the firm. Expansion of the firms creates new resources (including new market reputation and managerial resources) which induce and enable more expansions (Penrose, 1959; Ghoshal *et. al.* 2002). This virtuous cycle goes on and the firm can grow continuously unless slowed down and stopped by some constraints, as shown in Figure 2.3.6.2 which is inferred from Penrose (1959). The model has inspired Garnsey (1998) who studied theory of firm growth. For Penrose (1959), the firm has no optimal (equilibrium) size, because knowledge can be increased endlessly and there are always ‘new combinations of resources in the firm’ (Penrose, 1959, p.85) leading to expanding opportunity set (Foss, 1998). The conceptualization of Penrose (1959) on sustainability of firm growth has been basis for a number of the recent papers on competitive advantage, entrepreneurship and growth. This conceptualization may catch the essence of sustainable growth of firms, for it pinpoints the generative mechanism and internal dynamics of continuous growth.

Figure 2.3.6.2: Conceptualization of causal mechanism of sustainable firm growth



Yet, there are some questions that the model in Figure 2.3.6.2 does not address well, if it is to be more relevant to management practices and management research. The assumption of automatic increase in knowledge due to the very nature of the firm is questionable; it looks more like a overt simplifying of organizational learning, for it does not even care to probe the drivers and specific sources of learning; what turns productive opportunities into firm growth, which concerns detailed execution, is important but is clearly ignored in the model. What is more, as argued in previous section, managerial resources may not be the most important resources for growth of a firm, if it is not a big bureaucracy. There arises the question on whether the model can be generalized to firms other than industrial firms.

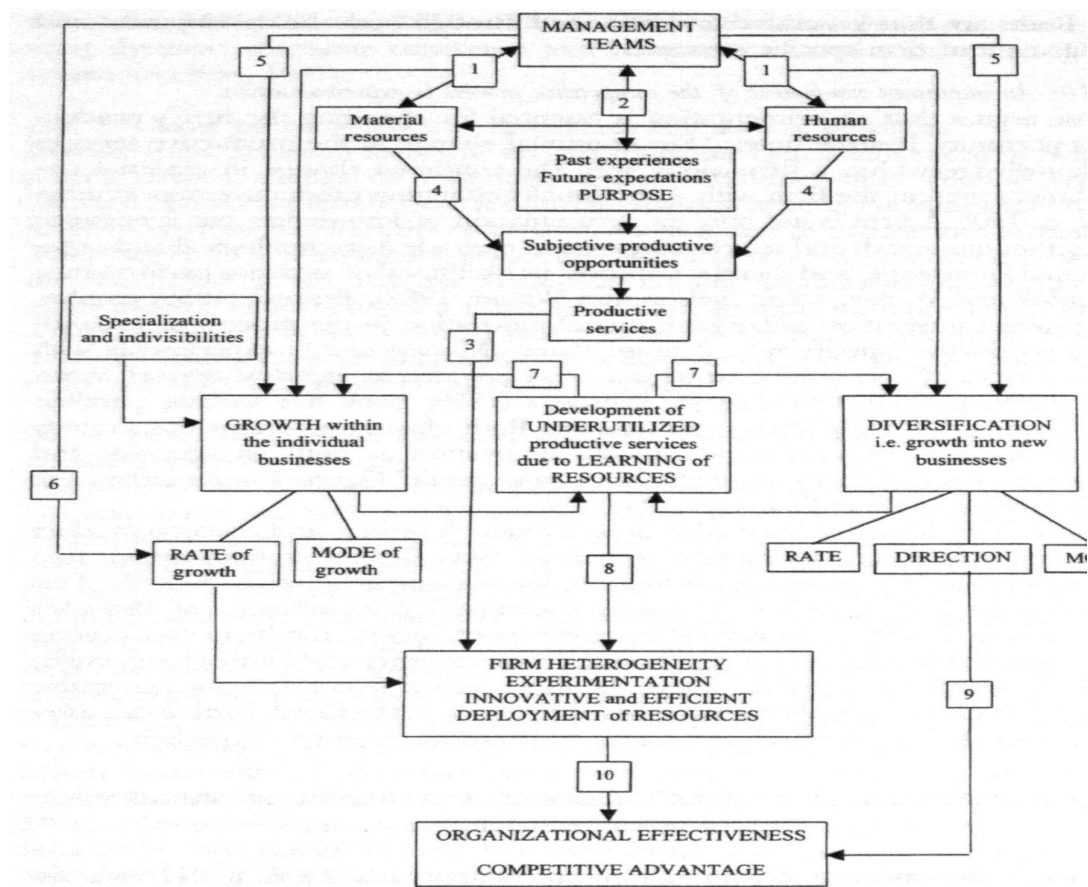
2.4 ‘The Theory of the Growth of the Firm’: a synthesis of all its argument

2.4.1 ‘The Theory of the Growth of the Firm’ as a single argument

Penrose (1959) insists that her work ‘*The Theory of the Growth of the Firm*’ must be read as a single argument and previous chapters must be read if the coming conclusions are to be understood. She may be emphasizing her ‘single, holistic argument’ on growth

of firms (Blundel, 2003, p.124) or she may foresee that her book is ‘packed with ideas’ (Marris, 1961; Pitelis, 2002), unusually rich and diverse in concepts (Blundel, 2003), which may distract her reader from the coherence of her argument. It could be both. Being packed with ideas, ‘ranging from the psychological traits of entrepreneurs to the role of small firms in the industrial policies of the nation-states (Blundel, 2003), the book resists any attempt to synthesize it into a single simple argument explaining growth of firms. As all great works, Penrose (1959) is often ‘interpreted differently and its fundamental message has been insufficiently appreciated’ (Foss, 1998, p.1-2). Nevertheless, some scholars have made such attempts (Foss, 1998; Kor and Mahoney, 2000; Blundel, 2003). Kor and Mahoney (2000) sum up the book into ten ideas and develop a framework to show the model of the theory of the growth of the firm by Penrose (1959), as shown in Figure 2.4.1 below. The framework tries to capture the essence of Penrose (1959). The number is the sequence of Penrosean arguments as summed up by Kor and Mahoney (2000).

Figure 2.4.1 Penrose's model on growth of firms drawn by Kor and Mahoney (2000, p.120)



This framework helps to visualize how the arguments of Penrose (1959) on firm growth generally flow. Kor and Mahoney (2000) draw this framework after they summarize the arguments of Penrose (1959) into ten ideas. Among them, two are especially relevant to the current research. The first one is about the driver of firm growth. Penrose (1959) believes that internal resources can not always match exactly the ‘productive opportunity’ and thus, actions taken to grow a business almost always leave some resources unused, which become organizational slack (unused managerial services) for further growth. To her, excess capacity of productive services of resources drives firm growth. ‘In other words, excess capacity of resources (managerial resources) and market frictions are sources for expansion to achieve full utilization of resources’ (Kor and

Mahoney, 2000, p.117), which Penrose (1959) refers to as ‘balance of processes’ (Kor and Mahoney, 2000, p.117). This properly answers the first question raised by Penrose (1959) as to what incentives there are for firm to grow. The second idea of Penrose (1959), as summarized by Kor and Mahoney (2000), is that managerial capabilities is the binding constraint that limits the growth rate of the firm—the so-called ‘Penrose effect’. The famous ‘Penrose effect’ means that if a firm grows faster than it can supply firm-specific managerial services, the firm will go into a period of stagnation. Firm-specific managerial service is the limit on the growth rate of the firm. This seems to answer the second question raised by Penrose (1959), that is, what constraints are for firm growth.

In her book, Penrose (1959) uses no framework (Pitelis, 2009) which may be too restricted and abstract. Unlike Kor and Mahoney (2000), Blundel (2003, p.103) develops ‘[s]ix principal components in Penrose’s (1959) argument, which he claims match more or less the ten ideas as summed up by Kor and Mahoney (2000), as shown in the two table below:

Table 2.4.1a: Six principal components in Penrose’s (1959) argument (Blundel, 2003, p.103)

1	‘Authoritative communication’: bounding the firm
2	‘Resources’ and ‘services’: a vital clarification
3	‘Productive opportunity’: option value and conjecture
4	‘The receding managerial limit’: agency and constraint
5	‘History matters’: cumulative and situated growth
6	Dynamics of the ‘interstices’: a forgotten mechanism?

Table 2.4.1b: Ten fundamental arguments and the six principal components (Blundel, 2003, p.103)

Summary of the ten fundamental arguments described by Kor and Mahoney (2000)		Six equivalent component(s) summed up by Blundel (2003)
1	Firm growth can be usefully studied as a dynamic process of management interacting with resources.	(5)
2	Firms are institutions created by people to serve the purposes of people.	(1)
3	Services of resources are drivers of firm heterogeneity.	(2)
4	Services that material resources will yield depend upon the knowledge possessed by human resources.	(2) (3)
5	Firm growth is a function of firm-specific experiences in teams.	(2) (3)
6	Managerial capability is the binding constraint that limits the growth rate of the firm (the so-called 'Penrose effect').	(3) (4)
7	Excess capacity of productive services are drivers of firm growth.	(4)
8	Unused productive services of resources can be a source of innovation.	(2)
9	Firm diversification is often based on a firm's competence that can lead to a sustainable competitive advantage.	(5)
10	An important component of the competitive process is experimentation.	(3)

Based on his summary of six components, Blundel (2003) makes an attempt to synthesize Penrose (1959), which is not very successful. Blundel (2003, p.132) ends the attempt by claiming: 'The synthesis took the analysis of the growth process a great deal further than competing explanations [on growth of firms]. However, the integrated and concentrated nature of the 'single argument' has made it difficult to summarize, either verbally or visually.'

This example shows that despite attempts to synthesize Penrose (1959), scholars have not been able to show her ‘single argument’ in literature. Without a single argument, it is difficult for readers to grasp her book as a whole. After all, what is her single argument, or rather her parsimonious theory, on growth of firms? It may be possible to uncover her ‘single argument’ or theory which binds the book together if the book is examined in light of logic of a dissertation. A dissertation starts with a research question and ends with an answer on the research question. The answer to the research questions is the thesis binding the dissertation. The same is true for academic book as ‘*The Theory of the Growth of the Firm*’. Given that her research question is whether there is something in the very nature of a firm which promotes its growth but at the same time limits the rate of its growth, her single argument may be summed up as: growth of knowledge (both objective knowledge and tacit knowledge--experience) of a firm, which exhibits itself as growth of managerial services (Lazonick, 2002), promotes firm growth but at the same time limits the rate of firm growth. As Blundel (2003, p.129) observes, “[t]he growth of knowledge is the unifying theme, the ‘glue’ that binds the Penrosean synthesis.’ This holistic single argument of Penrose (1959) is apparent in her own words:

‘[A]n automatic increase in knowledge and an incentive to search for new knowledge...are ‘built into’ the very nature of the firms’ (Penrose, 1959, p.78). ‘Many of the productive services created through an increase in knowledge...provide an internal inducement to expansion as well as new possibilities for it (*Ibid*, p.14). [A] firm’s rate of growth is limited by the growth of knowledge within it; but a firm’s size by extent to which

administrative effectiveness can continue to reach its expanding boundaries.’

(Penrose, 1995, p. xvi)

It seems that the book’s thesis, or the single argument, which is summed up in the above paragraph, is plausible, as it is supported by words of Penrose (1959). She basically argues that not only is the firm a repository of productive knowledge, but it is also an institution that develops and manages this knowledge (Foss, 1998; Pitelis, 2002) and that the growth of knowledge within a firm, which is embodied in growth of managerial resources (Lazonick, 2002), generates its growth but at the same time limits the speed of its growth. This single argument can be found in every chapter of the books and it is the logic that ties them up into an influential theory on growth of firms, explaining very well the growth of firms (Foss, 1998; Blundel, 2003).

The theory of the growth of firms by Penrose (1959) consists of several major components, arguments which are developed step by step in a very logical sequence. The first component is the definition of a firm suited to her problem—her problem of researching for explanation on what drive firm growth and what limit the rate of its growth (size of growth is not limited by anything, according to her). She defines a firm as a bound collection of resources in an administrative framework whose boundary is set by administrative coordination and authoritative communication. This definition of a firm contains two constructs which prepare well for the next logical argument. The first one is the construct of resources. This construct cover many types of elements in the firms, in particular, knowledge stock, which can be created and increase. The second

construct is the concept of managerial service embodies in the words of ‘administrative framework’, ‘administrative coordination’ and ‘authoritative communication’. This definition of a firm leads well to all the rest of components of her theory on growth of firms.

First, with managers placed inside the definition, the firm becomes alive and its acts are purposive. The firm wants to grow because its managers want to continuously making profit to enrich their personal dream which can be done through firm expansion. Profit motive (internal economy) is the driving force of all expansions of the firm. Secondly, Penrose (1959) argues that, given that a firm wants to grow, the firm can grow by expanding its stock of knowledge. This argument in her theory naturally leads to the next on how firms grow. She argues that automatic increase in knowledge and incentive to search for new knowledge are built into the very nature of the firm. As knowledge grow, productive services of resources increase which leads to increase in innovation, which in turn leads to increase in productive opportunities and finally, firm expands. The expansion of the firm feedback with new resources and learning, which are underutilized in daily operation and the desire to maximize return from them induce the firm to further expansion. This virtuous cycle repeats itself, which leads to continuous growth of the firm. A question arises: is the firm going to grow endlessly? This question from the third argument in her theory leads to her last argument: managerial services of the firm are limited at any one time and thus, limit the rate of its growth; but size of the firm is unlimited because it can develop multiple product lines and enter multiple markets and even multiple industries, hence growing in many directions, without

meeting a cost curve as demonstrated in product life cycle. All these arguments run naturally into each other forming a coherent theory explaining causal mechanism of growth of firms, or to be more specific, industrial firms. Indeed, all these arguments form a single argument: growth of knowledge of a firm, as embodied in growth of managerial resources, leads to firm growth, while limiting its rate of growth but not its size of expansion.

2.4.2 Contributions and limitations of '*The Theory of the Growth of the Firm*'

Based on all previous sections of this chapter, this section assess contributions and limitations of '*The Theory of the Growth of the Firm*', as relevant to the current research on growth of HR service SMEs. This critical assessment is a preparation for the application of the theory in the empirical work of the current research. In the following, the first part of the section presents contributions of the work and the second part describes its limitations.

The work is influential today and unchallenged (Loasby, 2002); this influence is gaining momentum (Cantwell, 2002; Kay, 2002; Pitelis, 2002). RBV as a very important school of thought in strategic management is generally said to root in this work (Kor and Mahoney, 2000; Pitelis, 2002), although Foss (2002) questions this association. Many ideas of Penrose (1959) are seminal and create a path for researchers' further research into the growth of firms, which has yet to be completed (Martin and Wiklund, 2010). Penrose (1959) has made some 'extraordinary' contributions by her insightful thinking

in the book (Pitelis, 2002). The work 'has already earned her a place in pantheon of the very best' scholars (Pitelis, 2002). She gives a classical definition of a firm bringing out another version on the nature of the firm which complementing that of neoclassical version (Pitelis, 2002). In addition, the book has opened up the inside of the firm which is treated as a black box in the theory of the firm and theory of growth in neoclassical economics (Ghoshal *et. al.*, 2002). The process theory of growth of firms by Penrose (1959) for the first time describes causal mechanism of the phenomenon of firm growth (Loasby, 2002), allowing researchers to see through the phenomenon: what drive it, how it happens and what limit it.

The first significant contribution of Penrose (1959) lies in her contribution to the issue of the 'nature of the firm', namely, the question why firms exist (Coase, 1937), although she did not explicitly deal with this issue (Pitelis, 2005). Coase (1937) and later Williamson (1985) explain the existence of the firm to the 'efficiency benefits derived from reductions in market transaction cost'(Pitelis, 2009); this forms a typical 'modern contractual theory of the firm in which all problems of economic organizations are treated as problems of aligning incentives' (Foss, 1998, p.16). This is a cost reduction approach in explaining the nature of the firm. Penrose (1959) takes a different approach which complements transaction cost theory on the nature of the firm; she puts 'forward a new theory of the firm, based on knowledge and cognition' (Foss, 1998, p.15). Firms provide a legitimate and efficient framework for creating knowledge and efficiency gains which markets fail to do (Foss, 1998; Pitelis, 2009), because knowledge including objective and tacit knowledge which can not be bought and sold in the open market.

Through ‘endogenous innovation (equal) knowledge-growth’, productivity enhancement can be achieved. This is an ‘adequate nontransaction-costs-related explanation of the nature of the firm’ (Pitelis, 2009, p.34).

The second important contributions of Penrose (1959) is that she develops a theory of growth (resources creation), hence reviving and further contributing to the theory of wealth creation (Pitelis, 2009). Prior to her contribution, neoclassical theory only emphasizes, through neoclassical price theory, resource allocation, ignoring how these resources are created at the first hand. Penrose (1959) ‘dynamic innovation (equals) knowledge and (thus) productivity-growth’ perspective (Pitelis, 2009, p.33) complements the neoclassical theory of resource allocation, bringing a full picture of resource creation and resource allocation.

The argument that growth of knowledge leads to growth of the firm is, however, the most important of all the contributions Penrose (1959) makes (Loasby, 2002), which uncovers causal mechanism of firm growth and has become a ‘lasting influence’ (Pitelis, 2009); Foss (1998) regards Penrose (1959) as a master piece following the traditional of Marshall and Keynes; the firm of Penrose (1959) is a institution of knowledge production and knowledge coordination to drive growth (Loasby, 2002; Foss, 2002). On this contribution, Pitelis (2009, p.31-32) has the following comment:

‘The argument, first, is not simply about the theory of the growth of the firm; it is an argument about the theory of (growth) of knowledge....For Penrose, it is

firms which help create knowledge, indeed firms are seen by her as better at doing so than markets.’

Thus, Pitelis (2009) argues that by her arguments, Penrose (1959) not only explains well the growth of firms but she goes further, firms are the more efficient place to produce knowledge beneficial to the society, even this knowledge is most suitable for production-related activities.

Perhaps an equally important contribution is that Penrose (1959) argues on managerial services as limit to rate of firm growth but not size of its expansion. Prior to this development of this argument, neoclassical theory, which is based on price theory on a single product, argues that there is a optimal size for firms (Coase, 1937); this thought misleads many in thinking about firm growth. By claiming that there is no limit to the size of a firm, Penrose (1959) frees entrepreneurs and managers alike from this neoclassical misinterpretation of reality, which helps them to set bold vision. Furthermore, the argument augments the importance of managerial resources and leadership development in firm growth. Today, leadership development has become ultimate tasks for firms.

Indeed, from conceptualization of a firm, to the description of growth motivation, growth process and finally to causal mechanism of firm growth, Penrose (1959) has undoubtedly made great contribution on the topic of firm growth which is one of the most important topics in management studies and in economic growth of society as a

whole. She has made tremendous influence on strategic management research. Unfortunately, ‘there has been a powerful tendency to integrate Penrose’s ideas in terms of mainstream economics’ (Foss, 1998, p.8); her theory on growth of firms was absorbed into mainstream economics and her criticism of equilibrium was not taken seriously. Thus, her theory was lost in the academia which was dominated by theories of neoclassical economics and her contribution has largely been ignored (Foss, 1998);

For all its great contributions, ‘*The Theory of the Growth of the Firm*’ has some of its own limitations, which, more or less, are similar to those of RBV criticized by scholars of many other schools of thought. The first commonly seen criticism of RBV is that it is tautological, which Penrose (1959) foresees and strongly defends her work against.

Penrose (1959, p.7) observes:

“Finally, a comment on an alleged ‘tautological problem’ which some have feared is inherent in a theory of the growth of firms concerned only with firms that can successful grow. ...I am not concerning such firms [which do not grow], only concerned with the process of growth, and with the limits to the rate of growth.... I am not asking what determines whether a particular firm can grow, but rather the very different question: assuming that some firms can grow, what principles will then govern their growth, and how fast and how long can they grow?’

It seems that Penrose (1959) is concerned with intentional firm growth. Doubtlessly, she

has avoided successfully this accusation which is often seen with papers criticizing RBV. This school of thought is accused of being static (Marriss, 2002), not being able to explain dynamic process of daily execution of firm growth. Penrose (1959) has, as shown in the previous sections of this chapter, developed a detailed process theory on firm growth after she advances her concept and thus, she withstands this criticism (Pitelis, 2002).

Another common criticism is about specificity of RBV (Williamson, 1999; Priem and Butler, 2001) which may be relevant to Penrose (1959), although some scholars may not think so (Kor and Mahoney, 2000). The construct of knowledge, for example, may relate to information of many facets in the operation and expansion of a firm, and relate to information of many kinds outside the firm. Increase of knowledge in the firm is the engine of growth but what kinds of knowledge (Pitelis, 2002) are most critical in such circumstances? Insufficient specificity on these constructs in her theory may make it less meaningful and more difficult to apply. Management of firms do not know how best to apply her theory to their firms; as Pitelis (2002, p.12) concedes, 'more and better operationalisation and empirical work is needed on all fronts'.

The third problem of her theory is that it is void of inter-firm conflict, which, according to behaviour theory (Cyert and March, 1963; Geve, 2008), weakens the profit motive of firm growth. Behaviour theory of the firm holds that diverse groups of stakeholders in a firm have different interests and there is, therefore, a pervasiveness of conflicting goals in the firm; for example, conflict arises between managers and owners which lead

naturally to agency cost that is harmful to growth of firms for the owners (Jensen and Meckling, 1976); conflicts arise because of ‘the growing separation between ownership and management’ (p. 253, Simon, 1959); these conflicts among group members are never fully resolved but only kept to a manageable level; problems are resolved partially so that organization can exist (Carter, 1971). These conflicts, however, are not totally destructive; they may induce innovation and firm growth (Pitelis, 2002). In this case, inter-firm conflicts could be drivers other than profits which work to change development of firms; this situation ‘has directed attention to the motivations of managers and the adequacy of the profit-maximization assumption for business firms’ (p. 253, Simon, 1959). Unfortunately, this is one of the missing links in Penrosean theory on firm growth; she does not touch on this theme at all in her theory.

Furthermore, her theory is believed to have the problem of rigidity, which Foss (1998) does not agree, and path-dependence. In her theory, it appears that ‘in each period of time there is a strict managerial limit (although it recedes in the next period) constraining growth and the firm’s horizontal boundaries are narrowly constraining to neighboring product-markets’ (Foss, 1998. p.14). As to path-dependence, Penrose (1959) obviously advocates this, which supports her preference for related diversification. However, the evolutionary nature of her theory is less relevant to the business in today’s fast changing environment. Her theory of firm growth, for example, can not explain growth of IT industry which is characterized by Schumpeterian ‘creative destruction’ (Pitelis, 2002).

The fifth problem is that her process theory of growth misses three important steps: causal mechanism for knowledge increase, development of firm capability and execution of a growth plan. Knowledge increase and desire to seek new knowledge, Penrose (1959) claims, are both innate in the nature of the firm. In other words, knowledge in the firm increases automatically as the firm operates. This claim simplifies knowledge increase which leaves little indication on the mechanism of such phenomenon, that is, what causes knowledge to increase and how knowledge increases. Given that knowledge increase is innate in the nature of firms, it follows that automatically knowledge increases in all firms; if so, all firms should grow, which is not the fact. Equipped with knowledge is only the first step (a cognitive step) towards firm growth. But ‘doing is more than knowing’ (Richardson, 2002, p.43). With appropriate knowledge, firms still need to assemble and reconfigure all sorts of resources to develop capabilities suitable for the task of firm growth. This is not as simple as it seems to be, in terms of resource ‘reconfiguration’ as used by economists. Equally complex and important is execution of the business expansion plan, for execution is itself a complex process which could determine whether firms can really realize their growth, given strong incentive to do so. Unlike economics, management literature now recognizes that execution of a growth plan is as important as, if not more, than strategy formulation. In light of this, Penrose (1959) remains a work of economics which seems to pay little attention to details of growth of the firm, as management literature does.

Another problem with the theory of Penrose (1959) is that although she admits the impact the external can have on firm growth through entrepreneurial judgment, she

gives no place in her theoretical model to external factors such as market demand, competition pressure and institutional force (Loasby, 2002); she simply acknowledges their role in inducing firm growth (Best, 2002) and excludes the interaction between firms and market in her theory (Ravix, 2002; Cantwell, 2002), which is expressed clearly in her comment that ‘productive opportunity of a firm will change even in the absence of any change in external circumstance or in fundamental technological knowledge’ (Penrose, 1959, p.56); Penrose (1959) puts ‘environment on one side in the first instance in order to permit concentration on the internal resources of the firm’ (Penrose, 1959, p. xiii). Many scholars (Marris, 2002; Loasby, 2002; Richardson, 2002) believe that Penrose (1959) should not do so. Marris (2002, p.77) remarks that ‘[i]t is these competitive dynamics, rather than static optimizing properties that are genius of the capitalist system’ and Richardson says that ‘[t]he availability of technical information...did not depend on the organization...entrepreneurs are acquainted with a certain “state of arts”...cooperation between firms is important for growth’. ‘Hers (the theory of the growth of the firm), Marris (2002) comments, ‘was lacking a theory of market demand, of finance and of stock-market...’. As a result, Penrose (1959) produces a one-sided theory of firm growth; it is not possible to see how these external factors interact with internal factors in her theory to produce firm growth, as shown in the model drawn up by Kor and Mahoney (2000). She argues that there are always productive opportunities in the market for a ‘qualified’ firm; but ‘in a very significant sense’, unused productive services (not external factors) determine the direction of firm growth (Penrose, 1959, p.87). To be simply put, direction of firm growth is determined by internal resources; ‘in her analysis, the growth process of the firm is independent of

the market and growth is from internal inducement' (Ravix, 2002, p.175). As a consequence, Her theoretical framework looks somewhat introvert (Porter, 1991, 1998), inappropriately ignoring the important role of external factor in producing growth. Inward looking, or at least, inward focusing, makes Penrosean model and theory one-sided, less complete and less relevant to real business expansion in which interaction of external factors and internal factors play a very important role and deserves a place in theory of growth of firms (Vinnell and Hamilton, 1999; Porter 1998; Garnsey 1998). Vinnell and Hamilton (1999) observe:

'Growth is a highly complex phenomenon that is the result of an idiosyncrasy and unstable process involving the interplay of local environment and features internal to the firm' (Vinnell and Hamilton, 1999, p.5)

Thus, as Garnsey (1998, p.553) comments, '[n]o firm is an island, and to understand its growth, it is essential to understand the webs of interaction which make up its environment'. This is particularly true in today's networking and globalization of enterprises. However, such networking was not apparent in the time when Penrose (1959) wrote her work and she clearly neglected the issue of collaboration such as joint ventures (Kay, 2002; Pitelis, 2002). In today's business environment, the prevalence of collaboration and globalization have rendered this 'either/or' strategy ineffective (Smith, 2009). There is a need for a new process theory which takes into account of the interactions between external and internal factors as driver for firm growth.

Regarding the constraints on firm growth, it may be justifiable to contribute the growth constraint to lack of managerial service in case of big enterprises which are complex and need much managerial service. But managerial service may not be a constraint on firm growth in the case of small firms which is very flat and simple (Georgiadis and Pitelis, 2011). Even for big firms, it is questionable to limit growth constraints only to the firm-specific managerial services or entrepreneurial services. As Pitelis (2002) points out, in her argument on firm growth, Penrose (1959) limit human resource to management. Labour is never a leading player, although it is somewhere in the background. This may not reflect the reality. In the view of system perspective (Katz and Kahn, 1978), the failure of firm growth may be contributed to its supportive system such as marketing or its adaptive system such as R&D, rather than to its coordination system as emphasized by Penrose (1959). Particularly in the execution phase of business expansion plan, the services of first line employees are as important as, if not more important than, the firm managerial services. Indeed, Pitelis (2002, p.315-317) argues that claiming that managers are more important 'for reasons Penrose did is neither convincing, nor essential, nor useful'; her theory 'does not requires the pre-eminence of management'.

2.5 Findings from literature review on growth of firms

From the current literature review, it appears that there is a lack of research on process of firm growth (Davidsson, 2000; Lowe and Henson, 2004; Mckelvie and Wiklund,

2010), both theoretically and empirically. As Lowe and Henson (2004, pp.2-4) finds out, existing studies on high growth firms are ‘mostly cross-sectional studies’ which ‘focus on examining the relationship between particular variables and the growth of firms’. Although a significant body of survey research has attempted to identify the reason why firms grow, ‘the process by which growth is generated and managed has attracted less attention’. As a result, existing studies are only able to suggest a range of ‘contextual and contingency factors associated with growth’, not the growth process itself. This view is later supported by Garnsey (2002, p.101) who claims that ‘industrial economists examine largely aggregate cross-sectional data on firm growth and use averaging methods which provide overviews with policy implications, but do not address the internal dynamics of firms’ and thus can not explain why some enterprises with successful characteristics fail while others succeed. An overwhelming number of studies examine ‘success attributes’ (Garnsey *et al.*, 2006, p.17) or barriers for firm growth but little attention has been given to the micro level of the execution of each growth task (that is, business expansion). Yet, execution matters more than ‘success attributes’ in achieving firm growth, as proved by Ala-Mutka (2006) and Harreld *et al.* (2006). Porter (1991) argues that a firm consists of a discrete but interrelated economic activities and it is these discrete activities, not firm attributes, that determine firm success. Activities performed poorly can create liabilities, not success (Porter, 1991). According to management research, many corporate strategy failures are mainly due to poor execution (Kaplan and Norton, 1996). As Harreld *et al.* (2006) observe, Gerstner saved IBM from the brink of bankruptcy and then brought continuous growth to it by focusing the whole organization on executing its strategies. It is possible that success of firm

growth depends on effective execution of each business expansion, rather than on various 'success attributes' as many scholars have argued (Porter, 1991; Lowe and Henson, 2004). Critical success factors are necessary but not sufficient conditions for firm to grow. Given that new ventures have the same or similar attributes of success, some of them grow but others fail to grow (Garnsey *et al.*, 2006). In short, it may not be appropriate to explain the success or failure of firm growth solely through determinants. As Child (1972) claims, a procedural research into organizations is desired; the real dynamic growth process in which entrepreneurs and managers respond to endogenous and exogenous development should be examined, because it could be this process which determines success or failure in firm growth (Porter,1991; Garnsey *et al.*, 2006).

The second conclusion can be drawn from the literature review is that there is hardly any research on interaction of internal and external factors to explain growth of firms. Literature has failed to identify how external and internal factors interact to enable firm growth, particularly how people interact with external and internal factors to enable firm growth. Penrose (1959) states that firm growth is a '...dynamic interacting process', which is supported by Marcus and Geffen (1998). It is well know now that capabilities of a firm, 'like an individual skills, are shaped in a mutually interdependent process (Best, 2002, p. 186). It is the constantly changing and cumulative process involved in the interaction between firm resources and markets that explains growth opportunities and their realization (Penrose, 1959). Yet, Penrose (1959) too ignores such interaction and focuses on internal resources of the firm; she explains firm growth based on internal interaction between managerial resources and other firm resources. Hardly any research

has been done taking interactions between firm and market as driver for firm growth. As Garnsey (1998, p. 1945) admits, ‘theoretical frameworks in industrial and organizational economics have not facilitated the integrated analysis of internal and external factors’. The problem may arise from the fact that few studies on firm growth are in-depth case studies on the actual process of firm growth; in the word of Loasby (2002), most theorists have preference for formal consistency over more representative theory, and for axiomatic reasoning over causal sequences (causes of growth process). Thus, cross-sectional studies are often pursued to explain firm growth but it may be only able to suggest a range of factors affecting growth of an abstract firm aggregated by statistics data (Lowe and Henson, 2004). This can not uncover causes of firm growth (Dobbs and Hamilton, 2007). Therefore, they are not able to observe and thus inform how external and internal factors may interact to enable firm growth in a real firm.

Thirdly, it can be concluded that most theories contributed causes of firm growth to only one-sided factors, either to external factors or internal factors. Researchers tend to simplify their research to only one side of the issues; for example, they tend to study either external cause or internal cause of firm growth (dichotomy), perhaps because such simplified studies can produce more parsimonious theories on firm growth. Discovery of causes of events such as firm growth may only be done by qualitative research, in particularly longitude studies which trace events of firm growth over a long period of time allowing causes to emerge from certain growth scenario (Van de Ven, 1992; Dobbs and Hamilton, 2007). However, such longitude study on firm research is lacking (Van de Ven, 1992; Davidsson and Wiklund, 2000). Some scholars believe that

societal environment determines the survival and growth of firms (Hannan and Freeman 1977; Gartner, 1985) while others insist that managers can secure survival and growth for their firms (Penrose, 1959). But, just as Porter (1998) claims, RBV is introverted, the school of thought which emphasizes external factors as causes of firm growth may suffer from being solely extraverted; both schools of thoughts are incomplete; in either case, these one-sided theories are less useful in explaining growth of firms which is a social process in complicated environment.

Another conclusion which can be drawn from this literature review is that there is not yet any integrated theoretical framework or theory to explain how SMEs can grow or fail to grow (Dobbs and Hamilton, 2007) and thus existing theories can not explain fully, and provide appropriate solutions to, the current problems in Chinese HR service SMEs development. The theories on firm growth as reviewed in the current chapter seem to concern themselves with a discrete part of the totality of a theory to explain firm growth. Indeed, little is know about the mechanism of firm growth (Peng and Heath, 1996). But social phenomena are complex and to understand them, they need to be seen in a holistic way and in systems thinking perspective (Senge, 1990). In other words, organizational reality is multifaceted in nature but the traditional theory building has tended to be rooted in one major paradigm and thus failed to provide a complete view of organization knowledge (Giola and Pitre 1990). The situation is similar in the case of research on SMEs growth. Although firm growth is a multifaceted organizational change process (Lowe and Henson, 2004), existing theories tend to theorize only one or two aspects of firm growth such as motives for growth or the path of firm growth. Any

single monolithic theory will not be able to capture the totality of the diversity of firm growth (Llewelyn, 2003). Research by Storey (1994) suggests that there is a need for comprehensive and prescriptive frameworks on SMEs growth. Artmann *et al.* (2001) too agree that there is a need for an integrated framework or theory to explain from management perspective how firm can grow, particularly how SMEs can grow. Such a theory is still at the stage of an implied research agenda and the ‘entrepreneurial venture remains an under-theorised area in the economic and management literature’ (Garnsey, 2002, p.101). Neither the mechanisms of firm growth nor the path of growth have been adequately theorized (Autio *et al.*, 1997 in Garnsey, 2002). Opportunity is open for developing integrated theories to better explain SMEs growth.

Lastly, it can be concluded from the literature review that the theory of Penrose (1959) is one of the most comprehensive theories on firm growth and can be useful for the current research. ‘*The Theory of the Growth of the Firm*’ covers several elements on firm growth: incentives for firms to grow, process of growth, causes of growth and constraints on firm growth. Her theory, ‘which explains’ why firms grow and the mechanism through which growth is accomplished’ (Ghoshal *et al.*, 2002), has been the source for many later theories, particularly the resources-based view theories (Garnsey, 1998). While other theories such as market position theory of Porter (1981) or core competence theory explore firm growth by examining behaviours of entrepreneurs, firms and industry, Penrosean theory has become the only pioneering economics theory which looks inside the black box of a firm, exploring the concrete process of firm growth. In addition, although Penrose developed her theory from observing growth of

industrial firms, her concept of knowledge being created inside firms and being driver of firm growth is relevant to all types of firms including industrial firms and service firms. Other components of her theory could have similar relevancy and it would be interesting to test this by applying them to explaining growth of professional service firms which are arguably different from industrial firms. For these four reasons, the theory of Penrose (1959) was chosen as the base theory for the current research which was to explore in depth processes underlying growth of HR service SMEs in Guangzhou City, identifying growth process, growth mechanism, growth causes and growth constraints, so as to be able to fully explain growth of these small professional service firms. No other theory has the same weight as her theory in this enterprise.

What appear to be the gaps in existing literature as presented and discussed in the above four paragraphs seem to suggest that in-depth case studies is urgently needed in order to fully understand the actual growth processes, growth mechanism and growth causes. The current research project attempted to do this by examining the growth process of HR service SMEs in Guangzhou City, China. There are four objectives for the research, as explained in Chapter One:

- ◆ to gain a better understanding of how HR service SMEs in Guangzhou City grew by exploring their growth process and growth mechanism
- ◆ to identify causes of growth of these HR service SMEs and to develop a theory to better explain their growth which sheds light on ways to facilitate their growth
- ◆ to come up with recommendations to improve management practices to

facilitate growth of these SMEs

These research objectives can be met by finding answers to the intellectual questions on how and why HR service SMEs were able to grow. These two formed the central research questions for the current research and were broken down into four sub-questions which guided research activities throughout the current research project:

- ◆ how did growth of these firms happen?
- ◆ why were they able to grow (what were the causes of their growth)?
- ◆ why were some of HR service SMEs be able to grow faster than others?
- ◆ why have some of these firms been able to grow continuously while others could not, given the same external environment?

In summary, the work of Penrose (1959), *'The Theory of the Growth of the Firm'*, argues that growth of knowledge in a firm, which is embodied in growth of managerial services (Lazonick, 2002), leads to its growth while limiting the rate of its growth but not the size of its growth. This revolutionary insight points to the causal mechanism responsible for firm growth, thus bringing out a very parsimonious theory on firm growth. As a result, it has become very influential for research on firm growth. However, in spite of its worldwide influence, the theory of Penrose (1959) has some historical and theoretical limitations. Consequently many more theories on firm growth have appeared but none of them is free from limitations of its own. Over the last fifty years since the publication of the work of Penrose (1959), firm growth has been the focus of sustained research interest but 'relatively little is known about this phenomena and much

confusion and misunderstanding surrounds it' (Leitch *et al.*, 2010, p.249). This sentiment is shared by many scholars (Davidsson & Wiklund, 2000; Garnsey, 2002; Delmar *et al.*, 2003, Shepherd and Wiklund, 2009; McKelvie and Wiklund,2010). McKelvie and Wiklund (2010, p.261) comment that 'despite substantial interest and massive empirical research, theoretical development in the field [research on firm growth] has been notably slow'. According to Pitelis (2002) and Lockett *et al.* (2007), it seems that almost there might be no better theory than that of Penrose (1959), which can properly explain firm growth. Consequently, for the time being, it is appropriate to suggest that the current research be guided by the theory of Penrose (1959) and by the research questions on how and why HR service SMEs in Guangzhou City were able to growth.

Chapter Three: Context of the current research

Human Resource (HR) service Small and Medium Enterprises (SMEs) have just emerged as a new type of professional service firm (PSFs) in China. These firms are different from industrial firms which have been extensively researched; to date, they have hardly received any attention in government policy and academic research. This chapter provides a description of the context for the current research on growth of HR service SMEs in Guangzhou City, which will enhance understanding of growth of these firms. The research context is divided into two dimensions: subject matter context which describes professional service firms—a unique type of enterprises to which the subjects of the current research (HR service SMEs) belong, and country context which describes Guangzhou City's socioeconomic development and its impact on growth of HR SMEs and development of HR service sector in the city. Accordingly, the chapter is divided into two parts. The first part of this chapter presents research on professional service firms (PSFs), which is very useful for understanding HR service SMEs. The second part of the chapter briefly describes the city's socioeconomic changes over last three decades and how these changes influenced growth of HR service SMEs. The information was developed to contextualize the current research on process and causes of growth of HR service SMEs in Guangzhou City. It is hoped that the contextual information provides sufficient background knowledge for understanding the current research.

3.1 Subject matter context: professional service firms (PSFs)

Due to increasingly complex and technology-driven business environment, demand for professional services has been on the rise (Turner, 1969; Brentani and Ragot, 1996; Bryson *et al.*, 1997; Amonini *et al.*, 2010). Professional service firms (hereafter PSFs) have been a major force in economic development of developed countries (Turner, 1969; Brentani and Ragot, 1996; Bryson *et al.*, 1997; Lewendahl, 1997; Glancey *et al.*, 1998; Muller and Doloreux, 2009; Nordenflycht, 2010). Even in developing countries such as China, PSFs are playing an increasingly important role of market intermediaries to facilitate effective innovation and smooth economic development. As such economic institutions, PSFs deserve careful study. Indeed, there has been an increasing research interest on PSFs (Nordenflycht, 2010). The following is a brief thematic review of research on PSFs. The review presents findings and arguments from extant literature, aiming to bring a full understanding about PSFs: PSF definition, PSF characteristics, PSF competition, PSF growth and PSF critical success factors. Since HR service SMEs, which are the subject for the current research, are a type of professional service firms, it is hoped that the review gives sufficient relevant subject contextual information for understanding HR service SMEs.

3.1.1 Representative literature and major topics on PSF research

There has been an expanding body of literature on PSFs since 1960s, but researchers have not achieved broad agreement on theories on what a PSF is, how it works and how it grows (Lewendahl, 1997; Nordenflycht, 2010). Research continues to rely on existing

organizational theories for studying PSFs (Lewendahl, 1997). However, ‘the applicability of existing theory (largely derived from studies of fundamentally different organizations—manufacturing firms) is being questioned’ (Greenwood and Suddaby, 2006, p.7). Traditional economies of scales, for instance, do not exist in PSFs and reduction of price does not lead to increase in sales (Lewendahl, 1997). It has now been recognized that PSFs offer a distinct research area, which can be studied in multiple research perspectives and in many different topics (Muller and Doloreux, 2009). One important research topic is the conceptualization of PSFs, which is still under development (Nordenflycht, 2010). The second major research interest is to find out PSFs’ characteristics that differentiate PSFs from other types of business organizations. Other research topics include marketing of professional services, PSF competition, PSF growth and factors which contributes to the success of PSFs. The table below lists representative literature and the contribution that these academics article have made to major PSF research topics: PSF definition, characteristics, competition, growth and critical success factors. Literature in this table forms the basis for the current review on PSFs.

Table 3.1.1 Representative research articles and their contribution to major research topics

Authors	Contribution to research topics on PSF				
	PSF definition	PSF characteristics	PSF competition	PSF growth	PSF Critical success factors
Turner (1969)			√		√
Zeithaml <i>et al.</i> (1985)		√			√
Harte and Dale (1995)		√	√		√
Patterson and Cicic (1995)	√	√	√		√
Brentani and Ragot (1996)	√	√			√
Brentani and Ragot (1996)	√	√			√
Bryson <i>et al.</i> (1997)		√		√	√
Lewendahl (1997)	√	√	√	√	√
Glancey <i>et al.</i> (1998)	√			√	√
Paulin <i>et al.</i> (2000)		√	√		√
Hitt <i>et al.</i> (2001)		√		√	√
Bettencourt <i>et al.</i> (2002)	√				√
Greenwood <i>et al.</i> (2005)	√	√	√		√
Greenwood and Suddaby (2006)	√	√			

Table 3.1.1 Representative research articles and their contribution to major research topics (continued)

Authors	Contribution to research topics on PSF				
	PSF definition	PSF characteristics	PSF competition	PSF growth	PSF Critical success factors
Gardner <i>et al.</i> (2008)		√		√	√
Muller and Doloreux (2009)	√	√			√
Nordenflycht (2010)	√	√	√		
Amonini <i>et al.</i> (2010)		√	√		√

3.1.2 Defining professional service firms

In spite of increasing interest in research on PSFs, there has not yet been any agreed definition on what a professional service firm is (Lowendahl, 1997; Nordenflycht, 2010). Different researchers have made dissimilar definitions on the term PSF. An exemplary definition is made by Greenwood *et al.* (2005, p.661): PSFs are firms ‘whose primary assets are a highly educated (professional) workforce and whose outputs are intangible services encoded with complex knowledge.’ Disagreement on the term PSFs presents a significant barrier to research on such business entities (Nordenflycht, 2010). To break down this barrier, Nordenflycht (2010) published a long article in ‘*Academy of Management Review*’ clarifying what a professional service firm is. Nordenflycht (2010)

admits that it is difficult to give an exact definition on what professional service firms are; however, PSFs can be seen as organizations sharing three common features: knowledge intensity, low capital intensity and professionalized workforce.

3.1.3 Characteristics of professional service firms

Although scholars cannot agree on a clear-cut definition of PSFs, they have consensus that PSFs are discrete types of organization different from product firms (Bryson *et al.*, 1997; Greenwood *et al.*, 2005; Muller and Doloreux, 2009; Amonini *et al.*, 2010). PSFs have some common features (Brentani and Ragot, 1996). They can be identified in terms of their unique output attributes, their low capital intensity and their professionalized workforce (Nordenflyght, 2010). Below is an elaboration of these characteristics of PSFs.

First of all, the output of PSFs is marked by knowledge intensity, intangibility, simultaneity in production and consumption, customization and perishability (Zeithaml *et al.*, 1985; Brentani and Ragot, 1996; Patterson and Cicic, 1995; Lowendahl, 1997; Greenwood *et al.*, 2005; Greenwood and Suddaby, 2006). Most important of all, PSFs provide knowledge-intensive service; in the words of Glancey *et al.* (1998, p.249), they ‘trade knowledge’. These firms apply their expertise to solve specific problems facing their clients. In addition to being knowledge intensive, service of PSFs is intangible and cannot be touched, removed, or evaluated by clients (non-experts) in term of quality and value (Patterson and Cicic, 1995). The third feature of PSF service is that in their

delivery, such service involves face-to-face interaction between PSFs and their clients (Patterson and Cicic, 1995; Lewendahl, 1997). In many cases, clients frequently form an integral part of the service offering (Carman and Langeard, 1980; Brentani and Ragot, 1996; Bettencourt *et al.*, 2002). Thus, success of service delivery depends on effective two-way interaction between PSFs and their clients. Besides, in time dimension, production and consumption of PSF service is simultaneous; for example, while a training session is provided by a trainer (production), it is consumed by training participants (consumption). Furthermore, service of PSFs is highly customized (Greenwood and Suddaby, 2006). Each case of service is different from another (e.g. heterogeneity of service). Lastly, service of PSFs has the characteristics of perishability, which means that it cannot be stored as goods do. In short, one feature of PSFs is that its output is marked by its knowledge intensity, intangibility, simultaneous production and consumption, heterogeneity and perishability (Lowendahl, 1997).

The second feature of PSFs is their low capital intensity (Nordenflyght, 2010). Unlike product firms, PSFs do not need much capital to set up and run, because they seldom require expensive equipments or a large number of fixed assets. Costs of running PSFs are mostly variable costs, such as overheads, office stationary costs and salaries. The biggest part of the cost for PSFs is the cost for maintaining a pool of talented workforce. Even such costs can be cut down to the lowest level, when business is tough, by changing the contractual status of professional workers, such as hiring part-time freelancers in the field. Low fixed cost means that there may be no gains from increased scale (Lewendahl, 1997), because if fixed cost is too small, the reduction of it due to

economy of scale has no significant impact on business profit. Overall, in the value creation process of PSFs, the role of individual professionals is critical but the role of capital may be minimal (Lowendahl, 1997). So, PSFs are often characterized by low capital intensity.

The third feature of PSFs, Nordenflycht (2010) argues, is that PSFs are of high skilled labour intensity and have a professionalized workforce. Clients need and depend on expert advice and service from PSFs, which in turn have to hire experts. Professional service ‘involves a high degree of discretionary effort and personal judgement’ (Lewendahl, 1997, p.20) and thus, only highly specialized personnel can deliver professional services. Thus, unlike firms manufacturing goods, PSFs require their employees to be highly educated, extremely talented and vastly experienced (Hitt *et al.*, 2001). They must be seasoned professionals in their own field. These “talents” possess knowledge, particularly tacit knowledge, of their firms. In other words, the assets of PSFs reside in their human capital (Lewendahl, 1997). The workforce is the most valuable asset, if not the only assets, of PSFs. Thus, it is characteristic of a PSF to depend on its professionalized workforce (Greenwood *et al.*, 2005; Nordenflycht, 2010).

Lastly, PSFs are characterized by their unique organization forms, namely, partnerships (Brentani and Ragot, 1995; Gardner *et al.*, 2008; Nordenflycht, 2010). Partnership is a corporate governance form which advocates decentralization, self-regulation, autonomy, employee involvement and active cooperation. In such organizations, formal rules,

standards and authority are often strongly resisted by professionals (Harte and Dale, 1995). Partnership suits well professionalized workforce who prefer operational adhocracy over organizational bureaucracy (Harte and Dale, 1995; Greenwood *et al.*, 2005), giving them maximum freedom while burdening them with commensurate responsibility. As a result, partnership is commonly seen as a more appropriate organization form for PSFs (Greenwood and Suddaby, 2006), not just in term of firm economic performance but also in term of corporate governance. Partnership remains the common popular corporate governance form for PSFs, although recently a tendency has arisen to change that, with more and more professional workers being converted into salaried knowledge workers.

3.1.4 Competition among professional service firms

There is disagreement in the literature on how much competition takes place among PSFs. One opinion holds that PSFs such as law firms and accounting have a historical reluctance to engage in competition (Lowe, 2004), or at most, have a muted competition (Nordenflycht,2010). This is because sector of such PSFs often has a self-monopoly (Friedson, 1970; Larson, 1977 in Nordenflycht,2010). Entry barrier to such practices is extremely high; associations of these PSFs strictly control the new entrants (Nordenflycht, 2010). As a requirement for entering law practice, for example, one must have proper education on law (Bryson *et al.*, 1997) and a lawyer qualification, which in most cases is extremely difficult to get. In these service areas, PSFs maintain monopoly, self-regulation and hence, competition among them is muted. However, competition for

other types of PSFs such as consulting firms may not be muted. The controlling power of professional associations for these PSFs (normative force) is weaker and professionalism of their employees (professional force) is lower. In this case, there can seldom be any service monopoly. By contrast, as Brentani and Ragot (1996, p.518) put it, among these PSFs, ‘imitation is common, entry barrier is low, intense competition is a fact of life’. To win competition, whether being muted or not, PSFs must compete on the following dimensions (Brentani and Ragot, 1996; Paulin *et al.*, 2000; Amonini *et al.*, 2010).

To begin with, PSFs compete on service superiority and innovativeness of their services (Brentani and Ragot, 1996; Lowe, 2004). This is especially true in the areas of professional services such as consulting services which have low entry barriers. Consulting services can be imitated easily, particularly in the age of internet, over which knowledge and information spread freely. In order to win business deals, PSFs in consulting sector must constantly upgrade their service to preserve their uniqueness; their service need to be perceived as superior to those of their competitors.

Secondly, PSFs often compete on perceived quality and value of their services (Turner, 1969; Paulin *et al.*, 2000; Amonini *et al.*, 2010). Since, in most cases, it is extremely difficult for clients (non-experts) to assess the quality and value of professional services which are intangible and very knowledge-intensive. Clients often judge value and quality of the professional services by their own perception (Kirkwood, 2009), rather than by objective measurements. Therefore, PSFs have to compete on perceived quality

and value of their services (Paulin *et al.*, 2000). Day and Barksdale (2003) observe that clients award their contracts to PSFs based on perceived capability, chemistry and client-orientation; Harte and Dale (1995) believe that clients evaluate the services they received by weighing these factors: timeliness, empathy, assurance, fees, tangibility and reliability. For this reason, PSFs need to do well for their clients on these attributes in order to maximize perceived quality and value of their service. Scholars often argue that PSFs should carefully manage, by two-way communication and education, the expectation of clients for professional service (Harte and Dale, 1995), because services are perceived to be excellent in quality and value if they can match the expectation of the clients (Harte and Dale, 1995; Lewendahl, 1997). Bryson *et al.* (1997, p.17) even suggests that PSFs should ‘persuades the client that the finished project has met’ their requirements and that their ‘organization appears to be more efficient and effective’.

In addition to competing on service innovativeness and perceived value, PSFs compete on market reputation (Zeithaml *et al.*, 1985; Bryson *et al.*, 1997; Paulin *et al.*, 2000; Hitt *et al.*, 2001; Amonini *et al.*, 2010). Since it is difficult for clients to judge quality and value of the knowledge-intensive service they use, clients could find assurance of service quality and value in positive market reputations of the professional service provider (Hitt *et al.*, 2001; Amonini *et al.*, 2010); in fact, clients often rely on market reputation of a PSF to decide if they would like to purchase services from this PSF. Hitt *et al.* (2001, p.23) argue that ‘positive reputation can help professional service firms build a competitive advantage because of the information asymmetries experienced by clients’. Facing this situation, PSFs go all out to build up their market reputation.

In regards to their human resources, PSFs compete for the best qualified employees. Talented employees will help to secure service quality and value (Bryson *et al.*, 1997; Greenwood *et al.*, 2005; Nordenflycht, 2010). For PSFs, whether they are law firms, accounting firms, training firms, or talent agencies, knowledge of the profession resides in the mind of their employees who have immense bargaining power. If PSFs are successful in hiring the best talent, the value of their firm's asset will rise; on the contrary, if PSFs lose the talent competition, they will go down in value in the marketplace. Clients often judge the value and quality of professional service by both the reputation of the firm and the qualification of their employees (Gardner *et al.*, 2008). Thus, PSFs often compete for the best talent in the human capital market and do their best to retain, develop and motivate these talents, so as to increase their firm asset value and to ensure continuous firm growth.

By contrast, Nordenflycht (2010) argues, PSFs do not compete for capital since one feature of PSFs is low capital intensity (Bryson *et al.*, 1997). This feature of PSFs reduces their need for raising investment funds and hence, reduces their need to court any outside investors (Nordenflycht, 2010). Really, it is very rare to see PSFs competing for bank loan or venture capital; PSFs often expand at the pace permitted by their own financial resources. Furthermore, PSFs do not compete on organizational efficiency. This is because organizations of PSFs are often very small and flat (Gardner *et al.*, 2008), which make them easily manageable, in comparison with other types of firms; in addition, professionalized employees of PSFs do not like bureaucracy and hierarchy;

they work independently with minimal need for organized support, guidance and supervision. In other words, since their organization is flat, organizational effectiveness does not affect very much the performance of PSFs and hence, is not a key differentiator for PSFs in their competition (Gardner *et al.*, 2008).

3.1.5 Growth of professional service firms

There are fewer studies on growth of PSFs, when compared with those on PSF conceptualization and characteristics. Small PSFs are often spin-off from big firms. Their founders were often those with expertise and experiences gained from large firms. They used their reputation and personal business contacts to establish small PSFs (Bryson *et al.* 1997; Glancey *et al.*, 1998). Glancey *et al.* (1998) find in their study that none of the PSF entrepreneurs they investigated mentioned growth as an initial objective for their firm. PSFs do not like to grow (Lowendahl, 1997). Kirkwood (2009) believes that there was a strong desire not to employ too many people for fear of losing control of the business. The most common initial objective for entrepreneurs of PSFs was to make a living. Later some of these entrepreneurs changed their initial goal; they pushed for growth, not as an objective in itself but as a means to other objectives such as survival in market, domination (in negotiation) and wealth maximization.

Glancey *et al.* (1998) explored growth of small PSFs and found several causes for these firms to go for growth; Growth happens not only due to market competition pressure but also due to intrinsic causes (Gardner *et al.*, 2008). Some small PSFs under the

investigation by Glancey *et al.* (1998) cite the need to develop wider markets as competitive pressures increased in initial niche market while other small PSFs cited the need to grow for getting a larger contract to reduce negotiation cost; yet, other PSFs hire more specialists in house in order to have better control over service quality and market reputation, which accounts for their firm growth. More commonly, small PSFs grow to capture market opportunity to increase their profit.

Research also reveals that small PSFs preferred ‘internal growth’ over merger and acquisition (M&A), although M&A among small PSFs also took place (Glancey *et al.*, 1998). Glancey *et al.* (1998) has found various modes of growth among small PSFs in their empirical research. One typical mode of growth is to develop their expertise to expand into specialist areas extended from original business scope (Hitt *et al.*, 2001). To implement this expansion strategy, small PSFs hire specialists, who originally were subcontractors, to take on more and more business in house. This is a type of vertical integration, which brings in larger, more complex and more valuable contracts. On the contrary, other PSFs grow by building network of associations to capture larger, more complex and more cost-effective contracts (Bryson *et al.*, 1997). In addition to expanding and extending original business, some PSFs diversify into new business lines, becoming multidisciplinary in practices (Greenwood *et al.*, 2005; Greenwood and Suddaby, 2006; Kirkwood, 2009), ‘in order to hedge against possible shrinkage in their client markets and exploit underutilized firm resources’ (Gardner *et al.*, 2008, p.1102).

However, to be successful, diversification by PSFs must be deemed by their workforce,

their professional associations and their clients to be legitimately compatible with their competence (Hitt et al., 2001), or in the words of Gardner *et al.* (2008), to achieve both cognitive legitimacy and social-political legitimacy. Furthermore, diversification cannot create too broad a business portfolio, which otherwise could contaminate corporate image of PSFs as centre of expertise (Greenwood *et al.*, 2005); moreover, diversification should not create an unbalanced business portfolio for PSFs, since this indicates unfocused professional service (Lowe, 2004; Greenwood *et al.*, 2005). Lack of concentration (specialization) of a PSF discourages clients to buy its service. On the whole, expanding and extending original business (multi-site expansion, for example), which still preserves a corporate image of experts, rather than diversifying into new business lines (multi-segment), which betrays an image of commercial generalists, seems to be a more popular option of growth for PSFs, particularly for small PSFs.

In term of limits for firm growth, PSFs are not constrained by lack of finance (which is usually the case for product firms), because PSFs have low capital intensity (Bryson *et al.*, 1997). In addition, PSFs, which have few complex organization processes, are not constrained in their growth by internal organizational ineffectiveness, as much as product firms are. Instead, the constraint for growth of small PSFs seems to be the lack of human capital, such as personnel with marketing, sales and management expertise (Bryson *et al.*, 1997).

3.1.6 Critical success factors for professional service firms

After reviewing literature on PSF competition and PSF growth, it is appropriate to examine factors critical for the success of PSFs in market competition and thus, important for their growth. In general, compared with internal organizational effectiveness, external market effectiveness is more critical to success of PSFs (Brentani and Ragot, 1996; Paulin *et al.*, 2000; Lowe, 2004; Greenwood *et al.*, 2005). To beat competition and grow, PSFs must have exceptional ability to comprehend market trends and identify business opportunities (Brentani and Ragot, 1996); moreover, they need to limit their business to a niche market (focus and specialization); PSFs also need a reputation to win their market competition (Bryson *et al.*, 1997; Greenwood *et al.*, 2005); to build up and to improve market reputation, they have to carry out appropriate marketing (e.g. interaction marketing) (Brentani and Ragot, 1996; Amonini *et al.*, 2010); furthermore, they have to interact effectively with clients and provide highly customized solution to problems specific to clients (Zeithaml *et al.*, 1985; Patterson and Cicic, 1995). In addition, to win competition and grow, PSFs need to develop strong client relationship; and most importantly, they must be able to attract, retain and develop professionals (Nordenflycht, 2010). The following paragraphs elaborate these critical success factors for PSFs.

Brentani and Ragot (1996, p.527) believe that PSFs should carry out ‘up-front market research’, which permits them to understand customer needs, key issues and major trends in the market. This argument is fervently supported by Lowe (2004). Firstly, Lowe (2004) argues, in-depth and timely information of market allows PSFs to develop appropriate service category to meet market needs; and service market-fit is critical for

the success of PSFs (Brentani and Ragot, 1996). Secondly, Lowe (2004) maintains, traditionally, PSFs had a disdain for competition and thus, refused to study marketplace and competition; if a PSF studies competition and has ‘a real understanding of the marketplace’, it will have some competitive advantages, because such an understanding will lead the firm ‘to make strategically effective internal efforts to compete’ (Lowe, 2004, p.8).

After PSFs comprehend market development trends and identify potential business opportunities, they need to select the right market opportunities which suit their specialization (Glancey *et al.*, 1998). By definition, PSFs are ‘placed in the niches where a high degree of customization is required’ (Lewendahl, 1997, p.41). Specialization in their niche market is necessary for PSFs and is a sign of their competence and expertise value (Brentani and Ragot, 1996; Bryson *et al.*, 1997; Greenwood *et al.*, 2005; Amonini *et al.*, 2010) which encourages clients to buy their services. If a PSF has too broad a business portfolio, it is often seen as not specialized in its business, or put in another way, it indicates that the PSF has no expertise in their home field (Carman and Langeard, 1980; Brentani and Ragot, 1996). Therefore, specialization in a niche market and possession of specialized expertise or products, is critical to success of a PSF, particularly a small PSF.

The third critical success factor for PSFs is their market reputation (Bryson *et al.*, 1997; Greenwood *et al.*, 2005). Since service provided by PSFs is knowledge-intensive and intangible, it can only be evaluated by their clients referring to some ‘social signal’

(Greenwood and Suddaby, 2006, p.13) or cues (Patterson and Cicic, 1995; Day and Barksdale, 2003; Amonini *et al.*, 2010). One of the most important cues is market reputation of the PSFs which can only be built up over a long time. Market reputation of PSFs embodies experience, expertise and competence as perceived by their clients. If a PSF has an impeccable market reputation, clients are inclined to trust it and buy its service. According to Kirkwood (2009), market reputation may be a key driver behind small service firms' growth. Therefore, PSFs should carry out appropriate measures including marketing activities to promote their market reputation.

Although professionals in PSFs do not like advertising their services (Turner, 1969; Zeithaml *et al.*, 1985; Bryson *et al.* 1997; Amonini *et al.*, 2010), marketing is critical for success of PSFs, in particular, for those in turbulent environments (Turner, 1969; Brentani and Ragot, 1996; Amonini *et al.*, 2010). For PSFs, whether to openly promote their services or not remains a dispute. Historically, PSFs had a distain for 'competition, self-promotion, advertising and bald profiteering' (Lowe, 2004, p.8); they took little effort to market their services. Even today, PSFs often have all-too-random acts of marketing (Turner, 1969; Lowe, 2004). Hence, professional service marketing is still an area under research and under development (Amonini *et al.*, 2010). However, there has been some recognition that like product firms, some categories of PSFs such as consulting firms, need to conduct, although differently, marketing activities in order to sell their services, (Turner, 1969; Lowe, 2004). They often do so in low profile or implicitly through other activities (Amonini *et al.*, 2010) such as publication in journals and trade magazines, sponsorship for targeted events and participation in various board

and committee meeting. Most frequently, PSFs used client referral as a marketing tool of high impact. All these marketing activities are important for PSFs, especially for those in highly competitive marketplace.

Besides effective marketing of their service, to be successful, PSFs must interact closely with clients (Turner, 1969; Zeithaml *et al.*, 1985; Patterson and Cicic, 1995; Harte and Dale, 1995; Brentani and Ragot, 1996; Lewendahl, 1997; Greenwood and Suddaby, 2006), which gives them intimate knowledge of their clients' business, key issues and major problems (Brentani and Ragot, 1996; Amonini *et al.*, 2010). Profound knowledge of their clients gives PSFs necessary data and insights for developing effective customized solutions to their clients' problems (Patterson and Cicic, 1995; Bryson *et al.*, 1997; Lewendahl, 1997; Bettencourt *et al.*, 2002; Muller and Doloreux, 2009). In addition, unlike product firms, PSFs need active participation of their clients for successfully delivering their service (Brentani and Ragot, 1996; Lewendahl, 1997; Bettencourt *et al.*, 2002). In fact, in most cases, clients are complementary resources for PSFs (Hitt *et al.*, 2001) and they co-create and co-produce quality service (Smedlund, 2008; Muller and Doloreux, 2009). Clients' contribution to the service delivery process is necessary for service success (Brentani and Ragot, 1996) and thus, PSFs need to be selective of their clients who are willing and able to co-produce quality service (Glancey *et al.*, 1998; Bettencourt *et al.*, 2002). Finally, besides giving their clients a customized solution and ensuring successful service delivery, close interaction permits PSFs to reciprocally transfer knowledge between them (Muller and Doloreux, 2009). Suffice it to say that close interaction between PSFs and their clients is critical to

success of PSFs. In fact, as argued by Prahalad and Ramaswamy (2004), such co-operation between firms and their customers has formed new sources of competitive advantages for these firms.

Personal strong relationship with clients (client intimacy) is therefore very critical to the success of PSFs (Zeithaml *et al.*, 1985; Brentani and Ragot, 1996; Bryson *et al.*, 1997; Paulin *et al.*, 2000; Greenwood and Suddaby, 2006; Amonini *et al.*, 2010). PSFs must show genuine concern for their clients and be willing to make extra effort to solve their problems even if these problems are not in their service scope (Harte and Dale, 1995; Day and Barksdale, 2003; Kirkwood, 2009). Long-standing and harmonious relations between PSFs and clients bring a number of benefits to PSFs (Hitt *et al.*, 2001). Long-term relation can maintain greater trust between PSFs and their clients (Bryson *et al.*, 1997; Paulin *et al.*, 2000; Gardner *et al.*, 2008), which reduce the cost of business transaction. More importantly, close relationship between PSFs and their clients permits close interaction and cooperation, which is vital to the success of both PSFs and their clients (Smedlund, 2008). Furthermore, such relation gives PSFs much better chance to win repeated business from their existing clients; and repeated business is a sign of client satisfaction with service quality and value (Bryson, 1997; Bryson *et al.*, 1997), which can attest and enhances the market reputation of the engaging PSFs.

Lastly, a professional workforce is vital to success of PSFs in market competition (Kirkwood, 2009; Nordenflycht, 2010). Because PSFs have low capital intensity but high knowledge intensity (human capital intensity); the most valuable asset for PSFs is

its professional workforce which develop and possess all firm knowledge, skills, experiences and business contacts. Human capital has a direct and indirect impact on performance of PSFs (Lewenhahl, 1997; Hitt *et al.*, 2001). This makes PSFs depend on their professional workforce (Bryson *et al.*, 1997; Greenwood *et al.*, 2005; Gardner *et al.*, 2008; Nordenflycht, 2010). Furthermore, professionalism of workforce in PSFs upholds their market reputation and is an indication of their capability and service value. The more professionalized the workforce of a PSF is, the better market reputation it can enjoy, the more capable it will be and the more business opportunities it can have. In this sense, professionalized workforce is a critical success factor for PSFs in their market competition and firm growth; success of PSFs hinges on their ability to recruit, retain and motivate professionals who are highly mobile.

In summary, from the above thematic review of literature on PSFs, it is possible to argue that despite increasing research interest on PSFs, it is still true that ‘our understanding of organizations has suffered from an excess of attention to manufacturing enterprises’ (Greenwood and Suddaby, 2006, p.14), to the neglect of PSFs; hence, ‘little has been written specifically for professional service firms’ (Lowe, 2004, p.1) and even less has been written on growth of these unique firms. Extant research is mostly at the stage of PSF conceptualization and classification—a very early stage in research on a new organization genre. Theories on what a PSF is, how it works and how it grows are still under-developed (Bryson *et al.* 1997; Lowendahl,1997; Greenwood *et al.*, 2005; Nordenflycht, 2010). However, there seems to be some consensus that PSFs are discrete organizations different from manufacturing firms and

that existing theories on the later can not be readily applied to the former (Carman and Langeard, 1980; Bryson *et al.* 1997; Lewendahl, 1997; Greenwood *et al.*, 2005; Muller and Doloreux, 2009). This short review has found that different from product firms, PSFs are featured by knowledge-intensity, low capital intensity and a professionalized workforce (Muller and Doloreux, 2009; Nordenflycht, 2010). Moreover, it has also found that in terms of competition, PSFs compete on their superior and innovative service, on perceived quality and value of their service, on their market reputation and on professionalism of their workforce. In term of growth, this review has found that PSFs mostly adopt internal growth approach expanding and extending their core business in a niche market; diversification into new business lines is often seen as the last option for growth by their workforce and their clients, because too broad a business portfolio will damage corporate image of PSFs as firms with expertise in their home field. Finally, this review has found that critical success factors for PSFs are market sensitivity, professional service marketing, excellent market reputation, close interaction with clients, strong client relations (client intimacy) and professionalized workforce. PSFs must be market-driven in all its activities (Lowe, 2004). Capital availability and organization effectiveness do not seem to be so critical for success of PSFs in competition and growth, compared with the criticality of these factors for product firms which are more capital intensive and more complex organizationally.

3.2 Country context: Guangzhou City as a social arena for growth of HR service

firms

As the third largest city in China, Guangzhou City is an extremely vibrant metropolis in southern China, located on the Pearl River. Since 17th century, the city has traditionally been an important transportation hub and trading port of the region for the outside world. It has a population of over 13 million residents (as of 2009), including both permanent residents and migrants from all over the country. As the capital of Guangdong Province, which is one of the most prosperous and economically powerful provinces in the country, Guangzhou City was one of the first Chinese cities to open its economy to the outside world after 1978; it underwent economic reform and saw rapid growth, probably due to its close link to overseas Chinese and close proximity to Hong Kong. The city has now become one of the four booming economic hubs in China, the others being Beijing, Shanghai and Shenzhen. It is the main manufacturing hub of the Pearl River Delta which is one of China's leading commercial and manufacturing regions. Numerous MNCs have settled down in the city to produce and export their goods all over the world. Since 1978, due to its booming manufacturing-based economy, Guangzhou has attracted millions of migrant workers (peasant-workers) and professionals from overall the country. In 2008, Guangzhou achieved an annual GDP of about \$134.5 billion; more importantly, it has always been one of the key drivers behind annual 583.2 billions US dollars' GDP of Guangdong Province (as of 2009). It is largely due to the economic development and social development of the city in the last few

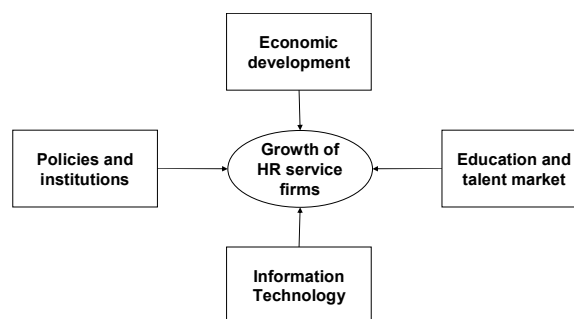
decades that HR service sector emerged and developed. Growth of these firms has greatly facilitated economic growth of the city and the region. On the other hand, socioeconomic development of the city has also facilitated growth of HR service SMEs of the city; this is to be presented in the following sections.

3.2.1 A simple model to explain external imprint on growth of HR service firms in Guangzhou City

Before examining how and why socioeconomic development of Guangzhou City impacted growth of HR service SMEs in the city, it is important to identify a proper framework for carrying out such examination. Traditionally, ‘PEST model’ has often been used to explain external impact on growth of firms and industries (Johnson and Scholes, 1997). ‘P’, which stands for ‘politics and policy’, implies that various political factors, in particular, governmental policy, exert great influence on development of a specific industry and growth of individual firms in the industry; ‘E’, which stand for ‘economy’, points to the fact that economic development affects significantly industrial development and firm growth; ‘S’ in the model stands for ‘social factors’ which also clearly impact expansion of industries and growth of firms; lastly, ‘T’ in the model stands for ‘technology’, indicates that technological innovation and revolution brings about many changes in industries, which facilitate growth of individual firms. Not all factors in PEST model have equal weight on development of HR service sector in Guangzhou and growth of firms in this sector. Although economic development did great impact growth of HR service firms in the city, it can be argued that political changes have had a lesser role in driving growth of these firms. Different from political

changes, however, various government policies, industrial support, as well as institutions, did have significant impacts on growth of HR service firms in Guangzhou City. In addition, in place of social value and social changes, education and talent market have had direct influence on the growth of these firms. Finally, information technology, rather than technology in general, has exerted strong influences on growth of HR service firms in city. Based on this understanding, a model can be developed, by modifying ‘PEST Model’, for use in the following paragraphs, to explain how major external social and economic factors have impacted development of HR service sector and growth of HR service firms:

Figure 3.2.1: A model to explain external influences on growth of HR service firms in Guangzhou (adapted from Johnson and Scholes, 1997)



The above model shows four prominent external factors which form the social environment of Guangzhou City that has facilitated and constrained growth of HR service firms in the city. Compared with factors in ‘PEST Model’, factors in the above model are much more concrete and more immediate to survival and growth of HR service firms in the city, hence possessing more explanatory power. The following section explains how these factors have changed over the last two decades and how their

changes influenced growth of HR service SMEs in the city

3.2.2 Explaining how economy and society changed in Guangzhou City and how these changes impacted growth of HR service firms in the city

3.2.2.1 Economic development in Guangzhou City: an overview

Since 1978, as other cities in China, Guangzhou City has been going through an incremental transition, as well as some revolutionary changes; its economy has shifted from state-planned economy towards a socialist market economy. Privatization has been the major theme in this economic reform, which greatly released productivity in the economy of the city. The economic reform has attracted major investments to the city, initially from Hong Kong, then from abroad and currently from within China.

For the purpose of this dissertation, economic development of the city can be roughly separated into four distinguished phases. Phase one was between 1978 and end of 1980s which was marked by export-oriented economic development. During this period of time, with investment mainly from Hong Kong and overseas Chinese, the city developed a huge sector of labour-intensive manufacturing which supplied the world with cheap products, bringing economic prosperity to the city and the region. In the following decade, MNCs poured their investment into the city to manufacture goods to sell abroad and at Chinese home market. To accommodate a fast expanding economy and the need of the MNCs for manufacturing sites, Guangzhou City set up a technological and economic development zone in Huangpo, far away from the city centre. After early 2000s, in the third phase of economic development of the city, the

source for economy growth shifted from international trade and foreign investment to state investment in infrastructure and heavy industry, as well as private sector investment in light industries. This wave of investment and development greatly enlarged the size of the economy in the city and at the same time, changed the dynamics of market competition. MNCs now have to compete head to head with local firms, which have brought about enhancement in the quality of goods and introduction of new market regulations. Recently, as the economy developed and cost of living increased, rising labour costs put great pressure on firms in the city; cost pressure has become increasingly felt since 2008 global financial crisis and a number of firms moved abroad or to inland cities where labour cost is lower. As a consequence, economy of Guangzhou City which was built on labour-intensive manufacturing suffered and had to be reformed again. Guangzhou City now wants to change its labour-intensive economy into knowledge-intensive high-tech economy and service economy.

3.2.2.2 How economic development in the city impacted growth of HR service firms

Development of the economy of the city since early 1980s has generated abundant growth opportunities for firms. Opportunities for firm growth in the city have attracted numerous entrepreneurial firms and big MNCs to do business in the city. Investment from abroad in 1990s has firstly brought in international manufacturers and then service firms such as executive search firms which provided business services for these manufacturers. Most important of all, foreign investment has brought to the city not only the capital which drove economic growth, but also knowledge spill-over and

human resource development. In short, economic development in Guangzhou City in the past two decades has provided a huge growing market for professional services; it has also led to the improvement of human capital in the city, which was critical for the development of HR service sector.

However, economic development in Guangzhou City has also created many problems for business service firms in the city. While it has created a vast market for services, it has also created ruthless and unpredictable market competition. Attracted by the booming economy of the city, new service firms have been constantly set up; at the same time, existing service firms struggling in the city died out quickly. Moreover, fast economic development of the city has created a shortage of talents for service firms and other business. The faster the economy of the city grew, the bigger number of business service firms emerged and competed for talent in the market; hence, the fewer these talents were available. This shortage of talents presented a major barrier to growth of HR service firms.

3.2.2.3 How institutions in Guangzhou City changed and affected growth of HR service firms

In the past two decades, as Chinese economic reform continued and the economy of Guangzhou gradually moved towards socialist market economy, its institutions such as social security system also underwent great changes. There are several specific economic institutions which need to be described and discussed in this section, because these external economic institutions have a great impact on the development and

deployment of firm capabilities, which in turn greatly influence growth of firms. The following paragraph presents changes in each of these economic institutions since 1980s and their impact on the development and deployment of firm capabilities.

The first of these economic institutions is the social security system in China. Social security in China was developed along with the opening up of its economy. It consists of pension, medical insurance, unemployment insurance and industrial insurance. These four components have been created to provide a social safety net for workers. After almost two decades of development, social security in Guangzhou has replaced the old safety net provided by work units before the opening up of the economy in 1980s; this change has greatly facilitated movement of labour contributing to the success of economy in the city. However, there are still many problems within this social security system. First of all, due to the regional difference, social security schemes based on these regional differences are not compatible. For example, Guangzhou City is more developed than most inland cities and thus, its pension scheme has much more value. As a result, it was, and still is, difficult to transfer social security of talents from across the country to Guangzhou City. Firms in Guangzhou has found it cumbersome to attract, to employ and to keep workers from other provinces. Firms finding ways to mitigate social security problems could have an advantage in talent market but those without such solutions lost out in talent competition. This situation has given rise to service opportunities for HR service firms which offered to address such problems for business community. Yet, at the same time, it has also made recruitment and retention of talents for HR service firms somewhat difficult. This problem has been particularly grave for

small HR services firms which were the biggest portion of firms in HR service sector of the city.

The second types of economic institutions greatly affecting firm growth are market intermediaries such as law firms, market agencies and auditors. These affect firm growth through their impact on market transaction conducted by firms. It is often argued that although these market intermediaries in Guangzhou City have been greatly improved since 1980s, many are still in their infancy, not yet as mature as their counterparts in developed economy. In case of labour disputes, for example, lack of legal advice for workers often made them powerless. Lack of effective market intermediaries also added transaction cost for sellers and buyers, because without the function of such organizations, market information is often asymmetric and market transaction was not very transparent. This has led to negative influence on growth of firms, including HR service firms, which is exemplified in the following paragraphs regarding credit system in the market.

Prior to the opening up in 1980s of its economy to outside world, Guangzhou City had little market transactions and there was not any need for showing market credits of various firms. Customers had little choice but buying goods produced by state-own enterprises and sold in state-run department stores. After early 1980s, the city quickly moved to a market economy, without developing proper institutions to provide information to the market about the creditability of firms. As a result, fake products and genuine products were sold in the same market with the consequence that the brand of

good products suffered great damage. Copying of product design or other intellectual property was also very common, which discouraged product innovation. In the past decade, the government of the city has made efforts to curb pirating intellectual properties and the situation has been improving. Yet, lack of proper institutions to publish and protect credentials of firms is still a fact of life in Guangzhou City.

Specifically, concerning HR service sector, there is no third-party which provides consultants of HR service firms with authoritative certification, a professional certification which is important to guarantee and demonstrate service quality. Clients buying HR services have little help and assurance in assessing quality and value of such services. Many HR service firms had to rely on various awards from formal and informal (sometimes dubious) organizations to show off their capability and value, which appeared like self-promotion and thus, less effective in convincing clients of their real capability and the value of their services. But this seemed to be the only way for these service firms to send signal to market on their capability, creditability and value. Partly due to lack of certification by formal trade association, it was extremely difficult and costly for outstanding HR service firms to sell their services directly to new clients. At the same time, however, lack of certification lowered entry barrier of HR sector in the city, allowing dubious HR service firms to sell their service to a market which lack ability to differentiate the value of these services.

As a consequence, development of HR service sector of the city and growth of firms in this sector was negatively affected by lack of effective HR services trade associations

that can certify service firms and safeguard service quality. For this reason, it was and still is extremely difficult for HR service firms to demonstrate and convince the market as to the value of their services and to urge investors and talents to join them to drive firm growth. Under these circumstances, HR service firms which knew how to develop and to maintain market reputation to show their value and credit had a much better chance for selling their products and services and for getting resources to grow.

3.2.2.4 How higher education and talent market in Guangzhou City changed and affected the growth of HR service firms

Higher education in Guangzhou City has experienced great change for the past few decades since 1978. In 1977, higher education resumed its normal operation after being interrupted by ten years' 'Great Cultural Revolution' which greatly damaged development of higher education and scientific research in the city. Universities in Guangzhou City, as others all over the country, began to enrol students through rigorous entrance examinations. However, degrees and programmes in the early 1980s in general were aimed at the market dominated by the domestic economy. As the export-oriented economy emerged and became prominent in late 1980s and in 1990s, more and more degrees with a global knowledge base and foreign language components were awarded, satisfying the talent demand by MNCs and firms aiming for international market. Since early 2000, higher education in the city went into other new directions, that is, popularization and globalization. More and more universities and colleges were set up; and more and more degrees were awarded together with universities from abroad. Recently, there was a trend in higher education in the city to provide professional

education which facilitates employment of its graduates. In short, higher education in the city has been greatly improved, producing more graduates with better quality knowledge suited to firm needs.

The development of higher education in Guangzhou City since 1978 has increased the talent pool for expanding firms; it has created big opportunities for development of recruitment business for HR firms and in addition, has greatly improved the quality of their human resources. More importantly, improvement of higher education in the city has increased the number of graduates in the business community, which in turn has increased the number of management members who were familiar with HR management concepts and theory. Firms with better knowledge of HR management seemed much more willing to outsource their HR services to specialized HR service firms. As a consequence, partly due to development in higher education, the market for HR services in Guangzhou City has been constantly expanding.

Similar to higher education, talent market in Guangzhou City has undergone drastic changes since 1978. This change has brought the greatest impact on growth of HR service firms. Before 1978, there was no human resource market in the city because all people were employed for life time either by government units or by state-owned enterprises; they could not choose their own employment and employers and they could only change jobs at the will of their employers, but not their own. After 1978, firms from Hong Kong and from other parts of the world began to recruit employees from state-owned enterprises and other units. However, in 1980s, this flow of labour was still

very tiny and job change was still carried out by government offices. Employees still found it extremely difficult to move around due to the ‘Hukou’ registration (residence registration) system; this system fixed people down in a specific place due to social benefits attached to it; this system is still in effect, although with much weaker force in some cities than in others; for example, it is comparatively easier to move from small cities to small cities, than from small cities to big cities such as Guangzhou.

In 1990s, as the economy of the city moved more rapidly from planned economy to market economy, more and more professionals from overall the country came to Guangzhou City for employment. Institutions for accommodating this talent flow have also gradually emerged and developed. Influx of these professionals gave rise to the need of HR services including handling of ‘Hukou’(residence registration) and their personal official files; in addition, as more and more MNCs were up and running in the city, recruitment of talents from the other parts of the country was much needed. This led to founding of numerous recruitment agencies. A talent market emerged and developed, as a result of economic development of the city. Beginning from 2000, firms increasingly needed in-house training to improve productivity and to retain talents; in addition, more and more talents needed continuing education to enhance their competitiveness in the talent market. These two needs gave rise to a niche market of training services, which is currently expanding. In a word, development of a talent market has led to establishment and expansion of HR service firms. The business community in the city needs services in recruitment, training, personnel management and labour advisory services. Furthermore, as a by-product, talent market development

has also made it easier for HR service firms to staff and retain their professional workforce which has greatly assisted their growth.

3.2.2.5 How IT in Guangzhou City changed and affected growth of HR service firms

Information technology in Guangzhou City has changed immensely over the past few decades since 1978 and now the city has become one of the most modern communication hubs in the country. In 1980s, telecommunication was still centred on telephone and telegraphs. It was extremely hard to make long-distance calls, even for businessmen, not to mention the general populace. From mid-1990s, telecommunication infrastructure in the city has been tremendously improved, with telecom investment increased in commensurate pace with economic development. Making long distance calls was not as difficult as before. Moreover, cell-phones appeared in early 1990s, although still cumbersome. This in turn brought vitality to economic development. Since 2000, telecommunication technology development has moved to and centred on internet technology. The world-wide web has become very popular in the city, allowing people to cooperate easily and to work on a mobile basis. In more recent years, internet technology development has led to the integration of telecommunication system, television system and internet system, which means that audio and visual production and communication is becoming commonplace and available for the general populace.

Development in IT and telecommunication has greatly changed the business model of HR service firms. Online recruitment appeared in late 1990s which replaced in early

2000s the traditional job fairs in which employers met job-seekers. Web-based resumes of job-seekers have accumulated into huge candidate databases for recruiting agents; this has made it easy to set up and run a recruitment firm, which has brought ruthless price-cutting competition to this niche market of HR services. Internet has also made it possible to link together various offices of a HR service firms and this has facilitated exchange of information and knowledge among consultants of the firm; furthermore, IT development has made it easier for HR service firms to cooperate with their clients and counterparts and thus, this cooperation has been on the rise. To sum up, development in IT has not only improved productivity of HR service firms in the city but also changed the way they do business; however, IT has intensified competition among these firms.

All in all, over the past two decades or so, Guangzhou City has emerged as an emerging market for professional services including HR services. Development of such an emerging market has been characterized by a number of salient features typical of any emerging market. First of all, the pace of development has been very fast, with evolutionary and revolutionary changes happening along the way. Client requirements and the market for professional services have been changing quickly. Institutions in Guangzhou City for a market economy have been greatly improved over the last two decades after the city opened its door to the outside world in 1978. Nevertheless, these institutions are still underdeveloped in comparison with their counterparts in the developed economy. As a consequence, it is still difficult for business service firms including HR service firms to demonstrate to the market their creditability and their value. This has made it difficult for them to get necessary financial resources, human

resources and other resources to develop their firm capability and thus, has slowed down the pace of their growth. Furthermore, the talent market for professional service personnel has not been developing very well, resulting in the lack of experienced consultants for HR service SMEs.

The above conditions of Guangzhou City as an emerging market for professional services have many implications for HR service SMEs in their drive for growth. Fast development and rapid changes of the market for professional services presented numerous opportunities for firm growth; but rapid market changes made these growth opportunities difficult to grasp. Those HR service SMEs which could follow closely market trends and were able to discern opportunities for growth had a better chance of seizing these opportunities. Apart from rapid development of the market, client requirements for more sophistication and better quality have been on the rise. HR service SMEs that took pains to understand their client business and to establish intimate client relations had a better chance of winning business orders. In addition, lack of market institutions to show firm capability, creditability and value implies that HR service SMEs could attract more clients if they had success in convincing them of their service capability, creditability and value. This was particularly important for the HR consulting firms which offered intangible services whose impact could only be seen long after these services were delivered. Client involvement in the delivery of services such as training courses was vitally important. Finally, due to the lack of an effective talent market for professional services in the city, experienced consultants could hardly be supplied by market and HR service SMEs had to develop their own front-line

employees, the success of which could have great consequences on growth of these service firms.

To sum up, this chapter provides contextual information for the current research. The chapter first presents the subject matter context—what are the professional service firms and how they work. The review has given some insights into professional service firms as a special type of enterprises, which should enhance understanding of HR service SMEs; but the review has not offered much knowledge on growth of professional service firms since there remains a lack of research and theorizing on professional service firms' growth process and causes of growth. In the second part of the chapter, a brief description has been made on Guangzhou City's socio-economic development over the last three decades and on how these socioeconomic changes have impacted growth of HR service SMEs and development of HR service sector in the city. The most important part of the chapter is devoted to the description of emergence and development of HR service SMEs and indeed, HR service sector, in Guangzho City, as a result of economic development and social development of the city. It is found that the market for HR services in the city has been fast growing. Nevertheless, the market was and still is far from being mature and stable, as is the case in a developed economy. Yet some of the HR service SMEs in the city have been growing continuously since their founding while others have been doing less well. Why is this? The phenomenon requires further research, which is why the current research was undertaken.

Chapter Four: Research methodology

This chapter describes the research methodology used to complete the current study on how and why some HR service SMEs in Guangzhou City could achieve their growth. As described in the following sections of this chapter, the research methodology has been properly used in the current research, which has ensured that the research was carried out in line with accepted business and management research methods, and that appropriate actions were taken to ensure reliability and validity of the research. In the first section of the chapter, a description is made on the choice of research paradigm, research strategy and research design. Following this section the process method using case studies is described. The research process primarily consists of five key components: defining research questions, developing propositions, collecting data, analyzing data and drawing conclusions. In the section that follows, a detailed explanation is made on methods for empirical research such as case selection, data collection, data processing and data analysis; this part shows that the current empirical research was carried out according to case study methods advocated by Yin (1994), Eisenhardt (1989) and others. In the last part of the chapter, measures taken to ensure research reliability and credibility are explained.

4.1 Research paradigms, research strategy and research design

4.1.1 The research paradigm for current research: qualitative research

How and why HR service SMEs were able to grow were two research questions for the

current research, which explored firm growth process as a complex social process embedded in dynamic the economy and society of Guangzhou City. Qualitative research approach is often preferred over quantitative research approach for studying complex social phenomena which are deeply embedded in its context and need to be seen as a whole if it is to be understood (Senge, 1990). Qualitative research often seeks to understand in depth how and why certain social phenomena happen, not just what, where and when such phenomena happen (Miles and Huberman, 1994). To achieve such a deep understanding, qualitative research often uses qualitative data gathered through: (1) participation in the setting, (2) direct observation, (3) in depth interviews, and (4) analysis of documents and materials.

The philosophical belief underlying qualitative approach is constructivism. It holds that people understand their world in a very subjective and personal manner, even if they are constrained by contextual factors. When examining constructivism, Crotty (1998) finds that the term should be understood in several steps. Firstly, meanings are constructed by human beings as they engage with the external world which they are interpreting. Second, constructivism means that people make sense of the world based on their historical and social perspective. Lastly, according to constructivism, the basic generation of meanings by a human being is always social, arising from one's interaction with people. As a result, researchers examining social phenomena have to look for various views allowing them to construct the meanings of the phenomena, which can not be reduced to a few categories or concepts. The researchers can only interpret the phenomena through the view of the participants and themselves. They use

open-ended questions to interview people for their opinions and seek to make sense of the interview records.

Qualitative research approach has many merits. Firstly, it can explore many variables that impact the social change. In addition, it could provide rich context for the study (Remenyi *et al.*, 1998). Thus, the qualitative approach is good at understanding social processes which are complex and have to be understood in their rich context. It can facilitate effectively the understanding of how and why questions in research. Besides, this approach gives the researchers much more flexibility, keeping them alive to changes which occur during the research process. On the downside, the qualitative approach makes data collection very time consuming. The data are also very difficult to be analysed. From the outset of the qualitative research, the researchers can not be sure if their research can bring out some patterns or not. Finally, the research results employing qualitative approach are often perceived by outsiders as less credible than those in the tradition of quantitative approach.

To sum up, qualitative research paradigm is more suitable for studying complex social phenomena which is deeply embedded in its context. It is particularly appropriate for exploring and studying the causality of social events (Van de Ven, 1992). As Miles and Huberman (1994, p.147) observes, ‘qualitative analysis’ is a ‘very powerful method for assessing causality’:

‘Qualitative analysis, with its close-up look, can identify mechanisms, going

beyond sheer association. It is unrelentingly local, and deals well with the complex network of events and processes in a situation. It can sort out the temporal dimension, showing clearly what preceded what, either through direct observation or retrospection. It is well equipped to cycle back and forth between variables and processes—showing that ‘stories’ are not capricious, but include underlying variables, and that variables are not disembodied, but have connections over time.’

The current research aimed to examine the dynamic process of growth of HR service SMEs in Guangzhou City, which is a complex multi-dimensional social phenomenon (Lowe and Henson, 2004). Growth of a firm can be driven internally and is affected by many internal and external factors. Such a complex social phenomenon can only be understood by taking into consideration many variables and the rich context of firm growth process. This warrants qualitative research approach. Thus, qualitative research paradigm was adopted for the current research.

4.1.2 Research strategy for the current research: case studies

Within the paradigm of qualitative research, there are two research strategies which appeared relevant to the current research and worthy of discussion: ethnography and case study. Each of these two research strategy has been employed to study complex unknown social phenomena, with clear strengths and weaknesses.

Ethnography is a qualitative research strategy used quite often by anthropologists and other social scientists. It employs systematic and extended observation of small social groups, focusing on everyday behaviour and the meanings underlying it in a wider social context. It has no structured research design and relies on detailed daily observations to uncover any patterns in the observed behaviours. As such, ethnography is often used by anthropologists to study the society of certain human groups, such as traditional tribal group or marginalised or secret social groups, such as gangsters, in modern cities. This research strategy, however, was not considered suitable for the current research because the research did not study the human behaviours but a live social phenomenon: growth process of firms. In such a process, activities leading to firm growth may not be readily observed; to take for instance, it is hard to observe how employees of a firm internalize their experience of success and failure and industrial knowledge since the process is made of intangible mental activities that defy any observation. Thus, ethnography method has not much value for the current research.

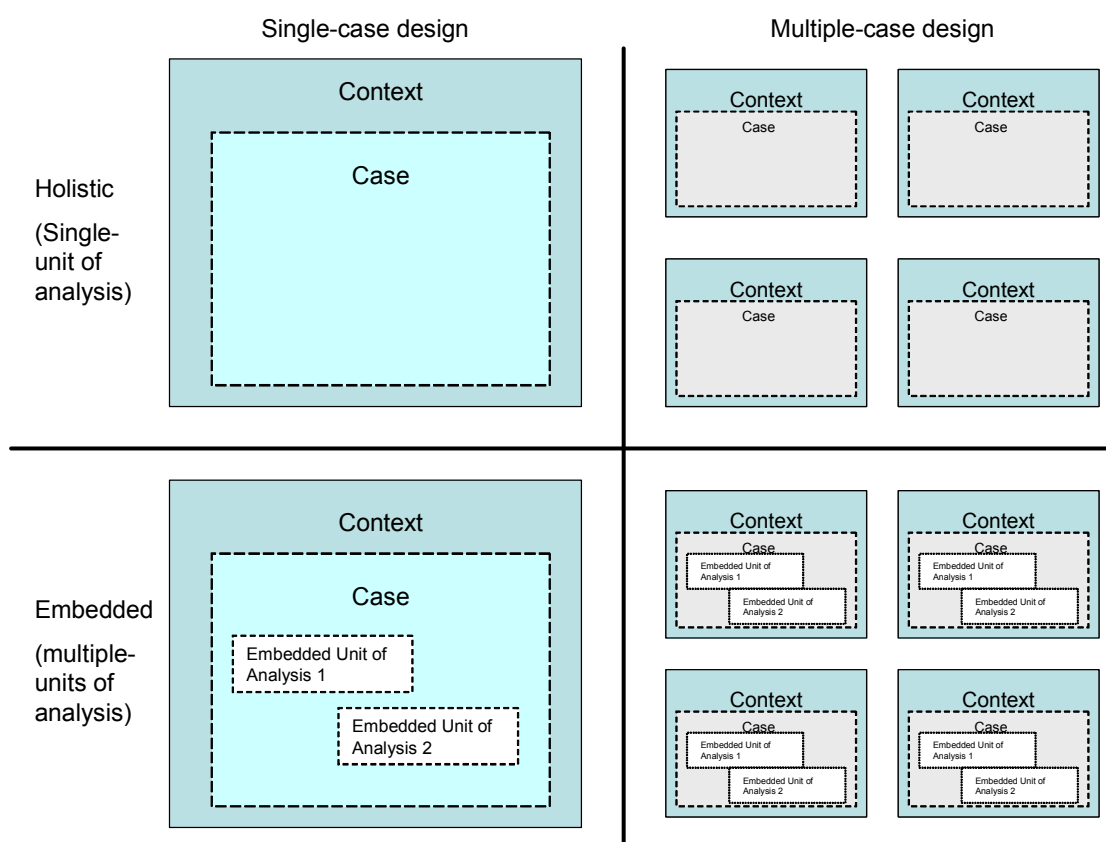
Case studies are, as Yin (2003, p.13) defines them, ‘an enquiry that investigates a contemporary event within its real-life context, especially when the boundaries between phenomenon and context are not clearly evident.’ Case study is very suitable for studying complex social phenomena embedded in their wider social contexts, particularly appropriate for use to answer research questions beginning with how and why (Lowe and Henson, 2004). This research strategy can use both quantitative methods and qualitative methods to collect and analyze data.

In comparison with ethnography and many other research strategies, case study as a research strategy fits much better with the current research, which sought to find out how SMEs in China could grow and why some succeeded and the other failed in their growth process. First of all, the current research examined the firm growth process, which is complex and multidimensional (Lowe and Henson, 2004), so as to understand how HR service SMEs in Guangzhou City grew. A case study strategy permitted the researcher to look carefully, by interview, by observation and by group discussion, at live growth processes of these SMEs, thus obtaining the first hand data. Secondly, in order to understand the force driving growth of these SMEs, the current research examined factors critical to firm growth stemming from various causes, which were situated in a complex social context. The boundaries between cause and context could not be clearly identified. A case study approach permitted a comprehensive exploration of various factors critical to the growth of these SMEs in their particular context. Moreover, the case study approach allowed the researcher to explore an issue in depth, particularly suitable for answering the current research questions of “how and why” some HR service SMEs in Guangzhou City were able to grow. Finally, as suggested by Lockett *et al.* (2007), empirical research in the case study tradition can lead to convincing management theory (argument). Thus, case study was finally chosen as the research strategy for the current empirical research for its fit with the current research questions (Lowe and Henson, 2004; Edmondson and McManus, 2007).

4.1.3 The current research design: multiple-case (embedded) design

With case study as the research strategy for the current research, there are several optional research designs to choose from. Below is the figure from Yin (2003, p.40) demonstrating four basic types of research designs for case studies, based on 2X2 matrix. As can be seen in the matrix, every case design includes contextual conditions for study. There are two basic types of research design: single case and multiple cases. Within each these basic designs, there can also be a unitary unit or multiple units of analysis. Therefore, there are four types of research designs for case studies: single case (holistic) designs, single case (embedded) designs, multiple-case (holistic) designs and multiple-case (embedded) design.

Figure 4.1.3: Basic types of designs for case studies by Yin (2003, p.40)



There are different rationales for using these different types of research designs for case studies, according to Yin (2003). The choice of the type of research design depends on the research questions. A single case study is analogous to a single experiment (Yin, 2003). Under five circumstances, it is appropriate to use single case study. The first one is when the single case represents the critical case in testing a well-formulated theory. As an example, Cuban missile crisis by Graham *et al.* (1971 in Yin, 2003) was used to test three theories on organization innovation. In another circumstances, when a single case represents an extreme case or a unique case, a single case design can be used; for instance, in clinical psychology, in which a specific injury or disorder may be so rare that a single case is worth documenting and analyzing (Yin, 2003). The third circumstance under which a single case study design is used is when a single case is the representative or typical case, for example, a typical project among many projects. The fourth circumstance warranting the use of a single case study is when a single case is a revelatory case. The example is ‘Street Corner Society’ by Whyte (1943 in Yin 2003). The book traces the sequence of interpersonal events over time, describes a subculture that had rarely been the topic of previous study, and discovers key phenomena—such as the career advancement of lower-income youths and their ability (or inability) to break neighbourhood ties. The last circumstance suitable for using a single case study design, according to Yin, is when a single case is the longitudinal case: studying the same single case at two or more points in time. In addition to these five rationales described above by Yin (2003) for using single case study, Robson (1993) also lists similar conditions for applying this research design. Unless these application circumstances as above are present, using a single case study as research design may

risk misrepresentation of the phenomenon (Yin, 2003). Hartley (1994) notes that with only a single case it may be difficult to draw out the unique from the common in organizations.

In comparison with the single case study as research design, multiple-case design has many advantages. The most important of all is that multiple-case design, like multiple experiments, allows replication. Two types of multiple-case replication can be done. The first one is literal replication, which means to repeat another case study to test the previous results, in predicting of similar results. The second type of replication is theoretical replication, in which results from previous case studies are put to test in a new case, in predicting contrasting results but for a predictable reason. The replication logic is different from the sampling logic. According to Robson (1993) and Yin (2003), the purpose of multiple-case design is not statistical generalization as with multiple surveys but analytic generalization. Multiple-case design is used for discovering patterns to confirm or refute the research proposition, not for strengthening the representation of a population. In multiple-case design, both literal and theoretical replications can provide compelling support for the arguments in the thesis. Indeed, evidences from multiple cases are often considered more compelling and analytic benefits more substantial (Yin, 2003). The reason is that the contexts of cases are different and if under these different circumstances, common conclusions from these cases can still be drawn, it would expand the external generalizability (transferability) of the research results. As a consequence, the overall study is regarded as being more robust (Herriott & Firestone, 1983 in Yin, 2003). The drawback of multiple-case design

is that it needs more resources and time. Moreover, the data analysis of multiple-case design can be much more complicated and the risk of making mistakes could be higher.

Within single case design or multiple-case design, it is possible to have more than one unit of analysis. When within each individual case, there is a subunit or subunits for analysis, this situation is called *embedded case study*. Otherwise, it is called *holistic case study*, that is, there are no subunits for further analysis. One problem with the holistic case study is that the whole case is taken as a unit of analysis at an abstract level, lacking any clear measures or data (Yin, 2003). Another problem is that the entire nature of the case study may shift, during the course of the study, without informing the researchers (Yin, 2003). In this case, all the data collected before would be irrelevant. Embedded case study also has its own problem, that is, the focus may be shifted to subunits from the case as a whole.

The design of multiple cases with embedded units of analysis was taken as research design for the current research, with firm growth as unit of analysis and growth events (growth of business line and growth scenario) as subunits of analysis. This choice is supported by several lines of argument. The reason for using multiple case designs was that the growth of HR service SMEs in Guangzhou City varied, given the different expansion strategies and societal environment. A single case design could not cover all these situations in the current search which was done for uncovering a generic growth process of HR service SMEs in the city. Multiple cases were needed for understanding generic growth process. The reason for choosing embedded case study is that the growth

of the firms was an accumulated firm expansions (growth of business lines or growth event such as geographic expansion) and each of these expansions had to be studied in order to understand how and why the firm grows. Hence, it was decided that the multiple-case (embedded) design suited best the current research.

4.2 Research objective, research questions and empirical questions

The management problem for the current research is to find solutions for improving the development of HR service SMEs in Guangzhou City, which are one type of important market intermediaries that help to drive economic development of the city. In order to identify proper solutions to this management problem, it is necessary to understand how these SMEs grew and why some of them were able to grow while others could not. Accordingly, three objectives were set up for the current research in the beginning, as were described in Chapter One:

- ◆ to gain a better understanding of how HR service SMEs in Guangzhou City grew by exploring their growth process and growth mechanism
- ◆ to identify causes of growth of these HR service SMEs and to develop a theory to better explain their growth which sheds light on ways to facilitate their growth
- ◆ to come up with recommendations to improve management practices to facilitate growth of these SMEs

To achieve these research objectives, first, literature was reviewed which found that

there was a lack of research on the process of firm growth and a lack of theory to explain growth of SMEs such as small service firms. Based on results from the literature review and research objectives, two research questions emerged, namely how and why these firms were able to grow; these two research questions were then broken down into several sub-questions. In addition, empirical research questions relevant to each of the sub research questions were also developed to guide the collection and analysis of empirical evidence, as shown in Table 4.2a. Based on the empirical research questions, questions for interviewing founders and managers of HR service SMEs in Guangzhou City were also developed, as exemplified in Table 4.2b.

Table 4.2a: Research questions and empirical questions

Central research questions: how and why were HR service SMEs in Guangzhou City able to grow?	
Sub research questions	Relevant empirical questions
Why did these SMEs need to grow?	<ul style="list-style-type: none"> ◆ What empirical evidence supports the view that there is a dialectical relation between market and firm? Why? ◆ What empirical evidence is there of imminent a threat to the firm's market positions? Why? ◆ What were other motives for growth of these firms? ◆ In case of multiple motives for expansions, what are the immediate needs? What is the ultimate? motive?
What is the process of firm growth?	<ul style="list-style-type: none"> ◆ What did these firms do which resulted in their growth? How did growth happen in the history of case firms? ◆ What activities led to incremental growth? ◆ What activities led to revolutionary growth? (creative destruction) ◆ What are the key activities important for the growth of firms? ◆ Why are they important to firm growth? How did they Contribute to firm growth?

Table 4.2a: Research questions and empirical questions (continued)

Sub research questions	Relevant empirical questions
What is the process of firm growth?	<ul style="list-style-type: none"> ◆ What is the logical sequence of these activities (steps?) ◆ What were the processes functioning (underlying) firm growth? ◆ How did these processes interact with each others in impacting firm growth? ◆ What roles did clients, competitors and other external factors Play in growth of the firm? ◆ How did efforts to overcome market challenges impact on growth?
Why could these firms grow? What was the generative mechanism of growth of these firms?	<ul style="list-style-type: none"> ◆ What seems to be the causes of firm growth? Why? ◆ Among these causes, which was the leading cause that Generates growth activities? Why? ◆ How did knowledge increase contribute to growth?
What promoted and at the same time constrained growth of these firms?	<ul style="list-style-type: none"> ◆ Did increase in knowledge promote and at the same time limit growth of these firms? Why? ◆ Were expansions of firms slowed down due to insufficient management services? Why? ◆ What else seemed to promote and at the same time limit growth of these firms?
Why were some of these firms able to grow faster than others?	<ul style="list-style-type: none"> ◆ What determined rate of growth of these firms ◆ Why were some of these firms able to grow faster than others?
Why were some of these firms able to grow in a sustainable manner?	<ul style="list-style-type: none"> ◆ What different activities did firms which continuously grow go through, in comparison with those which failed in their growth? ◆ What was the causal mechanism responsible for continuous firm growth?

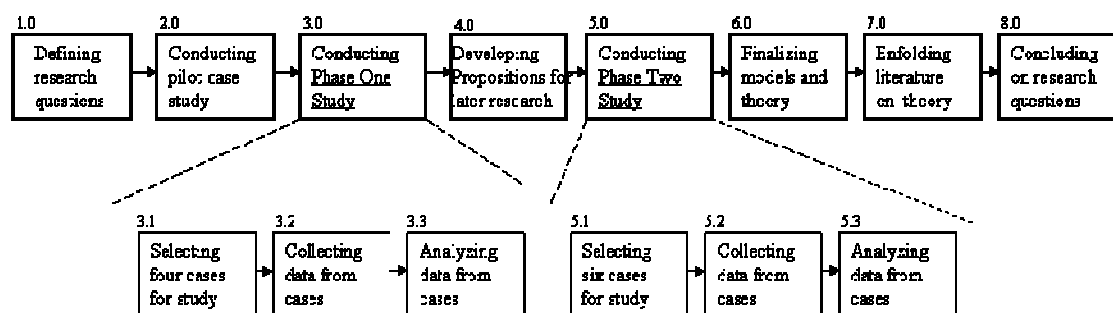
Table 4.2b: Sample questions for interview with owners and managers of HR service SMEs

Interview focus	Questions for interviews
History of the firm	<ul style="list-style-type: none"> ◆ When was the firm established? ◆ Please provide some current information of your firm: services, employee number and annual what? ◆ What is the timeline of your firm? ◆ Please provide data on growth of your firm: growth of services, growth of workforce and growth of annual revenue ◆ What were the major milestones in the history of the firm? ◆ Please describe each of these major miles tone: cause, process (activities), impact on growth? ◆ What lessons did you learn from each growth event? How did you use these lessons?
Growth of the firm	<ul style="list-style-type: none"> ◆ What is your concept of firm growth? How did you measure it? ◆ Why did your firm need to grow? What were the motives behind each growth event? ◆ What were the major challenges that your firm needed to tackle? How did it impact growth of your firm? ◆ What are the important activities that you believe have contributed to growth of your firm? Why? (product or process innovation, development of a client ase, marketing, business expansions, responses to competition, internal learning, employee recruitment, development and retention, organizational change and management system change) ◆ What important actions you took to achieve planned growth? How did they lead to firm growth? ◆ What activities contributed to unplanned growth? Why? ◆ What do you think are the major causes for growth of your firm over the past five years? ◆ What role did knowledge play in growth of your firm? What limits the rate of growth of your firm?

4.3 Research process

The current research was carried out aiming to develop from the empirical data a general argument (theory) on how and why HR service SMEs in Guangzhou City were able to grow. Research process of the current study basically follows research steps of case study methodology proposed by Yin (1994) and Eisenhardt (1989), as well as Carlile and Christensen (2005). The following figure shows the research process of the current research.

Figure 4.3a: Research process



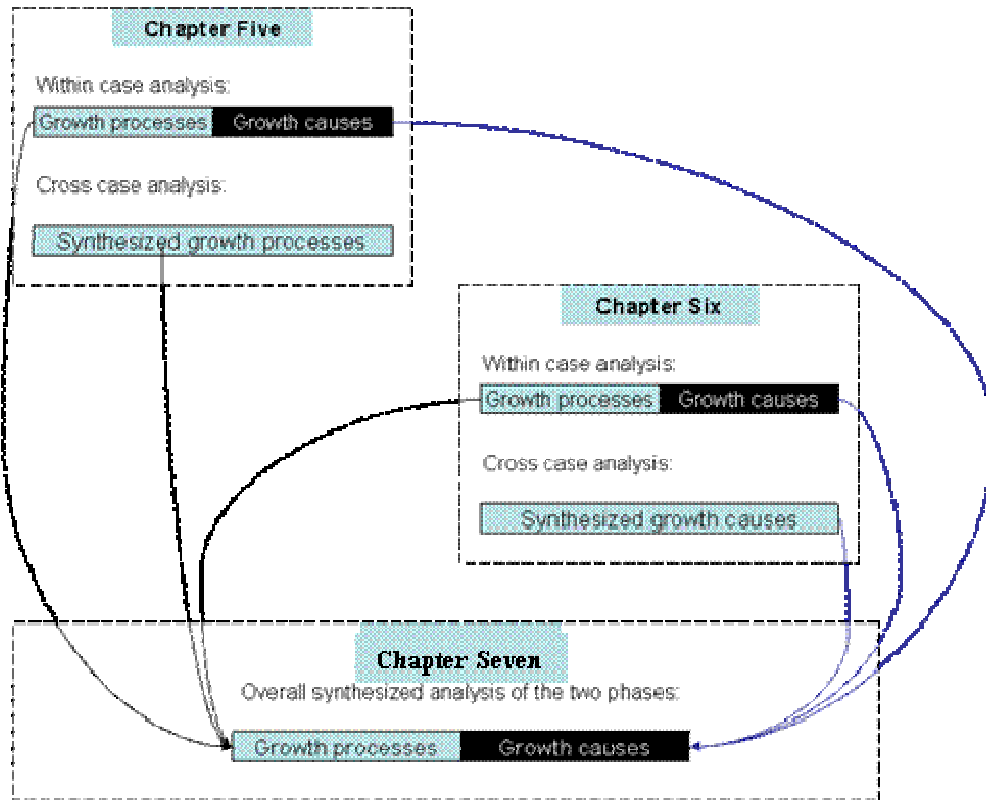
Research questions gave a well defined focus for qualitative research. Eisenhardt (1989, p.536) believes that ‘the rationale for defining the research question is the same as it is in hypothesis-testing research’. Without research questions, researchers can be easily overwhelmed by data. To Eisenhardt (1989), instead of a preliminary theory, research questions should be used in qualitative research which aims to discover a theory. Therefore, the current research started with research questions on how and why some HR service SMEs in Guangzhou City grew, with the support of the theory of Edith

Penrose (1959). The research, after a short pilot study to test the data collection plan and methods, was completed in two phases using case study approach.

The reason why the current empirical research was divided into two phases was that it was a procedural research into processes of firm growth which tried to develop from empirical data a new growth theory of causality following the 'grounded theory' logic (Glaser and Strauss, 1967) and as in other procedural research projects, the researcher had to find activities which led to firm growth before he could identify among these activities important drivers which generated growth. From these important growth drivers and the logic how they drove growth, it was then possible to discover causes of firm growth. With this in mind, the researcher divided the current empirical study into two phases: Phase One Study and Phase Two Study. In two phases of study, data about the growth processes and drivers of an individual firm were collected and analysed holistically during within-case analysis which led to the understanding of how the individual case firm grew and why it was able to grow. Based on the outcome from the within-case analysis of the growth of each individual case firm, cross-case analysis was carried out to identify growth processes and growth causes. However, the cross-case analysis in each of the two phases of study had different focus. Cross-case analysis of Phase One study focused on identifying how growth of these individual firms happened; it analysed growth activities and processes that led to firm growth (processes-focused). On the other hand, cross-case analysis of Phase Two study focused on identifying causes that led to growth (causes-focused). The following figure depicts the relationship of these research activities which were sequentially reported in Chapter Five, Chapter

Six and Chapter Seven of this dissertation:

Figure 4.3b: Two phases of empirical study in the current research



In Phase One Study, four HR service firms were chosen as cases for research to answer the question on how growth happened in HR service SMEs in Guangzhou City. Semi-structural interviews were conducted on the history of the firms, key events and their impacts on growth of the firms, as well as reflections of firm management on major actions accountable for the growth history of their firms. Data collected from firm archives and other sources were used to triangulate with the in-depth interviews. Raw data were finally processed and analyzed according to data analysis methods adopted for management research which is explained in the next section of this chapter. In the end of the data analysis, a discussion was conducted on the findings. In the discussion,

first of all, findings from data analysis were discussed, which led to the recognition that the research questions were only partially answered by the results of this phase of study; it was concluded due to the interactive nature of the growth process of HR service SMEs, dialectic theory could offer a better perspective for the second phase of research. Propositions in dialectic perspective were formulated to form the emerged analytical framework to guide the second phase of study to uncover causes of firm growth.

Guided by preliminary arguments (propositions) developed from Phase One Study, the second phase of the current research (Phase Two Study) was conducted on the growth of more HR service SMEs, aiming to identify causes of the growth of HR service SMEs studied. In term of empirical work, it is similar to that of phase one study. Six cases were chosen according to pre-set criteria and data were collected through in-depth interviews, observations and archival research. Within-case and cross-case data analysis were also conducted to identify patterns relevant to the research questions (propositions).

The last part of the research process, which was reported in Chapter Seven, was to discuss overall research findings from the two phases of the study and based on the results of the study, to draw conclusions on the research questions. The discussion was conducted to interrogate and evaluate the findings against extant literature, according to advice of Eisenhardt (1989): what in literature are similar to the findings and arguments thereof and what are not and why. However, the current research went beyond merely testing propositions in the growth literature; it uncovered new facts which have

provided a sound foundation for theorizing the growth of the case firms. Thus, after the discussion of the finding against the literature, a model was made in the tradition of systems dynamicsto show processes and dynamics of growth of HR service SMEs studied, building on theoretical and empirical findings; and a new process theory was developed in the perspective of dialectics to pinpoint the causes of the growth of these firms; together, both of them seem to better explain growth of the HR service SMEs studied. The emergent models and theory were then tested on evidence from the current study, which enhanced their internal validity. Based on this discussion of emergent models and theory, final conclusions were made on the research questions, that is, how and why these service firms were able to grow; thereon, the total research process ended.

4.4 Research methods for the current research

4.4.1 Conducting pilot case study to improve case study tools and to accumulate field experience

In order to test the interview questions for final case study and to accumulate some experience for field work, prior to any formal case study, the researcher selected four SMEs in Guangzhou City for pilot case study. The firms were selected for case study due to advantageous access, convenience and geographic proximity, with no regard to industry. Most import of all, they are selected because the interviewees at these sites were old personal contacts of the researcher and they were very congenial to the idea

that the researcher was at an early stage of his research. They were patient with the interviews and allowed free access for the researcher to their company documents.

Pilot studies permitted the researcher to identify problems with data collection plan which was intended for use in the formal case study. For example, after the pilot case study, it was decided that the current research should focus on firms in only one sector; otherwise, data were too scattered and the sector factor could not be controlled for an in-depth understanding of the internal mechanism of firm growth. In retrospect, the pilot case study provided sufficient information for the researcher to change interview questions and the way the field inquiry was conducted. For instance, some intellectual questions were taken out of the field interview guide while questions on major events in the history of case firms were added to the list to draw out what actually happened. Finally, pilot case study provided experience of conducting field work for the researcher and it built up confidence of the researcher in completing similar empirical research. After the study of each case, the researcher wrote memoranda recording experiences, lesson learned and changes done to the field procedure. In short, early in the current research, a pilot case study was conducted which prepared the researcher very well for formal case studies that were conducted on HR service SMEs in Guangzhou City, focusing on their growth process and causal mechanism.

4.4.2 Selecting HR service firms for case study research

From HR service firms in Guangzhou City, cases were selected for study using literal and theoretical sampling (Glaser and Strauss,1967). In the context of social research,

Theoretical sampling is one of the methods of qualitative research which is analogous to but different from sampling in quantitative research. The goal of theoretical sampling was not the same as that of the *probabilistic sampling* (Eisenhardt, 1989). It was not to have representative capture of all possible variations, but to gain a deeper understanding of analyzed cases and to facilitate the development of analytic frame and concepts used in the research. Thus, the current research took the following as case selection criteria:

- Cases chosen represented the types of business run by the population of HR service SMEs in Guangzhou City;
- Cases chosen represented firms with full life cycle of growth: from incorporation, expansion, maturity to closure;
- Cases chosen represented firms with different mode of expansions such as product penetration, product line expansion and geographical expansion, which allowed analysis of different growth activities and causes;
- Cases chosen represented firms which had similar business lines, which permitted comparison and synthesis (literal sampling—literal replication);
- Cases represented firms which had successful growth history and those which had reversed growth (stagnation and bankruptcy); this allowed data comparison and contrast (theoretical sampling—theoretical replication);
- Cases chosen were in compliance with the minimum cost principle.

In accordance with the above criteria for selecting sample cases for study, ten HR service firms in the HR service sector of Guangzhou City were chosen for study, with

four cases for phase one study aiming to uncover growth process and another batch of six cases for phase two empirical study to understand why some HR service firms were able to grow while others could not. These cases provided sufficient data to generate answers for the central research question and its sub-questions. It should be noted that the employee size of these case firms, which ranged from one to more than three hundred (big number of employees for some firms due to their outsource HR services), was not a particular concern for the researcher and therefore, not becoming one of the criteria for selecting cases to study, since the current researcher was only interested in activities that formed growth processes. In this regards, these case firms of various sizes had their similarity in that they had to go through similar processes of growth, experiencing similar activities and environment which shaped their growth trajectory.

4.4.3 Data collection method and data analysis methods

4.4.3.1 Sources of data

Yin (2003, p.86) suggests six sources of data available for researchers in case studies, as demonstrated in the table below. As can be seen in the table, each of the sources has its strength and weakness. For the current study, there were several major sources of data: information from informants in the case firm, information from the archives, information from operation activities of case firms and information from actors external to the case firms.

Table 3.4.3.1: Sources of data for case study (Yin, 2003, p.86)

Source of Evidence	Strengths	Weaknesses
Documentation	<ul style="list-style-type: none"> • stable—can be reviewed repeatedly • unobtrusive—not created as a result of the case study • exact—contains exact names, references and details of an event • broad coverage—long span of time, many events and many settings 	<ul style="list-style-type: none"> • retrievability—can be low • biased selectivity, if collection is incomplete • reporting bias—reflects (unknown) bias of author • access—may be deliberately blocked
Archival Records	<ul style="list-style-type: none"> • <i>[Same as above for documentation]</i> • precise and quantitative 	<ul style="list-style-type: none"> • <i>[Same as above for documentation]</i> • accessibility due to privacy reasons
Interviews	<ul style="list-style-type: none"> • targeted—focuses directly on case study topic • insightful—provides perceived causal inferences 	<ul style="list-style-type: none"> • bias due to poorly constructed questions • response bias
Direct Observation	<ul style="list-style-type: none"> • reality—covers events in real time • contextual—covers context of event 	<ul style="list-style-type: none"> • time consuming • selectivity—unless broad coverage • reflexivity—event may proceed differently because of it being observed • cost—hours needed by human observers
Participant Observation	<ul style="list-style-type: none"> • <i>[Same as above for direct observations]</i> • insightful into interpersonal behaviour and motives 	<ul style="list-style-type: none"> • <i>[Same as above for direct observations]</i> • bias due to investigator’s manipulation of events
Physical Artefacts	<ul style="list-style-type: none"> • insightful into cultural features • insightful into technical operations 	<ul style="list-style-type: none"> • selectivity • availability

4.4.3.2 Methods used to collect empirical data

In term of methods for collecting data, Yin (2003) gives several suggestions: data can be collected from interviews, documentary analysis, archival analysis, direct observation, participant observation and the physical artefact analysis. These data collection methods are very suitable for case study (Yin, 2003) and thus, they were deemed appropriate for

the current research which employed a case study as research strategy. Among these methods, semi-structured interview is frequently chosen as the primary means for data collection in qualitative research. Thus, semi-structured interview was also chosen for the current research. The paragraphs below explain why this choice was most suitable for the current research and how such in-depth interviews were conducted.

The method of collecting data by semi-structured interview was considered very suitable for the current research since the research questions on how and why HR service SMEs in Guangzhou City were able to grow are exploratory in nature, concerning process, sources and determinants of growth of these SMEs. In this situation, 'structured interview' consisting of pre-established, close-ended questions do not allow exploratory investigation and can not produce adequate assessment of respondent reactions. Thus, this type of interview was not considered suitable for the current research. On the other hand, although unstructured interviews can be used for exploratory investigation, they may lose focus and waste much valuable time. It, too, was not considered appropriate for the current proposed study which has limited time and resources. Semi-structured interviews were seen as more suitable for collecting data for the current study, in comparison with other types of interviews. It allowed the researcher to adapt to the respondent's needs and to have greater scope for probing, while giving structure to the interview by the virtue of an interview guide composed of key interview questions. For all these reasons, semi-structured interview was chosen as major data collection method for the current research.

Most of the interviews in this study were conducted in person, with a few over phone.

Usually, each of interviews lasted about one hour or so. Over eighty per cent of the interviews were recorded in tapes. Some interviews were recorded by notes since the interviewees were not willing to allow their talks to be taped. These recordings were in Chinese but were then transcribed into English by the researcher who is a fluent bilingual speaker and writer. They later provided evidences for data analysis for this exploratory study. The following table gives more information on the interviews:

Table 4.4.3.2: Information on the interviews

Firm (Founding year)	Business scope	No. of employees	Position of informants	Number of People	Number of Interviews	Time
<u>Firm A</u> (1996)	recruitment service, executive search, training service and consulting service	75(as of 2007)	Partner (founder)	1	3	About 1 hour
			GM	1	3	About 1 hour
			Training manager	1	2	About 1 hour
			Trainers	1	3	About 1 hour
<u>Firm B</u> (1996)	executive search, training service and consulting service	29 (as of 2007)	Partner (founder)	1	4	About 1 hour
			Managers	1	3	About 1 hour
			Consultants	1	3	About 1 hour
<u>Firm C</u> (2000)	mainly training service, with some consulting services	30 (as of 2007)	<u>Partner (founder)</u>	1	3	About 1 hour
			<u>Managers</u>	1	3	About 1 hour
			<u>Consultants</u>	1	2	
<u>Firm D</u> (2005)	Executive service	12 (as of 2007)	<u>Partner (founder)</u>	1	4	About 1 hour
			<u>Consultants</u>	1	5	About 1 hour
			<u>Consultants</u>	1	3	About 1 hour

Table 4.4.3.2: Information on the interviews (continued)

Firm (Founding year)	Business scope	No. of employees	Position of informants	Number of People	Number of Interviews	Time
<u>Firm E</u> (1992)	recruitment service (both job fair business and online recruitment business), executive search, training service and labour outsourcing	155 (as of 2007)	Partner(foun der)	1	3	About 1 hour
			Training manager	1	2	About 1 hour
			Managers	1	2	About 1 hour
			Consultants	1	3	About 1 hour
<u>Firm F</u> (1999)	Executive search service	76 (as of 2007)	Partner (founder)	1	3	About 1 hour
			Managers	1	2	
			Consultant	1	2	
<u>Firm G</u> (1993)	mainly temporary personnel service and some executive search service	356 (as of 2007)	Partner (founder)	1	3	About 1 hour
			Managers	1	2	About 1 hour
			Consultants	1	3	About 1 hour
<u>Firm H</u> (1995)	Mainly executive search service and some training	53 (as of 2007)	Partner (founder)	1	3	About 1 hour
			Director	1	3	About 1 hour
			Consultants	1	2	About 1 hour
<u>Firm I</u> (1999)	Consulting service, training service, executive search	1(as of 2007)	<u>Partner</u> (founder)	1	3	About 1 hour
			<u>Consultants</u>	1	3	About 1 hour
<u>Firm J</u> (1999)	Consulting service, training service, executive search service	4 (as of 2007)	<u>Partner</u> (founder)	1	3	About 1 hour
			<u>Consultants</u>	1	2	About 1 hour

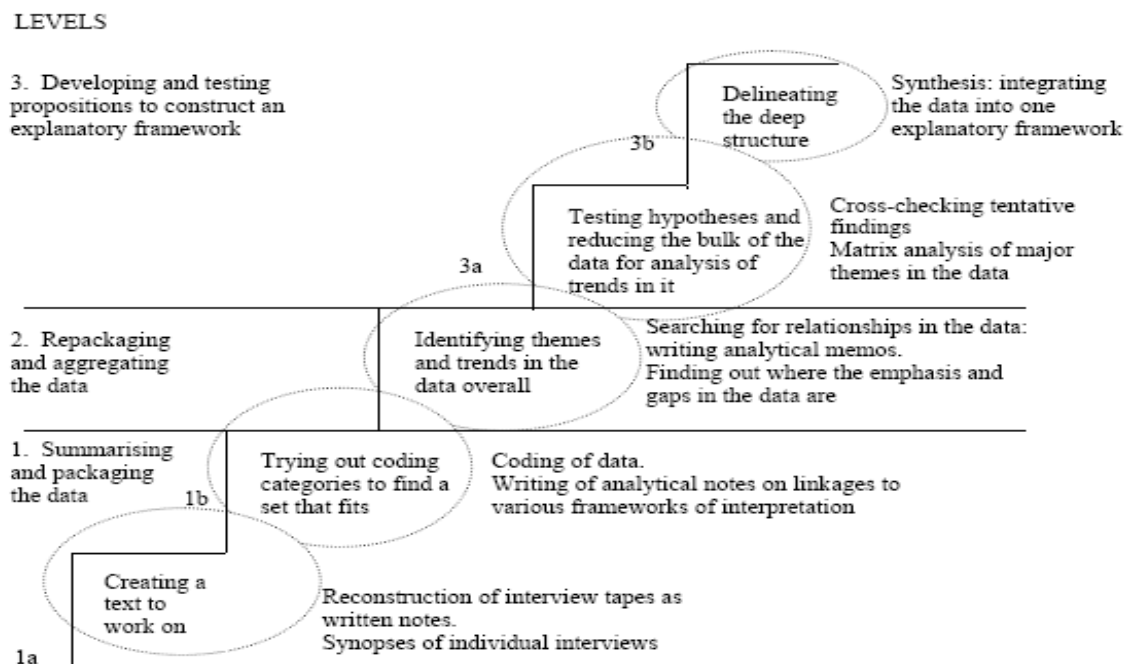
In addition to semi-structured interviews conducted with informants inside the case firms, other data collection supplementary activities were performed. Direct observation was often made by the researcher during his visit to a case firm; observations were made on the case firm's location, the physical artefacts in its offices such as expansion project road maps. Furthermore, archival documents were analysed to gain insights into growth history of the case firms. Finally, information from government offices and clients was also collected. These types of information were used to triangulate the internal information on the growth history of the case firms.

4.4.3.3 Methods for analyzing data

4.4.3.3.1 Logical flow of qualitative data analysis

Qualitative data analysis was applied to the data from the current empirical research as advised by Miles and Huberman (1994), shown in the figure below:

Figure 4.4.3.3.1: The ladder of analytical abstraction (Miles and Huberman, 1994, p.92)

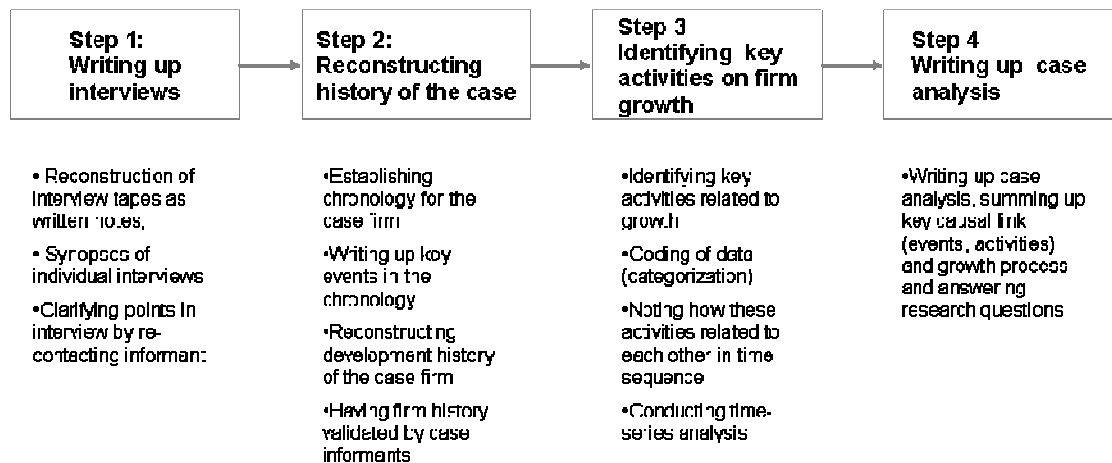


In the framework of Miles and Huberman (1994), during qualitative data analysis, the current researcher took eleven specific actions as proposed by (Main, 1999): 1. counting; 2. noting patterns; 3. seeing plausibility; 4. clustering; 5. noting relation between variables; 6. building a logical chain of evidence; 7. making conceptual/theoretical coherence; 8. making contrast and comparison; 9. using extreme examples and outliers; 10. checking for negative evidences and 11. triangulation in its various guise. In this way, the current research treated qualitative data to generate meaning, relations and patterns, in both within-case data analysis and cross-case data analysis.

4.4.3.3.2 Within-case data analysis process

The analysis of data on the growth of each individual case firm was carried out basically following the analysis process as proposed by Carney(1990 in Miles and Huberman, 1994), which is explained in “Figure 4. 4.3.3.2a”. As is depicted in the figure, the data analysis process has four steps, beginning with creation of a text to work on. In this very first step, the main task was transcribing interview tapes and writing up summary of individual interviews; this gave order to the otherwise disarrayed interview notes and field notes. In addition, points unclear in these notes were clarified by re-contacting the interviewees or informants. This took up a large portion of time during the data processing and analysing stage. The result was some interview texts available for reconstructing development history of the case firm.

Figure 4.4.3.3.2a: Workflow of within-case data process and analysis



The second step was reconstructing the history of the case firm. It was done according to the chronological order of development for the case firm. Firstly, chronology of the case firm was reconstructed, as shown in Figure 4.4.3.3.2b below. The chronology of the firm was used as a reference for writing up case reports. Where there were data available, a chart of revenue and employment development over time was also constructed (as exemplified by Chart 4.4.3.3.2). These actions created a skeleton of history of the case firm. Then, based on the interview summary, key growth events in the history of the firm were added to the case report, as meat added to the skeleton; the description of key growth events included external environment and its opportunities and threat, main actions taken by the firms (related to marketing, sales, operations and organizations) and the rationales behind and results from these actions. Finally, a narrative history of the case firm was created and confirmed by informants in the firm. The history of the case firm offered material basis for data analysis.

Figure 4.4.3.3.2b: Chronology of Firm A

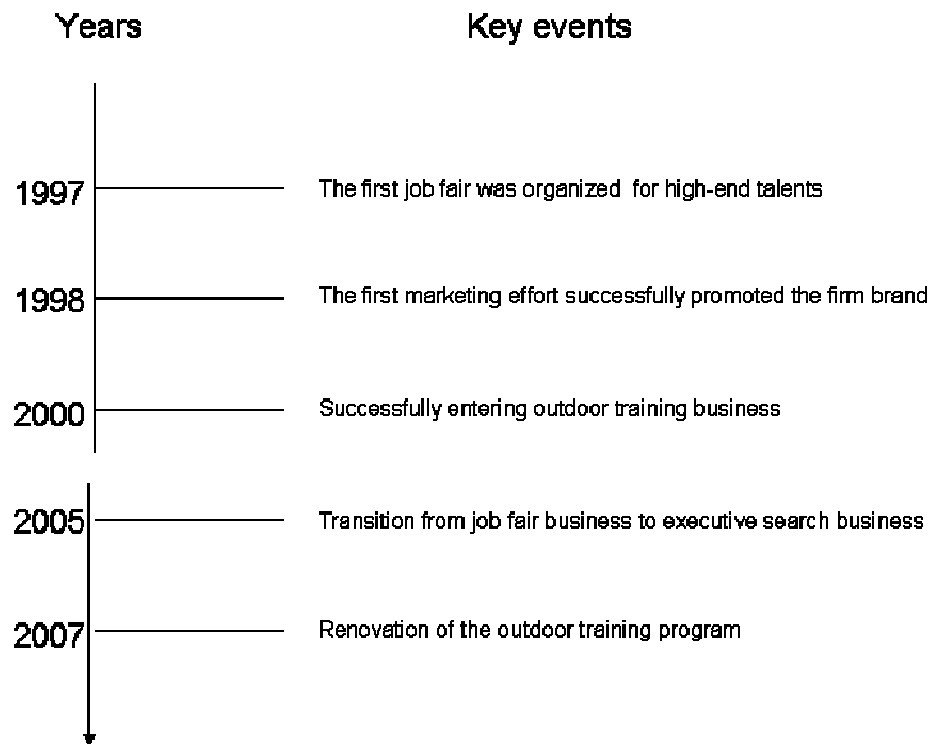
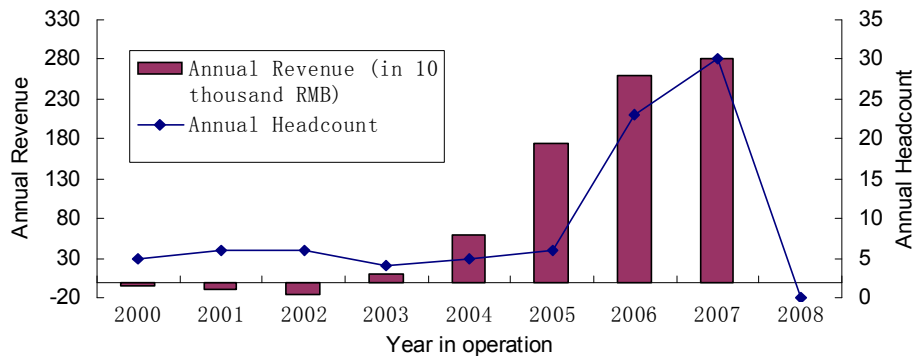


Chart 4.4.3.3.2: Revenue and employment growth of Firm C (a copy of Chart 5.2.3)



Notes: 10 thousand RMB = USD1474.93

Step three began the process of data analysis for the case firm. Using the history of the case firm and interview notes, key activities related business expansion and capability development of case firm were identified. Later these activities were categorized into

themes in response to the research questions (propositions): market sensing, brand development, client relation development, capability development, business development and business delivery. Primarily based on the sequence of these events (activities) and logic of firm growth as suggested by the literature, relationships among these variables, as well as the relationship between these variables and firm growth were constructed, which was followed by time-series analysis to portray the growth processes of the firms. Growth processes show succinctly how and why growth of the case firm happened. In this way, the case analysis answered the research questions. More importantly, it became materials for cross-case analysis

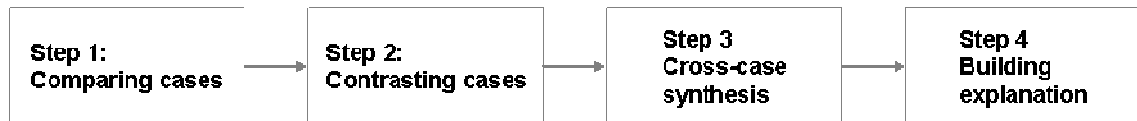
Finally, in step four, a case report was written up for each of the case firms. The case report consists of an overview of the case firm, the growth story covering major growth events and an explanatory analysis on how and why the case firm grew, as well as the way it did so (growth, stagnation, or decline). Apart from explaining growth of the individual case firms, the case reports formed the material basis for cross-analysis that was to come in the process of data analysis

4.4.3.3.3 Cross-case data analysis

In each of the two empirical research phases, after within-case analysis was done, evidence from these individual cases were compared and contrasted to identify major patterns related to answers to the research questions (e.g. how and why some HR service SMEs in Guangzhou were able to grow). In cross-case data analysis, a case firm

as a whole, not its summary or analysis, were compared and contrasted, as if they were fresh ones, based on themes leading to answer to the research questions. Below is a figure showing process of cross-case data analysis:

Figure 4.4.3.3a: Cross-case data analysis



As shown the above figure, in step one, one case of a specific type of business or businesses was compared against another case with the similar business genre, on the evidences answering the research questions. In accordance with advice from Yin (1994), initial answers to research questions (themes) developed from the first comparison was then matched against evidence from another case firm (literal replication). This action was repeated from all relevant units of analysis until patterns on the research question appeared and confirmed. The comparison was made, for example, to identify patterns on motives for firm growth, as shown in Table 4.4.3.3a which is reproduction of Table 6.3.2.

Table 4.4.3.3.3a: Comparison on motives for HR service SMEs to grow

Firms	Growth attempts and motivation
<u>Firm E</u>	Expanding into job fair business to avoid competition in job agency business; Expanding into labour outsourcing as a diversification attempt to survive the crisis brought about by online recruitment technology
<u>Firm F</u>	Geographical expansion into Shanghai City, in part to satisfy needs of clients who had expanded into Shanghai Market and in part to establish new source of candidates to beat competition
Firm H	Expanded fast from 2004 onwards by diversification into recruitment of different job categories in part to capture fast market growth and in part to beat competition
<u>Firm G</u>	Expanded in 2005 into higher position in the value ladder of temporary personnel service due to the market condition change (labour law change) which imposed extra heavy cost on enterprises
<u>Firm I</u>	Fighting hard to grow to earn money for survival
<u>Firm J</u>	Growing to get extra money for a better living

In the second step, if necessary, findings from two cases of different nature (firms which grew and those not grew, for instances) on research questions (themes) were contrasted (theoretical replication). Result from contrasted cases on the same issues was used to confirm or disclaim initial answer or proposition to research questions, making such findings much more robust. This step can be illustrated in the table below, Table 4.4.3.3.3b, which is a reproduction of Table 6.3.7 intending to identify pattern on relations between employee development and firm growth.

In step three, synthesis was developed from comparison or contrast to identify potential findings on (answers to) research questions. First of all, the results of previous

comparison or contrast were described. Then, findings from these individual cases were synthesized, which produced aggregating findings on themes answering the research questions.

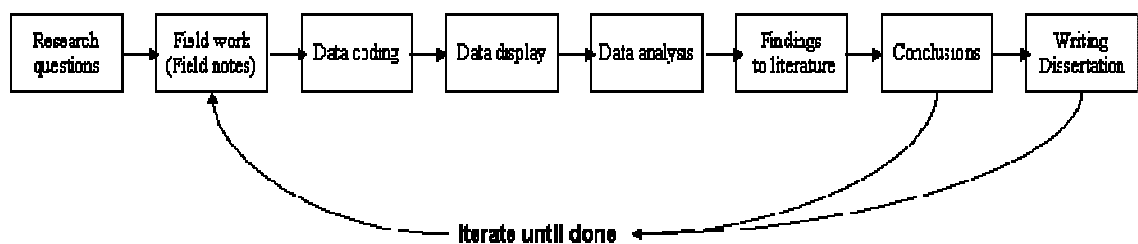
Table 4.4.3.3b: Contrasting HR service SMEs which grew continuously and those which could not

Behaviour of HR service SMEs which grew continuous: (<u>Firm E</u> , <u>Firm F</u> , <u>Firm G</u> and <u>Firm H</u>)	Behaviour of HR service SMEs which suffered from their growth—stagnation or decline: (<u>Firm I</u> and <u>Firm J</u>)
<p>The owner of <u>Firm E</u> was daring and innovative; the firm closely followed market development (when he did not, growth of his firm declined) and developed innovative business model such as licensed employment agency network; it promoted its brand and service aggressive through newspapers and HR forums; it interactive intensively to develop new solutions such as labour outsourcing and actively development of its workforce.</p> <p><u>Firm F</u> paid much attention to market developed and foresaw the burst of high tech bubble and successfully diversified to avoid this; it trained its workforce and using existing client relations, it expanded cross the country to satisfy the clients who expanded nationwide. The firm also actively promoting its brand by subtle means such as leveraging client brand such as Coca-cola in its sales of services to new client</p> <p><u>Firm G</u> quickly adapted to new market condition when labour law change and developed new business model and revamped its brand to enter high end service market in which it provided combined service of consulting and servicing.</p>	<p><u>Firm I</u> did few brand development except for sales call; client relation development mostly depended on personal contacts; the firm kept client contact to its owner; the firm had few internal employee development activities (no formal training); it had shallow interaction with clients and learned very little from them; the firm failed on several assignments (over promised service but failed to overcome market challenges, which led to dissatisfaction of clients)</p> <p>The owner of <u>Firm J</u> had little ambition to grow; he spent insufficient time to run his firms, in particular, to meet his clients. No formal market studies; client relation development depended on personal contacts; the firm had no formal training for its employees</p>

The last step was to develop explanation from the evidences from cross-case data analysis. Explanatory statement, which reflected some theoretical propositions in literature, was built to answer the research question. These explanatory statements were materials for discussion, which turned out a general argument (a process theory) to explain firm growth of these HR service SMEs Guangzhou City; this general argument is the thesis of this dissertation.

In summary, the current empirical research is an iterative journey between theory and data. It started from research questions which came from the literature review on growth of firms. This stage was then followed by data collection (in the form of field notes). From field notes, data were coded by research questions (propositions) for better data display which showed patterns among data. From data display, analysis was performed to identify themes (findings). These findings were then compared with views in the literature for confirmation and disconfirmation. Finally, conclusions were made on the research questions. However, during the research process, if data did not match theory, the research cycle was repeated. The figure below, which was adapted from Miles and Huberman (1994), shows the iterating journey of the current research:

Figure 4.4.3.3b: Iterating journey of the current research



4.5 Measures to ensure research reliability of and validity

Quality of any empirical social research can be judged, according to Yin (1994), by results of four tests: trustworthiness, credibility, confirmability and data dependability. Success of all these four tests depends very much on reliability of research procedures and methods, and validity of the findings. Reliability is the consistency of research findings--the degree to which research procedures and methods can have the same results from repeated trials. Validity is the extent to which findings from a research reflect the construct or relationship the research is attempting to uncover. Without reliable research methods, the credibility of research findings is questionable; and without validity of the findings to what researchers attempt to find, the research findings are meaningless. Therefore, measures were taken to strengthen reliability and validity of the current research, which is explained in the following paragraphs.

4.5.1 Measures taken to strengthen reliability of the current research

Several measures were taken to improve reliability of the current research. Basically, the research has followed accepted practices of case study, as advocated by Yin (1994) and other established scholars in this field such as Eisenhardt (1989). Case study protocol, which is attached in **Appendix I**, was developed and used throughout the project. In addition, the project used transparent and systematic research procedures, case selection criteria, data collection and data analysis methods; all these were kept in good record. Transparent and systematic methods in record for the current study permit dependability

audit, and in theory, allow repetition of the case study in similar context.

In addition to employment of accepted case study research methods, several actions were also taken during data collection to ensure reliability of the research findings. First, the interview guides, which are attached in **Appendix II**, were tested in pilot study before they were used in the empirical studies. Pilot case study allowed the research to identify and address some problems with the interview guide, for instance, questions that were too abstract to be understood by interviewees. Then, cases were carefully selected based on several critical criteria so that quality access to the case firm for study has been ensured. During the interview, data collection methods were changed in some occasions to get the most reliable data from the interviewees. For instance, group interview with low level managers was once employed because these managers were too shy to voice their opinions when facing the researcher alone. All interviews were recorded in audio whenever possible, or otherwise in notebooks. Moreover, multiple sources of data were used for each case firm so that data collected could be triangulated.

During data processing phase, care was also taken to improve reliability. Interview recordings were transcribed for easy inspection and use. Translation of raw data from Chinese into English was carefully done solely by the researcher who has nearly ten years' bilingual tertiary education in Chinese and English. More importantly, a database, both electronic and paper-based, was developed for each case which contain interview record, field notes, narrative of the case firm as well as other materials on the case firm, The database for each case offers an objective repository of raw data for research and

allows dependability audit; the reader of the case study can follow the derivation of any evidence, ranging from initial research questions to ultimate case study conclusions (Yin, 1984).

Data analysis phase has also seen actions taken by the researcher to ensure reliability of the current research. The data from field study were coded according to thematic responses to research questions; and they were analysed by the researcher in person and processed using appropriate and reliable conceptualization gained from literature, such as qualitative data analysis procedures from Miles and Huberman (1994). Both measures have ensured consistency and repeatability of the process. Most important of all, data were coded and analysed based on case narrative composed out of interview notes and other sources of information. Case narratives are objective data depositories which permit dependability audit and repeating analysis by other independent researchers.

All measures mentioned in the above four paragraphs are part of the actions taken to ensure data dependability and reliability of the current research. Many other actions were taken to improve reliability of the current research, which has led to reliable research findings. Reliable research findings from data collection and data analysis have strengthened the confidence in the credibility of the current research findings and thus, contributing to the reliability/strength of the current dissertation.

4.5.2 Measures taken to ensure research validity

Validity of research is critical for establishing trustworthiness of the research. General meaning of research validity can be found in the Oxford English dictionary: a valid assertion of research should be well founded and applicable, sound and to the point, against which no objection can fairly be brought. Other meanings of validity are less unified among scholars. Remenyi *et al.* (1998) believe that validity concerns whether the researcher has gained full access to knowledge and meanings of respondents; Gummesson (1991) refers to validity as representing a ‘good fit’ between theory and reality. In the current research, actions were also taken to ensure external validity, internal validity, construct (descriptive) validity and interpretative validity, as described below.

External validity in quantitative research refers to research generalizability, the degree to which the result of a study can be generalized to a wide field of knowledge. However, many qualitative studies are not designed to be generalized and thus, in qualitative research, the term ‘transferability’ is preferred over the term ‘external validity’. The current research was designed to investigate how and why some HR service SMEs in Guangzhou were able to grow, without the intention to transfer research results to a broader population. Nevertheless, three major actions were taken in the current research to increase its external transferability. Literature review in Chapter Two and discussion of the findings in Chapter Seven connect the current research findings to existing literature, thus increasing its transferability. Secondly, similar research methods were replicated across and similar findings were obtained from, all ten cases; hence, the

findings and the theory from the current research should have better transferability, as Yin (1994) argues. Finally, to help the reader to judge how far the results of the current research can be transferred, Chapter Three of the current dissertation provides details on the context of the research; Chapter Four, which describes transparent ontological and epistemological stance, provides case study methodology and research methods, informing how the current research was done; and finally, Chapter Seven discusses the conditions under which the results of the current research can be applied or not applied. This should improve accuracy of transferability of the current research results.

Internal validity concerns with causal (or explanatory) case studies in which an investigator is trying to determine whether event x led to event y (Yin, 1984). This is the case for the current research which explored causes for growth of HR service SMEs in Guangzhou City. To enhance internal validity in this concern, the current research used pattern-matching and rival explanation (negative case) to establish causal link between activities taken place in the case firm to its subsequent growth. The second concern of internal validity is making inferences from the interview and documentary evidences, in case that an event can not be directly observed. This concern is difficult to alleviate. Nonetheless, according to advice from Yin (1994), actions were taken during the current research to address this concern to improve internal validity: the researcher used logic model from dialectic theory review to infer causes for growth among HR service SMEs in Guangzhou City; in addition, the researcher addressed the rival explanations by analysing three negative growth cases.

Construct validity (descriptive validity) is how well specific measurement reflects theoretical concept it intends to measure. In case studies, Yin (1994) suggests improving construct validity by using multiple sources of evidence, establishing chain of evidence and having key informants review draft case study reports. Construct validity in the current research was ensured by following advice of Yin (1994). First of all, in all cases studied, evidences from interviews with different informants, from archival sources and from external sources were triangulated to uncover growth process of these case firms and causes for firm growth, stagnation and decline; then, a chain of evidence was established for each case firm by development of case database for them which stored all evidences related to the case firms; findings from empirical studies were systematically analysed in theoretical constructs of dialectical analysis to develop theory on growth of HR service SMEs and thus, moving data to theory; indeed, iterative journey was taken from data to theory, which has ensured that for the current research, findings were grounded in data; and finally, case study reports were sent to key informants of each case firms, for review and confirmation.

In addition to actions taken to improve descriptive (construct) validity, measures were also taken to enhance interpretative validity for the current research. Participant accounts were put in their own words, concepts and tones. Abstracts from interviews were quoted to reflect the actual account of the story on firm growth as told by key informants of the firms, with their own wording and concept well preserved. Moreover, views of the author were clearly noted in data analysis. As a result, data and their interpretation were clearly differentiated in the current research. These actions were

taken on purpose to improve interpretative validity.

In short, various tactics were employed during different stage of the current research in order to enhance the reliability and validity of the current research. Particularly in case studies, tactics were used by the researcher to ensure research reliability and validity, following the advice of Yin (2003), which is shown in the table below:

Table 4.5.2: Tactics to ensure research reliability and validity in case study by Yin (2003, p.34)

Tests	Case study tactics	Phase of research in which tactic occurs
Construct validity	Use multiple sources of evidence	Data collection
	Establish chain of evidence Have key informants review draft case study report	Data collection Composition of data
Internal validity	Do pattern-matching	Data analysis
	Do explanation-building	Data analysis
	Address rival explanations	Data analysis
	Use logic models	Data analysis
External validity	Use theory in single case studies	Research design
	Use replication logic in multiple-case studies	Research design
Reliability	Use case study protocol	Data collection
	Develop case study database	Data collection

Overall, in the current research, great care were taken to ensure a good integration (fit) of research questions, methods, data, results and conclusions drawn. Also, there is a clear, systematic description of the methodology, as shown in the current chapter, on how data were collected, processed and analysed, and how conclusions were drawn. Such a description allows effective peer review of the research and thus, enhancing the

reliability and validity of the current research.

In summary, this chapter has introduced the methodology which was used to carry out the empirical study on the growth of SMEs in China. In the first part of the chapter, qualitative research paradigm is presented and its pros and cons discussed. Since the current research was on the process and causes of SMEs growth and the research questions are exploratory in nature, it was decided that qualitative research paradigm was more suitable for it. Accordingly, due to its fit for investigation into complex, multidimensional and context-bound process of firm growth, case study was chosen as the research strategy for the current research and multiple-case (embedded) design was selected as its research design. The current research was completed in two phases; Phase One Study was carried out mainly to find out process of growth and Phase Two Study was conducted to identify causes of growth. The process and methods of collecting data and analyzing data used in each of the phases are well described in this chapter. In the last part of the chapter, measures taken to ensure research reliability and validity are described. They were components of methodology used for the current research. This chapter, it is hoped, has shown that the current empirical research has been carried out with appropriate research methodology, which has been able to ensure robust quality of the current research. It follows that the research findings on growth of HR service SMEs in Guangzhou City are relatively robust and convincing.

Chapter Five: Analysis and discussion of Phase One Study

This chapter presents the data analysis and discussion of the Phase One Study. The Phase One Study was descriptive research exploring processes underlying growth of HR Service SMEs in Guangzhou City, with the intention to discover activities important to the growth and processes underlying growth; the study was guided by the theory of Penrose (1959) and the research question of how growth of these firms happened. Answer to this research question is critical for later research on the causes of growth of these SMEs. The chapter first gives a summary profile of all the case firms in the Phase One Study so that a rough idea of what were studied can be gained. Then, growth of each case firm is analyzed. The within-case analysis of these individual firms answers the question how and why growth happened and at the same time it builds up materials for later discussion on how and why firm growth occurs. The cross-case analysis that follows focuses on activities and processes that gave rise to the growth of the case study firms. Following the within-case and cross-case analysis of the research results, a discussion is carried out on the research findings and on what has remained for the next phase of study. Finally, a summary is written to round up the chapter.

5.1 Profile of the case firms in Phase One Study

There are four HR service SMEs which were studied in Phase One Study. Each of these case firms was set up mostly by one individual entrepreneur who came across business opportunities in 1990s or early 2000s, the early years of the formation of HR service

sector in Guangzhou City. By employment standards, these firms were small and since they were new types of firms different from manufacturing firms which dominated the city economy, they received virtually no attention in government policy or business research. To date, they are not yet very well-known to the external world. The following table is a brief summary of these service SMEs:

Table 5.1: A short profile of HR service SMEs in Guangzhou City in Phase One Study

Firms	Business scope	Years in Operation	Employee Number	Ownership
<u>Firm A</u>	recruitment service, executive search, training service and consulting service	1996—the present	75 (as of 2007)	Partnership
<u>Firm B</u>	executive search, training service and consulting service	1996—the present	29 (as of 2007)	Partnership
<u>Firm C</u>	mainly training service, with some consulting services	2000—2007	30 (as of 2007)	Partnership
<u>Firm D</u>	Executive service	2005—the present	12 (as of 2007)	Partnership

5.2 Within-case analysis of growth of the individual case firms

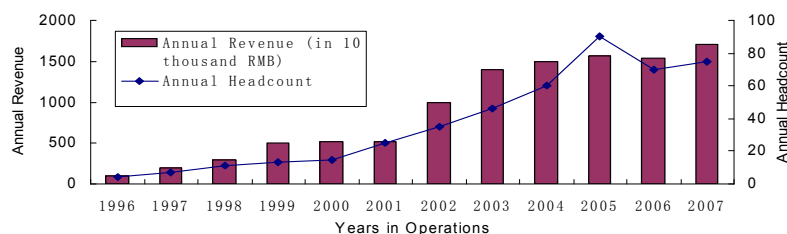
In this part of the chapter, analysis of growth of individual HR SMEs is presented in details. Before analysis is made on the growth of an individual firm, an essential overview of the firm is presented, including its founding date, its business scope, its business model and its growth trajectory. The full story of the growth of an individual firm is very long and is omitted in this chapter, but given in full details in **Appendix III**. Clearly, the main focus of the presentation in this section is on the analysis of the

growth of the individual firms. The analysis provides sufficient materials for later cross-case analysis, and discussion on how and why growth of these firms happened.

5.2.1 Growth of Firm A: a firm of multiple HR services

Firm A was a small HR service Firm established in 1996 in Guangzhou City. At the time of fieldwork it had three service lines: executive search, training and consulting. In addition, it had some HR outsourcing businesses which were not significant enough to form independent service lines. The clients served by Firm A were mainly MNCs and SOEs, with only a small number being big POEs. Its growth attempt often started with building a relation with a client to meet their specific need. With this relationship, it started to expand the wallet share of the service demand of that client. Built on the success of servicing this client, it then replicated the service model to other clients in the same area. Finally, to further grow, the successful business model in one location was applied to clients in other geographic areas. The full story of the growth of Firm A is in **Appendix III**. The following chart shows the trajectory of growth of Firm A:

Chart 5.2.1: The trajectory of growth in annual revenue and headcounts for Firm A



An analysis of growth of Firm A:

This section presents an analysis of growth of Firm A, aiming to show important activities leading sequentially to growth and processes that generated growth. For this purpose, this section first of all displays and analyzes critical events in the history of the firm, presenting key activities of each event and their major impacts on growth of the firm. Then, the section analyzes temporal chains of growth activities of two major business lines, which shows sequence of key growth activities. As shown in the full growth story of Firm A, the growth history of Firm A has been dominated by several critical incidents which either positively or negatively impacted its growth, as listed in the table below:

Table 5.2.1: Critical incidents and their impact on firm growth

Critical incidents/Year	Activities	Impact on growth
1 st Job Fair/1997	Sensing market demand, learning to organize job fair, conducting innovative marketing, collecting application forms	Learning to use marketing tool, brand recognition, unique know-how of organizing high-end job fair, applicant database
1 st marketing effort/1998	Designing a journal, publishing information on HR management and on the firm, connecting clients with the help of the magazine, stopping publication of the magazine due to a net loss	Learning to develop a marketing tool, establishing a brand in the region, losing some money which could otherwise be used in other ventures

Table 5.2.1: Critical incidents and their impact on firm growth (continued)

Critical incidents/Year	Activities	Impact on growth
Failed attempt to expand into Shanghai market/1999	Setting up office in Shanghai, operating at long distance HR services, withdrawing from Shanghai market (failure from insufficient knowledge of Shanghai market and unknown brand in this new market, lack of managerial resources)	Learning lessons in geographical expansion, refocusing on core business in core market (GZ)
Entry into outdoor training/2001	Sensing market demand, learning to carry outdoor training	Learning to lead market, experience in leveraging client database and existing market influence to enter new market, learning new service
Failed attempt to expand into low-end job fair business/2003	Identifying market opportunity and business partner in this area, managing low-end job fair like high-end job fair, being deceived by business partner who ran off with joint-venture fund, ending this expansion attempted (failure of expansion: losing about four million RMB due to lack of experiences in low-end market, lack of knowledge about market changing to online recruitment mode, personal (not solid legal) trust)	Lessons on using past success and on using personal trust, sensing market change and reinforcing decision to abandon job fair business, lost some financial resource for expansion
Transition from job fair business to executive search business/2005	Closing down job fair business in response to declining demand, retrain (in English, management knowledge and job skills) and redeploy employees to executive search business	Organizational transformation experiences, building up stronger executive search capability, lesson in not catching up market change

Table 5.2.1: Critical incidents and their impact on firm growth (continued)

Critical incidents/Year	Activities	Impact on growth
Failed attempt to expand into online marriage brokerage business/2007	Setting up team to work on this new business, designing web site, attempting to leverage existing professional data, stopping expanding into this new field (failure due to lack of funding, knowledge, experience and brand recognition)	Lessons in expanding into unknown field, losing some venture financial resource which could be for other potential expansion, accumulating some experience in developing web-site
Renovation of outdoor training programme/2007	Organizing R&D team, redesigning outdoor training programme, retraining outdoor training trainers	Maintaining high margin for the outdoor training course and leading brand position, learning innovation and building R&D capability in training courses

From the critical event analysis in the above table, it is possible to see that Firm A has been working to satisfy client demand amidst competition; market demand pulled the firm to expand while competition pushed the firm to innovate their service to keep the market position of the firm; both pull and push forces led to development in firm capability and increase in firm value. For example, renovation of outdoor training programme in 2007 is the response of Firm A made to market demand (declining profit due to intensifying competition). External forces were important drivers of Firm A growth, as the owner of the firm said in his interview:

‘...Clients grew very fast in their ability of selecting training courses and trainers. In the beginning, they accepted what we offered. After two years, they understood well how to choose training courses which suited their needs and

how to choose the best trainer and training company. This escalated their requirements for us the training providers.’

The second indication from analysis of critical events in the history of Firm A is that learning activities and knowledge of market seem to be important for growth of the firm. Entry into the job fair business and training started with knowledge of the services supported by client database that Firm A had at the time. These two services grew as the firm learned and perfected these services. The fact that learning and knowledge increase are important steps in growth process was admitted by the founder who acknowledged the lack of knowledge as cause of his failed attempt to expand into low-end job fair business in 2004: ‘[We] lacked knowledge in this business and ran it like high-end job fair business which we had been very good at; in addition, I over trusted the partner who had worked with me in my previous employer’.

The third important message from the critical analysis is that change of service and organization to adapt to market shift was very critical to ensure smooth and continuous growth. For example, when the firm saw the shrinkage and disappearing of job fair business, it took great pains to make the transition from focusing on the job fair business to focusing on executive search; this transition ensured that the firm could continue to grow, although it was in other business areas.

In addition to analysis of critical incidents in the history of Firm A, growth of two business lines could be analyzed to identify processes responsible for the sustainability

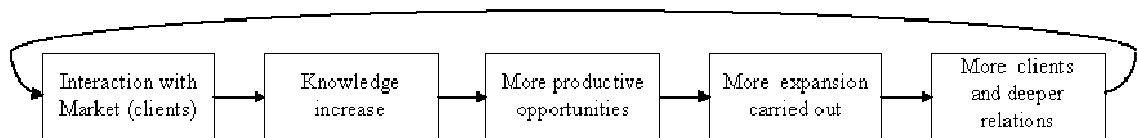
of its growth. The first is the rise and fall of the job fair business in the history of Firm A. The motives of the firm to enter and expand the job fair business seemed to be to earn money and to accumulate information on clients and job seekers--information that was important for building client relations, client database and candidate database. The process of entering the business began with the firm's interaction with clients in executive search service, which built and expanded client base for the firm. As information on (and knowledge of) clients increased, the client database became big enough for Firm A to organize its first job fair in 1997. Later, year after year, Firm A learned to perfect the job fair business, satisfying the need of its clients for recruitment of professional talents and junior management; the market reputation of the firm in the high-end job fair business rose, which attracted an increasing number of clients to join the event. From 1997 to 2005, Firm A firmly maintained its first mover advantage in this niche market. However, growth of the high-end job fair business of the firm tailed off and was eventually closed down in 2005, due to the rise of substituting online recruitment; the firm paid insufficient attention to this new recruitment channel, perhaps because it was over confident with, or rather, overwhelmed by, its past success in organizing job fairs.

In retrospect, it seemed that Firm A's successful entry into job fair business were due to its early sensing of market need for innovative recruitment channel, its client database at that time (although still small), its innovative marketing and its daring entrepreneurship. Growth of this business seems to lie in the continuous learning of the firm; it accumulated experience from its own operation in this business. The growth of this

service also lay in growth of its individual employees.

There seem to be two important processes underlying growth of job fair business of Firm A. One of them promoted growth of the business, as shown in Figure 5.2.1a. Interaction with market brought to the firm new knowledge on client needs and ways to compete in this niche market; knowledge increase led to more productive opportunities which in turn led to further expansions. Increase in expansions increased the number of clients and deepened client relations, which in turn led to more and closer interaction with the market (clients). This cycle repeated itself, driving growth of job fair business of Firm A:

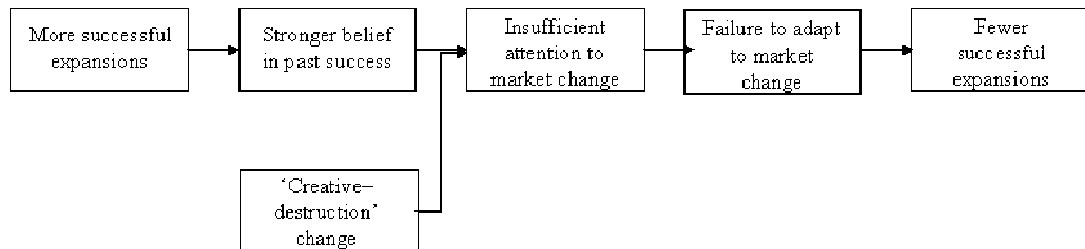
Figure 5.2.1a: A conceptual process which promoted growth of Firm A



On the other hand, there seems to be another underlying process that worked against growth of the business, as shown in Figure 5.2.1b. Successful expansions (organizing job fairs) strengthened the belief of Firm A in its past success, which reduced the firm’s sensitivity to its changing market, such as the coming of the new form of recruitment which was done online, contrast to physical job fairs which the firm was very familiar. Online recruitment was made possible owing to the coming of internet technology and it completely disrupted the traditional job fair business in recruitment market—a typical ‘creative destruction’ (Schumpeter, 1942) in the recruitment sector in Guangzhou City.

Failure of Firm A to adapt to online recruitment technology led to fewer successful expansions (job fairs).

Figure 5.2.1b: A conceptual process which constrained growth of Firm A



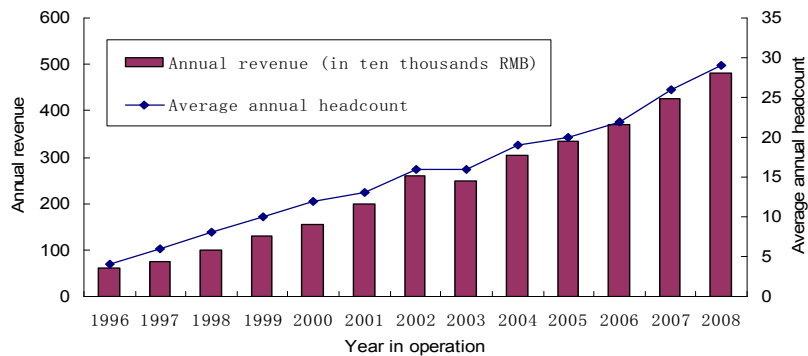
Entry and expansion of training business for Firm A is another story of growth. The firm learned about the training business through the market by using some freelancers to provide training for its clients who asked for such services; later, it learned to sell licensing training courses. After about two years, the firm's knowledge and experiences accumulated in organizing training courses as a training broker and organizer; more importantly, Firm A had built up its own marketing and sales team to sell training services. In 2001, due to its frequent interaction with its clients, the firm saw, much earlier than its competitors in the city, great opportunity in the outdoor training business which enabled participants to learn, in an active and interesting manner, teamwork and other management practices. The firm hired licensed outdoor trainers and launched this innovative training programme. It was an instant success and it kept growing as the firm and its trainers learned and perfected that trade. However, by 2007, outdoor training in the region became a common commodity and profit plummeted. Firm A renovated its outdoor programmes and this service line continued to grow. It seems that market demand for training service gave business opportunities for the firm but expansion of

training business in turn also created more and more market opportunities; furthermore, it seems that learning, knowledge and innovation were important factors underlying continuous growth of Firm A; and sources of learning, knowledge and innovation came from interaction with external market (rather than internal socialization within the firm): interaction with clients, competitors and other sources such as trainers.

5.2.2 Growth of Firm B: A firm of multiple HR services

Firm B was a small HR consulting firm established by an ex-HR manager in 1996 in Guangzhou City. It had three core service lines: executive search service, training service and consulting service. Executive search service was its biggest business, consulting service the second biggest and training service the third biggest. Other business lines of the firm were not significant. The firm started out as an executive search firm and gradually added other services lines to its business portfolio based on client demand. The growth model of Firm B was simple: first, it built client relations by providing a client with one of its best services, which in most cases, means executive search service. After the initial relationship was built, Firm B tried selling other services to the client. Relying on its market reputation spread by “word of mouth”, the firm was able to expand its client base step by step. It also successfully extended the reach of its businesses, by means of partnership, to enter new markets in other cities such as Beijing, Shanghai and Hong Kong. The full story of the growth of Firm B is in **Appendix III**. The following chart shows the growth of Firm B.

Chart 5.2.2: The trajectory of growth in annual revenue and headcounts for Firm B



An analysis of the growth of Firm B:

Development and growth of Firm B is the result of the firm’s active interaction with market (clients and competitors). As a former HR manager from an MNC, from the very beginning, the owner had the necessary qualification to talk to MNCs and had the credit of getting their orders for recruiting management members for them. In turn, the firm cited their successful services for MNCs when trying to convince new clients of their capability and credibility. As the firm became a major HR service player in Guangzhou City, it began to meet strong competitors; this gave pressure on the firm to raise its stake or otherwise it had to give in, meaning to stop growing or even to fall back. This is why the firm went through transformation in mid-2000s, even though its business suffered briefly due to such transformation. The transformation made it stronger. The firm grew due to this sort of efforts to overcome market challenges. Several critical events in the history of Firm B have greatly impacted growth of the firm. The table below shows the activities of these events and their impacts.

Table 5.2.2: Critical events in the history of Firm B

Critical Incidents/Year	Key activities	Impact on growth
Completion of urgent business order passed on from a global executive search firm/1998	Interacting with client to understand their requirements, searching for suitable candidates, re-discussing with clients on revising requirements, completing the order	Developing capability of the team, gaining recognition as key player, getting similar orders
Expansion into Beijing, Shanghai and Hong Kong/1998	Establishing office in the cities, developing business relations, gaining orders and resources	Extending brand to other regions, developing capability by cooperating other entities, gaining orders from these cities
Guangzhou Daily HR Forum/2003	Organizing the forum, interacting with clients, developing new relations	Wider exposure of the brand, building more client relations
Organizational transformation/2003-2006	Changed organizational structure, developing employees, implementing management CRM system	Adapting organization and developing employees to meet market challenges, strengthening sharing and cooperation, improving operation efficiency
Entry into consulting business/2006	Initial advise on employee retention issues, advising on management improvement, building up consulting business	Entering high-end service niche market, adding value to the brand, gaining opportunity to develop employees, gaining new orders

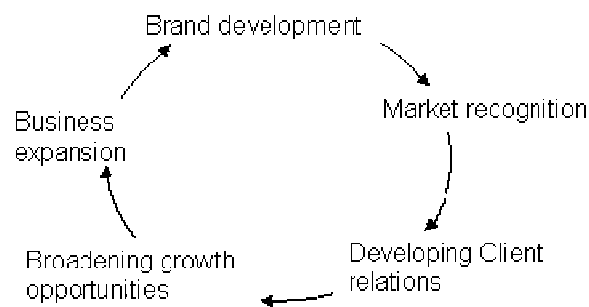
The above critical events facilitated growth of Firm B by increasing its knowledge and experiences in their market and business; in addition, they facilitated interaction between the firm and market, strengthening their relations; more importantly, these critical events built up and improved market reputation (brand) of the firm which is very

important for success of HR service firms whose service is not tangible. It is important to note that these growth events happened through the interaction between the firm and market. In 1998, the firm had to cooperate with a MNC client in completing the urgent executive search orders; without the cooperation of the client, the firm could not have overcome the recruitment challenge passed on to it from a global competitor and without learning from the client, it would not have been able to develop its team capability. The firm's successful entry into consulting in 2006 was also a result of interacting with clients. The clients presented their problems in retaining talents, which led to the involvement of the firm in diagnosing their management system. In co-operation, the firm and its clients identified and corrected management problems, which not only improved talent retention for the clients, but also developed ability of the consultants from Firm B. Furthermore, when competition increased pressure on the firm in 2003, the firm took the challenge by transforming its organization, its people and its business model. From all these interactions between the firm and market (clients and competitors), the firm continuously learned, developed and grew.

There are three important activities which worked to facilitate growth of Firm B. One of them was the interaction of brand development, market reputation, client relation (business development) and expansion. Firm B actively developed its brand as a key HR player in the region. In 1998, it organized HR forum for *Guangzhou Daily* which was a great success and enhanced its recognition as a key player in the region; at the same time, it also built up larger client bases by organizing that event, which brought to it many more business opportunities and hence facilitated its growth. In 2005, it

managed to get the award as one of ten best HR service firms in the country which immediately brought to it countrywide recognition as a national player in HR services and allowed it to extend business to other regions, hence broadening client base and opportunities for growth. Below is a figure showing the self-reinforcing process of brand development, which was the result of interaction between the firm and market:

Figure 5.2.2 Brand development process of Firm B



An important indication from the brand development of Firm B is that the firm was often in active dialogue with the market to seek market recognition in order to win over client support; clients only gave business opportunities to HR service firms which seemed qualified. Brand development, therefore, was important for HR service firms to grow as professional service firms.

Active dialogue with the market was also apparent in another activity which facilitated growth of Firm B: learning from doing. The organizational learning process worked to assist Firm B in its entry into and expansion in, management consulting services. The inducement was the problem of retaining talent recruited by Firm B for its clients. As clients asked the firm to look into the issue, the firm had deep dialogue with its clients to diagnose the problem of losing talents. Both the firm and its clients worked together

to find the root causes of the problem why the firm could not retain its talents; then, both sides worked together to develop solutions for such problems, that is, measures to be taken to retain key talents. From this interaction, Firm B developed ability of its consultants to provide management consulting service; as the firm developed its ability from working with clients to solve their management problem, it built up better market recognition which brought more and more business opportunities. It is important to note that learning and development of the firm capability happened in process of working with clients to solve client problems; in other word, growth of the firm happened in interaction between the client and the firm. It could be said that without the actions of the clients, the firm could not develop its capability and thus, it could not grow.

Internal organizational change and development, however, did play a very important role in the growth of the firm's capability, as was demonstrated in the transformation process carried out by the firm during the period between 2003 and 2006. The firm took three major actions to upgrade its capability: it restructured its organization, it upgraded knowledge and skills of its employees and it built up its CRM system to share information. The internal process of organizational transformation upgraded Firm B and allowed it to break the bottleneck of capability in its drive to prosper. The owner observed in his interview that he saw organization transformation as a critical process for growth of the firm:

‘We asked our consultants to apply what they used for solving client problems to our internal problems; we recruited talents with masters or doctoral degrees

and of high calibre which are needed for knowledge-intensive consulting; we conducted vigorous internal training programmes. In the end, we had a team of much higher quality and much stronger ability, although we suffered some loss in the organizational transformation. This was critical for our next phase of growth'

Learning from clients and internal organization transformation worked favourably towards growth of Firm B. These two activities seemed to work with brand development to facilitate growth of the firm. As the brand of the firm was developed and its influence enhanced, the firm had a broader and deeper client relation base which brought in more business opportunities; and more business opportunities allowed the firm to have more expansions, which allowed the firm to learn more; learning enhanced awareness of the firm on market opportunities and threats which in turn led its organizational transformation and capability development; as capability of the firm was developed, it had many more successful expansions which enhanced its brand. These self-reinforcing processes worked to facilitate growth of the firm.

Constraints on rate of growth of Firm B seemed to lie in three factors. As the owner says, the goal of Firm B is long-termed survival in the market and this necessitated favour for service quality over service quantity (revenues, for example). The firm was cautious in undertaking expansion and it grew slowly until it was forced to expand rapidly in recent years. Besides lack of daring entrepreneurial spirit, the fact that firm kept a low profile in the beginning of its history also greatly affected the rate of its

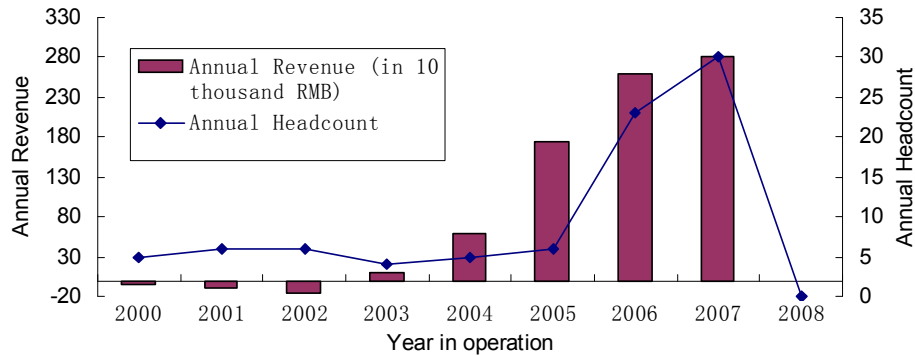
growth, because low profile in a service market may resulted in slow market recognition, which naturally slowed down its growth. Finally, slow growth of Firm B in the beginning had to do with slow development of its workforce, in terms of training and recruitment of new employees.

5.2.3 Growth of Firm C: A training firm

Firm C was a HR and consulting service firm providing professional training courses and consulting for its clients. Established in 2000 by some professors, PhD researchers and consultants, Firm C took as its mission to assist SMEs of potential to become unique firms and leaders in their sector. It positioned itself in the market as a training and consulting firm solving business problems through conducting in-depth case studies. As such, Firm C had a unique business model in which clients were provided with training, consulting and investment advisory service based on successful real life cases. When clients took training courses in classroom, they had the opportunity to visit leading case firms in their sector to see how concepts, theories and cases as taught and discussed in the classroom were applied in the actual operations. This unique business model gave Firm C competitive advantages in consulting and training market; it easily attracted clients and brought in a stream of revenue for the firm. However, it also laid the trap for its doom in 2008 when its unique business model broke down because the case firm, which was supposed to be learned from, exposed the training participants to its poor management quality, not the excellence that the participants were supposed to learn from. The full story of the growth of Firm C is in **Appendix III**. The following

chart shows the growth and sudden bust of Firm C.

Chart 5.2.3: The trajectory of growth in annual revenue and headcounts of Firm C



An analysis of growth and bankruptcy of Firm C:

The rapid growth and sudden bankruptcy of Firm C owed much to its innovative but risky business model. Firm C based its training courses on real case of success in the region. This made what it preached in the training courses appear to be real. This innovative aspect of the training courses attracted business owners, who wanted to learn what they could apply immediately to their own business. These business owners had the opportunity to observe and to learn in person how their peers in the case firm managed their business. The strategy of Firm C was to have an innovative business model to attract business owners to attend its training course, which in turn spread its credit among the potential clients. From these course participants, Firm C was able to obtain more business opportunities in providing training and consulting. In this way, Firm C would be in a benign cycle of growing its business. However, to base its

business model on such a unique case was itself a very risky business decision. The factor creating growth of Firm C was the cooperation of the case firm. When the case firm withdrew its cooperation from this partnership or if the case firm deteriorated in operation quality (to be disqualified as an exemplary firm), Firm C had very little to fall back on and thus, it failed. It seems that innovation was important to the growth of Firm C, provided that it was sustainable.

Another factor which brought about growth and bankruptcy to Firm C was its choice of industries to serve. In the first half of its history, Firm C mainly provided training for manufacturing plants which were numerous in China and were in a better position to pay for such management training. Firm C had a big market to sell its training since most Chinese SMEs competed on cost leadership and therefore wanted to imitate the way the case firm *Galanz Business Group* managed its business. This was the right choice for Firm C. However, Firm C made a wrong choice when he attempted to provide training and consulting to the hospitality industry. The choice proved to be wrong in several ways. Firstly, in Guangzhou City, the hospitality industry was not as big as manufacturing industry and thus, the market for Firm C was much smaller. In addition, it seemed that the owners of the service firms had less time and money to spend for training courses; they were mostly small firms in hospitality and were sensitive to cost. Lastly, the quality of a firm in the hospitality industry was less tangible and stable; thus, the success of the case firms chosen from this sector may be less visible and less constant, which made these firms not quite suitable for study and emulation. This proves that interaction with market and understanding of its

characteristics played a critical role in growth and decline of Firm C.

Thirdly, marketing and sales effectiveness brought both success and failure to Firm C. In the first half of its history, Firm C co-operated with a strong professional sales team which sold many training courses built on the case of *Galanz Business Group*. It was this effective marketing and sales of the training courses that facilitated growth of Firm C. In other words, growth of Firm C owned to this successful marketing and sales capabilities of its business partner. On the contrary, in the late half of its history, Firm C built its own sales team which was not as effective as the one it used to sell the courses built on *Galanz Business Group*. The sales team did not bring in as many business opportunities as expected. This weak marketing and sale capability worked against the growth of the firm and Firm C declined. In short, sales and marketing played an important role in driving growth of Firm C.

Lastly, Firm C did not have a good process of building up its capability. Although the new partner, whom it recruited in the middle of its brief history, was able to bring in some practical management experiences and built up a team of consultants, Firm C did not invest much in training and developing its employees. Very few development actions were taken besides asking the employees to learn by doing on their job. In addition, measures were not taken to retain good talents. Even the new partner was neglected until the bankruptcy of the business and what had been promised for him never materialized. Developing and retaining good employees, it seems, was extremely vital to survival and growth of Firm C.

5.2.4 Growth of Firm D: a small executive search firm

This is a case study of a small executive search firm which grew very fast and then went into stagnation. The firm, Firm D, was set up in Guangzhou City in 2005 by three partners. One of the partners was from a global executive search firm and two others from other types of multinational companies. The clients of Firm D were mostly multinational firms and POEs which had abundant financial resources. These clients constituted a high-end sector in executive search market. It currently had three offices, the first one in Guangzhou, the second one in Shenzhen and the third one in Shanghai. Each of the offices operated under direct supervision of a partner. The business model of Firm D was different from those of its competitors. It served only a few clients, with one senior consultant, usually one of the three partners, acting as account manager for each of the clients. The consultants searched for all executive vacancies for an individual client. They did not search for executives for a single job category. The result was that the client got focused attention and that the consultants were continuously motivated by the variety of their searches. The full story of the growth of Firm D is in **Appendix III**.

An analysis of the growth of Firm D:

The growth process of Firm D is very typical in this industry sector. With the know-how and experiences in executive search business, the owner of Firm D was able to start his

own business on a solid basis. He was, in a sense, a one-man firm in the sector, meaning that he possessed the capabilities to do the business (executive search) and the resources to do the business, with minimum need for organizational management. Then he expanded his business capabilities by hiring experienced HR personnel who brought with them basic capabilities and business knowledge such as industrial knowledge and corporate operation know-how. The knowledge and know-how were turned into business development capabilities which led to business opportunities. In addition, these new hires also brought with them their social connections which allowed Firm D to enter some organizations to search for the most suitable candidates for executive vacancies. Equipped with some successful search cases either completed by Firm D's owners or his experienced consultants, the partners were able to demonstrate to major clients the capabilities and credit of their firm. Some of these clients were convinced by Firm D and gave one or two executive search orders to Firm D. Firm D made all efforts to complete these orders. The more orders Firm D completed on time and with due quality, the more orders it was able to get. After Firm D developed better credit and relations with the first batch of clients, these successful relations were used as a marketing tool to expand the base of clients and businesses. Recently, the partners of Firm D have come to the conclusion that they should slow down the firm's business expansion to ensure high service quality, avoiding damage to their reputation. The key words associated with growth here are knowledge, client relations, marketing, credibility and reputation. These are important activities that allowed growth of Firm D.

Several factors existed to promote the growth of Firm D. One important factor was the working history of the owner of Firm D. It encompasses the capabilities, experiences and the social connections which he was able to accumulate over a number of years when he worked for a global executive search firm. This heritage laid a good foundation for Firm D to grow. The second important factor was the ability of Firm D to attract, develop and retain experienced ‘talents’. In executive search business, the consultants’ skills of handling client relations and their knowledge of the industry and management act together as critical capabilities to complete a business deal. In other words, in this service sector, the capabilities of individual consultants are firm capabilities. Thus, actions to attract, develop and retain experienced talents equals to development of the firm capability which allowed the firm to complete business transactions. The owner of Firm D was well aware of the importance of its front-line employees, as he expressed in his interview which is quoted below. He put all his efforts to coach his team to build up their capabilities in executive search. He went as far as to open an office in another city in order to retain an experienced consultant: ‘We have no magic secret of successful growth. All the accomplishments so far have been made by our people. People are our assets. They determine our future.’

Another factor accountable for the growth of Firm D is its business model. In order to deliver new executives to its clients on a timely basis, Firm D decided to focus on a few clients. With such dedication, Firm D was able to secure several loyal clients which outsourced their executive search exclusively to Firm D. For example, in the past few years, Firm D has been awarded by Philips China as one of its best human resource

service suppliers. Philips gave all its executive searches exclusively to Firm D. This model of dedicating to a few clients drove the growth of Firm D. The last important factor driving the growth of Firm D was that it operated within its resources and its capabilities, which allowed the firm to grow on a very secure and steady basis, although slowly.

In short, among all the activities that facilitated growth, talents development and retention seems to be the most important process driving the growth of the firm. Second to this was the building of client relations by using accumulated successful cases. In this, Firm D was able to fully utilize the capabilities, experiences and social capital of its owners, its partners and its experienced consultants.

There seems to be a few factors constraining the growth of Firm D. One factor which constrained the growth of Firm D was the caution of its partner not to take the risk in expanding business beyond the limit of its resources and capabilities. The owner of Firm D feared that without proper legal framework to secure cooperative partnership, expansion of the firm might lead to mistrust among partners of the firm, which could then damage the firm. Therefore, he did not want to expand his firm beyond three offices which he was able to control well. Another factor constraining the growth of Firm D was that the partners of Firm D lacked motivation for further growth when they was financially secure and saw few benefits from taking the risk of failure in growth.

5.3 Cross-case analysis of the growth of the case firms

This part of the chapter presents cross-data display and analysis of all individual cases in Phase One Study which are analyzed individually in the last part of the chapter. Cross-data display and analysis in this chapter are carried out following advice from Yin (2004) and other case study proponents such as Eisenhardt (1989), which allows robust patterns to emerge from multiple empirical data points. The purpose of this part of the chapter is to identify patterns from cross-case synthetic evidences to answer the question on how growth of the case firms happened. To achieve this purpose, activities important to growth from different case firms which have appeared in within-case analysis are grouped and arranged in response to investigation themes which have been identified in review on growth literature; the focus of these themes is clearly on process of growth.

5.3.1 Motivation for HR service SMEs to grow: why these firms want to grow

Motivation for HR service SMEs to grow seemed to be various and differed in different phases of firm development. In the beginning, founders of these SMEs seemed to grow their firms for earning more money for a better life. As the owner of Firm A observes in the interview, they ‘have to catch all opportunities to make money to prepare for a rainy day’. Soon after these firms entered the market to serve their clients, their clients increased their service demand in term of quality and quantity. The HR service SMEs had to grow in capability and in geography to ensure that these client demands were

satisfactorily met. The founder of Firm A reflected on why his firm had to grow, and interestingly, noted that greater profit was not always the outcome:

‘I did not expect that my firm could become as big as it is. I founded the firm to utilize my resources [social connections] for a modest living. Later, however, my employees and our clients all led me to expand my business. Expanding my business did not always make money...’

Then, as market matured and competition intensified, these HR service SMEs faced the pressure of keeping progress in market (survival pressure); these firms had to take actions to develop themselves into stronger entities to beat competition (McGrath et al., 1995; Marcus and Geffen, 1998). For example, Firm A had to put resources and energy to renovate its outdoor training programme, to keep up its premium price, which it did successfully; and this developed its own R&D capability and kept its competitive advantage. Facing competition, Firm B took similar actions, reorganizing its resources and upgrading its employee knowledge and skills. This was a transformation, as its founder said in his interview:

‘We did accelerate our growth after 2006, because if we did not, we may be overwhelmed by our competitors; they expanded their firms very fast, as product firms often do when they enter a new market. Our active expansion in part has helped uplift us from low-end market to top-tier market of executive search services’,

Getting into top-tier market allowed the firm to grow again. It seemed that these HR service firms were in a constant interactive relation with the market and that they grew in response to market demand (client requirement and competition pressure).

In summary, it seems appropriate to say that these HR service SMEs expanded their business for three reasons: making more money, meeting client demand and competition challenges. These motivations might co-exist. However, at any one time, one of them seemed to dominate others to power growth of these HR service firms. It seems that as these firms grew, dominant growth drivers shifted from making money, to meeting client demand and then, to meeting competition challenge. It also appears that these HR service SMEs were in deep interaction with market which constantly challenged the firms for better services; and these firms had to grow to meet these challenges. Thus, market was a stronger force than entrepreneurial goal to make more money in driving growth of the case firms, given that many expansions were carried out to meet market demand and not all increased immediate profits. Most of the time, these SMEs expanded to meet client needs. Growth to meet client needs seemed to lie in the nature of firms, as demonstrated by growth of these HR service SMEs. For example, Firm D expanded to Shanghai City to following expansions of its client into Shanghai market.

5.3.2 Where did the knowledge (experience) come from that led to growth?

Penrose (1959) observes that knowledge (experience) increase leads to growth and that

knowledge is automatically increased within the firm. In the current research, however, evidence suggests that knowledge and experience of HR service SMEs did not automatically increase within the firms. Rather, they were created by the cooperation between the firms and their clients. The table below shows three examples of knowledge and experience occurred in cooperation of clients and firms:

Table 5.3.2: Co-production of knowledge and experience in HR services

Firm	Knowledge and experiences	Co-production process
<u>Firm A</u>	Outdoor training service	Learning from training firms in other cities, introducing licensed course to Guangzhou City, developing business, getting feedback from participants, renovating the course
<u>Firm B</u>	Consulting service	Clients asked for advice on retaining talents, diagnosing with clients their management issues, working with clients to find solutions, advising on client management issues
<u>Firm C</u>	Training materials	Work with case firms to develop and publish their success story, which led to development of training material; the training material was improved with client feedback

From the above table, it is possible to see that firms' active interacting with clients generated knowledge, which helped to improve their capability and led to innovative service models that fulfilled wishes of their clients and beat the competition. For instance, in the example of outdoor training service for Firm A, the firm interacted with clients to get their feedback on outdoor training course, which increased their knowledge on the change of the market and the direction for improvement and such knowledge assisted the development of its R&D to renovate the course; renovated course in turn was very effective in attracting clients, which allowed continuous growth

of the firm.

In addition, different from a product firm which could produce products within the firm, these HR service SMEs had to work with their clients to deliver their service; such co-work produced knowledge and accumulated experiences. For example, even with active development of its capability, Firm B could not rapidly grow its consulting service, perhaps because their solutions were not well received by new clients who might not be fully aware of the value of such services which were intangible and transient. Knowledge and experience of Firm B in consulting services remained limited and had to be accumulated in future co-working with clients. When asked why executive search services of his firm grew better than its consulting services, the founder of Firm B pondered and said:

‘The difference may be due to many factors. In executive search, we worked with MNCs which were experienced and we worked with them to find out solutions to their problems. We learned a lot. On the other hand, clients using our consulting services were local small firms who could not work with us to learn and solve management problems. From these local clients, we got the revenue but not much learning. We progressed slowly and less successful in this interesting service field.’

By contrast, Firm C succeeded in involving the case firm *Galanz Business Group* to deliver training course which allowed training participants to observe daily management

of the case firm. This involvement of training participants and the case firms led to successful delivery and further improvement of the training course—steps which increased knowledge and experience for the firm and brought to it fast business growth in the first half of its lifecycle.

5.3.3 Key activities impacted growth of HR services SMEs: the processes underlying growth

In order to answer the research question, how growth of HR service SMEs happened, it was necessary to uncover activities leading to continuous growth. There were two types of activities; one of these two was the type of activities which allowed the firm to deliver successfully their service to their clients and another was the types of activities, such as employee training, which were distant from service delivery but important to the sustainability of firm growth. Both activities underlay continuous growth of these case firms, as expressed by the trajectory of their continuous revenue growth and employment growth. The following paragraphs compare and contrast evidence from case firms, examining firm growth activities and the way they related to each other as processes which drove growth.

5.3.3.1 Process of activities which made firm growth happen

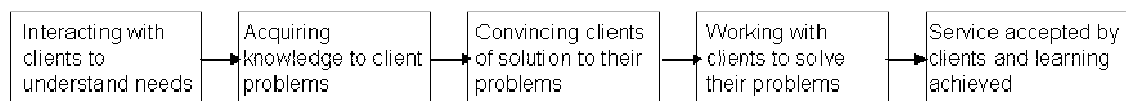
Judging the empirical evidence uncovered in analysis of growth of individual firms, growth of these firms was an evolutionary process dominated by critical events. It is not

possible to break down growth into discrete phases. However, for the convenience of study, it is assumed here that continuous evolutionary growth of a firm consists of growth cycle or expansion events (Penrose, 1959). Activities which completed each of growth events for these HR service firms were observed in the case studies. The first obvious activities were actions taken by these firms to understand client needs. For example, Firm C learned from interacting with manufacturers in Guangzhou City that clients needed to learn how the case firm *Galanz Business Group* was able to manufacture their products at a very low cost; Firm B, too, learned that its clients needed advisory service on the way to keep talents. Learning clients' needs was the very important first step in delivering service to clients. The second step was for the firms to acquire knowledge, from existing social knowledge, from competitors and from clients, on solution to client problems, which helped them design solutions and convince clients that they knew how to solve these problems. Firm C studied the case firm, *Galanz Business Group*, and published its work on knowledge of low-cost strategy of the case firm, which attracted interest of potential training participants; Firm B, too, by free advisory service, demonstrated to its clients that it knew what were their problems and what were solutions to these problems. After attracting clients to use services of these firms, they had to work with clients to deliver service, solving client problems. Firm C, for instance, worked with the case firms and training participants to deliver training services. The last action was to have clients accept the service delivered and to harvest knowledge from service delivery, which completed one cycle of growth. The process of key activities leading to growth seems to be born out in the explanation of the founder of Firm B, who said in his interview:

‘It is not so simple to develop our consulting business. We had to diagnose the client problems. Then, we looked for solutions to these problems but we were not always successful, for we sometimes lacked knowledge. I had to consult experts on these problems; these were normally professional managers. With knowledge (experiences) of our client problems, we was able to figure out how to address these problems. If our proposal to solve their problems were received by our clients, which was often not easy to accomplish, we had the chance to work with them to solve their problems. If the problems were successfully solved, we had a good case to learn from and to use in our marketing activities....’

The conceptual linear process of activity looks like the figure below:

Figure 5.3.3.1: Process of key activities which made growth happen



In the above figure, arrows show a causal direction in activities which link them into a conceptual linear process leading to completion of a growth cycle. In reality, these activities might be interwoven and could happen simultaneously. The process shows that although to have knowledge of problems and their solutions was critical to success of a growth event, convincing clients to accept solutions was also extremely important for service firms; without which, clients would not have been interested in what the

firm offered and satisfied with their services, as Bryson (1997) claims. Most important of all, the process in the above figure shows that active involvement of their clients was vital to successful delivery of service which allowed these firms to grow.

5.3.3.2 Process of activities which sustained firm growth over the years

During the history of HR service SMEs, there seemed to be activities which did not directly contribute to the delivery of service but ensured that these SMEs could constantly deliver services which led to continuous growth. The first commonly seen activity was the activity of these firms to follow market trend and identify growth opportunities. Firm A, as an example, followed market trend in training service and found in 2001 that outdoor training programmes were becoming fashionable; this early discovery led the firm to profitable growth on outdoor training; on the contrary, it did not take the right action to understand change in recruitment market and it missed the opportunity to adapt its recruitment business to online recruitment. The second commonly seen activity was brand promotion and to develop client relations, which were exemplified by Firm A's publication and distribution of a trade journal in the region and by Firm B's effort to organize HR forum and to seek award for service recognition. The third activity contributing to continuous growth of the firm was organizational transformation, which was illustrated by Firm A's restructuring in 2005 to move from job fair business to executive search business and Firm B's organization transformation which involved organizational restructuring and management system revamping and modernization, lasting from 2003 to 2006; it successfully moved Firm B

to a professional service provider with much greater expertise. The fourth often seen activity that contributed to continuous growth of these firms was the development of its workforce; learning from doing occurred daily, but that was not enough. Firm A and Firm B all spent resources to provide training for their employees and as a result, their consultants were able to grow and with that, their business was able to grow; by contrast, Firm C did not do so and its business suffered and was finally closed down.

Of the above activities which facilitated growth of HR service SMEs studied, one of the most important activities was following market trends to identify opportunity for growth; HR service SMEs which grew continuously could normally identify market opportunities earlier than the competitors by closely following market trends and proactively interacting with clients. Firm A was a good example; it identified the high-end job fair business opportunity much earlier than competition, because it listened carefully to clients and examined closely the job fair niche market in the city at the time. The firm also identified market opportunities for outdoor training programmes in the city, much earlier than competitors. As a result, it created and enjoyed first-mover advantage in these two types of business which brought huge profit to the firm. On the contrary, Firm D did not understand the hospitality industry very well which led to its failure in this market. As one of its partners reflected on the failure in his interview, the firm made a ‘hasty decision to copy and transfer the business model from manufacturing sector into hospitality sector of which it had little understanding.... It could be one of the causes for the failure.’

The second most important activity was brand development; HR service SMEs which grew well were able to successfully promote their brand of services, which was important for demonstrating credentials to the market. Firm A did this by publication of a trade journal which, as its owner admitted, ‘lost money but brought fame to the firm’. Firm B effectively promoted its brand by holding HR forum and by acquiring awards, which brought immediate business orders to the firm. Firm D demonstrated implicitly credit of its brand by opening brand offices across the country. All these efforts of brand development sent strong signals to the market on the ability and creditability of firms, which attracted not only clients but also talents. Continuous growth of these firms owed very much to these activities. When comparing growth of firm to that of Firm A, the founder of Firm B observed:

‘Firm A grew much faster than our firm; this might due to many reasons. For one thing, its founder was very ambitious and daring. It openly promoted its brand in the region which made the firm well known. On the contrary, we kept a low profile before 2006 and few people knew our firm... We grew much slower than Firm A.’

The third most important activity was learning and development; HR service SMEs which grew well invested substantially in organizational learning and transformation to develop firm capability which enabled them to overcome market challenges (meeting Perceived external demands). Firm B was a good case to illustrate this finding from the current case studies; it learned executive search from urgent executive search

assignments for a global client; it learned consulting service from interacting with clients to solve client problems of retaining talents. In addition, the team learned from other sources (its owner did an PhD in spare time), which was helpful in upgrading the firm from a pure executive search firm to a consulting firm which was much more knowledge-intensive. Furthermore, during 2003-2006, the firm transformed its organization and developed its workforce, to uplift the firm from a low-end market to a high end market, which was very successful. It increased the number of clients who were willing to pay retainer fee for executive search, which is a sign of the ability and creditability of an executive search firm in high end market. By contrast, Firm D failed to develop its marketing and sales force; and partly for this failure, the firm had to close its business.

5.3.3.3 Processes of activities which constrained firm growth over the years

As is clear from the empirical evidence of growth of the case firms, there may be several activities that constrained growth of these service firms. The most prominent activity that constrained growth of these firms was development of front-line employees. For example, Firm C failed to develop its sales and marketing team to perform their duty actively, which partially led to its failure. However, there was hardly any empirical evidence in this study to suggest that growth of these SMEs was constrained by growth of managerial services, as Penrose observed when she studied growth of big industrial firms. This may be because these SMEs were so small and flat in organization that managerial coordination and communication played a less important role in their growth.

Rather, front-line employees were directly working with clients to deliver what the firm promised and thus, their capability played a very critical role in the successful growth of their firm. As one of the partners of Firm C said in his interview, the failure of the firm could be contributed to its poor employee development:

‘After we withdrew our contract with the external marketing firm to sell our training programme, we recruited our own sales team but we did not do a good job in developing and rewarding our sales people; for that, we had a decline in sales, which eventually weakened our sales and marketing ability and brought downfall to the firm.’

Apart from poor development of front-line employees whose poor quality constrained growth of these service SMEs, resistance to change due to past success also blocked growth of these firms. One example is that Firm A failed to transform its job fair business into online recruitment business, because the firm was so successful in the job fair business that it stuck to this model of business in recruitment until it was too late to change. Another instance is that Firm C failed in its attempt to replicate its successful training model from manufacturing sector to hospitality sector, because it was so successful in its previous experience with manufacturing that it copied it without much change to the new industry.

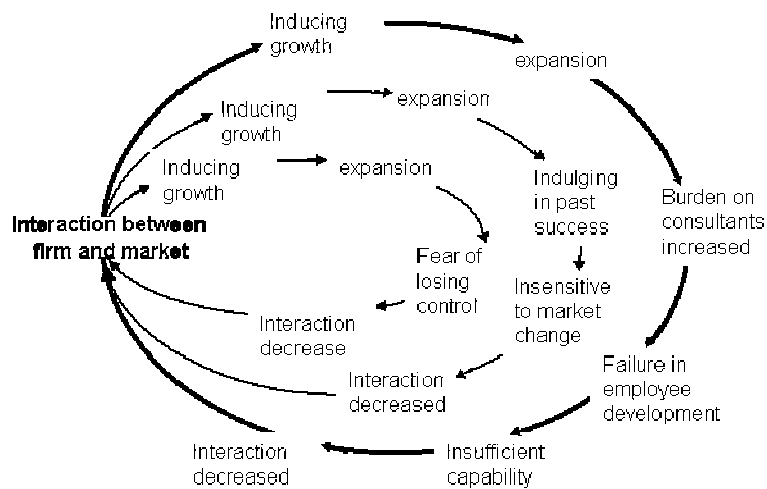
The last activity that might constrain growth of the firm was the fear of risk. Handling of risk might determine rate of growth of these firms. Firm A was daring and knew well

how to expand without losing control in its job fair business, which led to its relatively faster growth. On the contrary, Firm B was very cautious in expanding its business, in case quick expansion might damage its service quality; so it grew rather slowly until 2006 when competition forced it to grow quickly. Firm C also slowed down its growth for fear of losing control and loss of trust between partners. As the founder of Firm B admitted in his interview, caution of his firm on service quality prevented it from fast growing:

‘We have been growing more slowly than Firm A, because we concerned very much about service quality and long-termed survival of our firm; Firm A seemed more willing to take big risks in expanding to make more money and that may explain why it grew faster than our firm.’

The processes that constrained growth of HR service SMEs studied as described in the above three paragraphs came into being and intensified as firms grew; they could be working together to prevent firms from too fast a growth. In the current study, the most commonly seen one was the ineffective employee development which lagged behind growth of the firm. The second most commonly seen constraint was the insensitivity and resistance to market change and the less commonly seen growth constraint is the fear of losing control. The figure below attempts to depict the conceptual model of these constraining processes for firm growth.

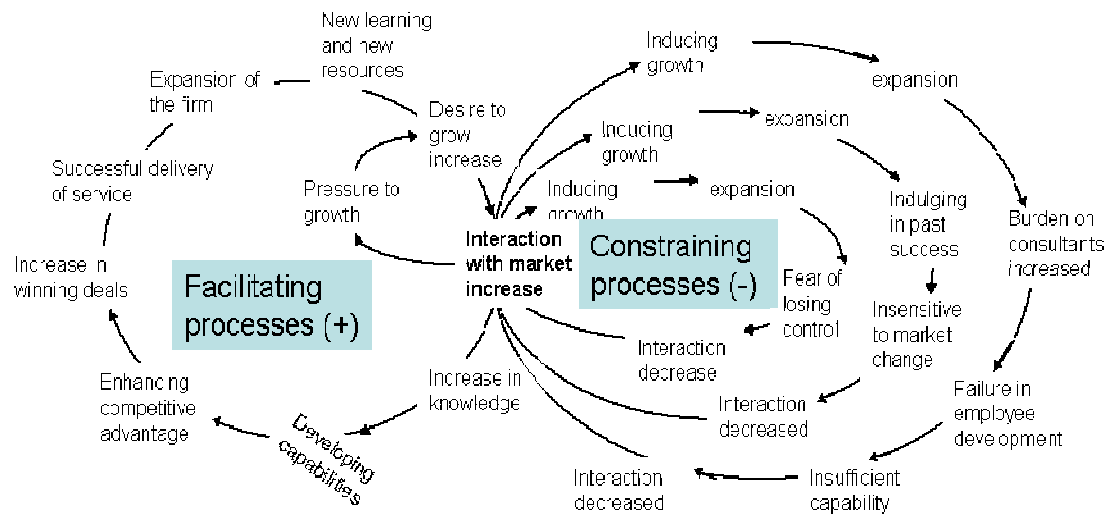
Figure 5.3.3.3: Processes that constrained growth of HR service SMEs studied



5.3.4 How did the facilitating and constraining processes interact to impact growth?

Garnsey (1998, p.523) studied the process of early growth of firms using ‘a systems model inspired by Penrose’; she observed that there are two conflicting forces that impact growth of firms: ‘...growth reinforcement and growth reversal forces contend’ in all phases of firm growth. What Garnsey (1998) says in her work might be observed in more concrete picture in the following systems dynamics growth model as shown in Figure 5.3.4 below which is constructed based on the above analysis of processes that facilitated growth of HR service SMEs and processes that constrained their growth; the model reflects some modification of the growth model built from the theory of Penrose (1959) as presented in literature review chapter of this dissertation. The figure shows that the most important generative activity for growth of these service SMEs was the interaction between firms and market actors (clients and competitors).

Figure 5.3.4: A growth model showing interacting processes underlying growth



The above systems dynamics model of growth of HR service SMEs in this study may have oversimplified processes underlying growth and their interactive relations and thus, not reflecting fully the complex reality of firm growth. Yet, as a conceptual model, it was useful for the current research because it presented something observable about growth process of these service SMEs, which has thus laid a good foundation for further study to find out causes of growth. The model focuses on interaction between these service SMEs and market actors (clients and competitors), which is different from the model of Penrose (1959) that centres on knowledge increase. According to the current model, interaction between firms and market increased knowledge and experience of the firm, which led to improvement in its capability; development in capability led to innovation and competitive advantage, which in turn led to market opportunities and growth; successful growth induced further growth but also led to the formation of growth constraints such as capability development that lagged behind growth and

resistance to change due to over indulgence in past success. The current model shown in Figure 5.3.4 demonstrates that two forces always contended in growth of a firm, with one facilitating growth and another constraining growth. However, the model only tells, in general, how growth of these firms happened through these interacting processes; it did not in itself tell why and under what circumstance these firms were able to grow and why some firms were able to grow continuously but others could not; all these remain as questions coming out of Phase One Study calling for further research.

5.4 Summary and discussion of the major findings from Phase One study

Major findings from Phase One Study which explored growth processes are summarized in the following. They are arranged in progressive order in accordance with research themes on firm growth which should be useful for a logical coherent argumentation to explain growth of HR service SMEs studied.

- ✧ HR service SMEs were found to expand mainly to satisfy client needs, with only a few expansions carried out purposefully to capture market opportunities for profit-making. It is not found that these firms grew in order to fully utilize slack resources, as Penrose (1959) found in the case of big industrial firm (which grew mainly to gain economy of growth).
- ✧ It is found that these firms had intense engagement with their clients, co-working with them to identify and solve client problems and thereby, co-producing

knowledge (experience). It is not found that knowledge is automatically produced within firm, as claimed by Penrose (1959) in her research on industrial firms.

- ✧ It is found that growth produced knowledge (experience) and knowledge increase in turn led to firm growth, as described in Penrose (1959).
- ✧ It is found that activities facilitating growth of these service SMEs were: market study, interaction with the market (clients and competitors), learning and development, innovation, marketing (brand development) and sales, effective delivery of services; it is found that these activities formed a self-reinforcing cycle which perpetrated growth.
- ✧ It is found that growth of these service SMEs was limited by growth of its front-line employees, and by adaptability of the firm and by ability of the firm to control risk in expansion. It is not found that rate of growth of these small service firms was limited by growth of managerial services.
- ✧ It is found that when firms could follow closely market change and predict effectively market trends, they had better chance to grow; it is also found that when firms promoted their brand widely, they had more market opportunities to grow.
- ✧ It is found that firms constantly upgraded capability of their workforce and restructured their organizations which allowed them to successfully adapt to market change and to grow.

Findings from Phase One Study have confirmed part of the theory of Penrose (1959).

They have confirmed that knowledge (experience) increase is important for growth of firms, particularly for knowledge-intensive professional service firms; besides,

innovation as a result from knowledge (experience) increase did lead to growth of the service SMEs studied. In addition, the study found that process theory of Penrose (1959) is largely applicable to growth of these service firms. Particularly, some growth steps in her theory and in the current empirical study are very similar: from knowledge increase, to innovation, to competitive advantage, to productive opportunity and to growth. Evidence from this phase of study also illustrates the principle that growth induces growth (Penrose, 1959; Garnsey, 1998): expansions of these service firms greatly increased their knowledge stock, market reputation and resources, which opened up more growth opportunities and encouraged these firms to expand further. The importance of internal resources, particularly client base, for facilitating growth was also well supported.

The study, however, has found that these service SMEs had few slack resources, if any, given their small size, and that slack resources did not form the most salient motive for their growth; rather, they grew to capture market opportunity and to satisfy market need, sometimes even with little or no slack resource on hand. The study did not find that knowledge (experience) increases automatically within the firms, as claimed by Penrose (1959). Rather, knowledge (experience) was co-produced by service firms and their clients. This is perhaps because, different from industrial production, service is relation-based business which needs the involvement of both firms and clients to make it successful. Finally, this phase of study has revealed that growth of these service SMEs was not much affected by growth of managers but greatly affected by growth of their front-line employees; this is perhaps because, due to its small size, small firms need

much less managerial coordination and communication; instead, because growth of service firms was co-produced by firms and their clients, the front-line employees play a very important role in their growth process. In short, it seems that service firms were in intensive interaction with their clients, which is different from industrial firms that can conduct product R&D alone after getting input from their clients; thus, Penrose's (1959) theory which explores growth of industrial firms only from within is not so effective for explaining growth of HR service SMEs in Guangzhou City, although many concepts of the theory are still valid.

Phase One Study has partially answered the research question of how growth of these SMEs happened, having identified activities important to growth and processes underlying growth. It has shown that interaction between firms and market actors (clients and competitors) was at the heart of activities which led to constant growth; however, it has not discovered forces (system energy) that powered these processes facilitating growth; or in other words, it has not discovered the causes of growth. A number of further questions have to be answered: why and under what circumstances these firm were able to grow: or given interacting processes as discovered in Phase One Study, what powered the interaction? Under what circumstances could such interactions lead to growth? With regard to rate of growth, why firms grew faster in some periods of time than in the others? Why some of these firms grew faster than others? It is also unclear that given the same growth processes, why some of these service SMEs could grow continuously but others could not. Efforts to answer these research questions may lead to the discovery of real causes of growth of these service SMEs. More empirical

work need to be done and this time, it should be an explanatory research which should uncover growth causes. This was the task for Phase Two Study. Given the interactive nature of processes underlying growth, as exposed by Phase One Study, one-sided growth theories such as Penrose (1959) which neglect collaboration (Kay, 2002) seem inappropriate for the research in Phase Two Study. A new theoretical perspective need to be found which takes interaction between firms and their clients as engine of firm growth.

Dialectic theory as presented in Van de Ven and Poole (1995) seems quite suitable for explaining growth of service firms which rely on interaction with their clients for delivering services and firm development. Dialectic theory is one school of thoughts that emphasize interaction between conflicting external factors and internal factors as dynamo of social change and development (Van de Ven and Poole, 1995; Sabelli, 1998; Ghoshal *et al.*, 2000; Kang *et al.*, 2006; Martin, 2009). For example, in Marxism, it is believed that interaction and struggle between labour and capital (class struggle) drove the development of capital society (Purcell, 2007).

As Martin (2009) puts it, dialectic theory is easy to understand: ‘contradictory social conditions set in motion forces to overcome the unsatisfactory social situation and the induced social processes (normally) lead to the overcoming of the underlying conflict and (hopefully) to social betterment, whereby the new situation ironically will breed new contradictions. Thus, dialectical processes are a motor of action and progress’. Sabelli (1998, p.429) also believes in dialectic theory because the union of the opposites

exists in nature and interacting opposites 'co-create novelty, complexity and diversity'. It must be noted that dialectical conflict here means contradictory union, which is different from the construct of logical conflict referring to something illogical, confused and impossible to understand. Dialectical theory can be traced back to its historical roots in the philosophy of Socrates and Plato. In the long history of dialectics, there have been a variety of theories on different dialectic change processes (Nielsen, 1996), but they share some common theoretical principles:

1. Everything is transient and finite, existing in the medium of time (this idea is not accepted by all dialecticians).
2. Everything is made out of opposing forces/opposing sides (contradictions).
3. Gradual changes lead to turning points, where one force overcomes the other (quantitative change leads to qualitative change).
4. Change moves in spirals (or helixes), not circles (sometimes referred to as "negation of the negation").

As evident from the above principles, dialectical process seems to always link with contradiction, dynamics, changes and development (Nielsen, 1996; Ghoshal *et al.*, 2000; Kang *et al.*, 2006; Martin, 2009). Indeed, the common aim of various dialectical theories is to explain the dynamics of change. On this, Hegelian dialectics seems to be the most cited dialectical theory. According to Van de Ven and Poole (1995), the assumption of Hegelian dialectics is that the nature of the world outside one's perception is interconnected, contradictory, and dynamic (ontology), and that an organizational entity (such as firm) may exist in a pluralistic world of colliding events, forces, or

contradictory values that compete with each other for domination and control. 'Change occurs when these opposing values, forces, or events gain sufficient power to confront and engage the status quo' (Van de Ven and Poole, 1995, p.517). In this case, if the organizational entity (a firm) is taken as a thesis and its environment as an antithesis, these two form opposing forces (Ghoshal *et al.*, 2000; Gjerding and Rasmussen, 2005) while also being 'deeply interlaced each one with another' (Pries, p.77); this contradictory union constantly gives rise to conflict and resolution of such conflict leads to synthesis—something of higher order, new and different from thesis or antithesis (Churchman, 1971). As Martin (2009) observes, '[i]deally, thesis and anti-thesis bring up a productive synthesis...'. In this sense, dialectic conflicts can be a source of progress and growth; in other words, development can be achieved through conflict (Schneider, 1971). However, not all dialectical conflicts can create constructive and creative synthesis, leading to progress (Van de Ven and Poole, 1995; De Rond and Bonchikhi, 2004; Martin, 2009). Internal conflicts such as power struggle in an organization, for example, may do damage to the organization and eventually destroy it. Only when conflicts are created and resolved to satisfy internal and external conditions for survival and growth of the organizations could they lead to progress.

In management practice, the potential of paradox as change motor (Giddens, 1986) has been used (Miguel and Rita, 2004). Thus, dialectic theory is an important tool for studying and understanding the dynamics of change and development in organizations such as the dynamics of firm growth; as such, it should be used more frequently in management research (Martin, 2009). Indeed, many scholars have used dialectics in

their management studies including Marcus and Geffen (1998), Miguel and Rita (2004), Ng and Ip (2004), Sorge, A. (2005) and Bledow *et al.* (2009). First of all, dialectics explains well the dialectical relation of an organization entity and its environment, which puts the organization under constant change. In addition, it points out that organizational change and development come from forming and resolving conflicts between environment and the organizations (firms); this is very relevant to management practices in the real world in which firms seem to develop by resolving conflicts (gaps) between market need and what they can do. Secondly, dialectic theory explains very well how quantitative changes in an organization may lead to qualitative changes in that organization, for instances, changes in organization structure. Finally, dialectic theory explains that organizational change moves in ‘dialectic acceleration spiral’, not in circles (Pries, p.77). This view helps to explain the process and path of organizational change and development including such phenomena as firm growth. Since a firm is one type of organizations, it seems that dialectic theory can be a useful perspective for exploring and understanding growth of firms, which is essentially a dialectical process (Greiner, 1972; Ghoshal *et al.*, 2000; Martin, 2009). Dialectical contradiction may play a very central role as dynamo of firm development and growth (Mason, 1996; Kang *et al.*, 2006; Flak *et al.*, 2008).

From the dialectical theory as explained in the above paragraphs and based on the empirical evidences from Phase One Study, it was appropriate to suggest potential answers for the remaining research questions (propositions) of the current research: why did the HR service SMEs want to grow? what caused firm growth? why could some of

these service SMEs grow faster than others? and why were some firms able to continuously grow? These propositions (potential answers) were used to guide Phase Two Study of the current research examining dialectical process and causes of growth of HR service SMEs studied:

Question: Why did the HR service SMEs want to grow?

Proposition: these SMEs existed to serve market need and depended for growth on meeting market demands; market demands kept growing and thus, these SMEs had to grow to satisfy market demand so that they could survive.

Question: Why were these firms able to grow?

Propositions: these firms were in dialectical relation with market (human resource market, product market, capital market); firms and market were in contradictory union (they needed one another but challenged each other); Constant conflicts were formed and resolved by firms and market; firms struggled to resolve conflict; resolution of conflicts escalated firm capability, firm reputation and market demands: firms grew due to its successful efforts to overcome challenges from market; and growth induced further growth;

Question: Why could some of these firms grow faster in some periods of time than in others? Why could some firms grow faster than others?

Proposition: Growth rate depended on extent of the conflict between market expectation and firm capability, as well as on effectiveness and efficiency of resolving such conflicts;

Question: Why could some of these firms grow continuously but others could not?

Propositions: Growth of firms was conditioned by how effectively they could follow market change and predicted market trend; growth of firms was both facilitated and limited by firm capability development and firm adaptability.

In summary, this chapter presents the analysis and discussion of Phase One Study on growth of HR service SMEs in Guangzhou City, which was a descriptive study aiming to discover activities important to growth and processes that underlay growth. From the study, one important finding is that these firms produced knowledge (experiences) in co-working with clients and such knowledge led to growth. Another important finding confirms that these activities were important to growth of these service SMEs: monitoring market change, interacting with clients, learning, capability development, organizational change, risk control, innovation, sales and marketing, effective delivery of services. It is also found that there were two types of processes which underlay growth of these service SMEs, with one type of processes facilitating growth and

another constraining growth; these processes interacted to produce growth, stagnation or decline. However, findings do not answer questions on why and under what circumstances these firms were able to grow. Questions remained to be answered on what forces (system energy) constantly powered processes that facilitated growth and why some firms grew faster than others, or why firms grew faster in some periods of time than in other periods of time. It is also unclear why some of these firms were able to grow continuously but others could not. It is suggested that due to the interactive nature of the growth processes, these questions on causes of growth may be better answered by using dialectic theory to explore growth of extra case firms in HR service sectors in Guangzhou City, which was the task for Phase Two Study of this research project.

Chapter Six: Analysis and discussion of Phase Two Study

This chapter presents the analysis and discussion of the Phase Two Study, which was explanatory research aiming to identify causes of growth of HR service SMEs in Guangzhou City. The first part of this chapter presents analysis of growth of the individual firms in the Phase Two Study. This within-case analysis of growth of these firms provides empirical evidence on the dialectical process of growth and causes of growth of these individual firms; in addition, the analysis lays the foundation for cross-case analysis and later discussion. Cross-case analysis examines empirical evidence by themes targeted to uncover causes of growth; these themes were tied to potential answers for research questions of the current research—propositions which were put forward in the end of the analysis of Phase One Study. The analysis centres on what powered processes that led to growth, why and under what circumstances these service SMEs were able to grow, what determined the rate of growth and why some firms could grow continuously while others could not. Based on within-case analysis and cross-case analysis, a summary of major findings from Phase Two Study is made and a short discussion is held on how well the study has met its objectives. Finally a summary recaps the main contents of the chapter and highlights findings on the causes of firm growth.

6.1 Profile of the case firms in Phase Two Study

These service SMEs carried out common HR service practices such as recruitment

service, executive search service, training service and consulting service. In addition, two of these six service SMEs offered two new services: Labour outsourcing and temporary personnel service, which were more labour intensive and for that, the two firms had extraordinarily more staff than other HR service SMEs. Another point of difference was that two of the six service SMEs were under sole ownership, not partnership which was the usual ownership of professional service firms. The following table gives an overview of these case firms

Table 6.1: A short profile of the six HR service SMEs in Phase Two study

Firms	Business scope	Years in Operation	Employee Numbers	Ownership
Firm E	recruitment service (both job fair business and online recruitment business), executive search, training service and labour outsourcing	1992—the present (registered in 2001)	155 (as of 2007)	Sole ownership
Firm F	executive search service	1999—the present	76 (as of 2007)	Partnership
Firm G	mainly temporary personnel service and some executive search service	1993—the present	356 (as of 2007)	Partnership
Firm H	Mainly executive search service and some training	1995—the present	53 (as of 2007)	Partnership
Firm I	Consulting service, training service, executive search service	1999-2007 (closed in 2007)	1(as of 2007)	Sole ownership
Firm J	Consulting service, training service, executive search	1999—the present	4 (as of 2007)	Sole ownership

6.2 Within-case analysis of growth of the individual case firms

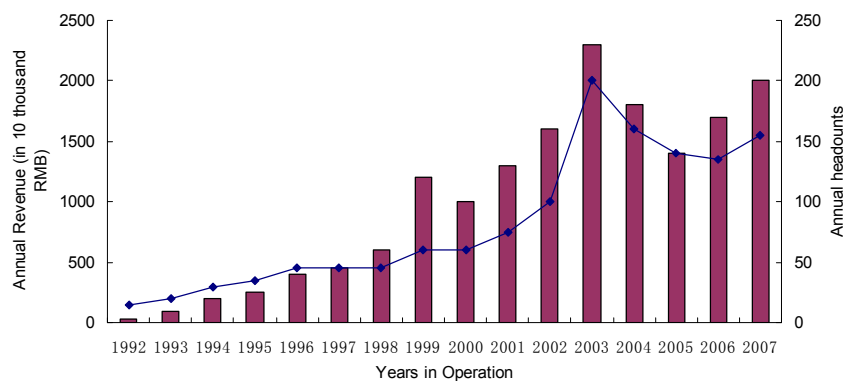
This part of the chapter presents detailed analysis of growth of the six sample HR service SMEs. The analysis of growth of an individual firm in Phase Two study aims to answer the questions on how and why growth of each of these firms happened, with a focus on uncovering the causes behind growth. Before the analysis is presented, an overview of the individual firm is given including date of its founding, its business scope and its growth trajectory. However, as with the case firms in Phase One Study, the growth of an individual firm is given here only in summary with its full story (which is very long) presented in Appendix III. Within-case analysis of growth of individual firms provides fundamental empirical evidences for later cross-case analysis and discussion on how and why growth of these firms happened.

6.2.1 Growth of Firm E: a firm of multiple HR services

Firm E was established in 1992 (but not registered until 2001) and has been growing continuously, with annual revenue of about \$3 million and a headcount of 155 in 2007. Its main business was labour outsourcing; in this business, the firm recruited workers and allocated them to clients according the need of the clients which had up and down in their demand for labour due to fluctuation in their production output. The firm charged clients fees for utilization of its labour and got profit from fees minus the cost of maintaining labour. Other service lines of the firm were similar to those of other HR service SMEs, including executive search service, online recruitment, outsourcing of personnel management, training and HR consulting services. The business model for each of these service lines was different. Executive search service got a fee for finding

candidates for clients who filled their professional and managerial positions; training service received fee from clients or training participants by hours/days of training or by training programme; personnel management outsourcing received fees from clients per transaction of service or per head of employees using the service of the firm. One thing in common was that service value recognized by the clients determined revenue and further growth for the firm. The full story of growth of Firm E is in **Appendix III**. The growth trajectory of the firm can be seen in the following Chart.

Chart 6.2.1: The trajectory of growth in annual revenue and headcounts for Firm E



An analysis of growth of Firm E:

The trajectory of growth in annual revenue and annual headcount in Chart 6.2.1 betrays several features of the growth of Firm E. One feature is that it continuously grew from 1992, although it saw a major downturn between 2004 and 2005; another characteristic is that it grew slowly until 1999 when its growth suddenly accelerated. Fast growth peaked at 2003 and the downturn began in 2004 and lasted till 2005. Finally its growth picked up again. Why growth of the firm happened in this way can only be understood

through careful analysis of the growth history of the firm. The following paragraphs present an analysis of the growth of Firm E.

It is evident that the time from 1992 to 1994 was a period of survival for Firm E (it was not yet a legally registered firm). It had only a few employees and a single simple business of making money from collecting and selling job opening information to job seekers in the street. Although job seekers were numerous, the fee from an individual was meager and could only be collected as each piece of job opening information was sold. This was similar to selling cakes to customers in the street by a food stall. Thus, growth expressed by annual revenue and annual headcount was slow.

As it saw the rise of vicious competition in which false information of job openings were sold by some job agencies, in 1995, Firm E began to organize job fairs by utilizing the license of ‘South China Job Market’; in the job fairs, employers and job seekers could meet each other and the firm collected entrance fees from both; this was very new and innovative at that time and Firm E had to learn from doing. Learning could be gained only by feedback from participants in the job fairs. In addition, client relations and the client base was also gradually built up. Trust was not easily formed since the niche market of job fair business was just coming into being, with rules of the games established only gradually together by HR service SMEs such as Firm E and their clients. As a consequence, this period, from 1994 to 1999, was a long period of learning and slow but steady growth for Firm E.

From 1999 onwards, more and more MNCs came to the city and there was fast increase

in the recruitment need; more and more clients came to use job fairs which were more cost-effective than job advertisement in newspaper, for both the employers and job seekers. As a pioneer in this niche market, reputation of Firm E was gradually established, along with the improvement in its service and the satisfactory results for participants of its job fair. From its interaction with participants of their job fair, the firm gradually learned and perfected its skill of organizing big job fairs; and its reputation and effectiveness attracted more and more participants to its job fair, which became bigger and bigger and the growth of the firm was greatly accelerated from 1999 to 2003, as demonstrated in Chart 6.2.1.

In early 2000s, however, online recruitment began to take shape and Firm E was aware of this change. On this market change, the founder of the firm commented in his interview:

‘We realized that this technology [of online recruitment] was coming but we did not expect it to become a dominating recruitment tool and our job fair business was fast growing, so we stuck to our old ways of doing thing.’

Due to this change in the market, business for the firm began to decline from its peak in 2003 and reached the bottom in 2005, because it had not yet developed any other service lines in time to back up the growth of its job fair business. This was the most disappointing time for the founder of Firm E. However, as usual, he was innovative and he studied the market, talking to his clients and found other businesses; one of them was

the labour outsourcing business and another was training service. Firm E began to diversify its business portfolio into these businesses and for that it went through painful organizational transformation and retraining of its workforce. From 2006 onwards, the firm began to grow again.

Some observations can be made here. The first one is that survival and growth of Firm E very much depended on the market; it could only exist and grow along with the development of the market; however, the firm also contributed to the growth of the market. This dialectical relation with the market was most evident in the growth of its job fair business, in which the firm grew due to market growth but market growth was also facilitated and even, to a certain degree, created by HR service SMEs such as Firm E.

Another observation is that in their dialectical relation, there arose frequently conflicts between firm and market, which, when overcome, elevated the firm in its capability and credibility. For example, by the coming of online recruitment in the job market, HR service SMEs were challenged to change their traditional way of doing recruitment, that is, organizing physical job fairs. Firm E overcame this market challenge by developing its own online recruitment web portal and by diversifying into other services and so it continued to grow.

The third observation is that restructuring of Firm E was critical for the rebound of its growth in 2006. In 2004, it began its restructuring of service lines, organization and

workforce, which was ‘very painful’ as the founder of the firm recalled in his interview. However, through this painful transformation, the firm adapted successfully to market change; it survived and grew again from 2006 onwards.

How growth of Firm E happened can be best observed by analyzing growth of its major businesses. There are four noticeable businesses Firm E has gone through, building them from zero and gradually expanding them. The four businesses became consecutively core business of the firm over time. In all these businesses, the firm engaged with the market to create market demand and set out to effectively satisfy the demand, thus continuously enabling its growth. The following table contains a summary of analysis on growth of its four businesses:

Table 6.2.1: Summary analysis on the growth of four business lines of Firm E

Business	Motives for entry and growth	Activities to create market demand	Activities to satisfy market demand
job agency service	Profit for living Client requirements	Market study; collecting job opening information	Posting job opening information for job seekers
Job fair business	Competition Client requirement	Following market trend; using brand of ‘South China Job Market’; brand development building reputation	Innovation; holding job fairs; learning and developing ability to organize big event
Labour outsourcing	Competition client requirement	Market study; Interacting with clients; client relation building; building reputation;	Site learning; restructuring organization; capability development; innovation; solving client problems; solving client problems
Licensing employment service	Competition client requirement	Brand development; building reputation	Innovation; capability development; solving client problems

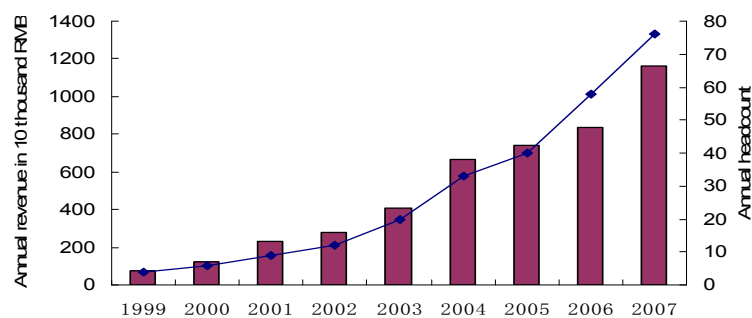
As evident in the growth story of four businesses, which is in **Appendix III** and is summarized in the above table, Firm E always followed market closely and was able to identify new growth opportunity when one of its businesses began declining. Then it entered the new business as a pioneering firm utilizing its existing client relations and established a strong brand. This gave the firm first mover advantage and its workforce had the opportunity to learn the new trade, usually learning from serving their clients. Innovative service model attracted more and more clients to use it; later, the firm went all out to promote the business and its brand, which brought to the firm bigger and bigger reputation in the business. When competition became overly intensive or new technology such as internet brought destruction to the niche market of the business, Firm E quickly transformed its organization and workforce to shift its focus to new service lines, which propelled it into another cycle of growth. In short, Firm E have been successful in growth, because it closely followed market development trends, identified very early new market demand and developed quickly to meet market demand; in fact, it actively created new market demand, such as labour outsourcing and developed its capability to meet the demand only one step ahead of competition by learning from doing the business it took up. It is such active dialogue with market that formed and resolved conflicts between market demand and firm capability that escalated the firm capability of Firm E, which led to its continuous growth.

6.2.2 Growth of Firm F: a firm of multiple HR services

Firm F was a professional executive search firm, with headquarters in Guangzhou City.

The firm was set up in 1999 by three local partners from the executive search industry, without any resource or connection from abroad. Its sole business is executive search: identifying and hiring executives for MNCs operating in the country or newly developed rich private-owned-enterprises (POEs), particularly those in the high-tech industry. As is the case with other executive search firms, the business model for Firm F was simple. It acquired clients and business orders by demonstrating its successful cases. It built and maintained client relations by the quality of its service, which translated as timely delivery of orders and quality candidates for its clients. Service fees were collected from clients for those successful assignments of executive search. Profits were made by upgrading service level, meaning escalating the level of vacancies the firm could fill, and by minimizing operation costs. Firm F sought to grow by snow-balling its database of candidates and clients, in the form of service line expansions and geographic expansion. It had business offices in Guangzhou, Beijing, Shanghai, Chengdu and Shenzhen at the time of fieldwork. The full story of growth of Firm F is in **Appendix III**. Below is the figure showing the growth history of Firm F.

Chart 6.2.2: The trajectory of growth in annual revenue and headcount for Firm F



An analysis of growth of Firm F:

The above figure shows that Firm F has been growing in a very sustainable manner since its founding. Firm F has witnessed most part of the development of executive search sector in China, which has a very short history, starting from mid-1990s. Growth history of Firm F is very representative of growth of executive search firms in the country. Firm F grew mainly due to increasing demand from clients, because its clients expanded nationwide and it had to follow them into new cities to satisfy their need, which is exemplified by its expansion into Shanghai City; in addition, it also expanded geographically for brand development, because multiple offices of an executive search firm is a sign of its strength which attracts employers as well as potential candidates; to a lesser degree, the firm expanded and grew in order to develop a network of resources and such capability which could upgrade it into a higher market position that made it less vulnerable from competition. On growth of the firm, one of its partners commented in his interview:

‘At the beginning, in early 2000s, we did not expand with a clear plan; we did so to meet the needs of our clients who went to big cities. Later, we grew and expanded with a clear idea to develop our resource network and to join the class of nationwide executive search firms, which allowed us to get better candidates and better deal’.

The successful growth of Firm F first had to own to its close interaction with market

and quick change to meet market demand. In 1999, when the founder of the firm knew that Coca-cola needed to localize its management team, he quickly seized the opportunity to sell the service of its firm to this client which has since become its long-termed client. In 2000, when the firm foresaw the burst of IT bubble, by interacting with clients, it quickly restructured its client portfolio to avoid this risk. Another example is that Firm F studied the Shanghai market intensively and did very good preparation before expanding into Shanghai. Therefore, it is possible to say that close interaction with market and following its trend and adapting to its demand were important actions that led to growth of the firm.

Secondly, the fact that Firm E bravely took up market challenges was critical to its growth. An example was the challenge of searching talents for several job categories (diversification) in 2000, which happened only one year after the firm was founded; to overcome this initial market demand, the firm hired better qualified employees, who effectively searched talents for multiple job categories. The second challenge for the firm was associated with expansion in 2003 into new cities such as Shanghai City. In Shanghai City, the effect of brand vanished and different market conditions were present. The firm studied well this new market before it entered the market; and then, it utilized existing client relations to build up the business in the market. In addition, in this new market, Firm F used its trainees who had gone through executive search practices in its home market in Guangzhou City; this had clear benefit for the firm in a new market, because these trainees were easier to manage and were more skilful in their work than any new employee hired from this new market. As a result, challenges associated with

expansion into Shanghai were successfully overcome; and the experience of this expansion was used for the firm's later expansion into other cities.

Thirdly, promotion of the brand had great impact on growth of Firm E. Since promotion of brand was rare in executive search sector, Firm F used several methods other than open brand promotion to develop its brand which was important for its market reputation and value upgrading; one of these methods was the leverage of its global client brand such as that of Coca-cola. The firm first served Coca-cola successfully; then, it effectively leveraged the famous brand of Coca-cola in its sales to new clients; this leverage attracted high quality candidates which made the service of the firm highly successful and profitable. Moreover, the firm improved its brand by polishing education of its staff, as exemplified by one of the founders. Firm F also utilized some traditional marketing tools such as high quality company brochure and forum of executive search industry to publicize its organization and services. All these means of tacit brand development had an important impact on the growth of the firm. The brand development promoted its market reputation which attracted and retained clients, candidates and employees.

However, the biggest force that propelled the growth of Firm F was its investment into the development of its employees and organization. The founder of the firm himself took seriously learning and education by obtaining a MBA from a university in the U.K. On-job learning was encouraged and many consultants improved their English by serving MNCs and the whole team learned by doing; they step by step accumulated

their experience in handling executive search assignments for multiple job categories. The team learned geographical expansion by actual expanding into Shanghai market. More importantly, the firm developed a trainee programme in 2004, which not only turned out ten qualified executive search consultants but also developed a mechanism of employee development for the firm. In addition to people development, the firm also invested in organizational development, standardizing operation policy and procedures, implementing very innovative IT platform for the executive search which allowed sharing of candidate information and cooperation among members of the team. All the learning and development efforts contributed greatly to the successful growth of Firm F.

In dialectical perspective, it could be observed from the analysis of Firm F that growth of the firm was a result of continuous forming and resolving conflicts between firm capability and market demand. Firm F and its clients existed in dialectical relation, with the latter constantly challenging the former via increasing quantity and quality of executive search assignments; the firm could exist and grow because it served the market very well. For example, serving Coca-cola not only brought to the firm revenue but also creditability and reputation. In turn, increase in reputation attracted more clients to use its service. Increase in client number and quality of their requirement forced the firm to develop itself, particularly its team, for instance, improving English communication skills of its consultants. When the firm improved its ability, it was able to overcome challenges from the market, which attracted more and better clients, propelling the firm into another round of growth. So, constant forming and resolving such conflicts upgraded the firm in a spiral and it grew. From 2004, the firm began to

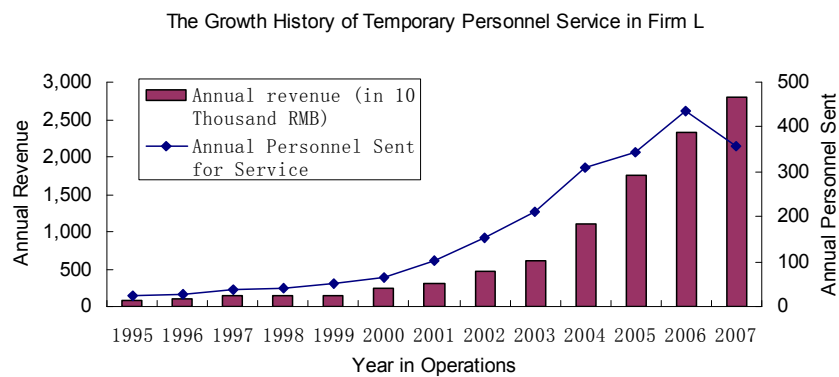
grow very fast, because it had established a reputable brand and sizeable candidate database, which attracted an increasing number of clients, fundamentally raising market demands and thus, extending the strength of the conflict between market demands and firm capability; the firm took the challenges by investing heavily into capability development and thus, overcoming all major challenges; effective and fast forming and resolving conflicts between firm and market thus greatly accelerated its growth since 2004.

6.2.3 Growth of Firm G: a firm of Temporary Personnel Service

Firm G has been providing temporary and contract staffing services to its clients for many years. When the business was founded in 1993, the firm was the only non-governmental company providing such service, and has grown into one of the largest temporary staff providers in Guangzhou City. Over the years Firm G has built a solid reputation among foreign invested companies for providing highly qualified temporary staff from its pre-screened and constantly updated database. These temporary positions were mostly secretaries or office assistants until 2005 when the firm began to supply its clients with temporary management personnel for client organizational change. The business model of the firm was also very simple: the firm hired some office staff on fixed terms and sent them to their clients for temporary service, collecting an administration fee within 20 to 25% on top of the salary for these staff. If the demands were higher than what the firm could supply, the firm hired some temporary staff directly from the market and sent them out for service fee. The full story of growth of

Firm G is in **Appendix III**. The chart below showed the growth history of this business line:

Chart 6.2.3: The trajectory of growth in annual revenue and headcounts for Firm G



An analysis of the growth of Firm G

From Chart 6.2.3, it is possible to observe that growth of Firm G was marked by three phases: Phase One from 1995 to 1999, was a survival period and saw almost no growth; Phase Two from 2000 to 2004, was a slow growth period for the firm; and Phase Three between 2005 and 2007, was a period of fast growth. Interesting questions arise: why was there such a difference in rate of growth in different periods of time? Why was the firm able to grow so much faster after 2005?

One of the founders was asked why the firm grew slowly until 2005. She contributed the causes of such slow growth to several factors. First, she said, the market of temporary personnel service in Guangzhou was virtually non-existent in the beginning;

it took a long time for the firm to create such a market. The development of the market was very difficult and they had to do door-to-door sales. Second, in retrospect, it seems that the temporary personnel service in the first two phases of the history of the firm had very low business value—what it sent out were mostly project staff and office staff, who brought in little revenue at that time. In her interview, she remarked:

‘The growth of the firm and the return on investment was so low that some of our shareholders from Hong Kong left the firm. We stayed on because it was our baby. But we were also worried; actually, in 2000, we did some other businesses...’

Thus, it is possible to say that slow brand development, lack of reputation and staying in the low end of the value chain of temporary personnel service contributed to slow growth of the firm in the first half of its history. The value of the service for clients was low and the requirement of the service was not very demanding. In terms of dialectic analysis, during this period of time, the extent of the conflict between market and firm was not particularly great, thus, the firm grew slowly, which can be seen in Chart 6.2.3.

In comparison, the period from 2005 to 2007 was a fast growth phase for the firm. By examining the story of the growth of the firm, it is possible to see what accounted for this fast growth. The fast growth was instigated by a sudden change in 2005 in labour law of the country which added so heavy a cost burden on firms such as Firm G that offered low value service; they would have become bankrupt if they did not change and

adapt to the new situation. Facing such a big market condition change, Firm G decided to take up the challenge. The only way out for the firm was to move into higher position in the value ladder of the temporary personnel service. By learning from experience abroad and studying the need of the market, the firm found that the solution was to place temporary top management in client organizations which needed some tough people to steer them out of crisis. This was a novel business model which combined consulting and managing work in one shot. However, to do that, the firm first had to revamp its brand which had been long associated with low value temporary personnel service containing no consulting and business advising service. In addition, the firm had to build up its pool of top management personnel who were willing to take such tough jobs in a temporary position. After spending some hard time convincing its clients of their innovative service, the firm got few responses. Fortunately, later, it came cross some clients who needed assistance to sort out a messy organizational change. Successful cases of their business model were built and these cases convinced more and more clients to use their new service. Summing up the struggle that they went through to bring the firm onto its track of faster growth, one of the founders said in her interview:

‘We had a bit of luck to come across some clients who looked for experienced and tough top management people to help them complete their fire-fighting in their crisis. In addition, our success in transition had to own a lot to our efforts in revamping our image and to build our ability and system. Otherwise, we may have closed this service line and gone into other businesses...’

In retrospect, both luck and the determination of the firm to face their challenge squarely have accounted for the success of its transition from a firm providing low value service to the one which provides high value service; this success has witnessed fast growth of the firm since 2005.

In a dialectical perspective, in 2005, the firm began to go for higher value service, which put a greater demand on itself; it greatly increased the extent of the gaps between its capability and perceived external demand (higher value service); later, the firm effectively met the client needs for high value service by placing temporary top management personnel in client organizations to steer clients through a dangerous organizational crisis. By hard struggle to overcome the new challenge in market conditions, the firm not only overcame the challenge from the market but also developed its capability and creditability in delivering high value temporary personnel service, which contributed greatly to its fast growth; Of course, its fast growth was also contributed by its geographical expansion but their successful transition to delivering high value service was, according to the founders of the firm, the main reason behind its faster growth from 2005. Some other observations can be made here. First, the growth of the firm benefited from its innovative business model which combined consulting and managing service. Before 2005, it did not operate in this model but the change in market conditions forced it to look for such a novel model which then put it on track to more rapid growth. Second, change to adapt to market development trends was critical for the survival and growth of the firm. Without such adaptation in 2005, it was hard to say whether the firm could have weathered the change of the market at that time. Lastly,

the firm initiated the dialogue (through marketing activities and direct talks) with its clients on its new service model which raised client expectations, thus increasing the extent of conflict between perceived external demands and what the firm could do. Active engagement with clients was important to raise their expectations, which later, when overcome, brought fast growth to the firm.

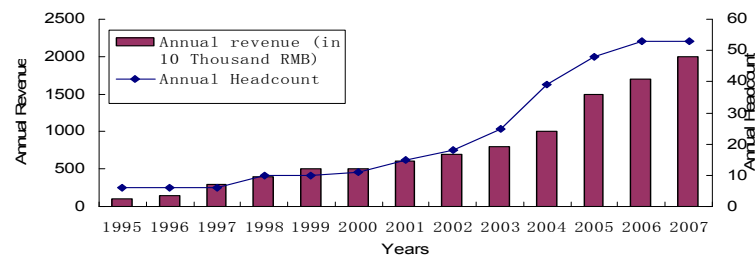
6.2.4 Growth of Firm H: a firm of multiple HR Services

Firm H was a HR service SME founded in Guangzhou in 1995 by overseas Chinese from Hong Kong and Canada which had early operations in Guangzhou (not incorporated as an independent legal business entity until 1995). Business scope of the firm included executive recruitment, management training, business English training (with a formally licensed Training School in China) and management consulting (mainly management diagnosis). At the time of this research there were over fifty employees in the firm working mainly on executive search service. A few other employees worked in Business English Training business, which was not the main business, but mostly done to satisfy needs of the clients. In addition, there were some consultants who provided consulting services for small enterprises, advising them on strategic planning, organizational changes and HR management system development. Consulting services gave access to the top management of many local enterprises which often gave other services such as executive services to the firm, due to the credibility the consulting services of the firm had created for the firm. Service income for the firm came mainly from executive search services and training services. Due to dedicated

effort of the staff and the loyalty of the clients, the firm had been able to grow continuously since its founding in the city. The full story of growth of Firm H is in **Appendix III**. The following is the trajectory of growth in revenue and employee for the firm and the key milestones in its history:

Chart 6.2.4: The trajectory of growth in annual revenue and annual headcount for Firm

H



An analysis of growth of Firm H:

As exhibited in Chart 6.2.4, there are two observations on the growth of Firm H; one is that it has been continuously growing for the past decade or so since it was founded in 1995 and another is that its growth was greatly accelerated from 2004 onwards. These two observations can be explained only through in-depth analysis of the growth activities and processes of the firm. The following paragraphs intend to present such an analysis.

After it was founded in 1995, until 2004, Firm H did not grow very fast for several years. This was mainly due to slow development of the market for HR services in

Guangzhou City, because only some MNCs used such service. Low market demand led to slow growth in many HR service SMEs including in Firm H. Nevertheless, this period of time was important for later growth in the history of the firm. It went through its survival stage by establishing some client relations; the few clients in early 1990s allowed the firm to interact intensively with business community and learned the professional skills of executive search service. As admitted by the business director of the firm in her interview, her team learned by working with clients in designing job specification for positions to be filled. In addition, during this slow growth period, the firm developed culture and system of effective quality control, which was vital for a professional firm's survival and growth. Thirdly, the firm developed its brand via many direct marketing activities such as journal distribution and indirect marketing activities such as successful completion of executive search assignment. Successful cases were used to open new doors of opportunity in the market which was not transparent and chaotic, without good measure of service value. As its brand was gradually established, Firm H saw more and more clients come to it for executive search service after 2000. In short, continuous and steady growth of Firm H was made possible by many important activities and investment in its early years which developed its brand and its workforce. One of the partners of the firm admitted this by saying in his interview:

‘Our steady growth in the early years gave us resources for later growth; we learned the trade [executive search service] and we developed our creditability in the market; we also accumulated a number of client relations. All had vital impact on our later growth.’

Firm H accelerated its growth from 2004 onwards; this can be contributed to fast growing perceived external demand, to its steady development in early years, as well as to the firm's active interaction with market and to its quick adaptation to market change. Specifically, from the year 2003 onwards, the market for executive search services began to grow very fast, not only because MNCs were using such services more frequently, but also because SOEs and POEs began to use such service, since they now had to compete globally with MNCs in product markets and human capital markets; this raised the market demand for human resource services. Firm H saw this change and quickly adapted to it. It gradually built up its workforce, which increased from fifteen in 2001 to fifty in 2007. The firm developed an internal IT system to allow its employees to work more effectively. Both the increase in workforce (volume) and the increase in effectiveness of working (quality) may partially explain the faster growth of the firm from 2004. More importantly, the firm had accumulated its critical mass in brand and in client relations over the past decade before the market for HR services in Guangzhou began faster expansion from 2004. This critical mass of the firm's assets attracted more and more clients to use its service, and increased business orders intensified the conflicts between market demand and what Firm H was able to do; fortunately, the increase in its workforce and enhancement in their ability matched the perceived external demand, addressed the conflict. This dialectical interaction between Firm H and a fast growing market put the firm on track to fast growth since 2004.

In dialectical terms, continuous growth of Firm H was a result of constant dialogue and interaction between the firm and the market since its founding. In the early 1990s when

the market was slowly developing, the firm had the business orders to fulfil, which helped the firm to survive in those days; in this light, the firm existed to serve the market and depended on its development for growth. However, continuous growth of the firm was not the result of mere dependence on the market; instead, it was the result of its active interaction with the market; Firm H actively learned from completing executive search assignments (perceived external demand). More importantly, it used its successful assignments to gradually establish its brand in the market and to develop and accumulate client relations, which in turn brought more clients to use its services; then, increase in the number of clients who used its service improved the firm's brand image in the market. Thus, Firm H was in a reinforcing cycle of continuous growth, driven by perceived external demand.

Indeed, the forces that drove growth of the firm seem to have come from the firm's dialectical relation with market as firm and market often constantly formed and resolved conflicts; for example, due to global competition, more and more clients wanted its managers and professionals to be able to communicate in English; this was and still is, a big challenge for executive firms such as Firm H, because few experienced managers speak good English. Firm H regarded this challenge as an opportunity and began its Business English Training programme, which improved English communication ability of candidates and resolved the conflict between firm capability and expectation of the clients who raised this demand. Resolving such conflicts led to growth of business for Firm H. Furthermore, as more and more clients knew that the firm could provide Business English Training and English-speaking candidates, they came to use the

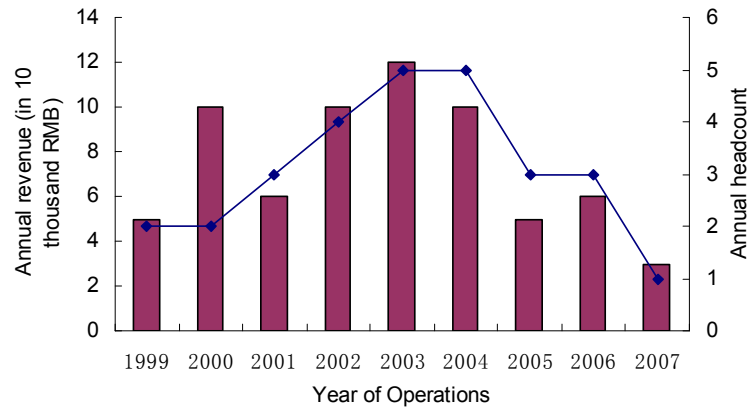
service of the firm; in turn, the sheer increase in volume of orders intensified market demand for the firm. Again, the firm had to further develop its organization and its employees to take up on this new challenge, and the cycle of growth began again. From these cycles, the firm was able to grow continuously. Therefore, it is fair to say that constant dialectical interaction between Firm H and the market generated forces which drove the growth of the firm.

6.2.5 Growth of Firm I: a small firm of multiple HR Services

Firm I was a HR service SMEs founded in 1999 by a former human resource executive after he resigned from his position in a MNC. The firm was closed in 2007, after struggling for several years, without much success in growth. Before its demise, it had provided a variety of human resource services, including executive search, recruitment, consulting, personnel outsourcing and labour law advice. From the profile of its services, the firm seemed to desperately struggle for survival and did whatever the market asked for. In that way, it had never successfully developed specialized skills and brand which are important for survival of a professional service firm in the market. The full story of growth of Firm I is in **Appendix III**. The following chart shows the trajectory of growth in annual revenue and headcount of Firm I. As evident from the figure, growth trajectory of the firm was not even and smooth. Rather, growth in annual revenue and headcount were up and down all the time until it was dropped to the lowest level when the founder decided to close it. In his interview, the founder joked that he did not have ‘the luck to be a millionaire in business.’ He reluctantly returned to be a HR employee

in a MNC after he closed his firm.

Chart 6.2.5: The trajectory of growth in annual revenue and headcounts of Firm I



An analysis of the growth of Firm I:

An overarching question to be asked in the analysis of growth of Firm I is why the firm failed in its growth and eventually had to close down. The mechanism that generated ‘reversal growth’ for Firm I is not apparent unless under serious scrutiny and deep analysis. The following paragraphs first present the analysis of each of the businesses Firm I attempted to enter or successfully entered but then had to exit; then, based on the analysis of growth and decline of each service, an overall analysis is presented to answer the question why the firm went into irreversible decline. The following table is a summary analysis of the growth of the firm.

Table 6.2.5: A summary analysis of the growth of Firm I:

Business	Activity to create market demand	Activity to meet market demand	Result
Business consulting	Using personal contact, lecturing	Having no experience in business consulting; learning some from books and other people; failing to deliver in-depth market reports	Compensation design completed; strategic planning and operation failed
Executive search	Using personal contact, cold call, site visit by founder	Back office identifying candidates; founder sold the candidates to clients	Some success with recruitment of HR positions but failure in other job categories
HR outsourcing	Communicating with some clients in person	Learning some practices	Failure to enter the business

As evident from the growth and decline story of Firm I (described in Appendix III) when Firm I was established in 1999, its first business order was the design of compensation system for a small firm. This was an area in which the founder had the knowledge and experience. He completed the project. However, when he later ventured into other management areas such as strategic planning and operation management, he had no knowledge and creditability and he could not develop an impressive market research report. He failed in these two projects, because he overshot his ability. As a result, his creditability in the niche market was greatly damaged. Or rather, he failed to establish his creditability in consulting service. In 2001, the firm turned to executive search business; the market of executive search, however, was more mature and it was hard for the firm to establish itself in such a market. Although, the firm had some successes in hiring HR personnel for clients because the founder of the firm had some

HR contacts, the firm failed in recruitment for other positions. A single job category was too narrow a scope for the firm to survive. Worse still, in early 2000s, competition from online recruitment firms increased the market demand on delivery time; the firm failed to complete some executive search assignment; failed executive search assignments damaged its market creditability, which caused the clients and the employee to leave the firm. Being desperate, the founder spent time on prospecting other business opportunities in the market and he tried to do HR outsourcing service but failed to convince the market to let him do this business, due to the liability of the small size of his firm. Eventually, the firm had to close down, because it failed to specialize and establish itself in HR service sector.

In retrospect, several factors accounted for the failed struggle of Firm I to survive and to grow. One of these factors was its failure to establish creditability (reputation and brand) in the market. To begin with, the founder of the firm did not have any past experience in HR service sector and so his firm was less welcome relative to its competitors. In other words, the founder did not bring in any personal creditability in HR service to the market and this was not a good start. If he had leveraged some established brands in HR service in Guangzhou, his firm might have had a good start. Moreover, later on, he had few successful cases to demonstrate to the market, which was not convinced of the ability of his firm. Also, he did not have effective brand development, although he did some sales activities. Virtually no marketing activity was done except publication of some short articles by its founder in local newspaper. Even these articles did not do any good to establish the creditability of the firm; As one of his clients said to the researcher

in his interview, the articles by the owner of Firm I ‘occupied such a small space in the newspaper that they damaged the creditability of the firm’. The worst thing is that the firm had no specific/unique/distinguishing skills to separate itself from the competition and to establish its particular creditability, because the firm did whatever it could seize in order to survive in business. To the date when it was closed down, Firm I had no success in establishing its creditability (brand, reputation); it was known to only a few clients it had contacted with. In short, the firm was not well accepted by the market, thus failing to attract clients and to create market demand.

Failure of Firm I in establishing its creditability in market, which is essential for a professional service firm to survive and grow, may be explained better in its failure to develop firm capability, particularly capability of its employees. The firm had little knowledge in HR services, because its founder had been only a HR manager, without any experience in executive search or business consulting. The firm did not have any alliance with established brands in HR service. For some time, the founder of the firm did learn very diligently but did so mostly from books and other sources; he had less to learn from his daily contact with his clients who were not industrial leaders in their own fields. A fatal mistake for him, as he recalled in his interview, was that he did not let his employees directly work with clients; but rather, he restricted them to back office work. As a consequence, critical learning and development opportunities for his team were lost. In addition, the founder of the firm was not clear about the effect of online recruitment on recruitment services such as executive search service, because he lacked knowledge of information technology. To sum up, the learning and development of the

firm's capability, particularly the capability of its employees, was far from what the market demanded, which led to failed business deals and damaged creditability of the firm in the market.

As a result of failure in brand development and capability development and the firm's ad hoc activities across service lines, Firm I often failed to attract clients to use its service. When it did, the firm failed to keep them. Solid client relations were not established during its lifecycle, besides a few personal contacts of the founder. There was not a sizable client base for the firm to survive. As a new comer in the market, the firm had the liability of being new and being small and weak. It did not have the power to overcome challenges from clients and from competitors; for example, it failed to deliver valuable and impressive consulting reports and quality candidates for its clients. It failed to adapt itself to market change which occurred due to the rise of online recruitment. Thus, it failed to grow and eventually closed down; or rather, the firm has never passed its survival stage.

In summary, Firm I failed to establish itself in the market because it did not succeed in learning and capability development, as well as in development of its brand. Without much creditability, it was difficult for the firm to sell its service to clients and it was easily beaten down by competition; the more difficult this situation was for the firm, the more prone it was to work on whatever was available in the market, which led to its failure in developing a specialized niche market for survival. Failure in business provided few chances to learn and to develop the capability of the firm, which in turn

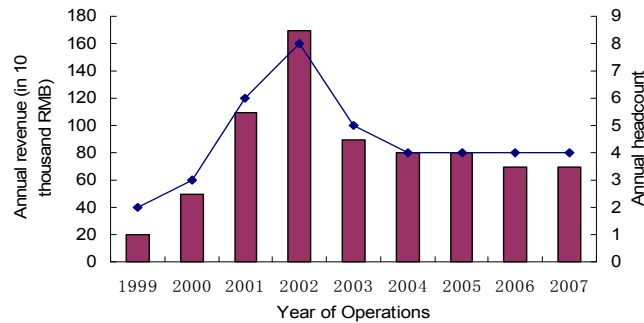
led to its failure in meeting client requirement and to meet challenge from market competition; this led to damage of its creditability. This vicious cycle has to be broken down by a firm if it is to pass its survival stage; unfortunately, it was not broken down by Firm I and consequently, the vicious cycle led to the firm's decline and downfall.

6.2.6 Growth of Firm J: a small firm of multiple HR Services

Firm J was founded in 1999 by its founder, a former HR director and consultant in MNCs. The mission of the firm changed twice over the years. When it was founded in 1999, the founder was still employed as HR director by a famous MNC. He founded this firm to make an extra sum of money for a better life. This purpose was not changed until 2001 when he left his position as HR director and joined an international HR consulting firm as business director. Upon this change, he continued to operate his own HR consulting firm to prepare for his retirement. He passed to his own firm business opportunities which the international HR consulting firm did not take up, thus keeping the firm going. Firm J was, therefore, run by an experienced subject matter expert in his spare time. The firm has so far provided a variety of services, as opportunities arise, including training service, executive search and consulting services. By the time of this study in 2007, the firm had been in stagnation for many years, barely surviving, because, as the founder said in his interview, he had 'little time to run the business due to the busy full time job I hold with the international HR consulting firm'. The full story of growth of Firm J is in **Appendix III**. The following is the trajectory of the growth and stagnation of the firm. From the figure, it seems that the history of the firm can be

divided into three phases: survival, growth and stagnation.

Chart 6.2.6: The trajectory of growth in annual revenue and headcounts of Firm J.



An analysis of the growth of Firm J:

The trajectory of growth in annual revenue and headcount prompts interesting questions. It will be interesting to know why Firm J was stagnated but nevertheless continued to survive. To know the answers will necessitate exploration into many causes that contributed to the stagnation of Firm J.

Firm J was founded by its founder to supplement his need for security in earning and career development. This situation is similar to other types of SMEs whose owners do not have big ambition to develop the firm into a big enterprise. The founder of Firm J, in his interview, made it clear that the firm was his tool to earn extra money and to prepare for his active retirement. He ran his firm half-heartedly. This gave the firm weaker motivation to grow into a big enterprise (although he still wanted to expand it to some degree for better survival). In the story of its growth, it is observable that effort to

create market demand for the firm's service was not strong; equally important, the effort to develop the front-line employees was also not very strong. This gave the firm not very strong pressure to develop and to grow. This is perhaps the cognitive reason why Firm J was kept small, barely surviving.

The second most important reason for the stagnation of Firm J is that the capability development of the firm was not very effective. While the founder had knowledge, experience and creditability in human resource management, which may be responsible for the continuous survival of his firm, these were not passed to his team. Firm J did hire some experienced consultants to coach its junior staff but systematic learning from jobs did not always happen. The reason is that the clients which the firm served were mostly SMEs whose knowledge base and management practices were questionable and so engagement with these clients did not bring much better knowledge of management, although experience of the employees involved was undoubtedly increased. It is perhaps because of this that the owner of the firm decided to join an international HR service firm in 2004. Without a formal training and development system in place, Firm J could not develop its employees as it needed to. Furthermore, owing to unstable business, employees in Firm J were not very stable in their positions. Some left after knowing that the firm lost contracts. An unstable workforce has little impact on growth of enterprises which have in place good knowledge management system and training programmes. However, in the case of Firm J, it was just the opposite and so losing front-line employees meant immediate loss of its knowledge, experiences and creditability. In short, it seems that the firm could survive may partially be due to the capability,

experience and creditability of its owner but its ineffective employee training and development may in part have prevented it from growing.

Another cause for stagnation of Firm J was due to its failure in developing a solid client base. Client relations have not been strong for the firm since its founding, because the firm wandered among different sorts of services, which weakened its image as a centre of expertise and thus, did not have strong attraction for clients. The founders managed to maintain a few client relations but they were not particularly strong; one of the clients gave three business opportunities to the firm, which was the test of maximum client loyalty to the firm. Other clients were not so loyal; they mostly bought one service, which was transactional in nature. As a consequence, the firm had to hop from one client to another, which not only wasted time and energy but also gave the firm very weak client relations. Another consequence is that without deep client relations, the firm had few opportunities to understand in depth the business of its clients and thus, knowledge and experience in serving these clients were less valuable in term of capability development for the firm; in fact, clients seldom gave the employees of the firm opportunity to help solving difficult and complex problems. Or in other words, poor client relations may be in partly responsible for the lack of demanding assignments for the firm and hence the ineffective development of the firm capability.

Finally, without some strong client relations, the firm had weak support in creating successful cases, which led to poor brand development--the third reason for its stagnation. Poor brand development not only resulted from lack of successful cases, in

fact, the firm did not actively go for brand development. Holding a forum, the only activity of brand development for the firm, was a failure, which did more damage than building up a good market image for the firm. The only sensible activity of brand development was visiting clients, which the firm did; but this was less effective than other marketing tools such as organizing industrial events and distributing journals or newspapers which promote the firm. Indeed, the firm did not appear to have any active promotion of its service, except some sales by its founder to a limited number of clients whom he could visit. As a result, the firm did not establish an effective brand in the market; it had no specialist expertise and not any niche market on which to focus. Instead, it jumped from one business opportunity to another, as these opportunities arose. Lack of an outstanding brand, the firm could not attract quality clients, not to mention multiplying the number of clients it could serve. Market demand for its service was, therefore, very low and the few clients it had were not a great source for learning and development, although they were a source of revenue.

In summary, it is possible that due to knowledge, experience and creditability of its founder and hard working of its employees, Firm J survived ruthless competition; however, various problems of the firm prevented it from growing. Ineffective development of its firm capability, particularly ability of its frontline employees, led to failure in many business cases; with few successful cases on hand, it was difficult for the firm to establish its brand in the market, which in turn meant that the firm could not attract quality clients. Without quality clients, it was hard for the firm to develop its capability and to establish its creditability in market. This reinforcing mechanism

prevented the firm from growing. In dialectical terms, Firm J failed to attract quality clients and thus, could not raise the expectation of the market, although it could attract some small clients, relying on knowledge and creditability of its founder; on other hand, the firm could have a few successful deal but it lacked the ability of a firm which could take up big market challenges and overcome them. Forming and resolving conflicts with market in a small way has kept Firm J alive; but obviously, it has been in stagnation since 2004, as shown by Chart 6.2.6

6.3 Cross-case analysis of the growth of the case firms

Within-case analysis created insights in addition to information on the growth story of each firm, both of which are very useful for cross-case comparison and analysis. In this section, cross-case analysis is to be carried out, guided by dialectical theory; it compares empirical evidence from the growth of individual firms in this phase of study to identify patterns associated to research themes on which research questions and potential answers (propositions) were raised in the end of Phase One Study for Phase Two Study. The cross-case analysis section first describes the propositions and then presents related empirical evidence collected from growth of the case firms in this phase of study; and finally, based on the evidence, the cross-case analysis confirms or disconfirms the propositions. This analysis is important for discussion in later chapters on how and why these HR service SMEs grew the way they did and argumentation on causes of growth of these service firms.

6.3.1 Cross-case analysis on relation between firm and market actors (clients, competitors)

The usual assumption in relation between firms and clients is that clients are the ones to be served and should be regarded as a god by service firms; and the assumption on the relation between firm and competitors is that they are enemies competing for the same piece of services available in the market. The assumption of dialectic theory is that firms and market actors are in contradictory union, which often gives rise to conflicts and then resolutions – in a thesis, antithesis and synthesis sequence. The empirical evidence from the study of six HR service SMEs in Phase Two Study tends to support the assumption developed from dialectical theory. The following are some observations from the study.

On relation with clients:

Firm E did a lot of marketing and sales activities such as free distribution of journals to attract clients. The firm needed its clients for learning, revenue and creditability. At the same time, clients benefited from its service such as getting talents from its job fairs. In this sense, the firm and its clients needed each other. Nevertheless, clients quite often increased their demands, in both scale of service and quality of service, as evident from increasing demand for quality candidate in their executive search service. Reflecting on the failure of his firm, the founder of Firm I commented:

‘I do not think that our firm had success in courting our clients who were so peculiar and changed their requirement so often that we could not catch up with them...all the time we had been courting them...they were not loyal to us and once their requirement were not immediately met, they ran away from us...’

Moreover, when clients found that online recruitment was a more effective recruitment channel, they left Firm E immediately for this new recruitment technology, which gave Firm E a devastating blow. The owner of Firm E admitted that clients were their gods, with immense power; but they were also gods which could be persuaded; they were in contradictory union. He commented in his interview on their relations that:

‘I depend on my clients for my living; that is for sure. We spent a lot of time visiting them and listening to their complaints quietly. Our clients are mostly big firms with big names. Nevertheless, in some new business such as labour outsourcing, we had our voice too’.

Firm F was in a similar relation with its clients. It benefited from serving Coca-cola by recruiting managers for this client. At the same time, Coca-cola depended on Firm F for staffing its important departments; it later gave Firm F the exclusive right to recruit professional talents for it. In this relation, Coca-cola has a much stronger voice and it constantly increased its demand for quality of candidates that Firm F supplied. Firm F seemed to be a weaker entity in this relation. Firm G and other firms were in similar

relation with their clients. They depended on clients for business orders; it was very rare to find that they had a voice as Firm E had in its innovative labour outsourcing business.

Relation with competitors:

Firm E worked with the ‘South China Job Market’ to organize and expand job fair business while it organized a network of licensed employment agencies to gain competitive advantage in talent sources and brand recognition. Firm G had few direct competitors in its niche market of temporary personnel service, which it almost created alone, but it felt the pressure from executive search firms which tried to hire permanent employees for its clients which substituted their opportunities to fill temporary positions for these same clients. One of the founders said in her interview that ‘the more these firms recruited for our clients, the less we can do to send out our temporary personnel’. Thus, she welcomed new players such Firm E to expand its business portfolio from labour outsourcing to temporary office personnel placement, which she wish could expand the market. On its relation with competitors, the founder of Firm I simply said in his interview:

‘We were late comers and the market of executive search service seemed to have been divided up by executive search firms. It was hard for us to break into this market, facing such strong competition. I wanted to have some sort of alliance with them but was refused’

Firm J was less pessimistic on competitors. He said in his interview that ‘I enjoyed my relation with them as HR director and now, as competitors; we sometimes need each other; for example, I learned quite a lot on delivering training programmes from our competitors via our clients’ .

From these observations, empirical evidence seems to support the dialectical notion that firms were in contradictory relations with market actors (clients and competitors). On the one hand, they needed each other; on the other hand, they challenged one another. It is clear that competitors competed with each others; but this study also showed that sometimes they worked together, consciously or unconsciously, to expand their market. While it is obvious that service firms and their clients worked together towards solutions of client problems, it is also true that they sometimes had opposite interests, as evident from clients’ frequent bargains for the best value they wanted. In a dynamic market like Guangzhou City, HR service SMEs studied were in a weaker position in their relation with their powerful clients such as MNCs, big SOEs and POEs, who constantly challenged these small service firms for better and more services.

6.3.2 Cross-case analysis on why these firms wanted to grow (motive for growth)

Various assumptions have been made on motives for firm growth, as presented in the literature review; some claims that firms wanted to grow, because of the drive for return on investment (Marshall, 1920; Penrose, 1959); others claims that firms grow due to the fact that their operations had better economy than market transactions (Coase, 1937; Williamson, 1985). Dialectical theory assumes that firms grow to overcome market

challenges to survive in the market. Evidence from the study of six individual HR service SMEs shows that there were many motives for these small firms to grow but evidence by and large confirms the assumption of dialectical theory on the motives for growth, which was also observed in Phase One Study. The table below contains empirical evidences on this topic.

Table 6.3.2: Descriptions of motives for HR service SMEs to grow

Firm	Growth attempts and motivation
<u>Firm E</u>	Expanding into the job fair business to avoid competition in job agency business; Expanding into labour outsourcing as a diversification attempt to survive the crisis brought about by online recruitment technology
<u>Firm F</u>	Geographical expansion into Shanghai City, in part to satisfy needs of clients who had expanded into Shanghai Market and in part to establish new source of candidates to beat competition
<u>Firm G</u>	Expanded in 2005 into higher position in the value ladder of temporary personnel service due to the market condition change (labour law change) which imposed extra heavy cost on enterprises
<u>Firm H</u>	Expanded fast from 2004 onwards by diversification into recruitment of different job categories in part to capture fast market growth and in part to beat competition
<u>Firm I</u>	Fighting hard to grow to earn money for survival
<u>Firm J</u>	Growing to get extra money for a better living

As clear in the above table, there were many motives for different HR service SMEs to grow; it is also normal to see that some firms had several motives for one growth attempt. HR service SMEs which have been growing continuously grew by satisfying demand from market (clients and competitors) while small service firms which have not been growing well seemed to grow for some extra profit. One of the partners of Firm F which has been growing well said in his interview:

‘We grew continuously; but that does not mean we were ambitious and wanted to make a lot of money. It was just that once we provided services for our clients, we had to expand our services to satisfy their growing needs...we had to expand into Shanghai City to satisfy the needs of our clients such as Coco Cola which had been there and demanded for our service. If we had failed to meet their needs, we might have lost them...’

On the whole, it could be said that most of the growth attempts were related to *survival* of these firms which must meet the need of the market. It was definitely so for the weak service SMEs which still had to fight for survival in their lifecycle. It was even true for firms with innovative business models of growth. The founder of Firm G once observed in her interview:

‘We have few direct competitors. However, this does not mean that we are safe from competition. It has always been there. Some of our clients turned their temporary position into tenured position, which drastically cut down their need for our services. It does not look any easier to survive when you are bigger and stronger. The market is really tough for SMEs like us.’

6.3.3 Cross-case analysis on how and why these firms grew

In Phase One Study, it was observed that there were processes that facilitated growth of

HR service SMEs studied and there were also processes that constrained growth of these firms; interaction between both types of processes presents a situation, in which ‘...growth reinforcement and growth reversal forces contend’ Garnsey (1998, p. 523). The growth reinforcement force was the motor that generated growth of these firms. How the force for growth was generated has been the topic for research for many years among researchers on firm growth. As one of the most authoritative voices in this research area, Penrose (1959) claims that knowledge increase and firm growth form the self-reinforcing cycle that propels growth of the firm. However, this study seems to suggest that dialectical interaction between firm and market (clients and competitors) is most likely the motor that generated growth. The following paragraphs describe observations on how and why growth of HR service SMEs happened.

Growth of Firm E is the result of its active engagement with the market. Its founder began the business of selling information on job openings for a small sum of money and when the market of such a business became viciously competitive, he entered the job fair business; he borrowed the license of ‘South China Job Market’, a governmental enterprise, to organize job fairs, which attracted many clients to his job fair events. The firm learned a great deal on job fair business by doing the business and in addition, accumulated a lot of client relations, which later enabled the firm to hold job fairs under its own license. The job fair business not only gave the firm revenue (resource for further expansion), but market reputation and credibility; these later gave the firm ability to enter labour outsourcing business, which further developed ability and market reputation of the firm; this is because labour outsourcing was a new and innovative

service and needed existing clients of the firm to use it first; the firm accumulated learning on this business by serving its client who worked with the firm to find out solutions for many problems in this new business; in other words, this new business grew due to dialectical interactions between the firm and its clients. On this, the founder of Firm E frankly admitted in his interview that although he introduced labour outsourcing to the market, it is the market that gave him many challenges which forced him and his team to learn and to develop:

‘Many of our clients knew better than us at the time because they were MNCs which used to buy such services in their home country. Although they sometimes gave us very demanding jobs, they were always patient with us who learned the trade by working with them. Our clients, indeed, taught us a lot. By overcoming their challenging requirement such as tight delivery time and high quality candidates, we learned how to conduct the labour outsourcing business with MNCs.’

Growth of Firm F began with its services for Coca-cola. Successful recruitment of managers for the famous international firm Coca-cola brought revenue and market creditability to the firm, which attracted more clients and talents to Firm F. As one of his partner said in his interview, the firm benefited from serving Coca-cola which laid a good foundation for the growth of the firm for years to come:

‘Our service for Coca-cola was coincident with many MNCs’ coming to the

market of this city. We had this great example to show our potential clients that we can be capable of serving them as well if we have done such a great job for Coca-cola. This opened up many more opportunities for us’

Soon, however, Coca-cola challenged for Firm F to move along with it into different cities in the country, as Coca-cola expanded countrywide. The firm had its first expansion into Shanghai; for that, Firm F set up its trainee programme and sent a team of employees to study Shanghai market and then to set up Shanghai office. Indeed, challenges from the market that urged Firm F to begin its geographical expansion forced the firm to develop its management system, its workforce and its business model to become an executive search firm able to operate nationwide; in other words, challenges from the market led to its growth. With offices in major Chinese cities, the firm now had, as one of his partners said in his interview, ‘a national network of candidate sources which attract nationwide clients’; that greatly accelerated its growth from 2004 onwards.

Other HR service SMEs which were successful in their growth grew in a similar manner. By contrast, firms which were not successful in their growth did not have such effective interaction with the market. Firm I started its business with no creditability in the HR service market, because its founder was only a former HR manager in a MNC without any experience in HR services; it began serving low level clients from whom the firm learned little and worse still, it could not accumulate good reputation and useful client relations. Thus, few clients were attracted to use its services. Firm I did whatever job

available in the market; and this gave the firm little credit as a centre of expertise which is necessary for a professional service firm to survive in the market. Consequently, Firm I was on its way towards bankruptcy. On the failure of his firm to grow, the founder of Firm J commented:

‘It is not surprising that our firm has been stalled in its growth. I spent little time running the business and we missed some opportunities...we learned little from our clients and we were less experienced than our competitors. Thus, we got fewer chances to be involved in the business of our clients who did not trust our recommendation. As a result, we got few deals and not much revenue; I had little to spend in attracting and developing our employees...our firm failed to grow.’

Based on the above observation of both successful growth and failed growth story, it is fair to say that constant conflicts which arose between an individual HR service SME in this study and its clients led to growth of the firm, because once the market need arose, the firm had to develop its capability to satisfy the need, otherwise it would have been given up by the market; and this development of the firm led to successful service for its clients which increased the firm’s capability, reputation and client base of the firm; as a result the firm grew due to its successful efforts to overcome challenges from market. In other words, observations from this study supports the assumption of dialectical theory on growth that HR service SMEs were in dialectical relation with market actors (clients and competitors), which gave rise to constant conflicts between firm capability and

market demand; and the resolution of the conflicts escalated firm capability, firm reputation and market demand; these sample firms grew due to their successful efforts to overcome challenges from market; and growth induced further growth. No empirical evidence has been gathered showing that inter-firm conflicts led to innovation and firm growth, as predicted in behavioural theory of the firm.

6.3.4 Cross-case analysis on one particularly important facilitator for growth—adaptation to market change

Several observations can be made from this study on how adaptation to market changes facilitated growth of HR service SMEs. Growth of Firm E was facilitated by several anticipations of market change and its quick adaptations to the change. In 1995, when the firm saw the coming of vicious competition among job agencies, it quickly abandoned the business and went for the job fair business, which kept it growing; In 2005, it studied the market and found that labour outsourcing could be a big business and thus it entered the market, which kept it growing. One of the managers of Firm E contributed the firm's successful growth to its owner who could, he said in his interview,

‘see things coming and turn around very quickly. The good example is his abandoning of his business of job agency work which still made a lot of money at that time. He sensed the coming of job fair which could solve the problem of rampant false information on job openings. Then, he foresaw in

2005 the market of labour outsourcing, which allowed us to establish ourselves as a pioneer in this field and grew from there.

Firm F also benefited in its growth from its market study, which foresaw the coming of the burst of high-tech bubble in early 2000s; it quickly diversified its business portfolio to avoid decline due to its limited scope of serving only high-tech and beverage sectors. This quick change kept it on its track to fast growth. Another observation is that Firm H knew from interacting with its clients that business English training was coming in 2002 and it quickly entered the market; this business now has become a new source of its income. In brief, observations can be made from this study that growth of HR service SMEs in this study was greatly facilitated by their effective market prediction and quick adaptation to market change.

6.3.5 Cross-case analysis of constraints on growth of HR service SMEs

There are several observations on constraints on growth of HR service SMEs. The first observation is that limited extent of risk tolerance seems to constrain growth of these firms. In this study, it can be observed that Firm E, Firm G and Firm H all grew very slowly in the early years of their lifecycle; besides the fact that the market was too small for fast growth, these firms' weak tolerance of risk in their survival stage for fear of losing service quality might have contributed to this slow growth. When asked the reason behind this slow growth period, the founder of Firm H said in his interview:

‘Our slow growth was due mainly to the market at the time. It was hard for us to sell our service to our clients, because it was new and intangible, difficult to see what value could come out of it. One question we were often asked was on our price. On the other hand, we were very cautious in our expansion lest our desire to grow go beyond our ability, because we wanted to built up our brand and service quality. Until 2004, we had paid more attention to our service quality than to our profit. Then, some competitors with the support of venture capital came into this market and grew fast; it forced us to go for fast growth, otherwise we may have lost all our clients and our people’.

This was obvious contrast to Firm A which was daring and it grew relatively fast even in its early years, compared with other service SMEs studied. This suggests that extent of risk tolerance may prevent entrepreneurs from quickening growth of their firms, as the observations in this study show.

Another observation was that Firm E declined from its peak of growth in 2003. The external cause was the shrinkage of the market of job fair business, because of the rise of online recruitment. However, Firm E internally had its problem. It did not believe that online recruitment could become the dominant recruitment channel so quickly and substituted physical job fairs in which employers and employees could meet face-to-face; and thus, the firm did not change the way it did business. One of its senior managers who witnessed the decline echoed the comments of the founder of the firm when he said in his interview:

‘Our business was so good and we were known all over the region for our brand. Although online recruitment was becoming popular, we did not think that it could compete with our job fair. So, even though we set up a team to develop our own online recruitment portal, we did not reduce our time, energy and money in our job fair business; nevertheless, our clients were leaving us. This led to the decline in our growth.

Decline in the history of Firm E may come from its failure to change its business portfolio in time to avoid the shrinking of the market, because it was so successful and would not believe that it needed to change so fast.

By contrast, Firm G reacted quickly to the change of labour law which put more cost on service firms such as Firm G; it changed its business model of providing low value service in office staff placement to a business model of management outsourcing, placing top management to steer its client out of troubles; thus, it was able to grow continuously. Firm H foresaw the burst of the high-tech bubble and quickly diversified its service portfolio to develop more markets to serve; due to this timely change, it was able to grow continuously.

One other observation from this study is that poor training and development of front-line employees constrained growth of the firm, as shown in the comparison table below. The contrasting activities of firms which succeeded in their growth and those

that failed in their growth seems to suggest that ineffective training and development of employees constrained growth of the firms.

Table 6.3.5: Contrasting case firms' employee development

Firms which did not grow successfully	Firm which grew continuously
<u>Firm I</u> restricted its front-line employees to contact clients; <u>Firm I</u> and <u>Firm J</u> did not have any formal training inside the firms	<u>Firm F</u> had a trainee programme to prepare its workforce for expansion into other cities and the firm invited external to train its employees in English; <u>Firm H</u> had its Hong Kong managers to train its employees in Guangzhou and the firm sent its employees to work with its clients to develop job specification for executive search assignments.

In summary, growth of HR service SMEs seemed to be constrained by many factors. One of them is the tolerance of risk by the owners of the firms; the less they could tolerate risk, the slower their firms could grow; another is that failure to change to adapt to market condition constrained growth of these HR service SMEs. Finally, poor development of the front-line employees constrained growth of some of these HR service SMEs; often, forces of constraint seemed to increase as firms grew.

6.3.6 Cross-case analysis on rate of growth of HR service SMEs

One clear observation is that rate of growth of the HR service SMEs in this study changed over time. Naturally, they all started as small firms and some of them suddenly grew very fast from a certain point in time. So what determined the rate of their growth? This is an interesting question that can be answered by examining what happened that

accelerated their growth.

Table 6.3.6: Factors accelerated growth of HR service SMEs

Firm	Observations on circumstance under which growth of the firm was accelerated
<u>Firm E</u>	<p>The growth of the firm was first accelerated from 1999 and lasted till 2003:</p> <p>Externally, the market of job fair business began to grow fast from 1999 and reached its peak at 2003, with which the fast growth of the firm coincided.</p> <p>Internally, the firm did many activities of promoting its service and brand, which attracted more and more clients to use its service; in addition, the firm increased its workforce and greatly improved its ability to organized job fairs by interacting with and learning from its clients through means such as feedback.</p>
<u>Firm F</u>	<p>The growth of the firm picked up quickly from 2004:</p> <p>Externally, clients of the firm expanded into other major cities in the countries, which necessitated the firm to go for geographical expansion in order to keep the clients.</p> <p>Internally, the firm increased its client relations and trained its employees through means such as trainee programme; and it restructured its organization and management system to accommodate for nationwide operation.</p>
<u>Firm G</u>	<p>The firm accelerated its growth from 2005:</p> <p>Externally, labour law change which put heavier burden of social cost on the firm required the firm to enter high end service area.</p> <p>Internally, the firm changed its business model and workforce which allowed it to combine consulting and servicing in one shot by sending top management personnel to help clients steer away from crisis. For this, the firm revamped its brand from low-end service provider to high-end service provider</p>
<u>Firm H</u>	<p>The firm accelerated its growth from 2004:</p> <p>Externally, the firm met fierce competition from the new type of executive search firms which openly promoted their service and expanded aggressively, just as product firms; in order to match the competition to keep clients and employees, the firm had to expand fast by entering more service areas and geographical areas.</p> <p>Internally, the firm abandoned its cautious attitude and became more aggressive; it promoted its brand and services openly and got important recognition and it reformed its management and intensified its interaction with clients; it developed its workforce and entered several new areas, as exemplified in its compensation survey for paint industry and its entry into business English learning.</p>

In summary, evidence from Phase Two Study points out that HR service SMEs grew fast in order to meet the external market need and they could do so due to their more daring attitude, more aggressive promotion of their service and brand, more intensified interaction with clients and greater effort in organizational development and employee development. By contrast, prior to their fast growth, these firms did not behave in this way. One of the founders of Firm H said in her interview:

‘Before 2004, we proceeded as any other professional service firms always do: keeping your profile low and do not boast your performance, letting the facts speak for themselves. This worked well for us; our brand became gradually valued by clients through word of mouth. However, in 2004, we witnessed that new executive service firms, which had the backing of venture capital, entered the market and behaved like product firms, aggressively recruited consultants from traditional firms like ours and openly promoted their service. We had no choice but to match the competition; otherwise, we might have already perished in market.’

6.3.7 Cross-case analysis on sustainable growth of HR service SMEs

Some of the HR service SMEs grew continuously but others could not. These two groups behaved differently, as can be seen in the comparison of activities they did in the following table. As evident from the observations in the Table 6.3.7, it could be said that

those HR service SMEs which grew continuously followed the market closely and adapted to market conditions as required; they interacted intensively with the market (clients) and actively developed their capability, in particular, the ability of their front-line employees. On the contrary, firms which suffered from their growth (e.g. being in stagnation or decline) did not do so well in these areas. On the importance of developing employee ability for the growth of the firm, one partner of Firm F commented in his interview:

‘Our successful expansion into Shanghai market was due to our employees there. At the beginning, few enterprises knew us and the Shanghai market was different, hence very hard conditions to work in. It was like starting overall again. However, the three consultants sent to our Shanghai Office worked day and night. They visited our clients who expanded from Guangzhou to Shanghai. In addition, they established some new client relations and their studied the Shanghai market, learning from clients and our counterparts (competitors). After some time, thanks to their hard work, we finally got our foothold in Shanghai market’.

Front-line employees, he said, were vital to the survival and growth of the firm, because they co-worked with clients to solve client problems, which allowed the firm to develop client relations, to gain new knowledge (experience) and to enhance credibility. Often, tacit knowledge of this group of employees was what the firm needed to depend on for survival and growth.

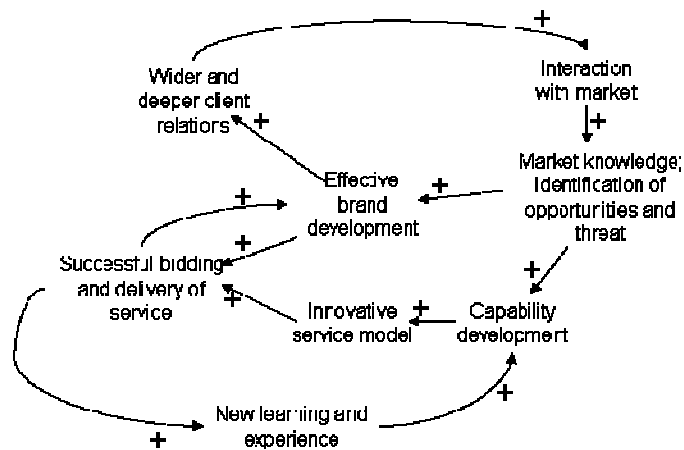
Table 6.3.7: Contrasting HR service SMEs which grew continuously and those which could not

Behaviour of HR service SMEs which grew continuous: (<u>Firm E</u> , <u>Firm F</u> , <u>Firm G</u> and <u>Firm H</u>)	Behaviour of HR service SMEs which suffered from their growth—stagnation or decline: (<u>Firm I</u> and <u>Firm J</u>)
<p>The owner of <u>Firm E</u> was daring and innovative; the firm closely followed market development (when he did not, growth of his firm declined) and developed innovative business model such as licensed employment agency network; it promoted its brand and service aggressive through newspapers and HR forums; it interactive intensively to develop new solutions such as labour outsourcing and actively development of its workforce.</p>	<p><u>Firm I</u> did few brand developments except for sales calls; client relationship development mostly depended on personal contacts; the firm kept client contact with its owner; the firm had few internal employee development activities (no formal training); it had shallow interaction with clients and learned very little from them; the firm failed on several assignments (over promised service but failed to overcome market challenges, which led to dissatisfaction of clients)</p>
<p><u>Firm F</u> paid much attention to market developed and foresaw the burst of high tech bubble and successfully diversified to avoid this; it trained its workforce and using existing client relations, it expanded cross the country to satisfy the clients who expanded nationwide. The firm also actively promoting its brand by subtle means such as leveraging client brand such as Coca-cola in its sales of services to new client</p>	<p>The owner of <u>Firm J</u> had little ambition to grow; he spent insufficient time to run his firms, in particular, to meet his clients. No formal market studies; client relation development depended on personal contacts; the firm had no formal training for its employees</p>
<p><u>Firm G</u> quickly adapted to new market condition when labour law change and developed new business model and revamped its brand to enter high end service market in which it provided combined service of consulting and servicing.</p>	

6.4 Summary and discussion of major findings from Phase Two Study

The purpose of Phase Two Study was to identify causes leading to growth of HR service SMEs studied. This phase of study has identified causal dynamics of the processes that facilitated growth of these firms; it has also identified constraints on growth of these firms. The findings in this phase of study exposed activities and dynamics that led to continuous growth of these firms, as shown in Figure 6.4a:

Figure 6.4a: Self-reinforcing activities that led to continuous growth of HR service SMEs.



In the above figure, it could be noted that active interaction with the market by firms initiated and maintained a self-reinforcing cycle. First, active interaction with market increased market knowledge of the firm which led to effective brand development; successful brand development led to successful bidding and widened and deepened client relations which in turn led to more interactions by the firm with market (clients and competitors) and the cycle began again. Another self-reinforcing cycle which enabled continuous growth of firms also started with firms' interaction with the market, which increased firms' knowledge of the market and identified growth opportunities and threats to firm survival; such knowledge gave pressure and direction for firm capability development; successful capability development led to innovation which led to

successful winning and delivery of service orders; successful winning and delivery of service orders brought more learning and experiences to the firm which facilitated its capability development; at the same time, successful winning and delivery of service orders led to wider recognition of the service brand which led to wider and deeper client relations; wider and deeper client relations led to more interaction by the firms with market, which restarted the cycle again. It is these self-reinforcing cycles that led to continuous growth of the HR service SMEs under investigation.

All the activities in Figure 6.4a appear to get their power directly or indirectly from dialectical interactions between firms and market actors (clients and competitors), which constantly formed and resolved conflicts between firm capability and the market. At the centre of these interactions was development of firm capability. As these firms developed capability to successfully deliver service, meeting challenges from market, the market then raised new expectations for these firms in the next round of service development. The heightened expectations presented new challenges for these firms which again had to develop its capability to meet these market challenges. This dialectical interaction went on in a self-reinforcing spiral which generated endless firm growth and only stopped if firms failed to meet market demand. The dynamics is demonstrated in the following figure:

Figure 6.4b Dynamics of continuous growth of HR service SMEs

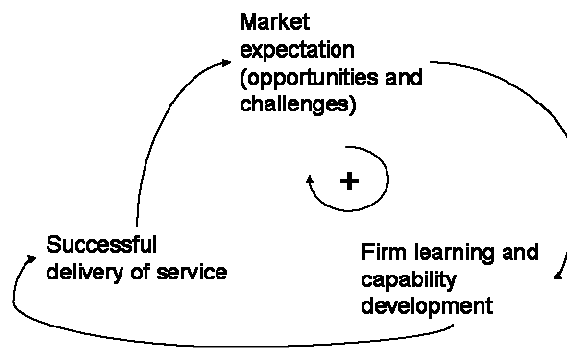


Figure 6.4b demonstrates the real dynamics underlying all processes of activities which generated and sustained firm growth. This finding came from empirical evidence from the current case studies. It seems to imply the importance of interaction between markets and firms which drove growth of the HR service SMEs. It may be concluded that causes of growth of these HR service SMEs were external market demands which kept growing because clients needed to grow and competitors needed to develop themselves to stand out in the market for survival, and the internal continuous development of firm capability, in particular, ability of front-line employees, so as to satisfy perceived external demands (to solve client problems and to overcome market challenges), which allowed the firm to survive in a buyer market of Guangzhou City; these two forces interacted dialectically, escalating firms' capabilities, reputation, client bases, firm value and market demand, hence leading to continuous growth of the firms.

In summary, this chapter presents the analysis and discussion of the Phase Two study.

The purpose of this phase of research was to identify causes of growth of HR service

SMEs studied. Growth of each of the six HR service SMEs is examined first in the within-case analysis, which attempt to expose the dialectical processes and causes of growth of these individual firms. Then, the chapter moves on to cross-case analysis on growth of these case firms; the cross-case analysis is carried out through a dialectical perspective developed for the analysis of this phase of study; synthetic evidences from all case firms, both firms with successful growth and those with failed growth, were compared and contrasted in light of research themes on firm growth. Cross-case analysis generated major findings on dialectical processes and causes of growth of these firms. Based on these empirical findings, a discussion is carried out which exposed the causal links between the activities in the dialectical interaction between firm and market actors (clients and competitors) and causes for the growth of these HR service SMEs. It is finally concluded that causes of the growth of these case firms were the increase of the external market demand which could be raised by these firms and the development of the firms' capability, particularly the capability of their front-line employees; both forces were in constant dialectical interaction and generated power to drive growth.

Chapter Seven: Summary and discussion of overall research findings

This chapter sums up and discusses the overall research findings synthesized from the two phases of study in the current research project. The purpose is to develop and defend a theory which can adequately explain how and why the HR service SMEs studied were able to grow. To achieve this objective, first of all, in accordance with the research questions and research themes, the overall research findings are synthesized from key findings of the two phases of study as presented in the previous two chapters. Then, these synthetic findings are discussed in light of the literature and research context for the purpose of interrogating and evaluating them against extant research and knowledge on firm growth. Based on these findings and according to a dialectical perspective, a new system dynamic model and a new process theory (thesis) is developed in the section to better explain growth of these service SMEs. Next, validity of the new theory is evaluated and discussed against empirical evidence from the current study to test its internal validity. Finally, a discussion is carried out on generalization of the theory which shows how much the new theory can be used to explain growth of other types of firms in other context.

7.1 A summary of overall findings from the current research

The two phases of the current research were carried out to identify processes underlying growth and causes of the growth of HR service SMEs in order to answer the central research questions of how and why HR service SMEs were able to grow. Phase One

Study was carried out as a descriptive study to identify processes of growth of these service SMEs and several findings were made from the empirical study of the four HR service SMEs; Phase Two Study was undertaken as explanatory research to address the question why these service SMEs were able to grow; thus, findings from this phase of study explain causes leading to their growth. In this section, all findings from the two phases of study are synthesized and arranged in progressive order according to research themes on firm growth attempting to give answers for research questions on how and why the service SMEs were able to grow. The first finding addresses the question why these firms wanted to grow; the second finding answers the question where growth of these firms happened; the third finding exposes causes of growth of these firms; the fourth finding shows how growth of these firms happened; the fifth finding lists the facilitators for and constraints on growth of these firms; the sixth finding addresses the question of rate of growth and the last finding shows why some of these firms were able to grow continuously while others could not. In the sections that follow, these findings are interrogated and evaluated against existing literature and knowledge on firm growth as well as specific context in which these firm grew.

1. HR service SMEs existed in a dynamic buyer market in Guangzhou City; in such a market, these service SMEs constantly faced imminent threat to their survival; in order to survive, most of the time, they had to grow to satisfy client needs or to signify their power and creditability to attract new clients and to fend off competition, with only a few expansions carried out purposefully to capture market opportunities of profit-making.

2. These service SMEs were found to be in contradictory union with market actors (clients and competitors); they were constantly challenged by clients and competitors to improve their services; and they had intensive engagement with their clients, co-working with them to identify and solve client problems and thereby, co-producing knowledge (experience) and growth therefrom.

3. It is found that dialectical interaction between perceived external demand and firm capability, which existed because firms and market actors (clients and competitors) were in contradictory union, produced a dynamics which escalated (in a spiral) firm capability, firm reputation, client relations and market demand, leading to continuous firm growth; the causes for growth of these HR service SMEs were the increase of market demand and the development in firm capability, which constantly interacted with each other, hence leading to firm growth.

4. The process of firm growth is found to be like this: when the market raised its expectation for services of these service SMEs, which was often facilitated by firms' effort to attract clients through brand development and client relation development, tension came into relations between perceived external demand and firm capability; and these firms needed to develop their (knowledge base) firm capability, particularly the ability of their front-line employees, to meet market demands; then, with an improved knowledge base and firm capability, the firm developed innovative solutions to address client problems; once the perceived

external demands (challenge) was effectively met, the firms grew and there was a new increase in firm knowledge and capability, firm reputation and firm client relations, which prompted another cycle of firm growth; firm growth went on and on, until they were constrained by the firms' fear of losing control, by the firm's lack of adaptation to market change and by unmatched development of firm capability, particularly ability of front-line employees who directly interacted with clients to incur growth.

5. It was found that these activities facilitated growth of these HR service SMEs: market study, interaction with market actors (clients and competitors), learning and development, innovation, marketing (brand development) and sales, effective delivery of services; it is found that growth produced counteracting forces which, unless overcome, constrained growth; these forces included fear of losing control, lack of adaptation and unmatched development of firm capability, in particular, the ability of its front-line employees.

It was found that when firms could follow closely market change and predicted effectively market trends, they had better chance to grow; it was also found that when firms promoted their brand widely, they had more market opportunities to grow; further, it is found that firms constantly upgraded capability of their workforce and restructured their organizations, which allowed them to successfully adapt to market change and to grow.

6. The rate of growth, which changed during the lifecycle of a firm or differed among

firms, had to do with the extent of conflict (strength of tension) between market demands and firm capability, and the effectiveness and efficiency of firm's resolution of this conflict; it was observed that firms often accelerated their growth by first raising market demands for more and better services through their expansion in service lines, geographical coverage and the sheer marketing to promote existing services and then, effectively and efficiently resolving client problems and meeting perceived external demands.

7. HR service SMEs which grew continuously followed the market closely, interacted intensively with market actors (clients and competitors), promoted their brand effectively and, developed actively their firm capability and business models to suit market change; on the contrary, those HR service SMEs which reversed their growth (stagnation, decline and bankruptcy) did not do very well in these activities.

7.2 A discussion of overall research findings in light of literature and research context

In this section, the overall research findings are discussed in relations to the existing literature which mainly centred on '*The theory of the Growth of the Firm*' by Penrose (1959). The purpose of the discussion is to see how well the findings are supported by existing knowledge, how well the findings answer the research questions and how significant they are for the discussion on how and why HR service SMEs studied were

able to growth. The findings are arranged and discussed by themes on firm growth, as reflected in research questions and sub questions. After the discussion of findings on each research theme, a final assessment is made on how well the research findings answer the research questions.

7.2.1 Discussion of findings on why HR service SMEs in Guangzhou City wanted to grow.

In order to understand forces driving growth of HR service SMEs in the city, it is important to understand why these firms wanted to grow. As revealed in literature review, various theories exist to explain incentives for firms to growth. It is often claimed by some economists such as Coase (1937) that firms grow due to reduction in transaction cost. Indeed, most economists such as Marshall (1920) tend to treat a firm as a production unit that grows for economic benefits (profits). On the other hand, some social scientists and scholars argue that firms may grow for motives other than mere economic benefits; for example, Starbuck (1971) and Perrow (1979) believe that firms grow for market power in order to dominate market. According to Stanworth and Curran (1976), firms may grow for survival in market. In her work '*The theory of the Growth of the Firm*', Penrose (1959) assumes that firms are management-controlled and that managers want to grow their firms for profit; with profit managers can have non-economic as well as economic value such as 'prestige [and] personal satisfaction in the successful growth of the firm'(Penrose, 1959, p.26-280). Most critically she argued that managers expand their firm to make the best use of their resources slack, which

bring about economy of growth; Marris (2002), however, disagrees with her on this and Kay (2002) thinks that vertical expansion does not fit her theory.

The current research has not gained findings that support the view of Coase (1937); expansions of these SMEs were not due to reduction of transaction cost, according to results of empirical investigation. Also, they did not expand simply for economies of scale or scope. Findings from the current research did not give any explicit support to view of Penrose (1959) that firms grow to make best use of slack resources (economy of growth) or to make profit for increasing managerial prestige and personal satisfaction. In brief, although economic motives may be behind expansions of these firms, evidence from the current research does not support the view that these HR service SMEs grew for *purely* economic purposes. Furthermore, these SMEs were in no way expanding for monopoly of their niche market, which they could not accomplish because of low entry barriers and a fragmented market. In fact, each of these SMEs was a tiny entity in a buyer market dominated by powerful buyer group such as MNCs. Evidence from the current study seemed to support the view of Stanworth and Curran (1976) that firms grow for survival--not life or death, but floating in their current business. Firm D, for example, expanded to Shenzhen from Guangzhou, not for profit but for keeping one of its key consultants; Firm F expanded into other cities like Shanghai, in order to satisfy needs of their dominating clients such as Coca-cola. Firm A expanded into outdoor training, originally for profit; later, it kept growing the business because of competition. One can say that profit was a more latent than driving force; it lay behind the motivation of manager-owners, but was not the particular reasons for specific firm expansion

ventures.

From Finding 1 of the current study, it is possible to observe that HR service SMEs in Guangzhou City expanded for immediate need of survival in their business (to satisfy client needs and to fend off competition), which was more strategy-oriented than economy-oriented, although profit-motive might also be behind these expansions. There are good reasons for the finding to suggest that these service SMEs grew for survival more than economic benefits. The HR service market in the city was very fragmented and competition was open and fierce. In addition, this market was far from mature and was not transparent; due to that it was hard to establish creditability of a firm which offered intangible service. Growth is a good sign of success, which implies ability and creditability (Perrow 1979). So HR service SMEs studied expanded to other cities, even in partnership with other firms, in order to show to the market that they were growing firms, implying that they were capable and creditable. This gave them reasons for being accepted by the market. In addition, and in contrast to industrial firms which could outsource their transaction to market if they believed outsourcing can reduce their costs (Coase, 1937), the HR service SMEs studied engaged in relation-based business in which relations were more important to them than cost in their long-term survival. For these service firms, internal economy was not as important as client relations; when these two came into conflict, these service firms had to put client relations before cost. That is why their growth actions seem to be carried out for survival, rather than for economic benefits. In short, empirical evidence does not support the view of Penrose (1959) that firms grow for profit and for economy of growth; rather, the empirical

evidence supported the view that these firm grew for survival in a fiercely competitive market. Penrosean views may explain well incentives to grow for big established firms which have slack resources and want to grow for economy of growth; it does not explain well SMEs which have few resources to spare but have to grow to satisfy market needs.

Finding 1 is significant in that it justifies growth behaviour of these HR service SMEs which may not lead to immediate profit but rather to survival in the market. In order words, these SMEs might have to grow, first and foremost, to satisfy perceived external demand. Market actors (clients and competitors), not the firm's desire for profit, appeared as the most important players in driving growth of these firms. The attention of these firms in growth had to shift from gaining economy to accommodating needs of their clients and to responding perceived external demand. In order to survive, they had to dance with these market players well, which pressured them to develop their capability. Finding 1, thus, lays a sound foundation for developing a process theory using dialectical analysis to better explain growth of these firms.

7.2.2 Discussion of findings on where firm growth happened for the HR service SMEs

According to dialectical analysis, development comes from internal conflict (Van de Ven and Poole, 1995); thus, it is often taken for granted that growth of a firm happens within the firm. Traditionally, in industrial firms, firm ability is developed and accumulated within the firm and products are made within the firm. This is the case

argued by Penrose (1959) who examined growth of manufacturing firms and assumed that firm growth happened within the case firms. However, when inter-firm cooperation arises, which is important for growth today (Marris, 2002), it is less certain whether firm growth happen within the firm (De Rond and Bonchikhi, 2004; Mesquita *et al.*, 2008). This is particularly so with service firms which have to involve clients in the process of production and consumption of services; learning and ability development from delivery of service such as resolution of problems for clients are carried out by both consultants from the firm and project members from clients. Growth of ability and revenue for these service firms are completed not within the firms but in their cooperation with clients.

Finding 2 from the current study point to the fact that firm growth happened within the dialectical union between service firms and their clients. Firm F, for instance, learned the art of executive search business by engaging with Coca-cola, a global firm, which was very demanding for the task but gave them many instructions for the assignment. As another example, Firm B learned consulting business by working with clients to solve their problem of retaining key talents, in which clients discussed with consultants from the firm about the root causes of losing talents and their plan to resolve the issue. Consultants of the firm gave their advice to their clients on the issue. Both parties learned and grew from the discussion and resolution of the issue of retaining talents. Success and failure of Firm C's training course both illustrate well the fact that firm growth happened in cooperation between the firm and its clients, which is a joint knowledge acquisition effort (Bettencourt *et al.*, 2002; Mesquita *et al.*, 2008). This locus

of firm growth may be very special and was valid for these relation-based service firms which could not alone complete activities of growth; it may be also valid for intra-firm business.

Finding 2 plays a significant role in advancing a new dialectical concept to explain firm growth, by identifying locus of conflicts to be not within the firms but between the firms and market actors. Traditional dialectical belief holds that development of any entity comes from internal conflicts of the entity and consequently, firm growth comes from and depends on, internal effort of the firms. Finding 2 points out that growth of HR service SMEs came from conflicts between these HR service firms and their market actors (clients as well as their competitors). The finding draws in market actors as a necessary actor in driving growth of these relation-based service SMEs. The finding points to the contradictory union between firms and market actors as an entity that produced growth, which involved firms and market actors. Dialectical interaction between firms and market actors within the contradictory union became the dynamics of firm growth for HR service SMEs. Traditional dialectical concept that development of an entity comes from its internal conflicts seems to explain well the growth of industrial firms which often can complete innovation and production within itself (although with some inputs from market) and then sell their products to customers outside the firm, given that they have the choice of co-production of products with their customers (and many Japanese firms go for the choice). In HR service sector, firms have only one choice of growth: co-production of service with their clients: innovation and production could only be achieved with involvement of clients. In this light, Finding 2 which points

out that growth of HR service SMEs involved firms and their clients fits very well the theorizing that looks into the dialectical interaction between firms and market actors for processes and causes of growth of these service SMEs.

7.2.3 Discussion of findings on why HR service SMEs in Guangzhou City were able to grow.

Why firms are able to grow has been a topic for many generations of scholars. Indirectly, Adam Smith has made some contributions to this research topic; from his work, it is possible to infer that growth of firms lies in specialization of labour which increases production efficiency (Best, 2002). Smith (1776) believes that there is an ‘interactive dynamic between the emerging opportunities and evolving activities of production. Every increase in the extent of the market increases the number of activities in production; further division of labour leads to increased markets (economic growth)’ (Best, 2002, p.181). Different from Smith (1776), Schumpeter (1942) contributes firm growth to entrepreneurial innovation, particularly ‘creative destruction’, which brought advantage to the firm, enabling it to grow; to him, innovation is the engine for growth of the economy. Chandler (1990, 1992) contributes growth of a firm to development of its organizational capability. Porter (1980), on other hand, contributes growth of a firm to its identification and defence of a niche position in an industry which allows it to exploit the industrial value chain. Others, such as Marris (1964) point to organizational learning and management as engine for growth. Penrose (1959) believes that increase in firm knowledge (both objective and tacit knowledge-experiences) generates firm growth. She

reasons that knowledge is automatically increased in firms where people work together and learn from each other and that as managers learn more about their resources, they know more utilities of their extant resources which opens up more productive opportunities for the firm. It seems that Penrose (1959) has discovered mechanism which generates firm growth.

In general, as shown in Finding 2 and Finding 3, evidence from the current study supports the view of Penrose (1959) that knowledge increase leads to firm growth. But these findings seem to go beyond her view. First of all, the findings have a different view on how knowledge (experience) of these firms was produced. Even given that employees learned from each other, these findings suggest that firm knowledge (experience) was not automatically generated *within* these firms, as Penrose (1959) claims; it was generated *in cooperation* between the firm and its client (Ospina *et al.*, 2008) or rather, from the activities of contradiction between them (Miguel and Rita, 2004). HR service SMEs interacted daily with their clients and worked with clients to solve client problems, from which both learned and increased their knowledge stock that led to their growth. Secondly, these findings further suggest that increase in knowledge (experience) alone was not enough to generate growth (Richardson, 2002). There were many activities between knowing how to do things and the result of actually doing the things. Firm A, for example, knew how to run outdoor training programmes to make money. Yet, it had to depend on its clients to make such training programme a success, which then contributed to growth of its capability and revenue. Similarly, Firm C depended on its clients to determine the success or failure of its training courses Thus,

although it might lead to firm growth, knowledge (experience) increase of the firm was not the ultimate primary cause of growth of HR service SMEs. In other words, Finding 2 and Finding 3 suggest that causes for growth went *beyond* knowledge (experience) expansion. They show that interaction between firms and markets produced a dynamic which escalated in spiral these SMEs' firm capability, firm reputation and client relations and market demand, leading to continuous firm growth; different from the view of Penrose (1959), these findings give a more nuanced answer to the question why HR service SMEs were able to growth. It is a good example of 'development through conflicts' (Schneider, 1971, p.667). According to the findings, the ultimate causes of growth were the increase of market demand and the development in firm capability, which constantly interacted with each other and this dialectical interaction powered growth of these relation-based service firms. It seems that sometimes growth was an outcome of their dialectic interaction, which was not necessarily the intent of the firm's managers (De Rond and Bouchikhi, 2004).

7.2.4 Discussion of findings on processes underlying growth of the HR service SMEs

Processes of activities which drive firm growth have been relatively neglected in research until recently (Mckelvie and Wiklund, 2010). An exception in this topic is the research on four basic processes of organizational development (which includes firm growth) as presented by Van de Ven and Poole (1995). The first type of process is the evolutionary process in which some organizations (firms) are selected by environment as winners and allowed to grow; the second type of process is teleological process in

which firms are pulled to expand by goals and vision set by their management; the third type of process is the life-cycle process in which firms go through various stages in their life-cycle, driven by their pre-fixed programme and the last type of process is dialectical process in which firms grow due to their internal conflicts. Regarding research on growth process, Penrose (1959) is an exceptional contributor. She says in her work '*The Theory of the Growth of the Firm*' that she was examining growth process, looking for a theory on growth process which economists were not interested at the time. In her process theory, she claims that it is in the nature of the firm to search for new knowledge and knowledge increase leads to continuous discovery of productive opportunities. Learning is the key activity in the Penrosean process which leads to firm growth. To her, growth is 'essentially an evolutionary process and based on the cumulative growth of collective knowledge, in the context of a purposive firm' (Penrose, 1959, p.xiii). In each cycle of growth, after managers learn and identify productive opportunities, they take actions to implement their growth initiatives; completion of expansion brings more learning and resources to the firm, which induces more expansions. Thus, the firm grows.

Finding 4 from the current study shows growth process of the HR service SMEs studied. Growth of these service SMEs was a process of dialectical interactions between firms and market actors. In part, the finding confirms and extends Penrosean process theory on firm growth. It confirms that learning of a firm from its expansion, from competitors, from clients and from other sources did play a critical role in inducing firm growth and in ensuring success of firm expansion. However, the finding extended the theory of

Penrose (1959) on growth process, pointing out that more activities than learning were responsible for driving the growth of HR service SMEs studied. Prior to any learning, there was the step of interacting with clients by these firms such as discussion between consultants and clients on root causes of losing talents, as in the case of developing consulting ability by Firm B. Learning for these consultants then took place amidst activities to solve client problems. This confirms the view of Miguel and Rita (2004) that knowledge could be created from the basis of dialectic contradiction. Apart from learning (accumulating experience), this intensive interaction with clients was also important for building client relations (client intimacy) which is regarded as critical for growth of relation-based professional service firms (Paulin *et al.*, 2000; Greenwood and Suddaby, 2006). Another important step in growth process was to develop innovative service and to convince market (clients and competitors) to let the firms solve problem for clients. If these service firms succeeded in convincing their clients and solved problems for them, these firms could then reap both fame and revenue, which facilitated the next round of growth. Findings from the current study reveal that there were many more steps in the action chain between learning (knowledge increase) and actual firm growth. For small service firms in dynamic (and chaotic market) such as that of Guangzhou City, as for other professional services, activities to provide innovative solutions (specialization) and activities to promote their reputation (brand development) (Greenwood *et al.*, 2005; Kirkwood, 2009) were two activities most important to their growth. Similarly, effective delivery of service, which heavily involved clients, played important role in driving growth.

7.2.5 Discussion of findings on what facilitated and what constrained growth for HR service SMEs

Finding 5 highlighted several activities leading to fast growth of these service firms. It found that market study and brand development (marketing) greatly facilitated the growth of these firms. Active engagement of the market was also important for growth of firms. Besides, employee development and innovation of services facilitated growth of firms. In general, the findings are in line with the literature on professional service firms. According to Brentani and Ragot (1996), to beat competition and grow, PSFs need to have exceptional ability to comprehend market trends and identify business opportunities. They need a reputation to win their market competition (Bryon *et al.*, 1997; Greenwood *et al.*, 2005). And to build up their reputation, they have to carry out proper marketing activities (e.g. interactive marketing) (Brentani and Ragot, 1996; Amontini *et al.*, 2010). Furthermore, they have to interact effectively with clients and provide highly customized solutions to problems specific to their clients (Zeithaml *et al.*, 1985, Patterson and Cacic, 1995). They also have to develop strong personal relationship with clients (client intimacy) (Paulin *et al.*, 2000). Lastly, development of their professional workforce is vital for the success and growth of these firms; in fact, to a certain degree, these firms largely depend on their human capital for their successful growth (Hitt *et al.*, 2001). Therefore, the finding that development of these front-line employees (specialists and experts) facilitated growth of HR service SMEs studied was firmly rooted in theory and in practice.

Finding 5 also confirms that growth of these service SMEs at some point produced a counterforce, which, unless overcome, actually constrained growth; this is in line with the work of Senge (1990) and Garnsey (1989). Senge (1990) believed that as a firm grows, it will produce a counterforce which slows down its growth unless mitigated; he pointed out that from a system's perspective, the harder one pushes for growth, the stronger resistance to growth becomes. Garnsey (1998, p. 523) remarked that in firm growth, '...growth reinforcement and growth reversal forces contend'.

One of the counteracting forces was fear of losing control that constrained the growth of HR service SMEs, as exemplified by Firm D in its late stage of growth and Firm H in its early years of slow growth. This finding reflects the fact that these small service SMEs were in a dynamic buyer market and their survival had to be earned everyday; it is consistent with literature on growth of PSFs (Lowendahl, 1997; Kirkwood 2009) which argues that professional service firms generally do not like to grow, for fear of losing control.

According to Finding 5, another element that constrained growth of HR service SMEs was poor adaptation to market change which arose from indulgence in past successes, because poor adaptation prevented firms from developing knowledge and skills to catch the next wave of opportunities and lost the attractiveness to their clients, as shown by Firm C and Firm A in their failure in 2004 to adapt to online recruitment. This finding is in line with literature in organizational change and the literature on growth of SME which emphasizes that a SME could survive and grow only in niche markets, relying on

its flexibility and adaptability. Even Penrose (1959) stresses the importance of ‘...flexibility, change and uncertainty’ (Foss, 1998, p.10).

The last element that constrained growth of firms, as confirmed by Finding 5, was ineffective development of firm capability, particularly development of its front-line employees (specialists and experts). This was by and large in line with the view of Nelson and Winter (1982), Chandler (1990, 1992) and Peng and Heath (1996) that growth is limited by organizational capability development. For example, both Firm A and Firm B had to change their organizational structure, rearranged their teams and to develop an information technology platform, in order to upgrade their status from a low-end service provider to high-end service providers. However, findings from the current research do not support the view of Penrose (1959) that managerial services ‘provide both an inducement to expand and a limit to the rate of expansion’ (Penrose, 1995, p.xii). This is perhaps because the case firms for Penrose (1959) were big industrial firms whose growth entailed enormous managerial coordination and communication (managers both allocated resources and embodied firm capabilities), whereas small HR service firms under the current study were professional service firms whose employees (specialists and experts) prefer operational adhocracy over organizational bureaucracy (Harte and Dales, 1995; Greenwood *et al.*, 2005). Indeed, PSFs seldom compete on organizational efficiency since they are small and flat (Gardner *et al.*, 2009) and did not need much managerial service to drive growth. Instead, these small service firms needed strong ability of front-line consultants to drive their growth, because these employees were interacting with clients on a daily basis and

it is their specialization and their collective and cumulated learning from client cooperation that determined the firms' knowledge (experience) accumulation, creditability and revenue.

7.2.6 Discussion of findings on what determines the rate of growth.

Finding 6 from the current research shows that *rate* of growth had to do with the extent of conflict (strength of tension) between market demands and firm capability, and the effectiveness and efficiency of firm's resolution of this conflict. This is consistent with dialectical theory which sees conflict as a generative mechanism of social development (Kaufman, 1965; Schneider, 1971). In the case of HR service SMEs under the current study which had intense interaction with clients to develop knowledge (experience), client relations, service delivery and reputation, this finding is more convincing than rather one-sided view of Penrose (1959) which emphasizes, from the case of big industrial firm, that it is the growth of managerial services which is the key factor determining the rate of growth. In terms of logic, Finding 6 relates well to Finding 5. The extent of conflict (strength of tension) between perceived external demand and firm capability were raised by the efforts of these service SMEs to attract clients and effective solutions of these conflicts were facilitated by development of front-line employees. Service firms grow faster, according to the literature on PSFs, when they have effective marketing activities (Amonini *et al.*, 2010) to attract clients which raise market demands, and when they have stronger front-line employees (Nordenflycht, 2010). This finding explains well the variability in the growth rates by firm and time; why some of firms grew faster in different periods in their lifecycle and why some of

HR service SMEs grew faster than others in the same setting.

7.2.7 Discussion of findings on why some HR service SMEs could grow continuously

Sustainable development of firms is an interesting research topic for many researchers. The basic argument is that a firm needs to have sustainable competitive advantage or a series of temporary competitive advantages (D'Aveni, 1994) in order to grow continuously. Views on what constitutes sustainable competitive advantage are various. Porter (1980) believes that sustainable competitive advantage comes from the strategic position in an industrial value-chain a firm is able to secure and defend. RBV scholars such as Wernerfelt (1984) and Barney (1991) believe that sustainable competitive advantage comes from firm resources which are valuable, rare and hard to imitate. Scholars of core capabilities (Prahalad and Hamel, 1990) believe that sustainable competitive advantage comes from core competence of the firm which is path-dependent. Scholars of dynamic capabilities (Teece *et al.*, 1997) believe that sustainable competitive advantage comes from dynamic capabilities of the firm to deploy firm resources; further to this, Eisenhardt and Martin (2000) argues that in a fast moving market (such as China), firms can develop dynamic capabilities to achieve a series of temporary competitive advantages which allow them to grow continuously.

Penrose (1959) assumes that firms can grow endlessly, without any limit to their size (there is no optimal size for firms). Firm growth brings more learning and resources to the firm, which induces further expansion. This cycle goes on and on, unless it is

stopped by bottlenecks in the development of managerial resources. Continuous growth of a firm, therefore, depends on growth of managerial resources, which is an embodiment of knowledge (experiences) increase (Loasby, 2002). Accordingly, firms which could grow continuously put more emphasis on organizational learning and knowledge improvement, which is demonstrated in growth of managerial services—more and better managers are produced and they brought benefits to the firms. Growth of managerial services lead to more innovations which enhance competitive advantage for the firm and thus, increase productive opportunities, allowing the firm to expand; and growth is stopped only by lack of managerial services.

Finding 7 from the current study do acknowledge that organizational learning is pivotal to sustainable growth of a firm (Teece and Pisano, 1994; Winter, 2003). However, the finding does not support the view that firms grow continuously thanks to the growth of managerial services which can automatically increase within the firm (Penrose, 1959). Instead, the current study found that growth of HR service SMEs depended more on industrial know-how and problem-solving skills than on experience of working together; such knowledge could not be produced internally; it was developed in cooperation with clients. In brief, active interaction with clients produced and accumulated industrial knowledge and problem-solving skills which induced and ensured further growth of HR service SMEs studied.

Interaction with the market, involving clients and competitors, was the motor for continuous growth for these service firms; this is different from pure knowledge

(experience) increase which could be produced internally, as claimed by Penrose (1959). The difference may be due to different type of case firms: growth of big manufacturer in Penrose (1959) depended more on growth of internally produced management knowledge (experience) while growth of HR service SMEs had to depend on effective interaction with clients who co-worked with the service SMEs to produce industrial knowledge and professional problem-solving skills.

7.3 Developing a new model and a new process theory to better explain growth of HR service SMEs studied

As presented above, Finding 1 to Finding 4 from the current study lend support to the argument that growth of HR service SMEs studied was created by a dialectical process of forming and resolving conflicts between perceived external demands and firm capability: these firms were able to grow, because they were in dialectical interaction with market actors (clients and competitors) which created constant conflicts (tensions) between market demand (in particular, client requirement) and firm capability; such conflicts forced firms to develop their capability, and resolving such conflicts by firms in the form of providing solutions to client problems met client needs (market demand) and brought to the firms further learning (experience), reputation and revenue (resources), which in turn opened up further expansion. Therefore, it is possible to argue that firm growth can only be generated through the firm forming and resolving, in cooperation with clients, conflicts between client requirements (market demands) and firm capability; such conflicts are the dynamo of firm growth, without which firms will not have the pressure, the direction and the knowledge to develop their capability and

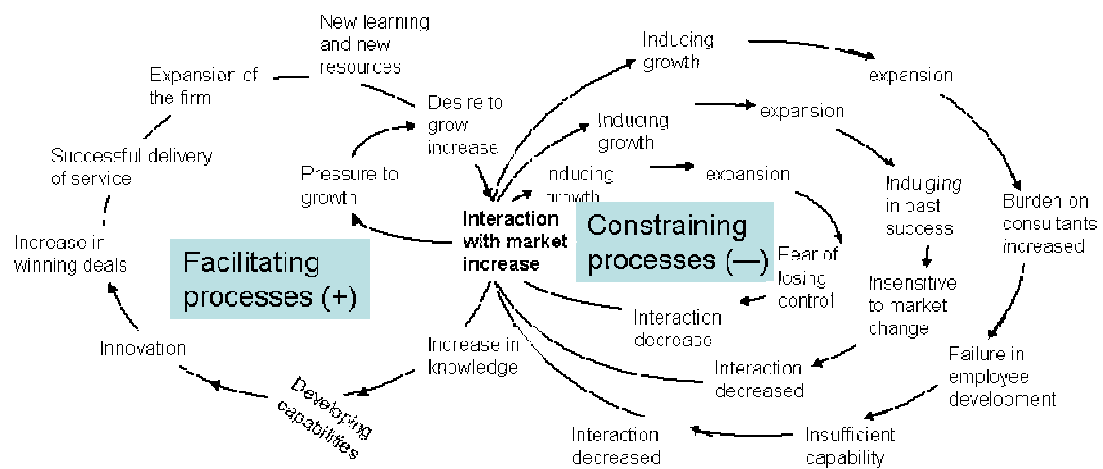
thus, they will not be able to grow. This is the first argument from findings of the current research.

Given the first argument from the current research that conflicts acted as the generative mechanism for growth of these HR service SMEs, [Finding 5](#) and [Finding 6](#) support the second argument that the rate of growth of HR service SMEs studied had to depend on the extent of the conflicts and the efficiency of resolving such conflicts. The extent of the conflicts between perceived external demand and firm capability determined the growth in scope and scale; the bigger such conflicts were, the higher the growth rate was, provided that such conflicts were under control (within the firm capability to resolve). Such conflicts could be made bigger by raising client requirements (market demand): firms often promoted their solutions and brands to attract clients and to ask for premium service price, which unconsciously raised client expectations for their services intensifying gaps (conflicts) between market demand and what these firms could do. On the other hand, effectiveness and efficiency of resolving such conflicts by firms could greatly speed up the rate of their growth. The more effective and efficient firms were in solving client problems to resolve conflicts, the faster they could grow. Thus, firms often continuously learned from their experience working with clients to solve client problems and hired experienced professionals to enhance firm capability in identifying and solving client problems. Active development of firm capability prepared firms well for coming growth opportunities in market and allowed them to effectively and efficiently solve client problems. This is the second argument of the current research.

Further to the previous two arguments, Finding 7 of the current research advances the third argument that growth could best be achieved by these firms' proactive engaging with market and active developing firm capability. Firms' proactive engagement with the market not only gave direction and lead time for these service firms to develop client relations and to promote their brand, which attracted clients and raised their expectations further, but also put pressure on firms (intensifying conflict between market demand and firm capability) to develop their capability; besides, proactive engagement with the market gave direction and lead time for firms to change and to develop firm capability and business solutions to suit market trend (Penrose, 1959). Active development of firm capability and resource base allowed these firms to capture market opportunity, to solve client problems and to put risk under control, hence meeting client needs, increasing firm knowledge stock and developing firm capability and these opened up further growth; in other words, growth induced growth. This argument is strongly supported by the literature on professional service firms (PSFs) to which HR service SMEs belong; research on PSFs (Brentani and Ragot, 1996; Paulin *et al.*, 2000; Amontini *et al.*, 2010) has found that client relations, client intimacy (cooperation), promotion of brands, which attract and raise client expectations (market demands) as evident in the current study, are critical success factors for development of PSFs; in addition, research on PSFs has also found that learning, specializing expertise and professional workforce development, which allow service firms to effectively solve client problems and meet client (market) expectation, are extremely important for success of professional service firms.

Based on the above three progressive arguments developed from findings of the current study, it is now possible to develop a new process model and a process theory within a dialectic perspective that seems to explain better growth of HR service SMEs studied. The conceptual process model of growth depicts how growth of these service SMEs happened, showing processes and dynamics of firm growth. The process theory, on the other hand, explains why these service SMEs were able to grow, why rate of growth varied and why some of these service SMEs grew continuously but others could not.

Figure 7.3a: A systems dynamics model showing dialectic process growth of HR service SMEs studied (a revision of Figure 5.3.4)



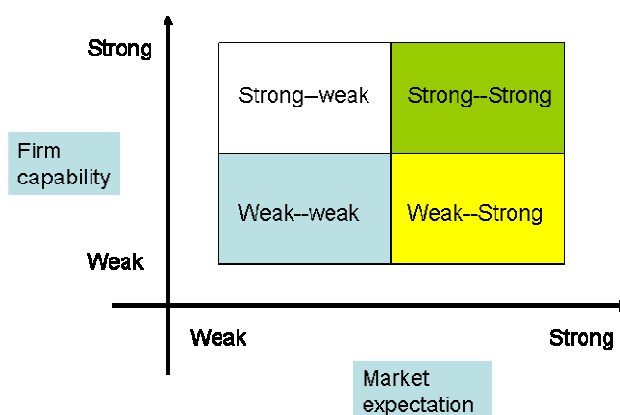
A dialectic process theory to explain growth of HR service SMEs studied:

HR service SMEs were able to grow, because they were in contradictory union with market (clients and competitors) and this dialectical relation gave rise to conflicts

between market demand and firm capability; forming and resolving such conflicts by firms and their clients escalated firm capability, firm reputation and market demand, which led to firm growth in a ‘dialectical acceleration spiral’ (Pries, p.77); firm growth, however, might produce counteracting forces such as fear of losing control, unwillingness to give up successful past and adapt to change, lagged-behind firm capability development, which, unless overcome, constrained growth of these service SMEs.

According to the above process theory, growth of HR service SMEs studied depended on the dialectical interaction between perceived external demand and firm capability which varied over time. It is the variety of status of this dialectic interaction that determined growth of these service SMEs, shaping them into their historical trajectory (De Rond and Bouchikhi, 2004). To simplify the matter, there were four types of circumstances of dialectical interaction between these two forces, as depicted in the following figure:

Figure 7.3b: Types of dialectical interaction between market demands and firm capabilities



As shown in the above figure, dialectical interactions between perceived external demand and firm capability could be classified into four categories, according to the relative strength of the two forces. There was the situation of ‘Strong—weak’ in which firm capability was strong and market demand was weak; this situation arose either from the fact that the HR service SMEs consciously developed a strong firm capability in anticipation of future growth or from the fact that these service SMEs had a surplus in firm capability because their niche market was on the decline. The former situation was exemplified by Firm F which deliberately developed extra capability through its trainee programme to prepare for coming expansion into other cities; the latter was exemplified by Firm E in 2004 when the shrinking market of the job fair business left the firm surplus capabilities, which fortunately, were reshaped to a fit new business—labour outsourcing; this circumstance meant decline of growth in firm business and market as a whole and the only way out for these service firms was to adapt to market change.

In the ‘Weak-Weak’ situation in which firm capability and market demand were both weak, the service SMEs studied grew very slowly but because both forces were matching, there was no risk in the continuity of the growth. Examples were the slow growth in early years of most of the HR service SMEs such as Firm G and Firm H. From mid-1990s to mid-2000, market for HR services in Guangzhou City grew slowly and market demand was weak; for example, there was little competition, as admitted by owners of these firms. Meanwhile, firm capability of these firms was also weak, in

terms of knowledge (experiences), skills and manpower. Therefore, these firms were able to grow slowly but steadily without much risk.

In the third situation ‘Weak and Strong’ in which firm capability was weak but market demand was strong, firms were promising too much for what they could complete, which eventually led to their bankruptcy. The examples are Firm C and Firm I; Firm C over-promised its training courses which it failed to deliver; the firm thus failed in its growth and closed its business; Firm I also over-promised in several projects for its clients; it failed to deliver what it had promised, which led to its downfall.

The last situation of dialectical interaction was ‘Strong-Strong’ situation in which firm capability was strong and market demand was strong. This situation meant that HR service SMEs could raise market demands but they were able to effectively meet market demand of that height, which led to fast growth. This happened to six of the HR service SMEs, such as Firm A in later part of their lifecycle, running approximately from 2003 to 2007 when market demand were high and these firms could effectively meet the market demand, even though that meant tough actions for these firms such as painful organizational transformation and troublesome geographical expansion into other unfamiliar cities.

In face of the insights into these four situations of dynamic dialectical interaction between firm capability and market demand, what could be *the best* route to fast and steady growth? This question was answered by Firm F. When it started its business of

executive search service in 1999, the market demand was weak and its capability was weak too. Then in anticipation of the coming of fast growth of the market, Firm F developed its firm capability; it developed its new front-line employees by running a trainee programme and it restructured its management system to improve the effectiveness of its operation. As a result, it moved into the situation of 'Strong-Weak' in which its firm capability was deliberately kept stronger than needed, which was reserved for later expansion into other cities as demanded by market. Finally, when clients demanded its services in other cities, Firm F was able to meet effectively the strong market demand and grew fast since 2004; this means that since 2004, Firm F was in 'Strong-Strong' situation in which firm market demand was strong and firm capability was strong, a situation which led to fast growth of the firm. The implication is that the best path to fast growth for these HR service SMEs was to study market and developed firm capability in anticipation of future growing market demand and when the market demand became high, the firms were in a good shape to meet the high market demand, which led to their fast growth.

In summary, it seems that the new process theory can explain aptly all phenomena of growth of HR service SMEs in this research (e.g. slow growth, fast growth, decline and bankruptcy), by referring to dialectical interaction between firm capability and market demand as the motor for continuous growth of firms. According to the new process theory, causes of growth are the increase of market demand and the development of firm capability; both of these forces interacted dialectically to produce continuous firm growth; when both firm capability and market demand were weak, these firms grew

slowly; by contrast, when both of these two forces were strong, firms grew fast; when firm capability was weak but market demand was strong, as happened to some of the case firms, firms failed to meet market demand and became bankrupt; when firm capability was strong and market demand was weak, the firms either was on track to fast growth or on track to decline, depending on whether the market was indeed declined and whether the firm was able to raise market demand; if the market was shrinking, to survive, the firms had to shift to other niche markets; for example, when Firm E saw in 2004 that the market of job fair business was declining, it restructured its organization and retrained its employees to shift from job fair business to labour outsourcing business.

7.4 Discussing how social setting of the current research has helped to shape the new theory

The economic and social setting of the current research in Guangzhou City has helped to shape the new theory in many ways. First of all, the market for HR services in the city was far from mature. It was scattered, with no prominent HR service firms dominating the market. Thus, the competition was ubiquitous and fierce. New entrants could easily upset existing market structure of the sector. Consequently, all HR service SMEs, even the more established ones, had to earn their survival day by day. Even if the owners of these firms were keen to earn their profit, they had to put this idea behind the realistic need to fight for their survival in competition. Furthermore, clients were powerful group that could put great pressure on these small service firms for them to

deliver high quality services for very low price. Therefore, HR service SMEs in the city lived in contradictory union with market (clients and competitors) and had to meet countless market challenges. This characteristic of the research setting provide the background for the development of the new theory.

Such a social setting in HR service market of the city often gave rise to conflicts between market demands and firm capability development. The market was fast growing and fast changing in its requirements; this demanded HR service SMEs to closely follow market change if they wanted to catch the growth opportunities. Firms sensitive to market changes were often in a better position to capture such opportunities and those firms which were daring enough to reach out for these opportunities had a better chance of growing. Moreover, since the market was immature, it was difficult to tell the bad from the good among numerous HR service SMEs. There was simply no effective institution to certify the capability and creditability of these firms. In such murky market, HR service SMEs had to be able to give clear signal of their creditability, their capability and their success stories if they wanted to attract attentions of their clients. This means that developing brand which showed outstanding market reputation, firm capability and firm creditability was particularly important for HR service SMEs to survive and prosper in the city. In addition, due to the fact that China is a relation-based society, keeping long-termed and mutually-benefited business relations with their clients was also very critical to the successful growth of HR service SMEs. This background required HR service SMEs in the city to proactively interact with their clients, not just to accumulate knowledge and experiences, but also to establish and maintain close

relations, which permitted them to grow continuously along with the development of their clients.

Besides, human resource market in the fast growing economy of the city was also far from mature. Talents had many career opportunities but had few skill development opportunities. On the one hand, due to poor social institutions such as social security system, HR service SMEs had no social intermediaries to help provide stable social security for their employees who opted to go for bigger firms for stable employment; on the other hand, clients were demanding services from high-skilled labour in the sector (a strong buyer-market). HR service SMEs had to find ways to develop and to keep their own people if they were to have any competitive advantages. Indeed, those firms which had better employee development programmes in place seemed to have a competitive advantages in attracting talents and in providing high quality services for their clients. In other words, effective development of front-line employees became particularly salient in this sector in the city in building up their competitive advantages.

In short, the social context of the current research in Guangzhou City, China, has provided inputs for forming major components of the new theory. Fast growing buyer-market brought about threats to HR service SMEs which had to fight daily against market demands for their survival; but such a emerging market also presented numerous growth opportunities to HR service SMEs which dared to take up market challenges. Immature market required these firms to have effective brand development to show their market reputation; and relation-based society demanded them to put

attention to client relations. All these gave particular importance to proactive interaction with clients. Finally, in a fast growing economy and a demanding buyer-market, attracting, developing and retaining talents was one of the most effective ways of developing competitive advantages for HR service SMEs and allowing them to grow continuously.

7.5 Discussing how well the new theory explains growth of HR service SMEs under study

The process theory using a dialectical perspective seems to explain better growth of HR service SMEs in Guangzhou City than existing theories. It points out the generative mechanism and the causes of growth of these service SMEs; it shows limits to growth and it exposes the principle which governs sustainability of growth of these firms. The following paragraphs use the new process theory to explain success and failure of growth for HR service SME studied, so as to test its validity.

As the first example, the growth and bust of job fair business of Firm A may be better understood in light of the new process theory on growth. The firm entered this business when it saw the market need (market demand) for high-end job fairs. After it entered the business, clients increased in number and in profile; clients increased their expectations as they learned more about these job fairs, giving the firm suggestions for improvement. The firm learned from organizing job fairs and together with some core clients, it developed and became a leader in high-end job fair business. As the service line's

profile and the reputation grew, more and more competitors joined the business, which reduced profitability and market share of Firm A. The firm had to restructure its business model of this high-end job fair business; it also had to strengthen client relations and develop its firm capability. All these actions made the job fair of Firm A more effective and attracted more and more participants; even some big POEs participated in job fairs organized by Firm A. The business was so successful during period from 1997 to 2001 that revenue from it dominated the income of Firm A and the whole firm was enmeshed in this business, to the neglect of other service lines such as executive search service. Then online recruitment channel became increasingly popular from 2001 but it was not noticed by Firm A as important market development. Its general manager acknowledged in his interview:

‘we were not sure if this technology could change the market but we were wrong; we did not catch the opportunity to grow online recruitment, perhaps because we were not educated in technology and were less sensitive to this market trend’.

As a result, the firm did not change to catch up with this new trend but continued to invest in the job fair business held in physical locations, since it had been cash cow for the firm. Market size for such business, however, was dwindling. The business for the firm was decreasing yet profitable. Therefore, the firm continued to focus on this business and even made an attempt to expand into low end job fair in 2003 which brought heavy loss to the firm. In 2005, the firm realized that the market had changed

and high end job fair could no longer be a profitable business; it closed down the department responsible for this business and initiated a transformation from a firm dominated by job fair business to a firm dominated by training services.

The story of growth and bust of the high-end job fair of Firm A was clearly in line with the logic of the process theory on growth as proposed in the above section; the theory informs the generative mechanism—dialectic interactions between the firm and its clients; it also sheds light on sustainable growth of the service line and limit to its growth—failure of the firm to catch market change.

With the help of the process theory, growth of executive search service of Firm B could also be better understood. The firm was established on services of recruiting professionals and junior managers for MNCs in the city. As it had more successes in the business, the firm had wider and deeper client relations. A global executive search firm noticed its ability and in 1998, it passed an urgent search assignment to the firm which it failed to complete. Firm B took up the challenge and cooperated with the client, an MNC, to complete the assignment within deadline and quality requirement. The success boosted morale of the team and developed its ability in executive search services. In order to attract more clients, the firm actively organized HR forum which helped develop client base for the firm. In addition, the firm created opportunity to win service award in 2005 which put it into the rank of national player in executive search business. Profitability of the business, however, attracted entry of competitors, many of which were international players. Competition became increasingly fierce and the firm's

market share and profitability were under attack. The firm decided in mid-2000s to undergo massive restructuring and development in order to raise its capability which allowed it to move into the rank of top firms so that it could charge retainer fee. During these years of transformation, the firm slowed down its growth; it restructured its organization, developed its workforce and automated its business processes; the transformation greatly improved firm capability for the firm, allowing it to grow again.

The story of growth of Firm B's executive search line also seems to be consistent with the process theory on firm growth as put forward in section 7.3. The theory points out that small HR service firms in Guangzhou City were in a dialectical relation with the market and there were constant conflicts between market demand and firm capability.

Firm B was indeed in such a situation. The theory argues that such dialectical conflict gave pressure for the firms to develop their capability which allowed firms to successfully solve client problems that in turn invited stronger market demand and market challenges; this interplay between firms and market escalated the firm's capability, forming a spiral of driving its growth. Firm B went through exactly the same process. The theory argues that continuous growth of a firm under this study could stop if the firm failed to catch up with market change and failed to develop capability to meet market demand. Firm B sensed market trend and succeeded in transforming itself and as a result, it continued to grow its executive search service; otherwise, as the case of Firm E, the firm would have experienced reversed growth (decline).

In summary, the theory holds up well against the empirical evidence from the current research, as illustrated by two cases in the above two paragraphs. The theory seems

valid in its logic of argumentation. This confirms the argument of Eisenhardt (1989, p. 547) that in theorizing from case studies, '[t]he likelihood of valid theory is high because the theory-building process is so intimately tied with evidence that it is very likely that the resultant theory will be consistent with empirical observation.'

The consistency between theory and growth story of the case firms reconfirms the argument that growth of HR service SMEs was a natural outcome of dialectic interplay between the firms and market; constant conflicts between market demand and firm capability escalated firm capability and put it into a spiral of continuous growth which could be stopped only by failure of the firm to change and to develop its ability to meet market demand. The consistency also reconfirms that some HR service SMEs grew continuously because they closely followed market trend, identifying market opportunity and threat very early and they successfully developed firm capability, particularly front-line employee capability to meet client expectation and competition challenges.

7.6 Discussing how far the new theory could be generalized to explain firm growth

In general, the dialectical philosophy of the theory that growth of firms comes from forming and resolving conflicts between market demands and firm capability could be applicable to explaining growth of many types of firms. Both relation-based service firm and product-based industrial firms can exist only if they add value to their clients

and customers (meeting market demand); indeed, more and more product-based firms are paying attention to customer relations and involvement of customers in their product design and production. Therefore, when market demands rise and a conflict (gap) is formed between market demand and what firms can do, the sensible way for firms is to use the conflict to pressure its workforce and organization to develop capability and products to meet market need. In doing so, firms can acquire more resources, stronger ability and better reputation, which then lead them into a spiral cycle of continuous growth.

Another construct in the new theory under discussion that failure to change to suit market change constrained firm growth can be applied to explaining growth of industrial firms and other types of organizations. It is often the case the organizations including firms may become so successful that they completely indulge in their own past success, without sensitivity to market change and the will to transform their organizations to adapt to market change. As a result, few of these organizations can continue their growth when confronting change in the market; they eventually stop growing and even become bankrupt, because these organizations have refused to develop capability to meet new market need and meeting market need is the only basis for their existence and prosperity.

However, the construct in the theory that firms expand and grow for survival is less true for big established industrial firm; survival is often not the biggest and the most immediate concern for these firms, because, in comparison with the service SMEs in

this current study, these big firms enjoy greater power in bargaining with the market and more freedom to take actions. Often a few large firms effectively control the market. In contrast to small service firms which can only survive if their powerful buyers are interested in using their services, dominating established industrial firms may create monopolies that coerce their customers into accepting their products, such as the case with Microsoft. For these firms, there may be more concerns for growth than the need to expand merely for survival. Some of them may grow for acquiring more market power while other may grow for economy of growth, as Penrose (1959) observes. In either cases, the construct in the new process theory put forward in section 7.3 that firms grow to meet market demand for survival is less applicable to explaining growth of big, established industrial firms.

Also, the argument of the theory that interaction with clients is the dynamo of firm growth seems to suit relation-based service firms more than product-based industrial firms. While service firms have to co-produce knowledge and to co-deliver services with their clients, industrial firms mainly rely on their own actions to complete product innovation (although with inputs from their customers), product manufacturing and product service. It is more of a give and take relation between industrial firms and their customers. Industrial firms have more freedom of action, because their value to customers is concrete and can be measured; they do not need to rely so heavily on building customer relations, although it is also important. As a consequence, industrial firms have less frequent interactions with their customers, in comparison with service firms. Knowledge (experience) increase can be completed within industrial firms,

particularly big firms, without involvement of customers, so far as these firms keep in close contact with market. Thus, the argument of the new theory that dialectical interaction between firms and market was the mechanism that generated knowledge and delivered value to customers may not always hold true for some product-based firms, although it may be true for many others which have gained much from close interaction and cooperation with their customers.

While it is true that growth of firms might be slowed down by resource constraint resulted by previous expansions, the new theory sees such constraint to lie in inadequate development of front-line employee capability (not managerial capability). This may not be true for big firms, both industrial firms and service firms. These big organizations are so complex that managerial coordination and communication may often surpass front-line employee capability as key factors for successful growth. Growth and bust phenomena in the case of over-expansion which was due to constraint of managerial resources were more popular with big firms than with SMEs.

In brief, some arguments of the new theory put forward in section 7.3 are applicable to explaining growth of many types of firms including industrial firms, both big and small, perhaps because growth of firms has some commonalities and these arguments are thus suitable for explaining these commonalities; in addition, these arguments of the new process theory are developed from a dialectical philosophy that demonstrates a universal truth about growth and development; as a result, these arguments can be applicable to explaining growth of many types of firms. Nevertheless, the new theory

may be more suitable for explaining growth of relation-based service SMEs than big service firms, not to mention big industrial firms; this is rather logic, because the new theory has been developed from empirical studies of small HR service firms in Guangzhou City. It may also be argued that as far as the context of growth is similar, growth of small service firms in other places or in other fields may be better understood using this new theory. However, whether and to what extent the new theory is applicable to explaining growth of large firms and product-based firms is unknown; this calls for other researchers to do further empirical studies to test this type of application by the new theory.

In summary, this chapter presents discussion on findings from the current research in light of '*The theory of the Growth of the Firm*' by Penrose (1959) and other theories. The discussion first interrogated and evaluated relevancy of the findings to extant literature: on the one hand, the discussion points out consistency of the findings with the literature which backs up validity of the findings; on the other hand, the discussion points out and explains the new aspects of the findings which add to existing knowledge on firm growth. In the second part of the chapter, an attempt is made to develop a new process model and a new process theory within a dialectical perspective to better explain growth of HR service SMEs studied; the new theory argues that growth of these firms came from forming and resolving conflicts between their capability and market demands, in dialectical interaction between these firms and market actors (clients and competitors) and that causes of growth were the increase of market demand and the

development of firm capability. The new theory also argues that some of these firms could grow continuously because they closely followed market trends, identifying growth opportunities very early and taking effective action to develop their capability to catch these opportunities to grow. In the last part of this chapter, this new process theory's internal validity and external validity is assessed and discussed. It seems that the new process theory in section 7.3 is sound in explaining growth of HR service SMEs from which it is built. The new theory might be less applicable to explaining growth of established big industrial firms which have more freedom of actions and do not need to involve their customers in such a intensive interaction, as HR service SMEs studied often did. However, this is unknown. Rather, this remains an empirical question for further research.

Chapter Eight: Summary and conclusions of the current research

This project aimed to find out how and why HR service SMEs in Guangzhou City were able to grow, which could bring a better understanding of their growth and thus, shed light on ways to facilitate such growth. This chapter intends to draw conclusions to answer the research questions. In the first part of the chapter, a summary is made on the research project, its major findings and thesis (general arguments). Next, reflections are made on the current research project's contribution and limitations. Based on the reflections, directions for future research to extend the findings and arguments of the current research are given. Finally, a recap is made to round up the chapter. The chapter focuses on developing conclusions on the research questions and reflecting on limitations which identifies areas for future research.

8.1 A summary of the current research

The current research spanned over three years since it was undertaken in 2007, with an iterating journey between theory and empirical studies. This research has been conducted in Guangzhou City, which has been one of the four major Chinese cities with fast economic and social development for the last three decades since 1980s. HR service SMEs emerged in 1990s and has been playing an increasing important role in facilitating fast economic development of the city. In spite of that, growth of HR service SMEs is still problematic. Some of HR service firms in the city have been growing ever since they were set up decades ago while others suffered in their development. It was

the aim of this research to find out why some of HR service SMEs in Guangzhou City could grow continuously while others could not, so that better knowledge could be gained on how these service firms grow and what can be done to facilitate their growth.

Thus, the current empirical study had the following objectives:

- ◆ to gain a better understanding of how HR service SMEs in Guangzhou City grew by exploring their growth process and growth mechanism
- ◆ to identify causes of growth of these HR service SMEs and to develop a theory to better explain their growth which sheds light on ways to facilitate their growth
- ◆ to come up with recommendations to improve management practices to facilitate growth of these SMEs

To achieve these research objectives it was necessary for the researcher to answer two intellectual questions: how and why were HR service SMEs in Guangzhou City able to grow? These central research questions were broken down into four sub-questions which have guided all research activities:

- ◆ how did growth of these firms happen? What is their growth process?
- ◆ why were these firms able to grow (what were the causes of their growth)?
- ◆ why have some of HR service SMEs been growing faster than others?
- ◆ why could some of these firms grow continuously but others could not, given the same external environment?

Given that the research questions for the current empirical research were exploratory in nature, after methodologies relevant to in-depth empirical examination were compared and discussed, a case study method utilizing qualitative research was chosen as the methodology for the current research. Within case study methodology, multiple (embedded) case studies were chosen as a research design for strengthening the robustness of empirical validation. Data collection mainly relied on in-depth interviews, supported by archival research. Data analysis consisted of both within-case and cross-case analysis, for comparison and contrast. The analysis was conducted at two levels: growth of service lines and growth events as sub-units of analysis and growth of firms as units of analysis. Two-level analysis in multiple embedded case study resulted in a robust empirical findings on HR service SMEs' growth process, growth mechanism and growth causes.

The process of the current research has been an iterative journey which started with research questions drawn from the literature review; it moved on to field work to data coding, to data display and then to data analysis; findings emerged from data analysis and were compared with existing literature, particularly '*The Theory of the Growth of the Firm*' by Penrose (1959). This iterative research journey has enhanced the validity of the analysis and argument of the current research.

8.2 Major research findings and theory development

Although profit making is the most salient growth motive for firms in general, as Penrose (1959) observes, in the case of HR service SMEs studied, the immediate need for survival surpassed profit making as force driving their growth; this is perhaps because these small firms were operating in a strong buyer market which was fragmented and fiercely competitive; thus, in their growth, SMEs had to put survival needs before profit. The second finding is that growth of these firms was generated from their cooperation with clients. These firms were able to grow, because co-work with their clients generated knowledge (experiences) which facilitated firm capability development and opened up productive opportunities for the firms; in addition, the co-production delivered services to clients, which satisfactorily met client expectations bringing reputation and revenue to the firms. The third finding is that there are five important activities facilitating growth of these firms: interaction, learning and capability development, innovation, brand promotion and service delivery. This finding confirms the process theory of Penrose (1959) that learning leads to growth; but the finding goes beyond the Penrosean theory; it has identified interaction with clients as an important knowledge and growth generator; furthermore, it has also identified brand development and client relation development as the most critical activities facilitating growth of these service SMEs. It is found in the current study that continuous growth of some HR service SMEs was driven by a self-reinforcing spiral of client interaction, learning, innovation, promotion and service delivery and that causes of growth were the increase in market demand and the development in firm capability, both interacting to produce a force to drive firm growth. The final important finding is that growth rate of

these firms was facilitated by strength of the conflict between firm capability and market demand, and by effective resolution of conflicts between firm capability and market demand, and that it was constrained mainly by growth-incurred counter-forces such as firm resistance to change and by lagged-behind development of front-line employees, not managers; this finding is different from the argument of Penrose (1959) that growth rate of firms is both facilitated and constrained by growth of managerial resources, which may only be valid for big firms whose growth depends on effective managerial coordination and communication.

Based on the research findings, a new process theory within a dialectical perspective has been advanced, which argues that HR service SMEs studied were able to grow, because they were in contradictory union with market agents (clients and competitors) and this dialectical relation gave rise to conflicts between market demand and firm capability; forming and resolving these conflicts by firms and their clients escalated firm capability, firm reputation and market demand, which led to firm growth in a 'dialectical acceleration spiral' (Pries, p.77); such growth was constrained by lagged-behind firm capability development, resistance to change and fear of losing control, which were often produced and intensified by growth itself.

8.3 Conclusions on the research questions

Based on research findings and theory development conclusions can now be drawn on

the research questions. The first research question was: how did growth of these firms happen? This is a question on processes leading to growth and should be answered by a description of these processes. It could be concluded that growth of HR service SMEs was a spiraling process of forming and resolving conflicts between their capability and market demand, which escalated firm capability and increased firm value. It began with a HR service firm's interaction with its clients such as discussion of client problems with client management and working together to find solutions to these problems; solving clients problems successfully brought to the firm knowledge (experiences) which led to innovation and capability enhancement, reputation which increased its creditability and revenue; in other word, by successfully identifying and solving client problems, the firm grew in capability, creditability and resources. Growth of the firm attracted more clients to use its service and increased client expectation, which led to wider and deeper interactions between firms and clients; in addition, growth also increased competition pressure as competitors put more effort to fight for market shares or for wallet shares of the same clients. Therefore, growth induced the firm to go for further growth to meet increasing market demand; and the cycle restarted. The cycle facilitating growth was counteracted by another process which constrained rate of growth. A constraining process was formed when the owner of some of HR service SMEs slowed down the growth of their firms for fear of losing control; yet, another constraining process was formed for some HR service SMEs when they indulged in their past success so much as to resist change to adapt to market development; this insensitiveness and resistance to change slowed down their growth; in other cases, processes constraining growth were formed when some of these service firms grew so

far that development of its front-line employees failed to catch up with growth speed, hence becoming a bottleneck constraining rate of growth. These constraining processes came into being and intensified as firms grew. It should be noted that these constraining processes could also be self-perpetrating: as these service firms stopped growing, things began to worsen and good employees and clients left, which reinforced the constraining forces, and if unchecked, led to bankruptcy of the firms, as it happened to Firm D and Firm I in the current study.

The second question for the current research was: why were these firms able to grow (what were the causes for their growth)? Based on the research findings and argument thereof, it could be concluded that HR service SMEs in the city were able to grow, because they were successful in forming and resolving conflicts between their ability and market demand; forming and resolving such conflicts by firms and their clients escalated firm capability, firm reputation and market demand, which led to firm growth in a 'dialectical acceleration spiral' (Pries, p.77); in this light, causes of growth were the increasing conflicts between market demand and the development in firm capability, both interacting to produce a force to drive firm growth. Conflicts led to development (Kaufman, 1965; Schneider, 1971; Bledow *et al.*, 2009). Firm growth could be constrained by growth-incurred counterforce from lagged-behind firm capability development, resistance to change due to past success and fear of losing control; when these constraints were removed, firms were able to grow.

The third research question is why some of HR service SMEs have been growing faster

than others. According to findings from the current research, rate of growth of these service SMEs depended on the strength of conflict (tension) between firm capability and market demand as well as on effectiveness of addressing and solving such conflict (tension). Therefore, it can be said that HR service SMEs grew faster in some periods of time compared to others, because, apart from expansion of the market, these firms did better in these periods of time than in others in increasing the strength of the conflicts they engaged in and in enhancing effectiveness of addressing such conflicts (tensions); it can also be said that some of service SMEs grew faster than by increasing strength of the conflicts they engaged in and in enhancing effectiveness of addressing such conflicts (tensions).

The last question for the current research was: why have some of these firms been able to grow continuously while others could not, given the same external environment? From empirical evidence, it is possible to see that HR service SMEs which have had successful and sustainable growth followed market trends and identified growth opportunity earlier than competition; they promoted their brand to attract clients (increasing market demand); then, they learned and developed their capability to match market growth opportunity, meeting market demand. So, it could be concluded that some HR service SMEs in the city have been able to grow continuously, because they proactively interacted with market, which created growth opportunity (increased market demand) and knowledge; then, in the process of cooperating with their clients, they actively learned and developed their capability which allowed them to successfully solve client problems meeting market demand and market challenges. Other HR service

SMEs did not carry out these activities effectively and consequently, they failed in their attempts to expand and could not grow continuously.

In summary, it seems that findings from the current study have provide satisfactory answers for the research questions and that the current research has met its objectives. It has identified processes important to growth of HR service SMEs and discovered mechanisms which generated their growth; more importantly, it has identified causes of growth of these service SMEs and ways to facilitate their growth; finally, it has developed a theory of growth of HR service SMEs studied which may be helpful for studying and understanding growth of HR service SMEs in particular and professional service firms in general. According to the research, it could be concluded that HR service SMEs in Guangzhou City were able to grow, because these firms constantly interacted with the market (clients and competitors) to successfully formed and resolved conflicts between market demand and their ability, which escalated the firms into a spiral of learning and growth.

8.4 Reflections on contributions of the current research

8.4.1 Having suggested significant revisions of Penrose (1959) for it to be more applicable to explaining growth of HR service SMEs (PSFs)

Several significant contributions to knowledge creation can be claimed for the current research. Firstly, the current research tested ‘*The Theory of the Growth of the Firm*’ by Penrose (1959) on empirical evidences. It is found that this important process theory

was only partially applicable to explaining growth of HR service SMEs in Guangzhou City. It proved true that knowledge (experience) increase led to firm growth, as Penrose (1959) claims. Findings from the current study also proved that growth induced further growth, which explained sustainability of firm growth. Furthermore, according to empirical evidences of this study, it is also true that growth rate can be constrained by growth of firm resources.

Penrose (1959) assumes that managers want to grow their firms for profit which benefits their career and life. But, in the current study, this claim proved wrong with growth of HR service SMEs which seemed to grow for survival in a competitive buyer market; the profit making motive was surpassed by the need to grow for survival, a motive which is more suitable for explaining growth of HR service SMEs in Guangzhou City.

More importantly, the current study found that knowledge (experience) increase did lead to firm growth; but the study also found that knowledge (experience) increase did not happen automatically within firms, as Penrose (1959) holds; knowledge (experience) was co-produced by HR service SMEs and their clients in their cooperation of identifying and solving client problems. It is the interaction between firms and their clients that generated knowledge (experiences). This is in line with (Prahalad and Ramaswamy, 2004).

The current study has also found that managerial resources played a less important role

than front-line employees in the growth of HR service SMEs in Guangzhou City. Accordingly, growth of these firms could be explained more effectively by the idea that growth of firms is both facilitated and limited by growth of front-line employees, which is a revision of the construct of Penrose (1959) that growth of firms is both facilitated and limited by growth of managerial resources. In addition, the current study has found that there were more constraints on the rate of growth other than firm resources; one of such constraints was the firms' fear of losing control due to over expansion and another was firms' resistance to change due to past success. In brief, the findings from the current study have pointed out that several revisions and extensions of '*The Theory of the Growth of the Firm*' by Penrose (1959) were necessary for it to be more applicable to explaining growth of HR service SMEs in Guangzhou City or other relation-based professional service firms in similar context.

8.4.2 Having developed a new process theory to better explain growth of relation-based HR service SMEs (PSFs)

As second significant contribution to knowledge, the current study has developed a new process theory to explain more effectively growth of relation-based HR service SMEs in Guangzhou City. Prior to this research, '...dialectical frameworks are uncommon' (De Rond and Bouchikhi, 2004) in management literature, particularly those on firm growth. This new process theory has several noticeable new theoretical insights. It has identified dialectical process that created and resolved conflicts between market demand and firm capability as growth process of firms; it also points out that forming and resolving such

conflicts was the dynamo of knowledge (experience) creation and firm growth and that causes of growth were the increasing interaction between market demand and development of firm capability. Other existing growth theories often theorize on one side of the growth process, as evident in literature review, hence failing to identify the dialectical interactions of firm capability (internal factor) and market demand (external factor) as growth generative mechanism for service firms. Furthermore, the new theory embodies the argument that the rate of firm growth depends on strength of the conflicts (tension) and effective resolving of such conflicts. This is a new insight on firm growth process which takes into consideration two sides (raising market demand and developing firm capability to effectively solve client problems) of the issue of increasing growth rate; it seem to have far more explanatory power than the theory of Penrose (1959) which deals with only one side (developing firm capability) of the issue and contributes rate of growth only to the growth of managerial services.

8.4.3 Having provided some significant insights into the growth of HR service SMEs (PSFs)

The third contribution of the current research is that by discovering the dialectical process and generative mechanism of growth of HR service SMEs in Guangzhou City, the current research has shed some light on growth of professional service firms. Prior to the current research, there had been research studying professional service firms (PSF) as a distinct new type of firms (what it is and how it works). However, research on PSFs is still underdeveloped, with its focus on defining and classifying such firms; hardly any

research was conducted on their growth. The current research explored the processes underlying growth of these firms to uncover how they grew and based on the knowledge on growth process of these firms, it identified causes leading to growth of these firms to lie in the mutual reinforcement by market demand and firm capability development. The current research could be claimed as pioneering research work on growth of HR service SMEs in specific and professional service firms in general. The research findings and arguments thereof may be extended to shed light on growth process and growth dynamo of professional service firms as a whole. Repetitive

8.4.4 Having provided practical guidance for management on facilitating growth of HR service SMEs (PSFs)

The final contribution of the current research is that its findings and arguments on process and causes of growth of HR service SMEs have provided practical guidance on improving management practices to facilitate growth of HR service SMEs: since active engagement with market is important to firm growth, HR service SMEs should establish and strengthen their marketing and sales function, which can greatly enhance interaction between the firms and their clients; such interaction can generate knowledge (experience), raise market demand; in addition, HR service SMEs should strengthen their function in developing and retaining front-line employees, which allows them to effectively solve client problems, hence meeting market demand and challenges. Currently, these two functions in the HR service SMEs studied are very weak, perhaps because these firms are too small to house such functions or because owners of these

service firms are less conscious of the need to develop these functions. In short, the current research has added significant knowledge on growth of HR service SMEs which sheds light on ways to improve management practices to facilitate growth of these firms.

8.5 Reflections on limitations of the current research

The first limitation of the current research may be its narrow data sources—case firms were from only one city (Guangzhou City). However, this was done on purpose out of two considerations. The first consideration was that due to limited time and energy of a single researcher, it would not be appropriate to study case firms from too many cities; case firms from only one city have the advantage of being limited in number and in space; this advantage saved time and energy for the researcher. The second consideration of drawing case firms from only one city was that the researcher wanted to control influence of external institutional environment on explanation of growth of the case firms. HR service SMEs from different city may have been operating in different environments and thus, differences in environment may account for differences in their growth. On the contrary, HR service SMEs operating in the same city should be subjected to the same economic, social and industrial influence, which eliminates impact on growth due to the different environments. Causes for growth of these firms would be due to their individual interactions with their market actors. This has simplified the research and produced an acceptable explanation.

The second limitation could be that the current research may over rely on semi-structural interviews for data collection, with insufficient archival data collected. It is commonly known that in case study, triangulation of different sources of data is very important for improving reliability and internal validity. In the current research, the case firms were small firms which had paid little attention to keeping their company files; few of the case firms had very complete archival information database. As a result, in most of the times, information from company archive was not sufficient for confirmation of information from interviews. The researcher mitigated this by interviewing more informants for better data triangulation. Nonetheless, insufficient archival information remains a limitation of the current research.

The third limitation could be that depth of case studies may have been compromised to certain degree for accommodation of more cases. Scholars disagree disproportionately on how many case firms should be studied in a case study project. What they can agree is that the number of case firms has to be determined by the nature of the research question and the context of case study. For example, a single case is sufficient for research topic on rare disease which could seldom be observed. The current research followed the advice of Eisenhardt (1989, p.545) that in general, the number of cases ‘between 4 and 10 cases usually works well’; less than four cases may not provided sufficient data for developing a convincing theory, unless sub-units of analysis are studied; more than ten cases will present too much for a single researcher to handle and there will be lack of depth in studies. The current study chose to study ten case firms to

balance depth and width of empirical evidences, given that HR service SMEs studied had simple organization and history and that only a single researcher worked on the project.

Another limitation could be that the study examined only interactions between firms and a limited number of external factors (clients and competitors). The consideration was that too many external factors involved in the study would have made the research too complex and too difficult to handle, although such study would have reflected better the reality; furthermore, to study interaction of firms with too many external factors may sacrifice focus of the research. As a result, the current research examined interactions of firms with only two most important external factors: clients and competitors. This permitted the researcher to focus on discovery of the most relevant causes for growth of HR service SMEs in Guangzhou City; but it also simplified the reality of this phenomenon, sacrificing richness in contextualization.

The final limitation of the current study could be that due to the need to focus on research questions and given limited resource, time and space, how HR service SMEs formed and developed their firm capability has not been studied to the depth that the researcher wanted. Firm capability is the most important variable escalating firm growth and therefore, in the current research, the researcher followed up several critical growth events to uncover how certain firm capabilities such as brand development capability were formed over time. The current study has opened up some routes to understanding the process of forming and developing firm capability. However, given limited

resources and time, the study did not go deeper on the topic beyond its need to support evidences for explaining growth of HR service SMEs studied. This remains an opportunity for future research.

8.6 Suggestions for future research

Research on firm growth is moving away from examining the size of firms to examining the process of firm growth (Mckelvie and Wiklund, 2010). Further research can be conducted on more HR service SMEs or other types of professional service firms in other cities, replicating the research design of the current study and removing the current research's limitation of relying on only limited number of case firms. Such research may be able to validate, by comparison and contrast, the findings of the current study and thus, making them more robust. A wider scope of data sources may substantiate empirical evidence from the current study and may extend the findings and argument from the current research; in addition, new research in this direction may uncover some other findings. In the end, understanding of growth of professional service firms, in particular, growth of HR service SMEs, could be enhanced by new research using the current research design of multiple (embedded) case study. In this way, external validity (transferability) of the current research can be extended.

Another research direction is to conduct research examining growth of professional service firms by taking in greater number of external factors, so that a fuller picture and

richer contextual impact could be produced. This type of research can overcome the current research's limitation of focusing on only two important market actors: clients and competitors. If more external factors are put into the model of growth, it may be possible to identify new causes for growth of these firms which may better reflect business reality. There is no doubt that the bigger the number of external factors is studied, the more resources and time will be needed. Nevertheless, such study is necessary and will be of great value, because it can supplement the current study to give a richer contextualization of growth of professional service firms.

To see if and to what extent the new theory developed from the current research can be applied to explaining growth of big firms and product firms, many empirical studies can be conducted. Currently, product-based firms (industrial firms) and relation-based firms (professional service firms) are getting closer and closer in the way they operate and grow. For example, many Japanese big industrial firms have built on long-termed cooperation between their suppliers and customers; both sides often design and co-produce products for customers, in order to tailor to the needs of customers. Worldwide, to complete just-in-time operations, many firms have their suppliers and customers on board in product design and even product production. Moreover, it is very common to see that conglomerates in emerging market often have both product firms and service firms under their umbrella. Nevertheless, fundamental difference still exist between product-based manufacturing firms and relation-based professional service firms, according to extent literature on professional service firms. It would be interesting to see how far the new theory from the current study can be used to explain

growth of product firms in these contexts by conducting more empirical studies on how and why they have been able to grow.

The last direction for future research is to study how firm capability is formed, evolved and developed in growth process. As self-apparent in the current study, firm capability of HR service SMEs studied was one of the most important determinants of growth of these firms and indeed, development of such capability was considered important part of firm growth. It will be interesting and valuable to explore how firms utilize various resources, organizational tools and other means to develop their firm capability, in particular, how development activities can be directed at creation and development of a specific firm capability such as ability to win business deal in open bidding. In such exploration, it is also important to understand what role interaction between firms and clients play in determining the direction and pressure of capability development. Results from exploring processes of developing firm capability may inform organizational learning; and it may shed light on how management practices can improve firm capability to suit market demands, given that such expectations can be identified.

This chapter has summed up the research project and made conclusions on research questions. In addition, the chapter has offered reflections on contributions and limitations of the research. Based on the limitations, the chapter has proposed future research on firm growth. It is concluded that HR service SMEs studied were able to grow, because they were in contradictory union with market (clients and competitors)

which constantly brought about conflicts between market demand and these firms' capability; such dialectical conflicts put pressure on the firms to develop their knowledge base and capability; this allowed them to meet market demand from which they learned, increasing their knowledge (experience); this cycle repeated itself and hence, these firms were able to grow continuously and were only stopped from growing by their own fear of losing control, by their own resistance to change to adapt to market due to past success and by their failure in developing front-line employees to catch up with market demand.

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Appendix I: Case study protocol

Introduction to the case study project

- Project objectives
- An overview of research questions
- Project plan
- Potential issues
- Reference

Case study field research procedure

1. Reviewing the case study design
2. Preparing for the site visit
3. Producing 'Introduction letter'
4. Explaining project objectives
5. Collecting data through interviews and other methods
6. Clarifying and adding any data if necessary
7. Keeping record of the data and make complete the data records such as interview transcript
8. Writing the case study report and send one copy to the case firm for review
9. Delivering thank-you letter and keep in touch for further data collection or

clarification in the future

Sample questions used in field work, sources of data and methods of data collection

Questions	Sources of data/Methods of Collection
How did growth of these firms happen? What is their growth process?	<ul style="list-style-type: none"> • Information from key informants in the firm/semi-structured interviews • Firm documents/Archival analysis
What are the key enabling and constraining processes underlying the growth of SMEs in China?	<ul style="list-style-type: none"> • Information from key informants in the firm/semi-structured interviews and focused group discussion • Firm documents/Archival analysis
What is the dynamics mechanism of growth in SMEs in China? Why were these firms able to grow (what were the causes of their growth)?	<ul style="list-style-type: none"> • Information from key informants in the firm/semi-structured interviews and focused group discussion • Firm documents/Archival analysis
Why have some of HR service SMEs been growing faster than others?	<ul style="list-style-type: none"> • Information from key informants in the firm/semi-structured interviews and focused group discussion • Information from other sources (consultants and academics)/semi-structured interviews • Firm documents/Archival analysis
Why could some of these firms grow continuously but others could not, given the same external environment?	<ul style="list-style-type: none"> • Information from key informants in the firm/semi-structured interviews and focused group discussion • Information from other sources (consultants and academics)/semi-structured interviews • Firm documents/Archival analysis
What can the research results on SMEs growth in China inform theories on firm growth?	Key stakeholders on SMEs growth/Interviews and focused group discussion, data analysis
What implications the results from this research can have for policy making and management actions aiming to improve SMEs growth?	Key stakeholders on SMEs growth/Interviews and focus group discussion, data analysis

Report outline

- Background of the case firm: organization, history, product/service, business model
- The story of the growth of the firm
 - Growth path (time series data including revenue, employees and income per hand: both absolute value and growth rate)
 - Phases of firm growth including major milestones
 - Major activities in time sequence
 - Events critical to firm growth (both success and failure): how it happen and why (causes)
- Analysis of the growth/stagnation/failure of the firm
 - How did growth growth/stagnation/failure happen?
 - the causes behind growth/stagnation/failure

Format for the data in case studies

- Direct quotation
- Tabulation of qualitative data
- Data arranged by themes
- Use and presentation of the other documentation
- Bibliographical information

Appendix II: Guidelines for interviews

Firm background

- Industrial sectors for the firm, value chain, business model, market competition and critical success factors, firm growth in this sector in general (relevant knowledge needed before meeting)
- Firm ownership, business, history (relevant knowledge needed before interview)

Two Successful Business expansions

- What was the motive for the business expansions? Is the expansion deliberate?
- What would you do differently in comparison with only maintaining operations such as daily service of a hotel?
- How did you carry out the business expansion? What were the major steps in process? What were the most critical steps? Why?
- How did you obtain resources from external for the business expansion?
- How did you shape your management system to make the expansions successful?
- What were the critical factors for the success of the expansion? Among them, what are the sources, drivers and determinants?
- In what way did each of these factors impact the business expansion?
- How was each of these factors related to the others?
- How did these determinants interact to enable the successful expansion?

- Looking back at the business expansion, what would have caused them to fail?

Two failed business expansions

Describing the business expansions (how):

- What was the motive for the business expansions? Is the expansion deliberate?
- How did you carry out the business expansion? What were the major steps in process? What were the most critical steps? Why?
- How did you obtain resources from external for the business expansion?
- How did you shape your management system to make the expansions successful?

Describing the causes for failures (what and why):

- What caused the failure? Why?
- What are the critical factors for the failure of the expansion? Among them, what are the sources, drivers and determinants?
- In what way did each of these factors impact the business expansion?
- How was each of these factors related to the others?
- How did these determinants interact to cause failure of the business expansion?

Firm learning from each of business expansions

- What are the lessons to be learned?
- What lessons and experiences were put as feedback into your firm? Why?
- What if these were not put as feedback into your firm?

Firm growth

- How do you define 'growth' in your sectors and your firm?
- Could you describe the growth history of your firm, including major timelines and milestones? What are the critical phases?
- Can you distinguish each growth from the growth history of your firm? How did the previous expansion impact the later expansions?
- How were these growth events related to each other?
- What are the key processes? In each case what are the reinforcing processes and balancing processes?
- Could you construct the growth path of your firm? What made it as such? What could make it different?
- In general, what are critical to the growth of your firm? Why?
- How were the critical factors related to on each other?
- How did they interact to enable firm growth?
- What would you describe as the sources of your continuous growth? The entrepreneurship? The culture of being better and better?
- What makes SMEs so different from big firms? What positive and negative impacts these difference can have on the growth of your firm
- Please comment on the growth of SMEs in China? What do you think are the critical factors for their successful growth? Why? What are the barriers for their growth? Why?

Appendix III: Narratives of growth of the case firms

Growth of Firm A: a firm of multiple HR services

Firm A was a small HR service Firm established in 1996 in Guangzhou City, China. At the time of research, it had three service lines: executive search, training and consulting. In addition, it had some HR outsourcing businesses which were not significant enough to form independent service lines. The clients served by Firm A were mainly MNCs and SOEs, with only a small number being big POEs. Its business model started with building relation with a client to meet its specific need. With this relationship, it started to expand the wallet share of the service demand of that client. Built on the success of servicing this client, it then replicated the service to other clients in the same area. Then, the successful business model was also applied to clients in other geographic areas. Profit came mainly from the service fee collected and from the reduction of operations cost Firm A was able to make. In the past ten years also, the core businesses for Firm A have been changing in accordance with market trends, from recruitment to executive search and then to training service. Amidst these changes, consulting, however, has never become part of its core business lines, with only negligible revenue.

Firm A has gone through five phases in its 12 years of continuous growth. In 1996, it was established by a young man who had been working as a recruiter in a SOE majoring in human resources service in Guangdong province, China. Firm A began to

enter the recruitment market in the same year and from there, it has been growing and changing until now. The following is the chart that shows the growth history of Firm A:

Chart of Firm A: The growth history of the firm

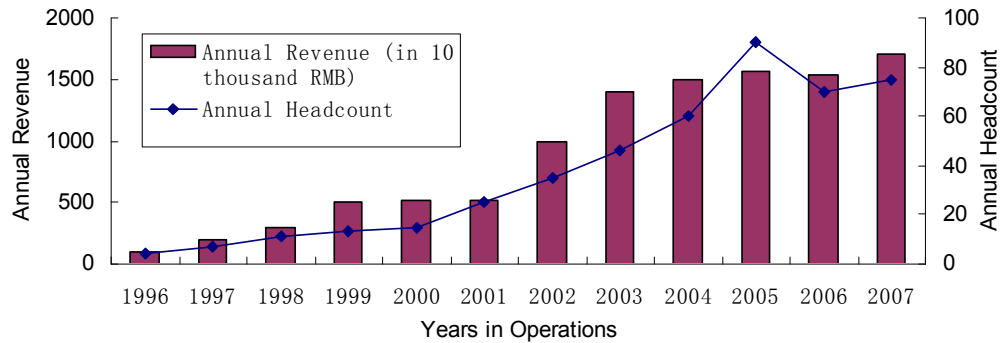
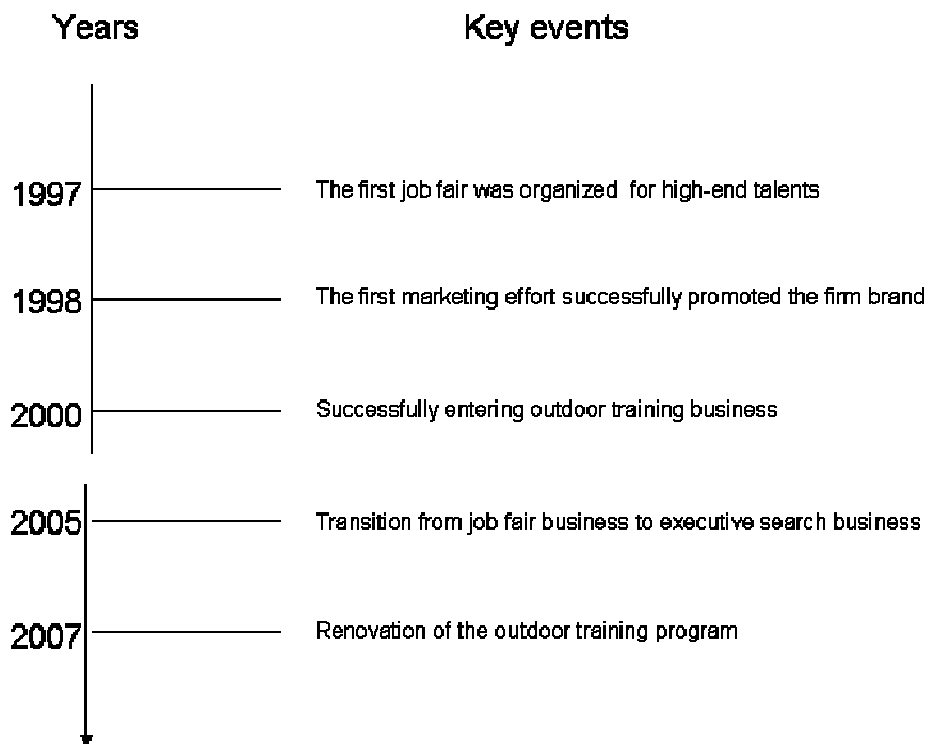


Figure of Firm A: The chronology of the firm



As shown in the chart above, Firm A have been growing continuously since its corporation. Growth of its annual revenue has been roughly smooth and gradual, with its peak of over 15,000,000RMB in 2007. Size of its workforce had been expanding

until its peak in 2005 when it had about 100 employees. Then, the number of employees dropped in 2006, to less than 80, while its revenue kept growing. In general, history of Firm A is a history of growth of a firm, which can be divided into five phases for the convenience of narrating.

Phase I (1996): this is the phase when Firm A was founded, with only 4,000RMB as investment capital. The firm employed four employees. The problem for the firm at that time was to identify a niche in fledgling human service market to earn some money for survival. The founder developed a network of human resource management professionals by making full use of the working relations he had established when working in the SOE human resources service company. Based on these work relations the firm was able to provide some executive search services. During these early days, an increasing number of MNCs entered Guangzhou Technology and Economy Development Zone (GTED) and they needed local Chinese talents to work for them. MNCs recruited their professional and management talent as they did in their home country, using media advertisement as a channels and executive search services. This market demand gave the firm first batch of orders which were very profitable and enabled the firm to survive.

Phase II (1997 to 1998): Firm A entered the recruitment service market. After operating in executive search services for about one year, Firm A found that recruitment through regional media advertisement by enterprises could only cater to the local talents while executive search service had the disadvantages of high cost. The disadvantage of both

channels created a need for a job fair in which applicants and employers in the region, mostly MNCs and outstanding POEs, could meet to discuss face-to-face possibility of employment. Firm A saw the opportunity and decided to enter job fair business catering to high-end employers and talents. It hired fifteen employees and in April 1997, organized its first high-end talent job fair in the province, under the brand named “Hero Meets Hero”. Before the job fair was organized for clients, Firm A promoted the high-end job fair in all types of media including the newspapers of the city. Many MNCs participated in this recruitment fair, making it a great success. Firm A reaped huge profit from organizing this job fair providing cash for its growth in the following years, in which such recruitment events were held seven to eight times per annum. Firm A earned annual revenue of nearly five million RMB, exceeding revenue from its executive search business. More importantly, from such recruitment events, Firm A was able to get many employment application letters which later became the sources for executive search business. Furthermore, the job fairs have formed and fostered many client relationships. These activities also built a very good brand for Firm A.

Phase III (1998-2001): by 1998, Firm A has built up a team of about 30 employees. In 1998, Firm A began receiving some inquiries from its clients on training service. After some more interaction and investigation, Firm A decided to take up the opportunity of training business, on the one hand to satisfy needs of its client and on the other to make more money. At the beginning, it invited some experienced human resources managers to provide training for the emerging human resource management professionals. Later on, Firm A sold some licensed training courses. A critical event happened during this

phase which further strengthened the brand of Firm A. This was the publication of a journal entitled “The World of White Collar Workers”. Although the publication was costly and lasted only two years but it was a good marketing activity exerting huge influence on human resources managers in the province. Almost all human resource professionals in the province, with very few exceptions, knew the word ‘Sam’s Party’, another brand name for Firm A. This brand building laid good foundation for the growth of Firm A in the following years.

However, another event happening during that phase negatively impacted the growth of Firm A. In 1999, Firm A tried to enter the human resources service market in Shanghai but due to the lack of funding and capable managers, was forced to withdraw from Shanghai market, losing half million RMB. The problem was that when the owner was in Shanghai, operations in the headquarters of Firm A in Guangzhou were not supervised and business suffered.

Phase IV (2001—2004): this is a phase in which Firm A grew rapidly. After the bad experiences in exploring the market in Shanghai, the owner realized the importance of organizational management. He began to hire professional managers in 2000; and the general manager he hired has since been working with him. In 2001, outdoor training courses became fashionable in China and Firm A entered this market. The course was called “Sunshine outdoor training”, which was very innovative at that time in the province. This new business generated more than seven million RMB revenue for Firm A in the first year and this income level has been staying at similar level ever since.

During this phase, Firm A also sold some licensed courses, particularly those mature training courses from abroad. In addition, two new markets besides Guangzhou market were developed and services for POEs expanded.

Phase V (2005 to the present): by now Firm A has become an organization of close to one hundred employees. It has been improving its internal management and at the same time upgrading its business. The organizational development effort has been going on since 2005. In 2007, for example, R&D department focusing on designing training courses began to take shape and now, Firm A had the ability to develop its own course to suit the business needs of its clients. Owing to this new product development capability, Firm A was able to revise its outdoor training course in 2007, keeping this business line in the high end of the market. This allowed it to reap huge market share and profit. It could now monopoly some courses in China. During this period of time, Firm A set up its Shenzhen Branch, which provided full range of human resource services to the clients in that city. Furthermore, by the means of partnership, Firm A opened its Beijing and Shanghai offices focusing on training service.

One critical event happened during this period of time. It was the upgrading of “Sunshine outdoor training” project as mentioned in the previous paragraph. After 2005, the market competition in this business became very intense. Many competitors competed on low prices which brought down the gross margin level for the business. In 2007, Firm A decided to upgrade its “Sunshine outdoor training” course in order to keep up its gross margin. Consequently, Firm A undertook an R&D programme to redesign

this outdoor training course. For that, trainers responsible for outdoor training were asked to attend internal management training courses to gain a deeper understanding of business and management. Then they were required to participate in R&D activities, which laid a good foundation for future implementation of the outdoor training courses. The new outdoor training course integrated very well management principles with outdoor activities. This change not only made the outdoor training more relevant to management practices but also distinguished the course from those of other competitors. Thus, by relying on this innovative course, Firm A was able to lead the training service market in the province while keeping the gross margin of this training course at a high level.

The second critical event in the period was that Firm A built up its executive search department. Since 2005, due to the rise of internet recruitment, the business of organizing recruitment fair had been declining. In 2005, Firm A decided to give up its recruitment service and put all its recruitment resources into its fledgling executive search team. It began the change by training its recruiters to assume the new job role as executive search consultants. Each employee in the executive search department had, on average, twenty days of training to develop their business know-how and the executive search skills. Firm A did not increase the annual revenue target for its executive search business department but instead, imposed training targets on it so that employees in the executive search business could become mature enough to have a dialogue with the executives of MNCs when they undertook the executive search assignments. In addition, Firm A also hired from market a number of able executive search consultants to act as

mentors for the team. Those employees who failed to develop their executive search skills were transferred from this department into other departments. After several years, Firm A had a much stronger capability in executive search business, which was demonstrated by the increase in the number of high-end clients it served.

The last event critical to the growth of Firm A during the period was its drive to improve internal management. In 2007 and 2008, Firm A restructured its organization, clarifying role and responsibilities. In addition, it built up a stronger human resources management team in seeking for greater ability to attract and retain key talents. At the same time, financial management and risk management were improved, resulting in better financial control and more objective performance assessment. Furthermore, Firm A invested heavily in employee training and career development, for example, hiring foreign English instructors to give English lessons to the team so that they could be motivated and at the same time, acquired the ability of getting better business orders from MNCs. Lastly, in term of management technology, Firm A set up OA system which has since provided a database for employees of all business lines to share client information. This IT platform also made the management of the firm much more transparent and more responsibilities were delegated down to the first line managers. It also gave the employees and clients a more positive company image. For example, performance assessment was more transparent, which helped to attract and retain key talents.

Geographical expansion of Firm A--an event critical to its growth:

In 2003, job fair service, one of the core businesses of Firm A, reached its peak of growth and there was sign of stagnation. This is because this type of business had come to full competition and market was saturated, which limit the growth of job fair service of Firm A. Although the firm was at its high growth (about 29% annual growth in revenue), it appeared to reach its growth plateau and there was a need to find new ways to grow the business, in order to maintain the momentum in firm growth.

Leaders of Firm A were innovative in developing business models and began a series of product line expansions in the same region, that is, Guangdong province. It did not occur to them that they should go into geographical expansion. This may be because they had a bad experiences expanding into Shanghai market in 1999, which failed because there was not sufficient managers to cover both market. The expansions of product lines in the same region witnessed success and failure. In 2003, Firm A went into field training and made it a great success, bringing in 5 million RMB in that year and years that followed. In 2005, Firm A went into human resources management outsourcing and executive search but these business lines did not grow much. In the same year, Firm A merged one recruitment firm which was a total failure, costing the firm 3 million RMB.

Attempts to expand the product lines in the same market were not very successful in accelerating the growth of the firm. The growth model of adding product lines to increase firm revenue seemed to disappear. As its general manager said in his interview, ‘we found that our old way of expansion has come to an end. It was not possible to just

add another business lines'. It dawned on Firm A that growth had to come from geographical expansion. This prompted the leaders of Firm A to study the possibility of geographical expansion. In 2005, Firm A made the decision to undertake geographical expansion.

Once the decision was made, Firm A began to prepare for this type of growth. Firm A developed a strategic plan to transfer its growth model from traditional expansions of multiple-products in the same region to the geographical expansion. It was the first time that Firm A went into expansion with clear strategic direction and plan. According to the plan, Firm A would firstly open its office in Shenzhen in 2007, its offices in Shanghai and Beijing in 2008.

After developing the plan, Firm A immediately put it into action. First of all, in 2006, Firm A stopped the business of job fair service. This was a big business transformation, which involved reorganization of administrative structure and work force, as well as re-allocation of other resources. Resources and staff of department responsible for the job fair service were transferred into other departments such as headhunting. Some staff members were re-trained to be consultants to work on executive search. Others were downsized. The transformation not only saved money for later expansion attempts, but also released staff for such expansions.

Secondly, Firm A set out to develop its capabilities for geographical expansion. In the first place, it further enhanced its business capabilities by refocusing its attention on its

core business lines: executive search, training and outdoor trainings. The intent was not only to grow these business in Guangzhou which was the main market for the firm but also to develop more talents in these business lines and to accumulate more experiences in preparation for later expansions. These expansions sought to replicate the three core business lines of Firm A to other market.

In addition to consolidate and develop its business capabilities, Firm A began to build its management capabilities in running business in multiple locations across the country. It did this by several major actions. The first action was to develop its management information systems including Office Automation (OA) System and Customer Relation Management (CRM) System. These IT systems permitted not only more efficient working in the headquarters, but also the possibility to let the operations in other geographical location to gain real-time access to the same database and the top managements in Guangzhou headquarters to have transparent operation data across multiple business lines in different locations. This is important for two reasons. It is important because it permitted effective governance of the organizations. Ineffective governance had been responsible for the first attempt by Firm A to penetrate Shanghai market in 1999. Real-time access to the same database is also important because clients now were running their business nationwide; and thus, Firm A needed to have simultaneous operation across the country to better serve its customers. Simultaneous access to the same information made it possible for Firm A to provide its clients with this type of nationwide service.

Developing management capabilities included the development and alignment of product policies, management policies and other regulations for operation in multiple locations. For example, product pricing policies had to be reviewed and amended to enable the same treatment for the same customers who should be given the same price for the same product across the country. Personnel policies, too, were aligned so that consultants of the same capabilities were given similar treatment working in different locations. The similar policies provided a solid platform for running operations in multiple locations, a condition needed for successful operations across the country.

In addition to building internal capability for growth, Firm A also took actions to save money for geographical expansion. From 2005, Firm A strengthened its financial control and streamlined operations, in order to cut down administration cost. Furthermore, Firm A put emphasis on profit, rather than on sales, when assessing the performance of its business lines. The message was to show the importance of cash-flow. For the past three years, annual profit doubled each year. The accumulation of profit kept Firm A in healthy financial position. More importantly, it provided the firm financial resources for later geographical expansions.

In 2007, Firm A opened its office in Shenzhen, another market close to its home market in Guangzhou City. The purpose of opening a branch office in its close vicinity was for the practical reason of effectively controlling the operation of that branch office. This strategy proved correct. The new office replicated three core business lines of the home market and was profitable from the first year of its establishment. The branch office

added revenue to the income of the firm. More importantly, it brought to Firm A learning on how to operate in a foreign market.

By the end of 2007, Firm A had accumulated some management experiences in running operations in multiple locations. By 2008, Firm A had convinced itself that it had gained the capability of running operations across the country. With the experiences of opening and running its first branch office in Shenzhen market, Firm A opened and operated its other office in Shanghai City and in Beijing City, in partnership with other firms. Business for Firm A began to grow again, which signifies that since 2008, Firm A has been successfully entering into a new grow strategy: geographical expansion.

The impact of geographical expansion on the growth of Firm A was quickly felt. Firstly, its revenue began to grow again after being flat for more than three years. Secondly, the expansion prompted the firm to build and strengthen its internal policy platform, information systems and other related management assets, which enabled later expansions. Thirdly, by geographical expansions, Firm A greatly widened its operation scope, bringing the prospect of further growth. Lastly, by such expansion, Firm A built up a team of managers who now possessed the capability to operate business across the country.

The story of geographical expansion of Firm A presents a clear process of firm growth activities. The first of such activities is identification of growth opportunities. After trying to grow by exploring multiple products in the same market, Firm A identified

geographical expansion as opportunity for further growth. The second activity is to plan for the growth. As such, Firm A quickly developed its growth strategy which laid out the process of implementing the geographical expansion step-by-step. After the development of such a plan, according to the strategy, Firm A took actions to build capabilities to implement the growth plan. Then, it gathered financial resources to enable the implementation of growth plan. Following these actions, Firm A executed its geographical expansion plan. It opened and operated its first branch office in close vicinity. After that, it opened other branch offices one by one in different locations. These operations delivered business results which brought revenue growth and capability development to the firm. It should be noted that in addition to expanding geographical scope for business, the purpose for Firm A to open its first branch office in adjacent city was to accumulate experiences in running operations outside its home market. In other words, firms can learn from their own growth actions.

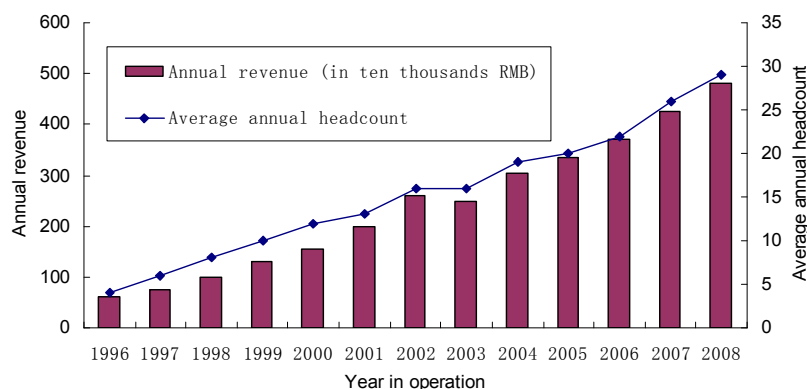
Growth of Firm B: a firm of multiple HR services

Firm B was a small HR consulting firm established in 1996 in Guangzhou City, China. It had three core service lines: executive search service, training service and consulting service. Executive search service was its biggest business, consulting service the second biggest and training service the third biggest. Other business lines of the firm were not significant. The firm started out as a recruitment and executive search firm and gradually added other services lines to its service portfolio based on client demand. The business model of Firm B was simple: first, it built client relations by providing a client with one of its best services, which in most cases, meant executive search service. After initial relation was built, Firm B tried selling other services to the client. Relying on its market reputation spread by “word of mouth”, the firm was able to expand its client base step by step. It also successfully extended the reach of its businesses, by means of partnership, to new markets in other cities such as Beijing, Shanghai and Hong Kong. Profit margin depended on the value of the orders Firm B is able to secure. Therefore, Firm B has been trying hard to conduct business with high-end clients such as big MNCs. However, in the area of its consulting business, most of the business came from small POEs.

In 1996, Firm B was the first HR consulting firm to register in Guangdong Province, according to the founder of the firm. From the very beginning, long-termed survival of the firm has been taken as the ultimate goal for all activities of Firm B. The owner said in the interview: ‘For our firm to grow large and strong is only a means to achieve its

goal of long-termed survival'. Accordingly, Firm B emphasized service quality over expansion. In order to maintain its high service quality, it refused to conduct and grow business beyond its own capabilities and resources. As a consequence, the growth of Firm B had been slow until recently when competition changed; new comers in human resources management service sector operated as companies of fast-moving consumer goods, promoting their brands, attracting investments and growing very fast. In order to survive and grow in such new competition arena, Firm B was forced to follow this market trend and stepped up its growth effort. There were four phases in the growth history of Firm B. Below is the chart which shows the growth history of Firm B, as indicated by growth of revenue and employee number.

Chart of Firm B: the growth history of the firm



Phase I (1996-1997): for Firm B, this was the period of starting up and entrepreneurship. The firm began its operation with recruitment and executive search business. At that time, business community in Guangzhou City was not familiar with this type of management service and Firm B had to spend much energy in cultivating the needs. The owner had been a HR manager in a MNC and so he had access to HR professionals in MNCs. First, he worked with a few MNCs which used executive search, helping them

to recruit local talents to join their management teams. Due to lack of trust by market in executive search, Firm B had to work hard to build and to protect a brand associated with high quality service. During that period of time, the firm kept a very low profile while serving its clients; as its owner said in his interview, the firm ‘did not expect to have much in return except building up some client relations which kept the firm alive. Its growth was slow. However, Firm B did build up many business relations, most of which were with MNCs in China. The work of this phase laid good foundation for the growth in the years that followed.

Phase II (from 1997 to 2002): this is a period in which Firm B grew rapidly. During this period of time, Firm B set up branch offices in Hong Kong, Beijing and Shanghai, which generated many business orders and the firm enjoyed a good market reputation. The role of the Hong Kong office was to act as the service window of the firm for the international business community, with the responsibility to get business orders from MNC Asia regional offices in Hong Kong. These business orders were then filled by offices in Guangzhou City and other cities. Beijing is the capital of the country and Beijing branch office of Firm B had the mission to develop connection with major HR service players in the capital. The training centre of Firm B, which was set up in neighbouring City Zhuhai in 1998, was the result of Beijing Office’s effort in building relation with Beijing Normal University. The training centre added much value to the brand of Firm B, giving it credit as a key player in training service market of the province.

One critical event happened during this period of time. In 1998, an MNC urgently needed three managers to work in Shenzhen City and outsourced the recruitment of these executive managers to a top-tier global executive search firm which failed to find suitable local candidates for the MNC. This executive search order was then passed on to Firm B. The firm saw this challenge as a good opportunity to serve prestigious clients, which, if successful, would place the firm among top executive search firms. Accordingly, it actively communicated with the client to understand well requirements for these positions and pulled all resources to search for candidates who may meet the requirements. The first two batches of candidates submitted by the firm were rejected by the client for their poor English. The firm had to educate the client about the current situation of the talent market in the region and at the same time, intensified its search effort to identify candidates with strong English language ability. By cooperating well with the client, the firm found two managers for the client within three months and the last one within half a year after it received the order. This achievement greatly motivated the team in Firm B and built up its reputation in the industry. The fulfilment of this order later brought many more business opportunities to the firm.

Phase III (from 2002 to 2006): this was the period of time in which Firm transformed itself from a low-end service provider to a high-end HR service provider. During this period of time, the clients became increasingly demanding and the competition became more and more intense. New players came in the niche market with new business model. They openly promoted their brand, following the marketing methods of the product firms; they got financial resources from venture capital to recruit the best talents by

offering very high pay. As the owner of Firm B says,

‘these new comers upset the traditional professional service business model which did not favour open promotion of service brand for fear of being accused of self-boasting; the new entrants tended to treat services as transaction and allowed rapid turnover of talents. In short, they operated as a product firm. Their untraditional actions brought great pressure to us. If we do things slowly, we may lose our people and our clients all together.’

In order to successfully overcome this challenge, Firm B needed to change its organization, its enterprise capabilities and to upgrade its business. First of all, Firm B restructured its organization and its workforce. It invested heavily in employee development including internal training. Furthermore, it set up an IT CRM system to provide a common database for its business lines. At the same time, Firm B found major strategic partners in order to strengthen its capabilities in the competition. Firm B also intensified its growth effort, expanding the size of its office across the country. As a result of this transformation, the quality of its employees was raised to a new height. Firm B now had a team of employees who held master degrees instead of bachelor degrees. Internal management had become much more efficient due to its IT system. Although business suffered during this period of upheaval, the organizational change and capability transformation lifted Firm B from a low-end market into a much high-end market. Firm was able to break the bottleneck in its growth and was again able to achieve new growth milestones.

One critical event happened during this period. In 2003, Firm B helped the management of *Guangzhou Daily*, the most popular media in the province, to set up its human resource management forum, which brought together practitioners and academics to discuss major human resource management issues. The firm saw this activity as an opportunity to sense new market trend, to establish new relations, to consolidate old relations and to raise market awareness of its brand. ‘Interaction with market in this way was necessary for us’, the owner said in the interview, ‘it not only provided us with knowledge of the field, but also gave us business opportunities, because it opened the doors of many clients for our team which was the most important step in business development’. The firm put all effort to organizing and facilitating the event and due to this, the event was very successful. The event was very influential in the human resources cycle in the province, as it was highly publicized in the country by various media. Firm B was able to build a very positive brand and to establish many useful client relations.

Another critical event was the award-winning ceremony in Great Hall of People in Beijing in 2005, in which Firm B was nominated as one of the ten greatest firms in human resources service market in China. This event made Firm B known to the whole country and brought many business orders to the firm, particularly the business orders which required nationwide recruitment efforts. In addition, due to this positive image of its brand, Firm B was able to attract and retain many outstanding talents. On this event, the owner of the firm said in the interview:

‘We had been recognized as a regional player before this event. We could compete for orders from regional firms recruiting of local talents. After the event, we became national players in this niche market, which attracted to our firm not only national executive search orders with much higher margin, but also talents of much higher quality from talent market. The event dramatically changed our profile.’

Phase IV (from 2006 to the present): this was the period in which Firm B has been seeking to become a top-tier professional service firm and to increase the value of its brands. From 2007, Firm B started its journey to becoming a very professional service firm. For example, in its executive search business, it could now have half of its order as retainer fee orders. To become an executive search which could get retainer fee for its business order, Firm B was forced to raise its service quality to a very high level. It had to invest in infrastructure, to adjust its organization and employee mix and to improve its operation process and management system. For Firm B, the journey to become a very professional HR service firm has begun but there are still many challenges lying ahead for the firm. On this goal, the founder explained in his interview:

‘To become a firm which can have eighty percent of its orders charging retainer fee is very challenging. However, this must be achieved because it is the hallmark of a top tier service firms in our market. One must provide high quality service, if it is to collect retainer fee for its service orders. We are

moving well towards this goal.’

During this period of time, besides the goal of getting retainer fee for its business order, Firm B also made effort to expand into high-end service areas: consulting services. When Firm B was set up in 1996, the problems for its clients had been much simpler than they were now. The solution to these problems was to hire good people to tackle them. As market economy became increasingly mature in recent years, the problems faced by Chinese enterprises also became increasingly complex, which could not be solved by just hiring one or two good employees. This was the case for many clients of Firm B which were small firms. Their internal management was very poor, which deterred talented people from working for them. In 2006, Firm B sent consultants to look for exact causes of high employee turnover in some SMEs. These consultants found that their clients had many management problems. They then advised their clients on how to improve their management. By this means, Firm B entered the market of HR consulting and training services. Gradually, Firm B took up full range of consulting services since some of their clients looked for total business solutions, not just the HR solutions. In order to be able to provide such consulting services, Firm B spent much energy to upgrade the knowledge of its team. In his spare time, its owner studied for PhD in management. In addition, Firm B hired experts in management to provide training and mentoring to its team of consultants. Finally, Firm B developed its consultants by asking them to solve management problems in the firm itself.

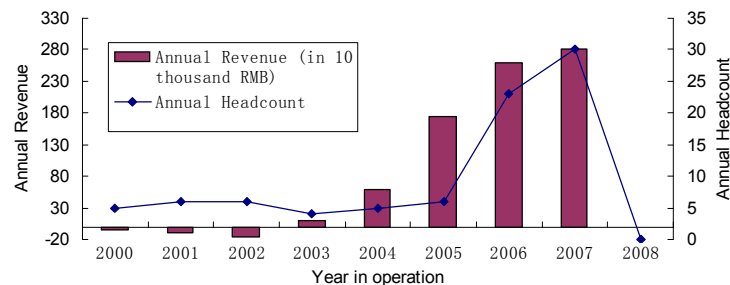
Growth of Firm C: a training service firm

This was a case study on growth of Firm C, which failed to grow, closing down its business after eight years in operation. Firm C was a HR service and consulting firm, providing professional training courses and consulting for its clients. Established in 2000 by some professors, PhD researchers and consultants, Firm C took as its mission to assist SMEs of potential to become unique firms and leaders in their sector. It positioned itself as a training and consulting firm solving business problems by in-depth case study. As such, Firm C had a unique business model in which clients were provided with training, consulting and investment advisory service based on successful real life cases. When clients took classroom training courses, they also had the opportunity to visit leading case firms in their sector to see how concepts, theories and cases as taught and discussed in the classroom were applied in the actual operations. This unique business model gave Firm C very competitive advantages in consulting and training market; it brought in a stream of revenue for the firm. However, it also laid the trap for its doom in 2008.

The founding of Firm C was a result of academic research. Originally, a group of academics studied growth of a very well-known enterprise in Southern China, *Galanz Business Group*, which specialized in manufacturing and selling home appliance, particularly microwave ovens. The research was to find out how the firm had come to be so successful and has grown into a huge conglomerate, which was known overall the world for its low cost and high quality products. The principal researcher, a PhD student,

saw the commercial value of the case study and registered a firm to develop the academic case study into training courses and to sell the training courses, and hence the birth of a small training and consulting firm. Firm C had a life span of only eight years before it was closed down. The following is a chart showing the trajectory of growth and failure of Firm C:

Chart of Firm C: The growth history of the firm



Period of investment and growth (2000-2005): During this period, Firm C focused its effort on studying the success of *Galanz Business Group* and in 2002, published a series of VCD presenting the successful growth of this firm. This publication was followed by another series of publications in other media including a book published in 2003 entitled ‘A manufacturing marvel—management practices of *Galanz*: how a firm with 25 years’ continuous growth has come to be No.1 in the world’. Another book was published in 2005 entitled “Business strategy of *Galanz*”. These publications by Firm C were the results of close cooperation between its team and *Galanz Business Group*. In this partnership, both partners earned market reputation and revenue. It should be noted that while Firm C helped to polish and spread the brand of its case firm, it also used the case firm to obtain business opportunities. It developed training courses based on the success

of *Galanz Business Group* and outsourced them for sales to a team of capable salesmen led by a manager who had strong entrepreneurial spirit. The training courses were jointly taught by the owner of Firm C and top managers from *Galanz Business Group*, which gave the audience a sense of being authentic management practices. The audiences were invited to visit *Galanz Business Group* during their training time. For some years, this business model of Firm C worked very well, which spurred the growth of Firm C to such a height that it backfired: the top management of *Galanz Business Group* came to believe that they were exploited by Firm C in this business relation. In 2004, they withdrew from their cooperation with Firm C. However, even without the support of *Galanz Business Group*, Firm C was able to further grow relying on the momentum it had built. Yet, without the cooperation of the case firm, Firm C lost its unique business model and the training business based on case study of *Galanz Business Group* gradually dwindled away. Firm C tried to replicate the business model to develop similar business partnership and training courses. Unfortunately, these partnerships were not as successful as the case of *Galanz Business Group*.

Period of decline and abrupt bankruptcy (2005-2007): in 2005, Firm C decided to refocus itself on service industry. In similar manner, it began to build a case of success using *Royal Hot-spring Resort* in Chonghua, a place near Guangzhou City, which specialized in luxury leisure hospitality. At the beginning, the business model worked well. As *Galanz Business Group*, the case firm *Royal Hot-spring Resort* extended its welcome to Firm C for its interesting business model. Firm C polished the brand of *Royal Hot-spring Resort* by publication of the case firm in a book entitled “Oriental

Service' and Firm C brought in many guests for the resort. These guests came for the training on service skills. They were mostly owners of business in hospitality. By taking the training course, they had the opportunity to observe how the case firm, *Royal Hot-spring Resort*, managed its business. For example, they were invited to attend the management meeting of *Royal Hot-spring Resort* and to examine the rooms to see how cleaning was done. For some time, many business owners took part in the training course. Many of the participants held the case firm in high esteem and praised the training course. It seemed that this venture might succeed. Later on, some participants began to note deterioration in service quality of the case firm *Royal Hot-spring Resort*, which might have run into management problems. *Royal Hot-spring Resort* began to fall as an exemplifying case study and the training course based on its success began losing its lustre. Moreover, the marketing and sales team which Firm C set up to market and sell this training course was not working as effectively as the professional team to which Firm C had outsourced the training course based on the case study of *Galanz Business Group*; In 2006, the number of participants in the training decreased, the marketing and sales team of the firm did not come up with proper measures to attract more training participants. Eventually, in 2006, the training business of Firm C shrank to be only about one fifth to two fifth of its total business volume.

At that critical moment, it recruited one partner who had been human resources manager and director for multinational companies in China. The new partner brought in practical management experiences which Firm C lacked. He also built up a team of about three to four consultants of high calibre. Some of them were returned overseas students who had

valuable knowledge and skills. Prior to this development, the founder of Firm C had completed some consulting projects but the firm had not had a dedicated team of consultants until then. New business model was developed by the new partner. When public training courses were held, this new partner would take the opportunity to give some training courses. In the audience were some business owners, who badly needed help of management consultants. They were later developed into clients for Firm C by the new partner. He then led the consulting work for these clients, which in turn built up the consulting capability of Firm C. In addition, some consulting opportunities also arose when the salesmen of Firm C were asked by the management of its clients to solve their urgent problems and passed these requests to the new partner. The new partner, together with the founder, was able to gradually build up the consulting business, which brought in about three fifth to four fifth of total annual revenue. Consulting business, however, was labour-intensive and less profitable, in comparison with licensed training courses. At the end of this period, turnover of employees was more frequent and the owner saw difficulty in getting quick money. He opted to close Firm C immediately when one of the prosperous clients in beauty-care business invited him to join his firm as a shareholder. Firm C closed its operation in 2008 and the team of about 30 employees lost their jobs.

Growth of Firm D: a small executive search firm

This was a case study on a small executive search firm which grew very fast and then went into stagnation. The firm, Firm D, was set up in 2005 in Guangzhou by three partners. One of the partners was from a global executive search firm and two others from other types of multinational companies. The customers of Firm D consisted of mostly multinational firms and POEs which were very healthy in finance. These customers constituted a high-end sector in executive search market. It had three offices, one in Guangzhou, another in Shanghai and yet, another in Shenzhen. Each of the offices operated under the direct supervision of a partner. The business model was different from those of its competitors. It served only a few customers, with one senior consultant, usually one of the three partners, acting as account manager for each of the customers. The consultants searched for all executive vacancies for an individual customer. They did not search for executives for a single job category. The result was that the customer got focused attention and that the consultants were continuously motivated by the variety of their searches. The profit model of Firm D was to raise the price for executive search service by continuously improving quality in term of the appropriateness of candidates and delivery time. To achieve profitable growth, Firm D needed to keep learning to move up the value chain in the executive search market.

When Firm D was set up in 2005, it had only one office located in Guangzhou. It had only one partner and five consultants. With his former working experienced from a global executive firm, the founder was able to bring a number of his former customers

into this new venture. In addition, he was able to bring with him the know-how in executive search. He hired two consultants in 2005. One of them was from a famous global multinational company, who was well connected to the professional talents in the IT talent market. She brought with her not only the knowledge of that market sector but also the personal image of a MNCs veteran. It is possibly due to this image that Firm D was able to hire and retain other top-quality consultants. In order to build up the organization, the owner did his best to create a cosy family atmosphere. He regarded coaching his team as his most important duty. He taught them knowledge of business world and know-how in business development. He did his best to help his consultants to grow, allowing them to make mistake and to learn from them. He even sacrificed his own earning by giving some search opportunities to his junior consultants so that they had a chance to learn executive search and to earn money. With care and patience, the owner of Firm D was able to gradually build up a team of five consultants, which was an acceptable size for a local executive search firm. The annual revenue for Firm D grew from only about 120 thousands US dollars to about half a million US dollar.

In 2007, the owner of Firm D decided to open a brand office in Shenzhen City, in order to retain one of his key consultants, who had been a top performer for the past few years. The consultant joined Firm D in 2005, after resigning from the position of a junior HR manager in a MNC in Shenzhen. She brought a business order to Firm D even before she formally joined the firm in Shenzhen. In the following years, she completed several important executive search assignments, acting as account managers for a number of MNCs. In 2007, however, she wanted to resign from Firm D because she wanted to go

back to Shenzhen to start up her family life. The owner of Firm D noted her value and contribution to the growth of Firm D. He had a discussion with this senior consultant concerning her resignation. He decided to open a Shenzhen office which was located near her home. The consultant was deeply moved and worked in the Shenzhen office as its manager. She was able to balance her life and work. For Firm D, it was able to retain one of its best assets. With about four consultants, Shenzhen office has since become a key player in the executive search market in the city.

In 2007, Firm D decided to set up its Shanghai office, in partnership with other firms. The reason was that the clients of Firm D moved to Shanghai and needed the support of Firm D. In the past two decades also, multinational companies had been expanding their business from one part of China such as Guangdong to the other parts of the country. With this expansion came their need for nationwide executive search service in the country. Firm D took this opportunity and opened its office in Shanghai, where most of its customers were originally from Guangdong province.

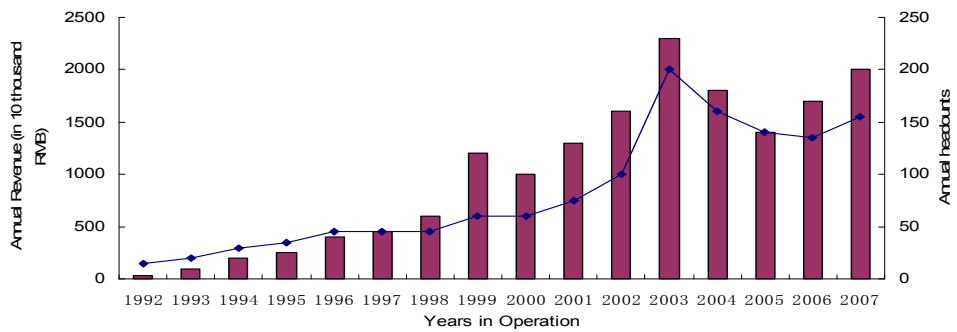
From 2008 onwards, Firm D set up a target of moving even higher in the value chain of executive search. It began to build connection with firms in other part of Asia. At first, it expanded its executive search to cover Hong Kong and Taiwan. Then, it gradually followed the need of its customer into the market in Singapore. It had recently completed several search orders for customers in that market. Realizing that going global was beyond the current capabilities of the firm, the owner of Firm D had decided to focus on Asian market. For that, he studied hard and learned Asian market step by

step through interacting with its customers when carrying out executive search for them. He was very cautious in venturing into these unknown territories even though he had some successes. At the same time, Firm D sought to raise the level of searched positions so that it could gain greater margin. This required that the partners of Firm D and its senior consultants possess sufficient business knowledge to conduct dialogue with the top management of big firms. For that purpose, Firm D has been undergoing major transformations to build up its internal capability, which included developing its current partners and consultants as well as hiring better qualified consultants.

Growth of Firm E: a firm of multiple HR services

Firm E was set up in 1992 (not registered until 2001) and has been growing till the present, seeing annual revenue of \$3 million and headcount of 155 in 2007. Its main business was labour outsourcing; in this business, the firm recruited workers and allocated them to clients according to the need of the clients which had up and down in their demand for labour due to fluctuation in their production output. The firm charged clients a fee for utilization of its labour and got profit from fees minus cost of maintaining the labour. Other service lines of the firm were similar to those of other HR service SMEs, including executive search, online recruitment, outsourcing of personnel management, training service and HR consulting service. The business models for each of these service lines were different. Executive search service charged a client fee for finding candidates for their professional and managerial positions; training service charged clients or training participants a fee by hours/days of training or by training programme; personnel management outsourcing charged clients per transaction of service or per head of employees using the service of the firm. One thing in common was that service value recognized by the clients determined revenue and further growth for the firm. The growth trajectory of the firm can be seen in the following figure.

Chart of Firm E: The trajectory of growth in annual revenue and headcounts for the firm



The growth story of the growth of Firm E began in 1992 when a young graduate from Wuhan City set up an employment agency (with no formal business registration as a firm at all) in Guangzhou for job seekers, because he failed to find a proper job in the city and thought that he could earn money by helping people like him. At first, he and his team collected job opening information from companies in the city which were not willing to put up advertisement in newspaper due to cost consideration, and then sold the information to the job seekers for a small fee. This service substituted job opening advertisement for the client firms, for which the founder and his team earned very good money for a living, because job seekers were so numerous. However, very soon, other people imitated this business model and some dubious personnel began to cheat job seekers with false information of job openings; this turned the niche market of recruitment into infamous sector, in which the bad and the good could not be differentiated.

In about 1994, the founder of Firm E foresaw this development of the job agency market; he realized that he must be able to give signal to the job market that he had genuine job openings before job seekers gave him fee for job opening information. He

wanted to organize job fair in which employers and job seekers could meet face to face; from the participants of the job fairs he could collect fee. However, he did not have a formal license to do this business. In 1995, he negotiated with governmental job market organizer ‘South China Job Market’ to let him use its license to organize job fairs for which he was willing to pay a substantial fee. He and his team operated a job fair in a building close to the most populous place in the city—Guangzhou Railway Station. The job fair was a great success from the very beginning; the founder and the job fair were known overall the southern part of the country which was the most vigorous place for economic development and employment. ‘South China Job Market’, owner of the job fair and its brand, earned a lot of money while the founder and his team was greatly developed, particularly in their ability to organize big event such as job fairs. The founder and his team was so much encouraged that they invited famous domestic firms to hold job fair in Hong Kong for top talents, which also turned out very successful.

The job fair was a great success in the city. As the founder of Firm E said in his interview: ‘we were very daring, ambitious; and we learned quickly. We were very innovative in the ways of conducting business, because without innovation, we could be given up by the job market very quickly.’ The founder and his team foresaw the worsening of the job fair business sector due to competition among traditional job fair organizers and the coming of online recruitment technology. They proposed to go for online recruitment and to diversify into other HR service lines, in order to catch up with market change. Unfortunately, as a governmental unit, ‘South China Job Market’ was unwilling to accommodate the ambition and daring business plan of the founder of Firm

E and his team. In 2001, the firm successfully registered as a HR service firms and in September 2002, Firm E announced to the market its separation from ‘South China Job Market’, which immediately made news in the southern part of the country, because of the fame of the job fair, its owner ‘South China Job Market’ and its organizer Firm E. Many people expressed their regret and their concern that Firm E might have given up too great a partner and too great a place for business; in addition, such action brought unknown future to the founder of the firm and his team. Nevertheless, the founder admitted in his interview that “it was the right move for us and for ‘South China Job Market’; we had our freedom to pursue our dream and ‘South China Job Market’ has got inherited a great job fair.”

The firm investigated the job market in the city and decided to set up its job fair in Guangzhou East Railway station, because the venue was close to other job fair venues in the same district and could attract more and better talents. Depending on the existing client relations, Firm E had immediate success in the new site. In this period of time, beginning from 2002, Firm E ran a newspaper of its own; fifty thousand copies of each issue were distributed free of charge to all the job fairs in the city. In addition, many other marketing events were organized; in 2003 alone, for example, the first human capital forum for entrepreneurs was successfully organized in Guangzhou Mingquan Resort and ‘Forum for Guangzhou and Hong Kong Enterprise on 2004 Graduate Employment’ was also successfully launched’. In February of 2004, contents and name of the firm’s talent newspaper was incorporated into ‘Win Weekly’—a famous media in the country. These events helped established the brand of the firm in the human resource

market of South China. More and more employers and job seekers came to use the service which made the firm very famous in the city and in the province. The founder of the firm said in his interview: ‘the relocation of our job fair from Guangzhou Railway Station to Guangzhou East Railway Station helped to establish our firm in the market; now we were able to develop our own brand, on which we could develop multiple service lines to achieve our business goal and personal career goal; we had a big platform to develop ourselves and only the sky was the limit.’

One critical event happened in 2003 which greatly changed the business portfolio: Firm E began its operation in talent leasing business. In the beginning, the founder got the information from his talk with MNCs that they had some temporary positions like secretary to fill, because these enterprises wanted to organize some big event such as year-end celebration. Since these MNCs were royal clients of the firm, Firm E immediately recruited such talents for these firms. Later more and more enterprises asked for such service, which prompted Firm E to investigate the need of this type of services. The result was encouraging and so the firm set up a group to study the business model and practices of talent leasing, by learning from books and international HR service firms over the internet. Furthermore, the firm negotiated with MNCs on their requirements; some MNCs were very helpful; they not only informed the firm about their requirements but also told the firm their experiences in using such service provided by international HR service firms. By 2003, Firm E decided to set up a department to run the talent leasing business. It hired consultants from market who had experiences in talent leasing business in international HR service firms and trained its

own employees to take up knowledge and skills in this service line. Then, the firm began with leasing office staff to its clients, which was quite successful.

However, there were also some problems in the process. One of such problems was that some of the talents leased to the clients of the firm found it difficult to adapt to the culture of the firms which leased them and so the talents' effectiveness and efficiency were reduced and the clients were not happy. Firm E investigated the problem and asked suggestions for solving the problem from the firms which leased the talents. Based on the investigation, Firm E formalized its process of selecting talents for leasing, by using proper tests to assess the personalities and skills which allowed the firm to match the talent with the culture of the clients. The talent leasing business was thus improved. Later in the year, some clients of Firm E asked for help on staffing labour due to their peak of production which demanded extra headcounts in production lines. Firm E recruited some workers and leased them to its clients.

This was a win-win situation for Firm E and its clients: these clients of the firm got their labour resources without going through complicated recruitment and management procedures and were able to use labour on demand which greatly reduced labour cost, while Firm E gained a good source of revenue. The business model of labour leasing was very simple. Soon, other HR service firms in the city began to follow. Firm E decided in 2004 to expand its sources of labour, which consolidated its position as leader in this niche market, by implementing its geographical expansion strategy of standardization and licensing of employment agencies, just as McDonald's does in fast

food market. It developed standardized work procedures and trained employees for its licensed stores across the region. This competitive strategy worked well because the clients which used this service were provided with timely labour and qualified talents. Firm E in this market began to dominate this niche market and its brand became well known in the region. At its peak in 2003, the firm had annual revenue exceeding \$3.5 millions and a workforce of close to 250 employees, both of which set precedents for HR service firms in the country.

Nevertheless, in 2004, Firm E faced a downturn in its business. Because the venue for job fair for the firm in Guangzhou East Railway Station was marked for re-development, the firm had to move to the nearby office building. Many employers followed the firm to the new venue but job seekers lost their way. At the same time, online recruitment was becoming a fashion which directly competed with traditional job fairs for employers and job seekers. These two compounded causes made the revenue of the firm decrease drastically in 2004. The downturn in business gave employees concern for the future of Firm E. Some able and experienced employees began to leave the firm for better jobs elsewhere in the region. Knowledge and skills began to lose. As a consequence, the firm lost some clients along the loss of the employees and business suffered. The founder of the firm was very worried about the situation. He began to talk to some of the key employees to listen to their concerns and to present to them vision and plan of development for the firm. In addition, financial incentive schemes were put in place to retain the best employees. In spite of these efforts of retaining employees, some good employees resigned from their jobs and some other employees who were not

performing well were asked to leave. The restructuring of the workforce reduced its number from about 240 to 180. In one year's time, annual revenue of the firm decreased to only about \$2.1 millions.

Faced with decrease in revenue and employees, from 2004, the firm began to change its operation strategies and business portfolio in order to move ahead. The firm began to strengthen its diversification strategy which already began from 2002 when the firm had its own license and brand; in that year, the firm set up its own executive service line catering to the need of big MNCs for professional and managerial talents. In 2004, much bigger effort was taken by Firm E to diversify its business portfolio. Organization structure was restructured, new business groups were set up and employees retrained to take up new jobs. In 2004, for example, training course for car dealers on automobile knowledge and skills was successfully launched, with 100% of its participants finally landing a job in automobile market; in the same year, 3000 professionals were leased by the firm to its clients, making the business one of the most prominent talent leasing businesses in the region; also, in foreseeing the coming of online recruitment and shrinking of job fair business, the firm developed its own online recruitment platform call 'hr3721.com', which helped to keep its clients which used its job fair service. In addition to business portfolio diversification, the firm began to implement its strategy of geographical expansion, attempting to replicate its successful model of job agency, in the form of licensing chain store like McDonald's. For that, it developed operation procedures and standards and trained owners and key employees of licensed job agency store in its brand.

Indeed, since 2004 restructuring has become the most prominent feature of the firm. The firm focused on brand development, diversification of business portfolio and geographical expansion. It actively followed market trend, promoted its brand and changed its structure and employee skills, in order to catch the trend and meet the need of the market. In 2005, Firm E became a member of HR Association of Guangdong Province, with its founder elected to the board as a vice chairman of the board. This was a great success for gaining support from the government and recognition from market. In the same year, the executive search division of the firm was also recognized as one of the top ten executive firms. Moreover, in term of business innovation, the firm set up and operated in 2005 the first bank [a database] of human resources across region in the country; and in 2007, the firm closed its job fairs, replacing it with employment agency recruiting talents on behalf of employers. As a result of successful restructuring, revenue and employment of the firm began to grow again from 2005 onwards.

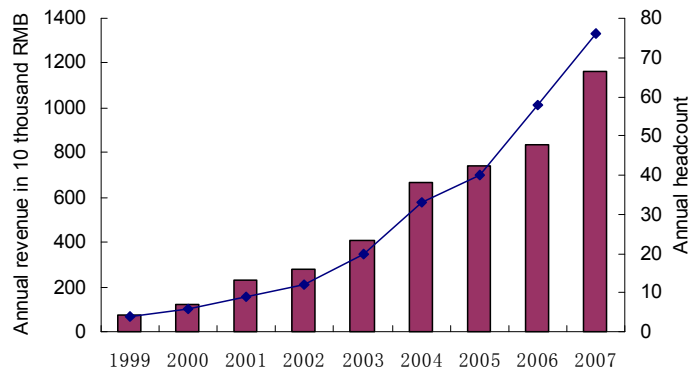
One critical growth event happened to Firm E in 2004. In that year, the founder of the firm began its geographical expansion by licensing its employment agency scheme. He believed that as middleman of employment, an employment agency should not, as he said in his interview, 'be limited to a region but instead, it should be a network of resource across the country'. Expansion by licensing was the fastest way to grow without the fear of losing service quality and network of resource base across the country was the best way to build up resource pool on which Firm E could survive. The scheme of expansion by licensing had been on his mind for quite a while. Competition

intensified his desire to do so; in 2004, he made his decision to expand his firm rapidly to get the best qualified job seekers, to develop its brand and to stand out from the crowd as a leader with critical mass. To do so, Firm E developed and standardized operation procedures; it negotiated with investors to develop the chain of employment agency store using its brand; it trained the employees for new stores across the region. At first, it opened three stores of employment agency in the city which allowed the firm to gain experiences and to control its service quality. More importantly, the stores were purposefully built close to job seekers and employers so as to spread the brand of the firm to the market while best served the market needs. In the same year, the opening of the three stores of employment agency immediately brought to the firm many resumes of quality job seekers which later became candidate database for development of the firm's executive search service line. Moreover, the firm was recognized by job seekers as an effective channel of finding jobs. Most important of all, the chain of stores did provide timely service to clients because of their vicinity to client sites, thus satisfying urgent needs of these enterprises and at the same time attracting more clients to use the service. It was a very successful experiment for the firm. From 2005, with experience gained from operating a chain of licensed stores of employment agency in Guangzhou City, Firm E quickly opened up more such stores of employment agency across the country, in both developed regions and under developed regions, which later turned into branch offices of the firm responsible for many business lines such as executive search service, training services and labour leasing services.

Growth of Firm F: an executive search firm

Firm F was a professional executive search firm, with headquarters in Guangzhou, China. The firm was set up in 1999 by three local partners from the executive search industry, without any resource or connection from abroad. Its sole business was executive search: identifying and hiring executives for MNCs operating in the country or newly developed rich private-owned-enterprises, particularly those in the high-tech industry. As is the case with other executive search firms, the business model for this Firm F was simple. It took on customers and got business orders by demonstrating its successful cases. It built and maintained customer relations by quality service, which meant timely delivery of orders and quality candidates for the customers. Service fees were collected from clients for those successful assignments of executive search. Profits were made by upgrading service level, meaning escalating the level of vacancies that the firm could fill, and by minimizing operation cost. Firm F sought to grow by snow-balling its database of candidates and clients, in the form of product line expansions and geographic expansion. It now had business offices in Guangzhou, Beijing, Shanghai, Chengdu and Shenzhen. Below is the figure showing the growth history of Firm F. The figure shows that Firm F has been growing in a very sustainable manner since its founding. Firm F has witnessed most part of the development of executive search sector in China, which has had a very short history, starting from early 1990s. Growth history of Firm F was very representative of growth of executive search firms in the country.

Chart of Firm F: Trajectory of revenue and employee growth of the firm



Since its incorporation in 1999, Firm F has been successfully expanding its business without any major setback. In retrospective, Firm F had four milestones in its history of fast growth over the past nine years. The first milestone happened in 2000 when Firm F successfully pulled through its survival stage. When it was founded in 1999, Firm F was very small and weak, with only three employees and scattered knowledge and experiences in the executive search. However, at that time, the market for fast moving goods (FMCG) and information technology in Guangzhou was booming and demand for professional talents for these two industries was very high. Accidentally in 1999, the founders of Firm F got the information that Coca-cola planned to move its headquarters from Hong Kong to Shanghai and Guangzhou. Hong Kong staff were not willing to move to the new sites since they could easily find new employments in Hong Kong. This meant that there were over sixty executive vacancies to be filled for this firm in its new office in mainland China. Coca-cola outsourced the recruitment to its global talent supplier *Kornferry International*. When it saw this business opportunities, the founder of Firm F persuaded Coca-cola that it could help in its urgent need of recruiting such a

big number of executives, by indicating that he had experience in China FMCG market and he had better knowledge of the local job market than consultants of international HR service firms. The client, Coca-cola, finally took his word and decided to give him a chance to demonstrate his ability. Firm F made every effort to complete the assignment and by local referral, it filled more than thirty of these sixty executive positions, which was a huge success compared with *Kornferry International*, which filled only about ten positions out of the sixty vacancies. This is because Firm F had local knowledge and some other advantages in local markets. From interacting with Coca-cola, employees of Firm F improved their English and communication skills; they also learned some basic skills of searching for executives. Moreover, success of executive search assignment for Coca-cola brought to Firm F much needed cash and credit in the market, both are important for further growth in later stages of its history. Indeed, as the founder of the firm said in his interview, the firm ‘grew along with growth of our clients; Coca-cola has been an important client for us; we expanded into city like Shanghai, Beijing and Chengdu, following Coca-cola’s expansion’.

The second milestone in the growth history of Firm F was in 2000 when the firm decided to diversify product lines [types of vacancies to fill] and client portfolio. At that time, there were some visible signs that information technology (IT) high-tech sector might go into recession. Founder of Firm F made the decisions to expand into other product lines in addition to FMCG and telecommunications, taking the challenges of searching talents for multiple industrial sectors which was particularly difficult for a new and small executive search firm. Firm had to hire many more employees who could

bring knowledge and experiences to the firm; to accommodate the increase of employees, the firm had to move into a much larger office which was over 200 square meters in space. It also raised the profile for its new hires. This strategy of diversifying product lines and customers portfolio later proved correct. After 2000, IT bubble burst and the telecommunication which was one of the only two sectors Firm F served in 1999 witnessed a slowdown in development. Many former mighty telecommunication firms which were the clients of Firm F went bankrupt and could not pay Firm F for the service they had used. Firm F successfully avoided being affected by this market downturn by diversifying into other sectors. In addition to successfully avoiding bankruptcy, the diversification of business portfolio gave Firm F experiences in handling complex product lines in the same market which was important for market penetration in the same geography.

The third milestone in the history of Firm F was that one of the founders of the firm went to study for MBA in the UK in 2002. At that time, the firm had already passed its survival stage and was well on its way to further expansion. Employees hired were able to operate well in their jobs and the business was expanding. Expansion called for more leadership. However, the founder decided to give up his business to go to the UK for further education, which, at first glance, might appear abnormal. Actually, it was a logical step for growing the firm in its history. There were triple purposes for this founder to go to study in the UK. One was that he wanted to be away from daily hectic operation so that he could calm down and summarize and learn from the past few years' business experiences; the second purpose was that he wanted to polish his education

history which is necessary in executive search sector; the third purpose was to look for strategic partnership with executive firms and clients in the UK. The impact of this event on the growth of Firm F was evident. The founder came back with some new learning methods for the firm. In addition, his education improved the image of the firm. More important, his action showed that the firm attached importance to high quality of consultants including their education, which motivated the employees to learn new things. Since then, the firm and its employees began to understand and to emphasize the importance of learning, including English learning, which gave the firm advantages in dealing with MNCs.

During survival stage and early growth, Firm F was able to expand its business because it successfully seized the market opportunities from 1999 to 2002 when FMCG was fast developing in Southern China, when telecommunication was also fast expanding and when other MNC were rapidly expanding their local business in the same region. For example, in telecommunication, Nokia expanded its sales workforce to capture market in South China. FMC used this opportunity to look for talent for Nokia which led to fast growth of the firm. In addition, localization of talents brought about executive vacancies for MNCs in China which meant business opportunities for executive search firms such as Firm F. Apart from market demand, the growth of Firm F during this period of time also owned to the fact that it took great effort to learn and to accumulate experience in executive search business; furthermore, it paid great attention to market trend and to customer service.

The fourth milestone in the growth history of Firm F was the expansion of its business into Shanghai in 2003. This signified the geographical expansion for growth for Firm F. There were several purposes for this expansion. Firstly, to the market, multiple locations signify sizeable operations for an executive search firms which is the sign of its power, resources and credits and thus, expansion of the firm into Shanghai brought to it a sign of market power. Secondly, through geographical expansion, the resources of the firm such as the database of candidates were better leveraged. Thirdly, multiple sites helped to attract and keep for the firm big clients who needed nationwide recruitment service. The founder of Firm F said in his interview: ‘some of our clients expanded into Shanghai and we had to go there to serve them. They needed our service across the country’. Therefore, in as early as 2002, Firm F started its plan and did preparation for opening its office in Shanghai, which was a huge potential market for the firm. In that year, Firm F’s leaders paid consecutive visits to Shanghai for two quarters to study the possibility of opening its office in the city: they studied the economic development in the city to identify growing industries; they studied the potential sites for business office in the city and they studied the talent market in the city to position their own talent strategy in the city. In addition to site visit, these leaders also studied the clients based in Guangzhou to identify which clients had branches or sister companies in Shanghai City; these client branches were later used for building the client basis for Firm F in Shanghai.

When the preparation was done and the office was open in city in February 2000, Shanghai office immediately encountered three challenges. One challenge for the firm

was that the clients were much bigger and more complex than its clients in Guangzhou; another challenge was that HRM model and social culture in Shanghai City was different from those in Guangzhou and the last challenge was that the database in Guangzhou could not be accessed effectively from Shanghai due to IT problems and high cost of using telecommunications. Operations in Shanghai office was, in effect, another entrepreneurial effort and very difficult. For example, local Shanghai employees were not as entrepreneurial and hardworking as those in Guangzhou, which presented new problems for the firm. From the beginning, the office began with only three persons including one administrator. Lack of transportation due to cost minimization also made life difficult for Shanghai office staff. Fortunately, these consultants were trained for two quarters in Guangzhou office before being relocated to Shanghai office. Entrepreneurial culture in Guangzhou office was also effectively transferred to Shanghai office. The pioneers worked hard and gradually they built up the business in Shanghai for the firm. The sharing of database was also made possible, thanks to the CRM system of the firm.

The successful opening of Shanghai office and its subsequent contribution to the growth of the firm's were the result of much careful preparation works and accumulation of experiences. The experiences, such as how to penetrate local market, how to develop local talents and how to solve IT problems, were later used in the firm's expansions into other geographical market. In short, the expansion into Shanghai market boosted the growth of Firm F.

In 2004, Firm F reached another milestone in its growth history: the establishment of trainee programme. The programme was set up to meet the need for consultants and managers required for expansion. Since Firm F was not a MNC and was not at all attractive to top talent, particularly those with experiences from big firms, it had to train its own consultants and managers. The founder of the firm had witnessed the success of management trainee programme in MNCs such as P&G and wanted to learn from it. It hired ten graduates into this programme. These trainees went through intensive training for half a year, which consumed much of management time and financial resources. They were taught how business operates in theory. Then, they were sent to the client sites to experience business operations, for example, to visit plants to understand how production was carried out. Experienced business managers were also invited to give lecture to these trainees. In addition, knowledge, skills and practices in executive search business were also passed on to these trainees. After such intensive training, these ten management trainees were sent to work in Guangzhou office and Shanghai office. They were highly successful in their jobs. More important, by such a programme, Firm F successfully created its people development mechanism, which enabled the firm to develop sufficient number of consultants and managers for later growth. With sufficient resources, Firm F opened its Beijing office, Shenzhen office and Chengdu office in 2006 and 2008.

During the period between 2005 and 2007, Firm F reached another milestone in its development: developing policy and procedures of operation and people management to harness the firm to become a professional business organization. It was done out of

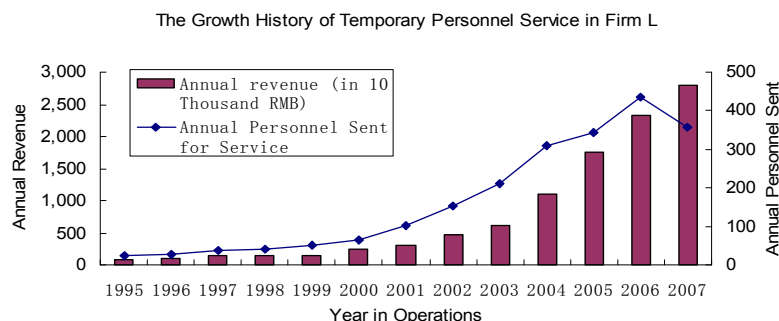
necessity. As Firm F grew, its organization became bigger and bigger. It became more and more difficult for managers to have personal daily oversight of the operations and the performance of employees. Friendly family atmosphere could no longer hold together the employees. Employees began complaining about unfair allocation of resources and business opportunities. Internal conflict began to pop up among the trainees. Five of the ten trainees resigned in the first year due to this type of conflicts. Partners of Firm F decided to manage the firm by systems, minimizing subjective influence. In operation, the firm streamlined and standardized operation process and procedures; based on this, the firm built an ERP system dedicated for executive search business which was an innovation in this industrial sector. In people management, the firm set up 360 degree appraisal system in order to objectively assess ability and performance of its employees. The firm also set up policy on employee contribution to the database of the firm and rewarded them accordingly. The database later became a platform for cooperation and learning among consultants. Since then, with the help of the system, the employees have been more fairly assessed and rewarded, which has become the main force that motivated these employees to work hard for the firm. On this, one of the partners of the firm admitted that ‘developing our people was a difficult job which surpassed the difficulties associated with geographical expansion and service line expansion. Yet, we had to do it, because effectiveness of developing our people determined growth of our business.’ The improvement in business management and people management resulted from standardizing, systemizing and digitalizing management of the firm has greatly accelerated the firm’s capability to serve the market. The policy and procedures thus set up has laid a very solid ground for Firm F to grow in

the later stages.

Growth of Firm G: a temporary personnel service firm

Firm G has been providing temporary and contracted staffing services for its clients for many years. When the business was founded in 1993, the firm was the only non-governmental company providing such service, and has grown into one of the largest temporary staff providers in Guangzhou City. Over the years Firm G has built a solid reputation among foreign invested companies for providing highly qualified temporary staff from its pre-screened and constantly updated database. These temporary positions were mostly secretaries or office assistants. The business model was also very simple: the firm hired some office staff on fixed terms and sent them to their clients for temporary service, levying an administration fee from 20 to 25% on top of the salary for these staff. If the demands were higher than what the firm could supply, the firm also hired some temporary staff directly from market and sent them for service fee. The figure below showed the growth history of this business line:

Chart of Firm G: The trajectory of growth in annual revenue and headcounts for the firm:



The business was built by founders of the firm from scratch. One of founders was from Germany; he was once a project manager in China and experienced the pain of finding

temporary personnel for projects. These projects normally had limited, and often very short, lifecycle. In this country, people normally did not like temporary jobs. Therefore, this founder of the firm believed that there was a market for temporary personnel service. It was possible that human resources service firms, such as Firm G, could survive and prosper by providing temporary personnel for firms who needed the service of such staff. However, such a market did not exist at that time and the founders of Firm G had to develop it. The following is a description of how Firm G and its business has been developed from 1993.

Period of survival and early growth (1993-1999) for the firm saw difficult business development and slow growth if any. The founders of the firm had to conduct door-to-door selling of their offering of temporary personnel service to the companies in the vicinity of their office building. Since this type of service had been in existence in the west and one of the founders was western expatriate in Guangzhou, the firm was able to connect MNCs operating in Guangzhou and sold their service offering to these multinational firms. After listening to the explanation of their service and its benefits, most of the MNCs confirmed that this was necessary service for them. They wanted to use temporary personnel service for two important reasons. One reason was that this service gave these companies opportunities to observe the temporary employees before offering them permanent positions, which was similar to probation but less complicated because these firms did not need to go through all procedures normally associated with employing probationary employees. The second reason was that the temporary employees sent by the firm were immediately functional, without training, which saved

cost and time for the clients. After market testing, the firm placed advertisement in the Yellow Page book of the city.

Some firms, such as Motorola and Johnson and Johnson, began to order temporary personnel service. Some of them wanted the temporary personnel services in the positions of receptionists and secretaries while others need these temporary personnel for their projects. The founder of Firm G began to get some orders. However, they had problems recruited people who were willing to take up such temporary service, because most of people were used to long-term secure jobs, particularly in cities other than Guangzhou which was more internationalized. The firm had to hire about ten secretaries on fixed terms and sent them out for short periods of temporary service for its clients. Sometimes, to fulfil urgent orders, one of the founders herself had to do the temporary service, as a secretary, on the client sites. Her excellent skills, for example, skills in using power-point presentation, and her professionalism won credit for the firm and more business orders came in.

In order to build up the business line, in 1999, the founders of the firm had to register their firm with Guangzhou labour bureau. In early 90s, the business of providing HRM services was quite new and they had to look for personal connections to gain their business license. After exploring a number of relations in the labour bureau of the government, the firm finally got its license for its practices in HRM service, becoming the first private firm in the city able to provide temporary personnel service. Their practice was then legitimized. It was carried out by a staff of three persons including

one of the founders of the firm.

Period of slow growth (2000-2004) saw expansion of the temporary personnel services, from project personnel and office staff into other positions such as promoters in marketing events. The growth of the business for this period was very slow because the positions in the temporary personnel service remained low in value and thus administration fee levied on the service remained small. To increase revenue, sometimes, the resources of the firm were taken away from this service line to other new service line such as executive search.

Period of fast growth (2005-2007) saw radical change in the external environment and in the direction of the temporary personnel service in the firm. Labour law in the country began to require employers to have fixed term contract with all employees for up to 2 years and must provide social security for their employees, both permanent and temporary employees. This drastically increased the cost for temporary personnel service, presenting barrier to the growth of this business. Internally, by this time, the other business lines in the firm have become mature and brought in much higher profit than temporary personnel service. Recognizing that temporary personnel service was of low-valued service, the firm decided to upgrade the service to the high-end market, hiring only white-collar workers to work in the client sites for high service fee. In 2007, it recruited two expatriates in Guangzhou to start up the service of interim management service (IMS) for clients such as Siemens. The firm sent experienced executives, particularly those western executives who had been working or living in China for years,

to clients who were going through major organizational changes such as M&A or some crisis such as downsizing. These interim managers took up operation positions in the clients to complete these changes. They provided not only advice but actual managerial service which distinguished the firm from other consulting firms which normally provided only services, not personnel. In addition to complete the hands-on operations, these temporary executives help recruiting staff for their temporary positions. The firm has a very successful case of IMS with a high-end North European chemical firm operating in Wuhan. This change of temporary personnel service dramatically increased the business income of this service line, at the annual growth rate of around 30-40%, which is evident in the previous chart showing the growth trajectory of the firm. The successful transformation which brought about fast growth of the firm owed much to its repositioning and re-development of its brand, as described below.

At the beginning, the market for temporary personnel service was virtually non-existent and the firm had a hard time creating one. The firm took much time and effort to promote its brand of such unique service. However, the brand of temporary personnel service had the connotation of labour leasing, hence low fee. This brand image was tolerable until 2005 when labour law required that all temporary employees must also be paid the social benefits entitled by tenured employees; this change drastically increased the cost for temporary personnel service and the firm had to revamp its brand for gaining higher service fee to offer set the cost. In the same year, Firm G decided to move up the value ladder in temporary personnel services to increase its profit. At first, it had to learn from similar business practices in the western developed economy,

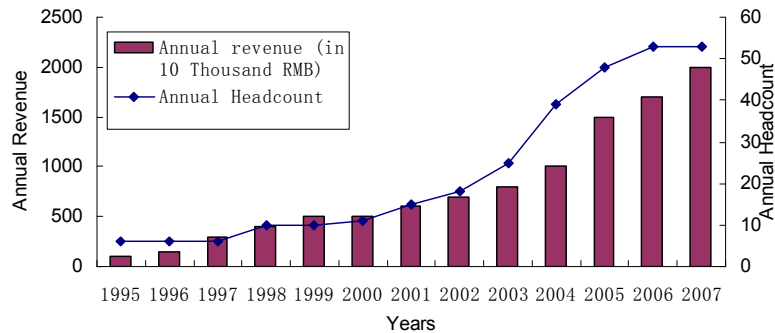
because change in the quality of temporary personnel sent means the change in value the firm could provide for the clients. After some investigation of the market, it dawned on the firm that personnel for managing organization change or fire-fighting in overcoming management crisis were most needed in the market. The firm founders talked to the existing clients to sell this idea. At the beginning, few responded with enthusiasm because they would rather hire their own tenured employees who could be responsible for the change policies they deployed. On some occasions, these firms could not find suitable candidates to take up such top change management positions and came to seek the help of the firm. Opportunity arose for the firm to send top change management position personnel to rescue clients in crisis. The firm seized the opportunity and built up two successful cases of temporary management personnel service. The top management talents sent by the firm not only put the crisis under control but were able to recruit candidates for permanent placement in the job. Success of these cases brought experience to Firm G and these cases were later used by Firm G to promote the brand, sending the message to the market that the firm was capable of providing temporary management services. New client relations were built in addition to the existing client base. Soon the brand new capability was spread by word of mouth and new service field was open to the firm by the end of 2005. The firm was able to develop brochure detailing its new services, which helped brought about new business opportunities in this new area. In addition, the firm participated in many organizational change forums in which it was allowed to promote their new services, supported by convincing successful cases. Within only one year, the business of temporary management placement took off, driving up the firm's annual revenue, organization size

and profit, as shown in Chart of Firm G. The transition of the firm to be supplier of high-end temporary personnel placement has been successful completed.

Growth of Firm H: a firm of multiple HR services

Firm H was a HR service SMEs founded in Guangzhou in 1995 by overseas Chinese from Hong Kong and Canada which had earlier operations in Guangzhou (not incorporated as an independent legal business entity until 1995). Business scope of the firm included executive search, management training, business English training (with a formally licensed Training School in China) and management consulting (management diagnosis). There were about fifty employees working mainly on executive search services. A few other employees worked in Business English training section, which was not the main business, but merely done to satisfy needs of the clients. In addition, there were some consultants working for other parts of the business community in the city, providing consulting on strategic planning, organizational changes and HR management system development. Consulting services gave access to the top management of many local enterprises which often gave the firm other services such as executive services, due to the creditability of the the firm developed from its consulting services. Service income for the firm came mainly from executive search services and training services. Due to dedicated effort of the staff and the loyalty of the clients, the firm has been able to grow continuously since its founding in the city. The following is the trajectory of growth in revenue and employee for the firm and the key milestones in its history:

Chart of Firm H: The trajectory of growth in annual revenue and annual headcount for the firm:



The milestones in history of Firm H:

- 1993: Appointed by Guangzhou Labour Bureau as Consultant for the Importation of Labour Scheme in Hong Kong;
Appointed by MTRC Hong Kong as the exclusive employment service vendor for the New HK Int'l Airport Project
- 1994: Provided Total Employment Solutions for the License Operator (GMK) of Catering and Accommodation Services for the New HK Int'l Airport Project
- 1995: Being the 1st Company of the kind to obtain the official license of executive search in Guangdong Region
- 1997: Appointed as project management consulting company for BJ Royal Garden International Club
- 1998: Elected as the 'Model' Company in executive search by the Special Committee governing consulting business in the National People's Congress
- 2000: Nominated as one of the 200 successful companies in mainland China from

various industries by the Beijing Economic Daily and was published in the 'China Economic Information Special Report in Memorable of China's Reform and Opening up for 20 years'.

2001: Formed strategic partnership with Guangzhou Labour Bureau (GZ Labour Employment Services Administrative Centre)

2002: Formed strategic partnership with Job Market Press (SH Haina Human Resource Company) in Shanghai;

Co-operated with Sussex Downs College of England in launching Business English training

2003: Launched country-wide industrial C&B Survey for the Paint & Coating industrial in China

Voted as No. 1 preferable English Training Institute in the First South China Education and Training Expo.

Appointed by ABN AMRO Bank (HK) in full HR management for marketing employees

2005 English club Lounge established in Guangzhou

Phase One Development (1993-1997) saw the establishment of Firm H in Guangzhou City. Development began with initial co-operation with Guangzhou Labour Bureau to export labour to Hong Kong for the construction of HK International Airport. Early operation from 1993 onwards was not in real sense business activity of a legally registered independent firm in the city, because the government had no idea yet what HR services were and was not ready to give business license to applicants for this type

of corporations. Yet, this was an important time for the opening of the firm; business activities were carried out in the name of the parent firms in Hong Kong, developing business relations and began to recruit and train employees for HR services which were new but began to receive attention of the firms in the city. By 1995, the city labour bureau and the business bureau learned enough and had the authority to accept application for establishment of HR service firms. The firm was the first to receive license in HR services, which came very readily since the firm had laid good social foundation before the application and the firm could supply evidences of success for official scrutiny by the government.

The big problem was to convince job seekers to join the firm and to establish business relations with MNCs. The firm began with only two local employees who had been looking for a better career opportunity which the firm was able to offer. However, the executive search at that period of time was not easy. The firm's employees were not experienced with this type of the work and had few business contacts. Fortunately, some MNCs had moved their manufacturing offices to Guangzhou which had some business contacts with HK parent company of Firm H. The firm used this opportunity and eagerly served these few clients. The positions which the firm was asked to fill were not top management but rather, some junior management and professional positions. This allowed the firm to begin executive search at low risk, because local candidates for junior management and professions were in plenty in the talent market during early 1990s. The business director of the firm (one of the first two employees in the firm at the time) observed in the interview:

‘We were very fortunate in the early days when there was sufficient demand for local management by MNCs in Guangzhou. The business orders mostly came from our Hong Kong office. The clients in Guangzhou knew our people back in Hong Kong and the positions for us to fill were not very high; besides, there were few competitors in the market and plenty of candidates’.

This initial business allowed the employees to learn and to establish client relations, which was later used as success cases to attract more clients. In this sense, this period was really the survival period for the firm in Guangzhou market. The firm had some knowledge transferred from Hong Kong offices and it used the license it obtained and the few success cases of executive search to open up new recruitment business opportunities resided in MNCs which were the first users of HR services in the city.

Phase Two Development (1998-2001) was a period of steady learning and growth for Firm H, in which the firm also gradually established its market brand and developed a solid workforce. Initial survival period from 1993-1997 witnessed some client recognition of the firm and a few employees joined the firm. However, except a few MNCs which used HR services, the market demand for HR services was underdeveloped and for that, it was difficult to get business, although competition was low. The manager of the firm frequently visited clients to learn their needs and their requirements. However, quite often they were not well understood. To make the firm known in the market, as advised by its Hong Kong offices, from 1993, the firm started

distribution of a journal to promote management knowledge. This was a monthly letter addressing the most updated topic in local management. The journal was distributed free of charge to more and more clients from 1995. This helped because it at least let the client HR staff know the firm and its business. In particular, the journal acted as a bridge for establishing new business relations. The most important improvement came when the firm developed their own company brochure which allowed the client to know who they were and what services they could provide for clients.

Due to the slow development of the market in Guangzhou City for HR services, Firm H had to devote much time and energy to develop client relations. The firm was cautious and did not recruit many consultants. It had only six employees in 1998 and it focused on only a few clients in the executive search business, in order to keep its promises of delivery and quality. Yet, this was a period of time in which the firm learned a lot and established some quality client relations. At beginning, some clients did not know how to specify their recruitment requirements for the firm, apart from telling them to help fill a certain vacancy. The firm was patient with such clients and its consultants spent a lot of time and energy to help to define job scope and responsibility for these clients. Both the consultants and the client HR staff had to interview the client business department heads to gather initial information to form a job specification so that executive search could began to work. This process was quite time consuming, but it allowed the firm consultants to learn the business of their clients and to develop loyal clients because these clients saw that Firm H had real concern for their business development. As a consequence, the market brand of the firm began to take shape and more and more

clients came to ask for the service of the firm. As the business director said in her interview, it was a time that

‘we made a number of friends, who knew that we earned little from them but rather, we helped them to overcome their difficulties. However, we internally acknowledged that we also learned from these early clients and were genuinely grateful that they not only appreciated our work but also helped to spread the word of mouth about our service and our quality’.

Words of mouth on quality service were important for the development of the firm. Besides, the firm also actively promoted its business in open forums. In 1998, it was elected as the ‘Model Company’ in executive search by the Special Committee governing consulting business in the National People’s Congress. This event marked a turning point for the firm. It was quite well known in the market by the time and had the confidences in its growth.

In 1998, the firm began to see the growth of the market for HR service in Guangzhou City and it expected this market demand to continue grow. Therefore, the firm began to recruit six more experienced consultants who were later turned into outstanding executive search managers. These consultants had rich industrial experiences but lacked professional experience and skills in executive search. In order to develop these new recruits into experienced ‘hunters’ looking for quality managers for MNCs, the firm asked consultants from its Hong Kong office to work with the new recruit. Systematic

on-job training was provided on how to handle cold call, interview and selection. After the confidence was built, the new consultants were encouraged to establish their own business relation from zero, with some help and advice from their supervisors. Some had success but most of them failed in the first few attempts. Nevertheless, these consultants were continuously trained, encouraged and rewarded, for up to one year, until they were able to be independent. Such training was not all lost, because the firm has developed a sizable workforce in executive search firm and many job seekers wanted to join the firm knowing that the firm had a good on-job training system. More importantly, the services provided by the firm for the client began to be distinguished by the clients for their high quality which in turn attracted more quality clients.

By 2000, the firm had become well established in the market, although its growth was not rapid, compared with other competitors, its was well known for its high service quality. In that year, Firm H was nominated as one of the 200 successful companies in mainland China from various industries by the Beijing Economic Daily and the nomination was published in the 'China Economic Information Special Report in Memory of China's Reform and Opening up for 20 years'. This witnessed the remarkable client relation and brand development for the firm. The firm began to have more and better clients looking for its services. To satisfy such demand, the firm devoted much more resources to develop its consultants, particularly to provide the English training for its consultants. Recognition in the business community soon brought about recognition by the government. In 2001, the firm formed strategic partnership with Guangzhou Labour Bureau (GZ Labour Employment Services

Administrative Centre). This period (from 1998 to 2001) of steady learning, growth and recognition laid a good foundation for growth of the firms in years to come.

Phase Three Development (2002-2007) was a rapid growth period for the firm. In 2002, the recruitment market was marked by quick entry and fast exit by small HR service firms. From this year onwards, the market for HR services also began to grow fast. Traditionally, business orders came from MNCs for the few HR service firms which grew slow because they did not have many employees and were highly sensitive to service quality and client relations, which is typical of professional service firms. However, as more and more state-owned enterprises and private-owned enterprises were able to compete with MNCs in product market, these local SOEs and POEs began to ask for HR services from the traditional HR service SMEs which failed to respond. In addition, internet technology began to make it easier to provide HR services. Many venture capitals saw opportunities in the market and began to assist some entrepreneurs to enter this fast growing service market in Guangzhou City. This brought immense pressure for survival for the traditional HR service firms such as Firm H; these traditional HR service firms had been keeping a low profile so far, as is the case with other types of professional service firms. In order to survive this new competition, Firm H began its transformation. It began to diversify in service lines and in geography. As its client expanded into Beijing and Shanghai, it began to open representative offices in these cities, which as one of its partner said in the interview, was a sign of ‘our coverage and our network for talent collection and was important for retaining clients with the need for nationwide recruitment and for establishing our national brand’. This resulted

in rapid growth of its workforce and annual revenue. The workforce grew from a mere fifteen in 2001 to over fifty in 2007 and its annual revenue grew from 1 million US Dollars to over 3 millions US Dollars.

This rapid growth had benefited from the development of client relation, brand and workforce in the first two periods in the history of the firm. Specially, the fast growth was enabled by its well known brand established over the past few years. In addition, it was enabled by organization development and applications of technology. A critical event worthy of mentioning was the development of a database for the firm. Foreseeing the application of information technology in the field, in 2000, Firm H began to plan for development of its database of candidates. In 2002, the firm began to devote more resources to this project. It bought services from IT firms to develop a prototype of a database for HR service firms which enabled the utilization of candidates cross industries and cross the country. The firm asked its consultants to key in information on candidates. At the beginning, it was a failure; consultants were not willing to put such information in the system, because they shared it without being rewarded. The firm then investigated and understood the root cause of the problem. It changed the incentive system to encourage sharing and learning. By 2005, this problem was by and large overcome and the database began to take shape. Timely updated database was a great help for the consultants who could now more effectively and efficiently complete their assignment of executive search.

Another critical event happened during this period of time. In 2002, the clients of the

firms in paint industry asked for compensation information which the firm could not provide. In order to satisfy this need of the client, the firm hired compensation consultants from the market and began to develop skills in this service area. In 2003, the firm invited enough clients in paint industry to complete a compensation survey of the sector. Although the firm did not earn much profit from the event, the survey proved to be a great tool for client relation and brand development for the firm; the information was a great help to the clients and the survey was used by the firm to establish a number of new client relations, which helped to establish the firm in this industry. This event later proved critical because it moved the firm towards specialization in specific industries, which was a trend of the market that the firm quickly followed, allowing it to grow fast and steadily.

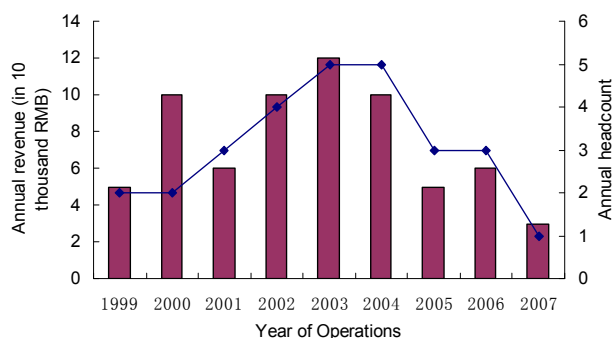
A similar event happened to the firm during the period (2002-2007). As the firm received more and more executive search orders for English speaking candidates, it gave more and more advice to the clients on improving their English training because the candidates from the market could hardly fully meet their requirement. Some of the clients began to ask for their help in this area and the firm saw business opportunity in this. With the help of the firm's Hong Kong office, in 2002, the firm entered English training business. It cooperated with Sussex Downs College of England to provide high-standard English training. Firm H made its mark in the market immediately. Only after one year in the business, in 2003, it was voted as No. 1 preferable English Training Institute in the First South China Education and Training Expo. This was the beginning of a great business service line for the firm. More importantly, the clients of the firm in

executive search business have become more satisfied with the additional help from the firm in English training. More and more clients came for such service. In 2005, the firm established 'English Club Lounge' in Guangzhou City, aiming to attract candidates who had the ambition to be at the top of management which required English speaking skill. This has since been working as a tool for the firm to attract candidates for both English training and for executive search; both of these business benefited from each other.

Growth of Firm I: a firm of multiple HR services

Firm I was a HR service SMEs founded in 1999 by a former human resource executive after he resigned from his position in MNC. The firm was closed down in 2007, after struggling for several years, without much success in growth. Before its demise, it provided a variety of human resource services, including executive search, recruitment, training, consulting, personnel outsourcing service and legal advisory service. From its profile of services, it seems that the firm desperately struggled to survive and did whatever the market asked for. In that way, it had never successfully developed a specialized skills and brand which is important for survival in a niche market. The following is the the trajectory of growth in annual revenue and headcounts of Firm I. As evident from the figure, growth trajectory of the firm was not even and smooth. Rather, growth in annual revenue and headcounts were up and down all the time until it was dropped to the lowest level when the founder decided to close it. In his interview, the founder joked that he did not have ‘the luck to be a millionaire in business.’ He reluctantly returned to be a HR employee in a MNC after he closed his firm.

Chart of Firm I: The trajectory of growth in annual revenue and headcounts of the firm



The growth story of Firm I was a good example of business stagnation and failure. However, at the beginning the firm looked very promising. In 1999 when the market for HR services in Guangzhou City began to grow fast, the founder of Firm I resigned from his position as a HR manager in a major MNC and founded the firm. Two years before his resignation, in his position as a HR manager, he saw the business opportunity when more and more HR service SMEs appeared and eagerly came to sell services to him. He began to gather knowledge and information on executive search and HR management consulting. After learning some of the business transactions in these two areas, he decided to resign from his position which was very demanding and lacked personal freedom.

As typical of many entrepreneurs, the founder of the firm was very ambitious and daring. After resignation, he wanted to found his own firm and to be his own boss. However, there was requirement for business registration, for example, capital for registration and number of employees, which he could not immediately meet. For this reason, he did not get his license until the last quarter in 1999. After he got his license, he started to sell his service to the potential firms. At first, he used his relations in other MNCs to establish business contacts. Past friends were willing to talk to him about their needs but unfortunately, these HR personnel were mostly working for a branch of a MNC and did not have the authority to buy HR services from a local vendor; such services were bought by their boss in their headquarters in Hong Kong or Beijing and the services were normally provided by sizable local or international HR service firms. Firm I was too small to be eligible for providing such services. Fortunately, by personal

contact, the founder was able to secure a service deal with a small local private-owned enterprise (POE) which asked for service in compensation design. The founder was very happy with the deal although the project was very small. With the help from his assistant, the founder completed the project and received about ten thousand US dollars in return.

Next year, in 2000, the founder decided to provide HR services for POE sector which began to ask for such professional service. Some growing POEs were eager to grow and they needed help in building up their management system. These POEs, however, needed not just HR services but comprehensive management services from strategic planning to operation improvement, which Firm I was not capable of providing. In addition, these enterprises were suspicious of management consulting because they could not evaluate such services and often due to this reasons, they had problems in paying the consulting fees. Nevertheless, the founder of Firm I was very enthusiastic about the prospect of big business with this group of enterprises. He worked day and night to design seminar materials and personally delivered lecture to some of these firms, free of charge. After several months' lecturing, two of the private firms were convinced of his teaching; and one of them asked for his assistance in designing a business strategy and another asked for assistance in operation improvement. Without actual experience in these two management areas, the founder decided to hire some experts to complete the projects for him, which was often the way to deal with such requests from client because they were beyond capability of the firm. Unfortunately, the clients were not willing to pay enough for the fees the experts of strategic planning and

operation management were asking for. The founder decided to outsource to a less qualified consultant the business deal of operation improvement; and he decided to work on the strategic planning project with the help from his assistant. It took six months for him to gather market materials and to write up the market development report. The client was not very impressed by his market analysis report; later he learned from internal informant that his market report was slighted by some of top management as lack of depth but at that time, the owner of the firm was determined to continue the contract with Firm I. Without knowledge of the bad reception of his market report, the founder of Firm I continued to work on the strategic planning according to knowledge from his previous learning, including learning in textbook. The final presentation was a total fiasco but the client management did not challenge him in the meeting. Nonetheless, the founder of Firm I became aware of the failure of his strategic planning. Later, although, the owner of the client firm paid him the consulting service fee, because of personal relation, he did not implement any idea of the report. This was very disappointing for the founder of Firm I and brought to him conviction that he should not do this type of consulting services which exceeded his experience and capability. Similar story happened to the operation improvement project which he outsourced to an external operation consultant. For the year 2000, although he received 20 thousand US dollars in total, he failed in developing a successful case for the future development of his firm. What he really learned was that he should stick to his experience and capability when selling his services.

In 2001, the founder of Firm I decided to focus on HR services. He learned from the

market that the most profitable and the most easily copied HR service was executive search. He felt that this was his advantage since he personally knew a number of HR managers in MNCs which used this type of service to recruit their management personnel and professionals. However, Firm I had no candidates at hand. So he decided to hire one more assistant to make cold call and to collect resumes. He personally went around selling his executive search service to his former HR contacts in MNCs. It was a very difficult time because those MNCs which used executive search service were normally in contract with one or more executive search firms. It is not easy for Firm I to compete with existing executive firms, because they had many more candidates and thus, they could deliver their service much faster. Finally, the founder of Firm I was able to secure a deal with a new MNC which just entered Guangzhou market and did not know much about the executive search firms. Firm I was asked to recruit two senior cost accountants for this client, which posed a difficult situation for the firm because such candidates were rare in Guangzhou market; the firm did not have any ready candidate and the two assistants did not know where to find these candidates. Although the founder provided some candidates from personal source, the client firms were not impressed with the experience and the English language of the candidates and so, did not hire them. Firm I did not succeed in closing this business deal, which was very negative for Firm I in the market because the client turned to another existing executive firm which fulfilled the positions for it. It now dawned on the founder of Firm I that the challenge for executive search mainly lied in the candidate pool which could not be easily built. There needed to be investment in time and energy in developing a sizable candidate pool for a specific job category. For a small firm such as Firm I, such

investment was out of question. Fortunately, the founder of Firm I had a number of HR contacts in MNCs which he could sell to his clients. In 2001, he managed to fill three HR manager positions for new MNCs by using his old contacts, which brought about ten thousand US dollars for the firm.

In 2002, the founder hired one more employees and now the firm had four employees including the founder himself. He aimed to focus his business on executive search of HR management personnel for MNCs, because he had some successful case in this job category. Besides, he was familiar with the requirements for the jobs in this area as he had used to be a HR manager himself. In retrospective, this seems to be the right decision for the growth of the firm. Using his successful cases, the founder now found it easier to sell his executive search service to his clients. Although sources of candidates were also hard to come by, Firm I managed to seize a number of resumes of HR management job seekers. Also, the employees learned from previous experience on cold call. All the employees worked very hard and they were able to fill three HR supervisory positions in the first six months, which was poor performance by industry standard but much better performance by the standard of the firm. Using the successful cases, the firm attracted further candidates to apply for opening the firm secured from its clients. Soon, a sizable current applicant pool was built. Unfortunately, in the next half of 2002, the firm did not receive any business order for recruitment of HR supervisor position or positions below. Instead, the firm was asked to recruit for the positions of HR manager for which the firm did not have ready candidates. The founder of the firm again tried to persuade some of his former HR contacts to take the new

positions but his attempts were not successful. With much difficulty, the founder was able to find several qualified candidates for three openings in the position of HR managers. This satisfied the need of the clients. In addition, Firm I was able to accumulate a sizeable database of candidates for HR manager positions, which laid a good foundation for the following years. By the end of 2002, Firm I managed to close six deals which brought in close to twenty thousands US dollars in annual revenue.

Judging the performance of his firm in 2002, the founder of Firm I was confident that he could further grow his firm. He hired one more employees in February, 2003, in expectation that more business deals could be closed. He realized that although he had been in business for the last few years, he had not yet established a known brand in the market. He began to spend more time on visiting clients to promote his firms and to seek business deals. Back office work was mostly carried out by his four employees. This strategy seemed to work for the firm. The founder was formerly an experienced HR manager and so he was well received by his counterparts in MNCs. More and more clients were willing to use his service. In the first six month, Firm I was able to fill four positions for its clients but unfortunately, two of the candidates did not pass probation and the firm had to deliver another two candidates to make up for the loss for its clients. In spite of this, the clients were less impressed with the cooperation with Firm I and began to question its ability in selecting the right candidates for them. The founder of the firm knew what was wrong; he had delegated to his employees the task of selecting the candidates because he was busy visiting new clients. At last he decided to complete the executive search assignment himself, which took away his time of client relation

development. After several attempts, the founder of the firm succeeded in finding the acceptable candidates to replace those who failed in their probation, which appeased the clients. Nonetheless, words had spread that there was quality problem with the service of the firm, which did harm to the brand of the firm. In the end of the year, Firm I was successful in filling eight persons in HR management area for its clients, including two HR manager positions. This brought in twenty thousand US dollars for the firm, the highest annual revenue since its founding. Unfortunately, failures of two candidates in client positions damaged the reputation of the firm, which affected its future growth.

In the year that follows, 2004, Firm I was more cautious with any new business orders, due to the failure in 2003. He corrected the mistake in 2003 by his own effort and informed his employees about what was wrong. However, the founder made a mistake by not letting his employees to mix with clients, maybe for fear of losing control over client relations. His employees remained unconcerned and ignorant of the requirements of the clients. They were responsible for finding candidates for the assessment of the founders before he sent them to the clients for review. This worked well for a time being when there were not many business orders and the time of delivery was long enough for slow action. The firm was able to fill four positions in HR management area for its client in the first four months in 2004. In June of the year, there was a change in client requirements for quality and delivery time of the services. The founder of the firm was not aware of what had happened but he was aware that some change had taken place. In his interview, he recalled that he was surprised by sudden client requirement for short delivery time but he did not realize that new competitors using online recruitment service were pushing them to the brink of bankruptcy. Nonetheless, relying on the

source of candidates it had, Firm I managed to finish eight executive search assignments, bringing in close to twenty thousand US dollar for the year 2004, although with some complaints about its delivery time. The real problem was that revenue did not grow but instead, declined and two of the employees who had the longest service with the firm left for other executive firms which were able to offer them positions with much higher salary. The loss of these employees and the loss of confidence of clients in the delivery time of the firm gave heavy blow for the firm, particularly for its founder. He did not realize that, however, this triggered the process of the decline of his firm in the next few years.

In 2005, some clients, which had complaints about the delivery time of the firm, left Firm I. This was not a surprise but still their words spread and put Firm I into difficulty. Moreover, with fewer orders coming in, the founder of the firm was desperate for business. He began to seize any opportunities that arose. He made frantic attempt to recruit candidates for some positions in productions and sales for its clients, without much success. After fighting for over four months, the firm managed to recruit for its clients only three low-level positions in sales and marketing. Meanwhile, the founder of the firm began to look for other business, because executive search orders were not coming in as he expected. He landed on outsourcing service in personnel management, which could bring him a much more stable income stream because service fee was paid annually by clients for a long time. He began to learn the business and visited government offices to seek license on this business. His effort, however, did not materialize. His firm was not capable of providing such service and the government

offices responsible for licensing such service did not believe in his business plan and expected growth. He returned to his executive search, but much time and many opportunities had been lost. That year, the firm had a very bad year, receiving only about ten thousand US dollars as annual revenue. The worst thing was that a number of business orders were not fulfilled, which brought heavy damage to the reputation of the firm. The founder regretted in his interview that he should have let his employees to directly contact the clients to complete executive service assignments, which ‘brought them learning and their ability to serve; if so, there might not have been any unfulfilled orders which damaged our reputation and client relations.’

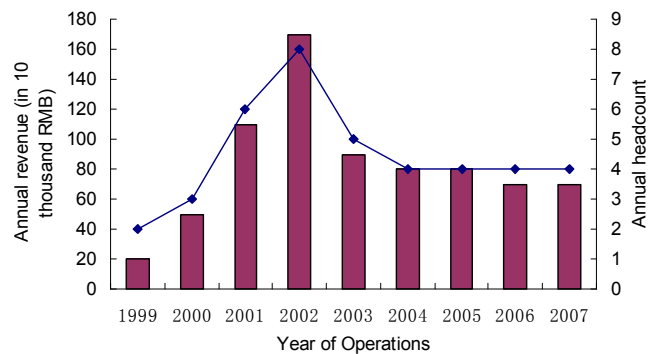
But damages have been done to the firm. In the two years that followed, 2006 and 2007, the founder tried by all means to build up the client relations and let his two employees to contact clients directly for completing their executive search assignments. In the beginning, it seemed to work. In the first half of 2006, the firm secured three business orders for filling the positions of HR managers which the firm managed to fill two, leaving one unfilled. This achievement surpassed the expectation of the founder of the firm but had not met the requirements of the clients which withdrew their contracts with the firm. This was immediately known to the employees who resigned on the pretext of personal reason in the last half of 2006. The founder now was totally on his own, which made him very disappointed with his own business venture. In 2007, he managed to close two deals but was not interested in continuing his business when he was invited to join a new MNC as a HR manager. He decided to close his firm for good, ending the story of growth, stagnation and decline of a business venture in HR service sector in

Guangzhou City.

Growth of Firm J: a firm of multiple HR services

Firm J was founded in 1999 by a former HR director and consultant in MNCs. The intention of founding and running such a firm has changed twice over the years. When it was founded in 1999, the founder was still employed as HR director by a famous MNC. He founded this firm to make money for a better life. This purpose was not changed until 2001 when he left his position as HR director and joined an international HR consulting firm as business director. Upon this change, he continued to operate his own HR consulting firm to prepare for his retirement. He passed on to his own firm the business opportunities which the international HR consulting firm did not take up, thus keeping it going; this operation continuity of his firm was to provide a means for his work and life after retiring from his former jobs as business director in the international HR consulting firm. Firm J was, therefore, run by an experienced subject matter expert in his spare time. The firm has so far provided a variety of services, including training service, executive search and consulting services; all these services changed over time as core business of the firm, in accordance with market demand. At the time of this study in 2007, the firm has been in stagnation for many years, barely surviving, because, as the founder said in his interview, he had ‘little time to run the business due to the busy full time job he had with the international HR consulting firm’. The following is the trajectory of the growth and stagnation of Firm J. From Figure J, it seems that the history of the firm can be divided into three phases: survival, growth and stagnation.

Chart of Figure J: The trajectory of growth in annual revenue and headcounts of the firm



Phase one was from 1999 to 2000 when the firm went through its survival period. In 1999, the founder of the firm saw increasing demand for HR service in his position as HR director. He believed that there would be a booming time for such services, which could be exploited by him using his knowledge and influence. At the beginning, he hired only two fresh graduates to work as his assistants who were willing to do so because they believed he could teach them HR management. The first business order was from a friend working in a MNC as HR manager; this HR manager had some funding and he proposed to set up a project to develop job description for compensation design and his proposal was approved, because he was able to invite the founder of Firm J as his consultant in the project, for a very small sum of money, four thousand US dollars. The founder of Firm J contacted the MNC whose management team were convinced by his professional eloquent presentation and gave the job to him. This was the first opportunity for the founder of Firm J; and it turned out to be a successful bid. However, he did not have much time for the detailed work of writing job description. So he hired fresh graduates to do the job who were supervised by him. It was not an easy time for the team of Firm J, because they were not experienced; they had not seen a real

job specification besides those in the text books. The founder of Firm J had to spend time training these new employees on how to write a proper job description. In addition, he had to spend a lot of time revising them. As he admitted in the interview, the project was completed with much difficulty; he had to do most of the job although he had three graduates to work for him. 'For such a small sum of money, we had to work for two months, which was unbelievable', he said, 'the good thing was that we finally completed the project and received the payment'. The learning from this hard job was not very useful because the firm never came across the same job in the years to come. During the first year, the firm managed to earn enough to pay for the salary of the employees.

Nonetheless, the founder was convinced that business would be coming. In the year that followed, 2000, he actively engaged with other HR personnel in the city using his position as HR director in a MNC, speaking to participants in training and talking to friends about his firm. His entrepreneurial spirit was not well received, perhaps because people might think that he was not very professional in running his own firm while working as a HR director for a MNC. Under such circumstance, it was hard for the founder of the firm to secure a business deal. He asked his employees to go out to sell service of his firm. However, because they lacked successful case to demonstrate their ability and quality, selling door-to-door did not turn out to be very fruitful. Out of tens of clients visited, only five private-own enterprises (POEs) were interested in coming to meet the founder of Firm J. The founder was enthusiastic and talked to owners of all the five POEs who did not seem to show much interest in his service. This failure of sales

of service did not discourage the founder. He continued to contact them in his spare time. At last, one of the five clients said that Firm J might be able to provide some time management trainings for his employees. This was a piece of good news and the founder of the training immediately went over to the firm to clarify the needs. After returning from the trip, he worked with his employees to customize training materials to suit the need of the client. This time, one of his employees began to show his capability; he was very organized and learned very quickly. Because he did not have much time, the founder of the firm asked this employee to organize the training, with the help from other employees. The founder went to the client to deliver successfully the training as promised. In the same year, the client asked for another training session in operation which the firm had to outsource to an external trainer. The two events brought to the firm enough money to cover the cost of the employee salary for the year. But the founder of the firm had no profit for his own use.

Success of the first two year from 1999 to 2000 was minimal but it allowed the firm to survive in its initial stage. Now the founder of the firm was quite confident. In 2001, he hired three more employees to prepare for expansion; he asked the old employees to partner with the new ones in carrying out their daily work. This partnership allowed quick learning to happen in the time they worked together. With more employees in the firm, the founder had to spend more time doing business development. He continued to involve himself in the business of the only client who used the service of his firm; this tenacity paid off and he got another chance to provide training for the client. In addition, he used the successful case with the client to promote his service to new clients. In the

middle of the year, one of the clients came back to the firm for training in management skills which the firm had to ask external help to complete. The firm now acted more like a training brokerage firm, selling and organizing training sections for the clients. This was not easy as it first looked. The firm had to work with the client to determine exactly the training needs which had to be done by the founder of the firm. The founder was always busy with his full time job as HR director in the MNC. Thus, he only did the first round of interview with management of the potential clients, leaving detailed work to be completed by his two more experienced employees. They cooperated with the clients to develop training agenda which they passed to the external trainers for review and revision. After the clients agreed with the agenda, the firm was able to organize the training delivery. During 2001, the firm managed to sell and organize more than ten training programmes, doubling the revenues of the previous years. More importantly, the firm built up some client relations, which was very valuable for the years to come. Unfortunately, however, the founder of the firm had to resign from his full time job because he spent too much time away from his duty as a HR director in the MNC. He later admitted in his interview that ‘this was in my expectation but it came too early in my career; the only thing I could do at the time was to develop my firm.’

After his resignation in 2001 from his position as HR director in a MNC, the founder of Firm J had sufficient time to spend on his business. In the end of 2001, he moved his firm from a lesser office building to a more decent one. This gave the firm a better professional image. As he had more time to manage the firm, in 2002, the founder decided to enter another business: executive search service. Now the firm hired eight

full-time employees including the owner, which was the highest number of employees in the history of the firm. Three of the employees who had experience in selling and organizing training continued to work in this service line. Other employees were staffed in the department responsible for executive search. It was not easy to develop a new business. The founder hired two experienced consultants in the field of executive search and these two employees began to train the other employees on how to do cold call and how to close the deal. The founder was a new learner in this area but he learned very quickly, due to his HR management experience in selecting employees for proper jobs. Then they began to approach some clients for orders to recruit management talents for them. At first, the founder used his past relation in MNCs to develop client relations, because these firms used executive search service. There were successes and failures. Two of the MNCs they visited agreed to use their service but with reserve. The firm went all out to work for these two firms, taking whatever orders they received. Some recruitment assignments, for example, recruiting IT professionals, were difficult to complete; as a result, only half of the ten orders were fulfilled, which was rather high for a new recruitment firm such as Firm J but did not meet the client requirement, because failure in hiring on time the personnel for clients proved costly for the client organization. Although the client paid Firm J the fees for the positions they filled, it did not had confidence to continue business with Firm J. This was a heavy blow to the firm in its early stage of growth. As a result, although the firm grew fast in 2002, due to its expansion to include two service lines, it was not a good year for the firm, as its founder observed in his interview.

In following year, 2003, which saw the beginning of stagnation of the firm, the founder of the firm decided to refocus his resource on executive search which seemed to be more profitable, discarding the service of selling and organizing training sessions for clients. Of course, if any client asked for training service, the firm still managed to provide the service by outsourcing it to other firms; but the firm did not dedicate employees to this business. The consolidation was accompanied by a shrinking in annual revenue. One important decision in 2003 was that the founder of the firm decided to specialize in recruiting HR management position and IT positions for the clients. In retrospective, he said that this was the right decision for his firm to survive in later competition which was at the time becoming fierce and even ruthless. He began to accumulate candidate resumes in these two fields. More importantly, he worked with two large client firms to develop the requirement for the jobs in these two categories. Then he asked his team to learn the requirement and visited client sites to learn the details of such requirement. As professional executive search consultants, they must be able to talk to their potential candidates and their clients in a knowledgeable way. So the founder of the firm had to train his consultants to focus on these two areas. After the training, he allocated quota to each trained employee who had to finish recruitment assignments in time and quality required. This was very demanding and two of the employees left in the first half of 2003. Nevertheless, the transition was successful and the firm was able to take up a niche market in executive search business which allowed it to survive the coming ruthless competition. Because the discarding of training service, in 2003, the firm earned much less than it did in 2002, less than twenty thousand US dollars; but this was enough to keep the team together; besides, the owner had some

profit.

The year 2004 was a turning point for the firm. The founder came across an opportunity to join a famous international HR consulting firm which he had always dreamed of joining. He now had to fight on two fronts, as he used to do when he was a HR director in a MNC. Fortunately, however, he had developed two very able consultants for his firm by the time he decided to take up the position as business director in the international HR consulting firm. Besides, he had in place some policy and procedures for executive search business. Another fortunate thing is that he was free to visit his firm whenever it was needed, because the job of a business director was not an office job which tied down a person. So in the beginning of the year 2004, he was able to frequently visit his firm. In spite of this, Firm J was operating differently, because the absence of its owner; only two supervisors were able to contact clients who were less enthusiastic to work with these young men than with the founder of the firm; consequently, the consultants of the firm had to spend a large amount of time on the client sites. The clients trusted them more when they were on site to talk to them and to deliver assignment report, perhaps because face-to-face meeting made up for the lack of trust due to their youthfulness, a type of trust which the founder enjoyed.

This way of working suited the clients better but it took up too much time. The business could not grow fast because the number of recruitment assignments could not be increased. The founder of the firm saw this but he was not willing to change, because he was busy with his new job as business director for the international HR consulting firm

and could not give much time to his own firm. Some of the clients began to complain about the absence of the founder of Firm J in client meetings. As a result, in 2004, four of the twenty clients left the firm, which was a great disappoint for the team in the firm and one of them left the firm too. Nonetheless, the firm was able to continue its contracts with the existing clients, earning a bit over ten thousand US dollars, about ten per cent less than the earning in 2003.

The decline in revenue in 2004 was in the expectation of the founder of the firm who cared less for the earning now because he had salary from his new job in the position of business director for the international HR consulting firm. What he worried was the leaving of his clients. So, in 2005, he decided to spend some time with his team in visiting clients. This was a boost for the morale of the team and for the confidence of the clients on the service of the firm. In order to build up a solid client base, the firm decided to do some marketing activities. The founder tried to organize a HR forum which would draw some HR managers together, an occasion for the firm to promote its service. He also asked his employees to invite their clients to join the activity which was supposed to happen in July 2005. After some active communication, some of the clients promised to join the forum. Unfortunately, few turned up when the event was held in university hall in Guangzhou University. The few who came were disappointed because they could not exchange with a larger audience their view on HR management. It was a failed attempt in marketing activity. Later, the team looked back on their ways of organizing the event and they came to the conclusion that this failure might be due to the fact that few experienced speakers were on the list of participants. The failure was

not expected but was a good learning for the firm; it now was very cautious in organizing similar things. In fact, the firm did not organize any market event after the failure. Instead, they used personal visit to client site to promote their service and their firms, which was not very cost-effective and was abandoned later in 2006. Amidst the difficulty, the firm managed to maintain its annual revenue which was enough to satisfy the need of its employees. The only problem was that clients were becoming more and more demanding but the firm was not able to readily satisfy their demand.

In 2006 and 2007, Firm J saw further slow erosion of its client base and its revenue base. It was not surprised to the founder who was well aware of the situation which his firm was facing. However, he was further drawn into the business of the international HR consulting firm to free himself to lead his firm. He said in his interview that ‘I was interested in keeping the business of my firm running because it was my baby and may well be my revenue channel after I retire in the near future; however, my current job is important to me because it allows me to absorb knowledge and to build client relation which will be critical for my firm in the future. I have to put my job as a business director before my responsibility as a business owner’. In 2006, the founder of Firm J began to experiment with consulting in his own firm; he passed to his firm the consulting opportunity which the international HR consulting firm did not take. Consulting became his major interest, although executive search was profitable and was still the main business for Firm J. He trained two of his employees to take up consulting assignments. This was risky and in 2006, the firm lost one more client who had used their executive search service for the last four years. Yet, the founder was interested in

building up such business in his firm. It appeared that such business was interesting for the employees in the firm too. The two employees who received training began to work with the founder on small consulting projects. In 2007, half of the revenue came from two small consulting projects Firm J were able to complete; one was compensation scheme design and another was training system design. However, partly due to this change, the firm was weakening its ability in executive search and annual revenue declined, in comparison with that in 2005. In his interview, the owner frankly said that he was not quite sure whether his firm 'should do consulting or executive search, because the former was more interesting than the latter but the latter was much more profitable and replicable than the former'. Future might be unclear but Firm J was clearly in stagnation in 2007 when this study was undertaken; indeed, the past five years were definitely a period of stagnation for the firm; it grew little, although survived in fierce competition.

Appendix IV: An introduction to HR service sector in Guangzhou City

1. History of HR service sector in Guangzhou City

An examination of the history of the development of HR service sector in Guangzhou City may shed important lights on causes of growth of firms in this sector. Development of HR service SMEs in the city generally paralleled the trajectory of economic development of the city since early 1980s. For this reason, this section presents the development of small HR service firms in four separate phases commensurate with economic development of the city in recent decades: the coming and dominance of international HR service firms (from 1978 to 1990), the emerging of small local HR service firms (from 1990 to 1995), formation and growth of HR service sector (from 1995 to 2005) and competition of HR service firms by brand and specialization (from 2005 till the present).

The coming and monopoly of international HR service firms in China started in 1980s and lasted till 1990. In this phase, managers of MNCs in their early operation in China needed help for better understanding the country: its culture, its society, its laws and its regulations. International consulting services firms, mostly based in Hong Kong, saw this opportunity and entered the country to provide consulting and training services on Chinese culture, social system and laws for new expatriates of MNCs.

Beginning from early 1980s, MNCs operating in Guangzhou City realized that there was an urgent need for their Chinese workforce to learn skills and management imported from their headquarters. In addition, they needed to get market information on local labour prices in order to hire local professional and labour. Yet, there was no local Chinese HR service firm to provide this information. As a result, International HR services based in Hong Kong such as William Mercers, DDI, IDP and Hays began their operations in Guangzhou City and Shenzhen City, providing advisory services and training services for MNCs on compensation, HR system and worker skill development. This phase of development of HR service firms ended with Chinese student movement in the year 1989 which saw withdrawal of some international firms from China and a decline in the inflow of foreign direct investment (FDI) into the country. HR services in the country during this period of time did not have great impact on the economy. Nevertheless, the result of this phase of development was significant in laying a foundation for the development of HR service sector in Guangzhou City.

From 1990 to 1995, there appeared a number of small local HR service firms in Guangzhou City to take up the niche market not controlled by international HR service firms. During this period of time, international HR service firms still dominated the wider HR service market, both executive search market and training service market. However, these international HR service firms were not interested in the business of recruiting low-level local office staff which was increasingly outsourced by MNCs. Such market niches attracted some overseas Chinese from Hong Kong, Singapore and Taiwan, some former staff from international HR service firms and some former

Chinese HR managers from MNCs. They set up their own small HR service firms in Guangzhou City to source talents for MNCs operating in the area. As a result, small local HR service firms emerged, most of which were recruitment and executive search firms. The new local players in HR consulting and service market had no brand and little knowledge in the business; they had a hard time surviving. Gradually, however, they built up some successful cases to demonstrate their capabilities which allowed them to open up some new business accounts. Accumulation of successful cases and profit from such business transactions provided basis for these small firms to grow. Soon, some more similar HR recruitment and executive search firms were set up, mostly by former staff from successful international and local HR service firms and former Chinese HR managers from MNCs. A big proportion of these small firms died soon after their establishment. Nonetheless, the emerging of local HR service firms during the time from 1990 to about 1995 initiated the development of small local HR service sector in Guangzhou City.

The decade between from 1995 and 2005 witnessed the formation and growth of HR consulting and service sector in Guangzhou City. On the one hand, as more and more MNCs entered the city after 1995, the need for HR consulting and services increased day by day. Furthermore, local enterprises, both state-owned enterprises (SOEs) and private-owned enterprises (POEs), also began to look for human resource services. On the other hand, the scope for HR consulting and services for most of these clients was increased to cover many more areas of services, besides traditional human resource service such as recruitment, training and leadership development. As an example, there

was a niche market for the business of human resource management consulting because local firms urgently wanted to upgrade their human resources to the same standard as those of MNCs with whom they had to compete for talents. Due to such new business demand and the increase in demand for the traditional services, human resource service firms in Guangzhou City, big and small, grew very fast. The number of these types of firms increased to over 50, some of which later became very strong and competitive.

From 2005 to the present, Chinese economy has witnessed many successes and economic institutions have also undergone significant changes; SOEs, POEs and MNCs have been able to compete as equal players in the market. The needs for HR services by various companies in this market, whether international or local, have been becoming increasingly similar. Thus, recently, HR consulting and service firms of all types have been offering compatible services. As a consequence, HR consulting and service firms openly competed, with many of them resorting to price cutting tactics; even international HR consulting firms were also forced to cut the prices of their services. Then, in order to survive and prosper, many small local HR service firms have started specializing in what they have been good at. Some executive search firms, for example, focus on recruitment of talents in IT industry while others chose to become a recruitment specialist in other industrial sectors. In Guangzhou City, HR consulting boutique stopped claiming that they could provide almost every conceivable service. Instead, they began to focus either on training services, or on recruitment, or on development of HR management system. This specialization trend emerged in early 2005 and has been since growing. Consistent with this trend, HR consulting and service

firms have begun to put more and more resources into building their brand which indicated their uniqueness in HR services.

2. Current status of HR service sector in Guangzhou City

Currently there are over 100 HR service firms in Guangzhou City, including international HR service firms such as William Mercers and Watson Wyatt, national HR service firms such as Zuoyou and local HR service firms in the city such as Yuexiu and Jingtian (Kingfield). Among these firms, quite a number of them are business service firms' HR service divisions, which focus on HR services, particularly HR consulting service. This section describes briefly the current status of HR service sector in Guangzhou City including the typical size of firms in the sector, their business scope, their business volume, their growth rate and their profitability.

By the information gathered from interviews of the key players in HR sector of Guangzhou City, it appears that size of these HR service firms is usually not very big, with about 80% of them having fewer than 15 employees. The majority of these HR service firms, about 50%, are exclusively executive agents; the next biggest group, about 30%, are training firms; following this group is another cluster, about 10%, which provides HR outsourcing services; only about 5% to 10% of the HR service firms specialize in HR consulting service. These consulting firms are often divisions of other business consulting firms.

The size market for HR service in Guangzhou City is hard to measure; it is estimated to be over 80 million US dollars. The year on year increase of the sales volume for HR service sector is often estimated to be over 20% over the last two decades. The fastest growing business is the executive search business, as more and more enterprises choose to outsource their recruitment of professional talents. Training business has been expanding quickly, which cover training on management, teamwork, leadership and operational skills. Recently, training service scope in the city has been broadened to cover training on psycho health and family life. A noticeable development is that HR service has been provided over the internet. This technology dramatically changes the landscape of competition; for instance, executive search is being rapidly commoditized because executive search over the internet provide easy access to candidates by executive agents and their clients.

In term of profitability, HR service firms in Guangzhou City are still among those firms with high ROE, commonly with 40% to 50% margin. Most of executive search firms are very profitable. Training service is also very profitable; however, not all training firms have been making profit. In fact, due to price-cutting competition, a number of small training firms in the city with outdated training courses have been losing money and going towards bankruptcy. HR consulting business is knowledge-intensive service and labour cost for hiring a consultant is very high. Therefore, HR consulting as a service has not yet become the main source of profits for HR service firms. Local HR service firms in the city usually lack the ability to attract, develop and retain consultants who are normally very learned and experienced but very expensive as business

resources. These firms do not want to seriously engage in HR management consulting. As a result, in the area of HR management consulting, international HR service firms are still dominant players and profit goes to these firms.

3. Market supply and demand in HR service sector in Guangzhou City

Market supply and demand in HR service sector in Guangzhou City is in general in balance. There are, however, two important imbalances in this sector. In time dimension, when economy was growing very fast, demand for HR services in the city often exceeded supply. Then, HR service firms in the nearby city and from other parts of the country rushed in to satisfy the extra market demand. In term of types of HR services in the city, knowledge-intensive practice areas such as HR management consulting seem to lack demand; other more labour-intensive practice such as personnel service, which is often controlled by governmental units of the city, see stable demand; demand for practices in between these two types of firm such as recruitment and training service seem to be on the rise. On the whole, both supply and demand sides are immature and seem very volatile. Paragraphs below present the characteristics of supply side and demand side of HR service sector in the city and the interaction between them.

Demand in HR service sector in Guangzhou City is mostly related to HR services with low knowledge intensity such as recruitment service and temporary placement service. Output of these services is more concrete and thus, their quality and value easier to assess. Executive search service is much more knowledge-intensive but still falls within

this category, since its output and value is measurable. Firms looking for such services can shop around in the market for the best deal, because such services are comparable. This indicates the immaturity of demand side in the city. The more knowledgeable enterprises are about HR management, the more likely they will purchase knowledge-intensive HR services such as consulting services; for example, some family-owned firms with less educated management are more willing to buy some HR services such as recruitment service and training service which have more concrete and measurable results, while other POEs in the city which have highly educated management team, are willing to buy knowledge-intensive HR consulting services. Hence, along with the development of higher education in Guangzhou City, market size of HR services has been increasing. Overall, in comparison with HR service market in the developed countries, the demand side of the market is immature; the demand for knowledge-intensive services such as HR consulting is still very small; most of the HR services in Guangzhou City relate to either executive search or training services which are less knowledge-intensive.

Supply side of HR service sector in Guangzhou City is also immature and is under development. Entry barriers to this sector are very low and entry-exit rate is extremely high. Most of HR service firms in the city are recruitment boutiques which have fewer than 10 employees. Different from executive firms with high quality staff, these recruitment boutiques mostly carry out labour-intensive, rather than knowledge intensive, recruitment assignments. Their employees are generally fresh graduates, not HR consultants as the term indicates; these employees collect candidate resumes and

after quick review, send them to their clients who are burdened with the task of selecting the best candidates from a bundle of CVs. Due to this reason, recruitment of staff and low level managers are done cheaply; these small HR service firms thus have to survive on volume of their business. Larger local recruitment firms have specialized executive search business and they charge much higher fee for recruitment. Specialization of skills in these firms, however, is still comparatively low, in comparison with international executive firms.

As for training firms in Guangzhou City, in comparison with the number of recruitment boutiques, they are much smaller in number. They are often small and lack their own special products to differentiate themselves in market. Most of these firms are tiny sales company selling a few training courses to enterprises; a training firm may consist of a trainer and a sales team selling what the trainer can deliver; or they are a group of salesmen organized by a sales manager to sell training courses for some master trainers who do not have their own sales team. There is seldom a formal quality control system. As a result, in the city, there are few training companies which can seriously develop, deliver and assess a training course for clients. They are mostly temporary team organized to earn quick money from selling training courses, without much concern for the effect of training on business of their buyers. Furthermore, for lack of certification by authoritative training associations, some trainers are not genuine trainers but people who have eloquent tongue while lacking professional experience and training skills; they can not bring much practical value to participants in their training programmes.

Similar to recruitment boutiques and training firms, most HR consulting firms in Guangzhou are immature and can not offer much practical management advice to their clients. HR consulting is often the smallest practice in a HR service firm which often simultaneously provides executive services, training services, HR outsourcing services. As mentioned before, most SMEs in Guangzhou City do not have good understanding of what HR management is and how it can impact their business; consequently, they are not willing to buy intangible and elusive HR services which show no immediate and concrete value for their business. As a consequent, it is difficult to sell and deliver elusive HR consulting services to firms in the city. Since firms are not willing to pay good price for such services and it is expensive to employ knowledge-intensive consultant, it is very difficult for consulting firms to make large fortune on HR consulting services, which in turn fail to attract the best talents to join the sector. Consultants in these firms are not really knowledgeable and experienced expert. They are not specialists, but generalists who try to meet every demand of the market. Too broad a business scope frequently claimed by HR consulting firms makes their services look less specialized and hence, less valuable for clients. HR consulting firms or consulting practice of HR service firms are struggling with this problem.

To sum up, supply and demand of HR service market in Guangzhou City is basically on balance. Demand for HR services is centring on more concrete and observable services such as recruitment services and training services and as a result, supply side consists of mostly recruitment boutiques and training boutiques. Both supply and demand sides are not so knowledgeable about HR management and its impact for business; accordingly,

supply side is not willing to pay for elusive and complex HR consulting services and demand side does not invest in building up knowledgeable expert pool which is expensive to maintain. Knowledge-intensive HR services have a very small market size in Guangzhou City while labour-intensive HR services have a large market. In other words, HR services in Guangzhou City are mostly labour intensive services with very low value.

4. Business models of firms in HR service sector in Guangzhou City

For the same service line, business models of firms in Guangzhou City are very similar. In fact, this is the hallmark of this sector in the city. This is because most HR services offered are labour intensive and concrete business transactions which can be easily copied, as exemplified by recruitment services. There is not much room for business model innovation for HR service firms. Their success hinges on price and client relation. As a result, it is not uncommon to see a new HR business service model disseminated very quickly, which led to quick entry of new HR service firms or quick imitation of the business model by existing HR service SMEs. Business model for each of the most common HR services in Guangzhou City is presented in the following paragraphs.

Recruitment service is the most common practice which is the sole business of many HR service boutiques. Recruitment service looks very much like a transactional type of business. In this business, most HR service firms recruit workers for clients for a specific fee per recruited head, very similar to selling products to customers. Profit

comes from total revenue (fee) minus total operational cost. HR service firms in this business have several options to increase revenue. One option is to increase fee level by moving to recruitment of more higher positions for their clients, which requires commensurate cost due to employment of more expensive recruitment consultants; another option is to increase the number of successful new recruits, which requires employment of a bigger number of recruitment consultants who may or may not be expensive; yet, another option is to simultaneously exercises two previous options. The first option is termed 'executive search', mainly involving recruitment of management or hot talents (scare resources). The key to the success of this option is to specialize in filling certain positions and to build and maintain a pool of royal clients. Profit for such service is often extremely high and increase in proportion to hierarchical levels of positions filled or difficulty of recruitment. Under this circumstance, firms without recruitment consultants specializing in certain industry or profession can not provide effectively such service and their clients may not be royal to them. The second option which is to increase the number of new recruits for profit (mass recruitment) mainly involves recruitment of professional level employees. This option needs a huge databank of candidates and smart, client-oriented young consultants who can quickly meet client needs. There are a small number of firms in Guangzhou City using the combination of the previous two options by focusing on a few clients; they act as recruiters for a limited number of clients and do all they can to fill positions of their clients in a timely manner. Relation with their clients is strengthened as success rate of recruitment for them increases. Profit depends on quality and delivery time of such service; the more reliable such service is, the more profit HR firms can make.

Training service firms in Guangzhou City are not as numerous as recruitment service firms. However, both of them are similar in term of labour intensity and business model. Most of small training service firms have the same business model. They sell a course to clients on behalf of some expert trainers or firms licensing the courses. Once they have recruited enough training participants, they organize the delivery of the course either as a public course or an in-house course. They charge clients for training courses delivered per participant or per course. Their revenue comes from the residual of training charge clients pay and profit equal to training charge minus operational cost of selling and delivering the training course. There are two types of training courses: one is business to business (B2B) such as training sections or seminars on management and another is business to individual customer (B2C), for instance, courses on professional skills for certification. For the first type of training which is a kind of relational business, it is important for training service firms to develop and maintain strong client relationship by providing quality training programmes, in order to expand training services and to increase profits. For the second type of training which is transactional in nature, it is very critical for training providers to carry out effective promotion of the trainer and training programme, so as to sell as many training participation tickets as possible. In either case, to have a trainer of high reputation on board is extremely critical for the success and profitability of a training course. In the case of a small training firm which is basically a sales operation for selling and organizing delivery of training courses, brand development is far from their interest. However, there are a few training firms in the city which develop their own training courses, employ their own trainers and

operate their own training services; their business model is somewhat different from most of the small training firms. Their revenue depends not only on sales and delivery of training courses, but also on innovation and improvisation of training courses. The more innovative their courses are, the higher market price these firms can fetch for these courses. In addition, they license their courses to other small training companies when market demand exceeds their capacity of delivery. In all cases, revenue and profit for training firms depends very much on reputable trainer and training firm, effective sales and delivery of training course and quality client relationship which reduce transactional cost.

Temporary employment placement service in Guangzhou City is also very common. This business is created and developed due to the need to tackle labour demand fluctuation problem by some manufacturing firms; these firms have production peak time and down time, which creates fluctuation in labour demand. In order to reduce fixed labour cost such as wage and social security charge and to avoid potential labour issues, these firms are willing to pay a higher fee to hire temporary workers from HR service firms to fill periphery positions—mostly labour intensive jobs, during production peak time; when production is in its down time, these manufacturing firms return these temporary workers to HR service firms which are their employers in the legal term. This is a good business opportunity for HR service firms in Guangzhou City and a number of them thus set up division for temporary job placement for business. They hire workers from all over the country and place them in different firms in the city during the year according to demand for labour, charging these firms for a fee which

includes workers' wage, social cost and service fee. These are often win-win situations for three parties in the city: manufacturing firms can use labour on demand, turning a fixed annual labour cost into a variable cost and thus reducing much cost; workers can have a higher income since through HR service firms, they can utilize their skills and time more fully; and HR service firms can levy a fee for the temporary employment placement they provide for manufacturers. In order to increase the service fee, HR service firms can manage either to increase the number of placements or to move up the ladder in levels of job placements. Indeed, some HR service firms in this business manage to increase value of their workers by giving them some training. Finally, when workers in their inventory are skilful enough to be headhunted, HR service firms recommend these workers to firms for employment and levy a recruitment fee. The business model for temporary employment placement brings handsome profit to HR service firm in the city.

Unlike other HR services as mentioned above, HR consulting service is much more knowledge-intensive and difficult to sell and deliver. HR consulting firms in Guangzhou has experienced a hard time in developing a market brand as HR specialists, before their clients were willing to pay for their services. The business model of HR consulting service in the city can be reconstructed on past actions of HR consulting firms. It often began with publication of their convincing expert view on HR issues, either through trade journal, management journal and other media such as weekly newspaper which were read by management of their clients; there was also a tactic of selling these knowledge-intensive services through public courses or seminars. In addition, sale of

HR consulting services was carried out in daily interaction HR consultants had with their clients. When clients were convinced that a certain HR consulting firm had the capacity to assist them in solving their management problems, the HR consulting firm was then invited to bid with their competitors for service contract. The winning firm delivered what it had promised in the contract, with active participation of client. They got their service fee for this delivery and profit was made by deducing operational cost from the revenue.

Currently, the most popular HR consulting services in Guangzhou City are compensation design, HR management system design and leadership development. There are several ways to increase the revenue and profit. One method is to develop a comprehensive solution to HR management problems, in term of coverage of management practices or of organizational units. The more comprehensive the solution is, the bigger the project revenue will be. The risk for this method is that HR consulting firms may propose a project which goes beyond their capacity and resources. Another way to increase consulting revenue and profit is to move the consulting project to a higher end in management solutions which is more complex and more difficult to complete. Some HR consulting firms go into partnership with other management service firms, particularly ERP implementation companies, which can provide them long-term HR service contract. Such a partnership can lengthen service time and reduce the time for consultants to be on the bench. By this means, HR consulting can increase their annual revenue and profit.

The last but also commonly-seen business model for HR service firms is to provide a combination of several services for a single firm; services for this client normally include executive search, training services and some HR consulting services. The business logic is that clients want to have one-stop shopping to simplify the internal process administrating their outsourcing service suppliers, to increase efficiency in external business contact and to cut down management cost. HR service firms with this business model have to build up several business lines which require more employees, bigger organizations and more expensive internal coordination. This business model is often practiced by medium and big HR service firms. This business model of multiple services is often a natural evolvement of the business model of a single service; HR service firms in the city often started small, focusing only on one service, which in most cases was recruitment service and later executive search. As they developed, some clients gained confidence in them and asked them to provide some other services such as training services. HR consulting often came much later when these HR firms were in a good financial position to hire expensive and experienced consultants. In term of business value, the business model of multiple services has its advantages and disadvantages. As advantages, this business model can maximize value of a client for HR service firms; HR service firms can use clients in their current database to develop new business and increase revenue. On the other hand, multiple services of the same HR service firms often betray them as generalists in market, without real expertise; this reduces market value of their services. Thus, the business model of multiple HR services does not seem to be the best option in highly competitive market such as that in Guangzhou City. Nevertheless, a number of HR service firms go for this business model,

in order to get short-term revenue.

5. Competition in HR service sector of Guangzhou City

Competition in HR service sector in Guangzhou City is fierce, as manifested by frequent price-cutting initiatives in market, a competition tactic often utilized even by famous international HR service firms. However, competition among HR service firms is not as open as those for consumer goods. It is betrayed often in business deals which do not go into open bid. The following paragraphs describe major causes for competition, major competitors, main competition methods and impact of competition on growth of firms in HR service sector.

Competition among firms in HR service sector in Guangzhou is very intense and there are many reasons for this market phenomenon. Firstly, both supply side and demand side are immature. Clients buying HR services often do not have sound knowledge of HR management and its impact on business. Often, they can not articulate clearly their needs and they lack the ability to tell the difference between HR services offered by various HR services firms. As a consequence, they purchase HR service in way as they buy products of the same type and function, mainly based on brand and price. They are very sensitive to price and not willing to offer high price for quality HR services in the market. Meanwhile, the demand side, those HR service firms in town, also offers services without much difference, because they lack necessary human and financial resources to develop differentiating services and furthermore, buyers are not willing to

pay for these differences. Similarity among services offered by different HR service SMEs accounts for severe competition based on price. The second reason for this price-based competition in HR service sector in the city is that the sector is scattered, with many small and big firms operating side by side and competing with each other. HR services in the city are not well segmented and the sector is not dominated by a few firms. International HR service firms such as Hays and local HR service boutiques may bid for the same contract of designing compensation because such contracts are quite small and required only one or two consultants to complete. Since the needs of the market for HR service such as recruitment of an executive are very focused and small, there is room for existence of highly specialized HR service boutiques which often lack necessary financial resources to maintain a talented workforce to offer innovative services for clients and hence, opt for services which can be completed by labour intensive tactics. It is in this area that competition among HR service firms is most intense.

Competition takes place across different tiers of HR service firms in the city. The first tier of competitors is international HR service firms such as Hewitt Associates; the second tier of competitors is made up of those local HR service firms with long-standing and stable business transactions; the last tier consists of those boutiques which are often run by one or two partners, who work on full-time basis or part-time basis. As mentioned above, these three tiers of competitors are not clearly differentiated in bidding for HR service contracts because HR service market is scattered and assignments are often small, HR services could be provided by firms of different sizes.

Nonetheless, due to some differences among these three tiers of competitors, they are introduced separately in the following paragraphs.

International HR service firms are often much bigger in size and in operation. The key difference is that in comparison with other two tiers of HR service firms, they have global database of HR knowledge and consultants; they have multiple business lines which offer a more comprehensive scope of services for clients; most importantly, they have necessary financial resources and career development path to attract, develop and maintain a pool of highly talented consultants. The following is a table showing profiles of major international HR service firms in Guangzhou City:

Table 1 of Appendix IV: Profile of representative international HR service firms in Guangzhou City

Company	Size of workforce	Main services in the city
Hays	<30	Compensation consulting, leadership development, performance management consulting,
Watson Wyatt	<20	Compensation consulting, organization design, work design, performance management consulting
Hewitt Associates	>40	Leadership development, employee benefit management, performance management consulting
William Mercer	<30	Compensation consulting, performance management consulting, work design

Source: interviews by the researcher in 2007

As apparent in the above table, there are many overlaps in service scope among international HR service firms, which may be one major reason for intense competition

among them; for instance, most of them are well-known for compensation survey and compensation consulting. Currently, a few of them go into leadership development which requires more experienced consultants.

The second tier of HR service firms are local firms established and developed in Guangzhou City; in term of business scope, they are quite different from international HR service firm which are more specialized and knowledge-intensive. Local HR service firms are generalists with wider scope of services. The table below shows the profile of representative local HR service firms:

Table 2 of Appendix IV: Profile of representative local HR service firms in Guangzhou City

Company	Size of workforce (as of 2007)	Main services in the city
King Field	75	Executive search, training service, HR outsourcing,
Yuexiu	29	Executive search, training service, HR consulting
FMC	76	Training services, HR consulting
HR partner	12	Executive search, HR outsourcing

Source: interviews by the researcher in 2007

The table above shows that there is also obvious overlapping of business scope among local HR service firms and as is the case with international HR service firms, this overlapping is one of the causes for fierce competition among them. In addition, most of local HR services firms have executive search service. In fact, this is the service from

which other business lines have been developed; to date, this is still the most profitable service line and the core business for these firms. The table also reveals that local HR firms usually have wider business scope which contains less related services. In short, they are less specialized than their international competitors.

The third tier of HR service firms in the city are HR service boutiques which often offer one or two services. Most of these HR service firms are recruitment agents searching and recruiting professionals for their clients: MNCs or other types of firms. These recruitment agents or executive firms are firms with one owner, plus two or three employees; they survive by focusing on serving their niche market: either a few clients, a few types of positions to fill or a combination of the two. Similarly, some HR consulting boutiques run by a well-known consultant or a professor survive comfortably by limiting their service to a certain number of consulting business lines.

The above three tiers of HR service firms in the city may compete against each other in the same bid. There are several strategies for HR service firms to succeed in competition. The most common strategy is to cut prices, due to little differentiation among these services by various HR service firms. Apart from price-cutting, sometimes, some firms differentiate themselves from their competitors by service innovation. In training services, for instance, training courses are often designed differently from products of competitors so that clients buy them willingly; other training firms enter contract with some well-known trainers which designate them as sole providers of specific training courses and allows the training firms to monopolize the market; yet,

other firms obtain license from training course developers to monopolize specific geographical market. Besides product and resource innovation, some HR service firms resort to business process innovation to compete. Brand development is often the spot light in the competition arena for many HR service firms. These firms continuously sponsor public events such as management seminars or forums to effectively communicate their brand. As if to illustrate Prahalad and Ramaswamy (2004), some other HR service firms co-operate with professional marketing agents to sell their training courses or other services, aiming to make up for their weak marketing function which is the problem for most of HR service firms. Besides the above competition strategies, it is also quite common for HR service firms in the city to build and maintain strong relation with their clients so as to prevent other firms to compete for business from their clients. Most important of all, a few HR service firms differentiate themselves from their business rivals by recruiting, retaining and utilizing talents from different universities; this has become a popular trend and work effectively as a competition strategy.

Fierce competition in HR service sector in Guangzhou City has great impact on the growth of SMEs in the sector. The positive impact is that it forces some HR service firms to be sensitive to market trend and proactively utilize their resources to their best advantages for their success; moreover, tough market competition compels HR service firms to upgrade their firm resources, particularly, their talent resources, which lays a good foundation for their growth; lastly, intense competition drives HR service firms to continuously move up the value chain in HR services, which not only increases their

revenue but also develops their firm capabilities. All these have had positive impacts for growth of HR service firms in the city. On the down side, fierce competition in HR service sector in the city leads to frequent entry and exit of HR service SMEs, or rather, HR service boutiques; furthermore, it also leads to decreasing in market prices for HR services, which does more harm than good to development of the sector as a whole, because it deters capital and talents to enter the sector.

6. Development trend of HR service sector in Guangzhou City

Recently, market for HR service in Guangzhou has been expanding and becoming more and more mature. Expansion of the market is partly due to the escalation of competition among product firms which need HR services. On the one hand, domestic firms set up and operated over the last three decade since 1980s have increased in number and become strong in capabilities because they have to compete not only against each other but also against MNCs in China and as a result, competition among them has intensified. On the other hand, globalization has led to wider competition arena (global market) and greater pressure for survival for all firms operating in the city. Under these circumstances, more and more firms have become aware that they need to develop their human resources to match competition abroad, which increase market demand for complex HR services. Besides increase in demand, the market for HR services is becoming more and more mature and client requirements are becoming more and more sophisticated. Although traditional labour-intensive services are still dominating the market, knowledge-intensive HR consulting services are witnessing some encouraging

increase. This is because managers of firms demanding for such services have been becoming more and more educated in HR management and its positive impact on firm growth; and HR service firms are able to offer HR consulting services with much better quality.

Expanding and maturing market for HR services in Guangzhou City has led to many positive developments in the sector. One of these is specialization of HR service firms. This trend has been developing for over one decade but is becoming more and more pronounced. Executive search firms, for example, are developing specialized skills in certain business areas; some of them are becoming specialists in recruiting high-tech professionals in a specific field while other firms are focusing their strength on the needs of a limited number of clients. HR service firms in the city are developing different brands, even different business divisions, to focus on different services. Specialization in skills of their consultants is placing them as experts in the eyes of their clients. Secondly, HR service firms are moving up the value chain of their services. In recruitment services, for instance, some recruiting boutiques are becoming executive search firms and local executive search firms are expanding their business into high-end market which demands for English-speaking consultants and experienced project managers; in training services, more and more training firms are becoming developer of original training courses which bring about much bigger profit. A third trend is the employment of IT in HR service firms to increase internal operational efficiency and to build database to leverage synergy across business lines to gain bigger revenue. A last observable development trend in HR service sector in Guangzhou City is the increase in

partnership and co-operation among HR service firms and between HR service firms and other business service firms. HR service firms in the city often establish partnership with their counterparts in other parts of the country. This is most apparent with executive search firms. Some executive search firms have their own offices across the country but still set up partnership with other executive search firms or at least occasionally cooperate with them, in order to benefit from exchange of candidate resources. A number of HR service firms co-operate with other business service firms such as operation improvement consulting firms.

In general, as the market for HR services in the city is expanding and maturing, the number of HR service firms has been growing fast, the capability of HR service firms and quality of HR services have been improving quickly. Nonetheless, market for HR services in Guangzhou City is still very scattered and competition is unruly and fierce: no firm dominates the market and every person seems to be capable of setting up his own HR service boutique.

7. Current challenges for small HR service firms in their growth

There are a number of challenges facing small HR service firms in Guangzhou City in their drive for growth. Various external difficulties and internal problems confront HR service firms; external difficulties are mainly market immaturity and lack of institutional support; internally, small HR service firms need to improve their management and their human resources. Below is an exposition on these challenges.

As mentioned before, market for HR services in Guangzhou City has been becoming more and more mature; yet, it is far from being a mature market for intangible and elusive services such as HR consulting services. Many business owners are forced to compete in talent market and urgently need external consultants to help them to manage their human resources. However, few of them have really deep knowledge of human resource management. As a consequence, they still prefer to purchase services which can bring them tangible result in a very short time, such as operation improvement services. Except for recruitment and compensation reform, HR services normally can impact long-term business results of the firms; they seldom can bring immediate short-term result. Partly due to this reason, it is extremely difficult to sell such HR services to business in Guangzhou City, as is elsewhere in the country. There is a lack of confidence and trust on the part of clients in services marketed by HR service firms. Even if some clients purchase such services, they are not willing to devote much time for delivery of such service which, to be successful, needs close cooperation between the enterprises that purchase the services and HR service firms which provide the services. Besides immaturity of the market, institutions in Guangzhou City are not always in favour of growth of HR service firms. Given small size of their organizations, HR service firms has great difficulty to attract the best talent in human resource market of the city; still, there is not any effective mechanism in current institutions to help HR service firms to overcome this difficulty. Lack of effective associations for HR service sector also leads to absence of certification for HR consultants and quality supervision for HR services. As a result, HR service firms have not any authoritative certification to

convince clients of their service quality and value while poor HR services are not detected and punished by market. It is not uncommon to see that some firms with poor service quality but low price beat their competitors which may have good quality service but a higher price. This situation gives rise to the lack of trust between HR service firms and their clients.

Internally, most of HR service firms struggle to hire the best talents from human resource market in the city. Except a few international HR service firms, local HR service firms find it difficult to attract and retain talents which they urgently need, because they are too small to give attractive pay and social benefits and to have effective system of developing and promoting talents who join them. Job hopping is comparatively high in HR service sector in the city, even in down time in economic development. In addition, most of HR service firms are boutiques without formal management system to run their operations. Although informality in management is seen in the sector as a sign of autonomy for professionals who sometimes value freedom over money, lack of effective management system bring ineffective business operation which can be fatal in the fast-moving business world today. For instance, non-existence or ineffectiveness of marketing function in HR service firms fail to facilitate the sales of services to clients and fail to build market confidence for such services; and lack of effective employee development system within HR service firms create difficulty in attracting talents. In short, combined with external difficulties, internal management problems present barriers to growth of HR service firms in the city.