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# **Entrepreneurship: Antecedents and Effects**

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**CRACOW UNIVERSITY OF ECONOMICS**  
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Department of International Trade



CRACOW  
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„International Entrepreneurship”

„Przedsiębiorczość Międzynarodowa”

# Entrepreneurship: Antecedents and Effects

edited by

Małgorzata Kosała, Maria Urbaniec, Agnieszka Żur

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## Foreword

Entrepreneurship is a wondrous human activity which has the power to transform people's lives, communities, accelerate economic development and improve the social reality. As a field of research entrepreneurship is a multi-stream and multi-disciplinary research area pursued by academics of various backgrounds, yet always focused on the heart of entrepreneurship which is opportunity identification and exploitation. As such, it has been associated with a set of human traits, as an economic function, as new venture creation, as a specific way of running organizations, and more. Because of its acknowledged impact and significance on economic growth and development, entrepreneurship research spreads upon increasingly wider areas of scientific pursuit and encompasses multiple levels of study (micro-economic, mesoeconomic and macroeconomic) in economics, management science and business studies. In spite of decades of progress and growing popularity, entrepreneurship remains a much fragmented and still expanding field of research. While many questions have been answered, still many remain incomplete, unaddressed or yet to be asked.

This monograph presents current research findings of various authors from different parts of the world making a hopefully valuable polyphonic contribution to the puzzle of entrepreneurship. Its focus is on antecedents and effects of entrepreneurship, addressing two broad and fundamental questions in entrepreneurship research. What enables and fosters entrepreneurship? What are its effects for individuals, organizations and society at large? It consists of nineteen chapters grouped into four parts.

The first part "Entrepreneurship antecedents: role of equality and education" focuses on two important antecedents of entrepreneurship, first being equal access to resources and opportunity exploitation and second being education, the utmost important driver of entrepreneurial attitudes and behaviours. **Monika Fabińska** presents the results of a Poland based mixed method study among women entrepreneurs identifying stimulants and barriers to their business success in the light of the equal opportunities principle. **Rabi Sidi Ali** employs feminist liberal and social theories to explain factors limiting women entrepreneurs growth intentions in developing countries. Both these chapters explore a critical and much neglected aspect of entrepreneurship research; that relating to equal rights and equal access to opportunity exploitation and pursuit of entrepreneurship. As these studies show, in developed as well as developing countries, still much remains to be done in terms of entrepreneurial gender equality. Next, two studies present the role of entrepreneurship education in higher education institutions. **Grażyna Nowaczyk** and **Anna Sobczak** present a critical analysis of an overview of curricula of entrepreneurship courses and emphasise the role of practicality. **Paul M. Lane** calls for an inter-institutional approach to entrepreneurship nests, as he calls universities, coupled with



deep commitment, administrative change, changed learning practice and reshaped physical environment in creating the right environment for entrepreneurship and innovation at higher education institutions.

The second part of this monograph titled “Entrepreneurship ecosystems and social frameworks” examines further antecedents of entrepreneurship: the ecosystem, environment, social networks, social capital, legal frameworks and regional support. **Muhammad Rahatullah Khan** analyses the evolution of entrepreneurship ecosystems and support for new venture creation in Saudi Arabia. **Agnieszka Brzozowska** and **Michał Zdziarski** present a critical overview of the state of the art on network theory referring to the complex mix of relationships entrepreneurs operate in. **Yuhong Zhou** investigates how these social networks can impact entrepreneurial innovation, when mediated by trust and diversity. **Luigi Lai** relates to the legal framework of entrepreneurship and discusses the aspect of insolvency, markedly important in post crisis period. **Tomasz Pilewicz** presents the results of a multilayer extensive research and identifies strategic activities local regions can undertake to create an entrepreneurship friendly environment, attractive for investors, entrepreneurs, tourists and inhabitants alike.

The third part of the monograph “Innovation and technology in small business research” is transitory as it is devoted to innovation and technology, which can be perceived as both antecedents and effects of entrepreneurship. **Luigi Lai** starts this section with an analysis of EU innovation policies, especially in the aspect of institutional cooperation with R&D in the public and private sector. **Małgorzata Gajowiak** presents the effects of intellectual entrepreneurship and results of a study which identifies key resources high-tech small and medium firms tap into to build competitive advantage based on intellectual capital. Next, **Sassan Rismani** and **Dimas Widiantoro** analyse data from 17 EU countries to test the relationship between R&D expenses and start-up IPO over 10 years identifying R&D capital inflow as an enabler of successful start-up IPO. **Agnieszka Skala** presents the results of the first research on Polish digital start-ups providing a valuable insight into this vastly growing area of entrepreneurship. Finally, **Sławomir Wyciślak** discusses the challenges of highly entrepreneurial firms in implementing both lean and agile management patterns in turbulent environments in the aftermath of 2008 crisis.

The fourth and final part titled “Development trends international entrepreneurship” discusses the effects of entrepreneurship in an international context, current developments and challenges of entrepreneurial firms. **Maria Halemba** and **Danuta Babińska** emphasize the role of trust and communication in SMEs acting as service providers via offshore outsourcing. **Wojciech Zysk** offers a much needed perspective on ethical and responsibility aspects of international entrepreneurship highlighting the concept of fair trade 3.0. **Sanja Gongeta** raises the issue of regulatory frameworks in the context of SME internationalization and participation in international markets. **Davar Azarmi** presents the results of a Spanish study identifying factors effecting venture capitalist exit decisions suggesting that factors relating to entrepreneurs and the external environment are key categories that should be taken into account when withdrawing investment. Finally **Yuliia Kleban** offers

a perspective on Ukrainian health resort industry and identifies existing opportunities for social venture creation as an example of successful local development strategies, providing social value added to various groups of the society.

The authors and editors of this monograph aim to contribute to the dynamic growth of entrepreneurship research and its spread over various geographic, institutional and organizational contexts. A broad scope of this monograph enables an overview, analysis and evaluation of current trends in entrepreneurship research, antecedents and potential effects that entrepreneurship bears on organizations and economies. Its interdisciplinary approach and presented research findings from different parts of the world enrich our discussion about how does entrepreneurship happen and what benefits, as well as threats, it brings to societies. The chapters of this monograph can serve to identify new avenues of research in entrepreneurship research linking various forms of entrepreneurship with socio-economic development. The potential audience of this work includes all those who research entrepreneurship and work in relating fields of inquiry and those who wish to know more about entrepreneurship today: students, policy makers or entrepreneurs. Hopefully the content of this monograph will provide inspiration to seek new enhanced solutions in the area of socio-economic development based on entrepreneurship and spark new research which will elevate our understanding of how entrepreneurship can improve the livelihood and prosperity of people, organizations and countries.

The monograph came into being as a result of project entitled “Advancing Research in Entrepreneurship in Global Context” conducted in the years 2015-2016 within the Polish Central Bank NBP economic education program and realized by the Centre for Strategic and International Entrepreneurship and Department of Entrepreneurship and Innovation at Cracow University of Economics. We cordially thank all those who made this publication possible, in particular all the authors for their excellent contribution and reviewers for their time, commitment and valuable suggestions.

Małgorzata Kosła  
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# Women's road to business success in the era of equal opportunities policy

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## Abstract:

In the era of equal opportunities policy, the road to business success is still more time-consuming and labour-intensive for women than it is for men. Numerous studies indicate that women are faced with specific requirements concerning the enhancement of their role in management. However, despite the existing procedural and legal solutions, women's access to leadership positions is still difficult. Analysing the situation in Poland, a change in the situation of women in the labour market after the accession to the European Union is practically imperceptible or insignificant, despite such strongly emphasised equal opportunities policy, especially in projects co-financed by the Structural Funds. The paper aims to answer the following questions: (1) what factors hinder women's entrepreneurial activity?, and (2) does the phenomenon of discrimination against women in the labour market still exist despite the strongly emphasised, especially after 2004, principle of equal opportunities? The provision of answers to thus formulated questions was preceded by an analysis of secondary sources and a CAWI study conducted on a sample of 353 randomly selected companies from Lodz representing various sectors. The respondents in the study were women-entrepreneurs or women occupying managerial/executive positions.

**Keywords:** entrepreneurial activity of women; equal opportunities policy; structural funds

**JEL codes:** L25, L26

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## 1. INTRODUCTION

In the era of equal opportunities policy, the road to business success is still more time-consuming and labour-intensive for women than it is for men. As shown by numerous studies, women are faced with specific requirements concerning the enhancement of their role in management. However, despite the existing procedural and legal solutions, women's access to leadership positions is still difficult.

Research hypotheses assumed in this article are as follows:

H1: Women's entrepreneurial activity is limited primarily by external factors.

H2: In the era of the principle of equal opportunities, there is still a phenomenon of discrimination against women-entrepreneurs.

H3: The implementation of the principle of equal opportunities in projects co-financed by the ESF and the ERDF in 2004-2013 contributed little to the improvement of the situation of women in business.

The main objective of the study was to examine the situation of women – managers and entrepreneurs – and to identify the factors of their professional success. The study was divided into two phases. In the first phase, an analysis of secondary sources – studies on the situation of women in business – was carried out, clearly indicating that women's entrepreneurial potential is not fully exploited due primarily to: (1) the existing external barriers hindering women's managerial careers; (2) a low impact of the equal opportunities policy on the improvement of the situation of women in management/business and; (3) virtually no change in the situation of women (a lack of improvement in the situation of women in management/business) as a result of the implementation in Poland since 2004 projects co-financed by the ESF and the ERDF in which the principle of equal opportunities is crucial. In the second phase, the CAWI was carried out on a sample of 353 randomly selected enterprises from Lodz representing various sectors.

In order to conduct the study, a questionnaire containing 37 questions divided into 6 thematic blocks and a personal profile form containing 11 questions encompassing socio-demographic data characterising the respondents were prepared. In addition, a scenario of individual in-depth interview containing 6 questions was developed. 21 women participated in the in-depth interviews. The material obtained from the interviews was used to develop recommendations for the activation of women aimed at starting entrepreneurial activity and to provide the description of "good practices". The paper contains the analysis related to 6 questions within the following thematic blocks: 2 - determinants of professional success; 4: barriers to managerial advancement and possible solutions, and 6: self-employment. Statements on stimulating entrepreneurial activity among young women made by the respondents during the individual interviews were used.

The respondents in the study were women-entrepreneurs or women in managerial/executive positions. The aim of the survey was to: (1) indicate stimulants and barriers to conducting business activities and management of the enterprise/organisational unit by women; (2) identify the path to professional success of women; and (3) determine the impact of the principle of equal opportunities on the situation of women in business. The study results confirmed the findings of the analysis of existing sources indicating the inhibition of women's entrepreneurial activity by the environment and its prevailing stereotypes. Attempts to improve the situation of women in business, by means of educational programmes, informational and promotional campaigns, as well as legislative solutions, etc., should therefore be continued.

## **2. FACTORS LIMITING WOMEN'S ENTREPRENEURIAL ACTIVITY IN THE LIGHT OF INTERNATIONAL AND DOMESTIC RESEARCH**

In the light of international studies, factors determining women's decision to start their own business can be divided into two groups (Jennings & Brush, 2013):

1. pull factors (independence, self-realisation, an increase in income);
2. push factors (dissatisfaction with work, flexibility and family reasons, insufficient earnings).

Regrettably, in the case of women, push factors are more likely to influence the decision about starting their own company rather than the perception of market opportunities and opportunities for personal growth (Fransson, 2011).

In many countries, women face particular difficulties in obtaining capital to operate their business activity, e.g.: by additional requirements for securing loans (Avolio Alecchi & Radović-Marković, 2012). At the same time, funding problems are more often a reason for termination of business activity than in the case of men. Moreover, women are more likely than men to feel the fear of failure in terms of founding a company. It is common in all regions of the world. In addition, women assess their skills and capabilities in business more negatively than men do. In many countries, it is harder for women to start a business due to their lack of education – the level of illiteracy is greater among women. In the group of people running their own companies, women are more likely than men to have difficulty with the development of their businesses (Kelley, Brush, Greene & Litovsky, 2012).

The situation of women in developing countries with low GDP per capita should be also noted. The following factors constitute the main barriers for women from these countries in making the decision to start their own business (Wube, 2010):

1. Difficulties in establishing and running businesses by women due to culture, religion and traditions.
2. Difficulties experienced by women in obtaining funds to run their own businesses in the form of bank loans and informal loans. Financial institutions require women to provide a higher collateral or the affiliation of loan agreements also by a man. As a result, when setting up a company, women are more likely to use savings than loans (which excludes from the market the women that do not have savings). In addition, investors are less interested in supporting companies run by women.
3. Women have less business experience than men. This is mainly due to the limited access of women to training in this field.
4. Women have fewer business contacts, they do not know how to deal with government bureaucracy and have less bargaining power, which limits their development (the problem with access to new markets due to the lack of contacts

and knowledge). Thus, they work on a smaller scale and rarely enter into network relations (which are mostly dominated by men and difficult to access by women).

5. A lack of or limited access to technology due to a lack of funds. Public places with the Internet access are not friendly to women because of the hours of work and an environment not favourable to women. Hence they do not feel at ease using modern technologies.
6. Legal and institutional barriers. Women have little access to decision-makers (experiencing problems with communication with public administration and not receiving reliable information). Legal conditions reduce the possibility of having resources or obtaining an inheritance by women.
7. Difficulties in reconciling business commitments and family obligations as well as lower mobility of women.

Moreover, in developing countries, women's entrepreneurial activity is very often a result of necessity (no other options to support their households).

The following factors prompt Polish women to run their own businesses (Balcerzak-Paradowska et al., 2011; Kupczyk, 2009):

1. striving for independence and self-reliance (to decide their own fate);
2. striving to achieve higher income and financial independence;
3. opportunity for professional development;
4. negative experiences from paid employment;
5. favourable market conditions;
6. the threat of unemployment.

Other factors – stimulants of entrepreneurial activity of Polish women – include:

1. economic factors associated with an increase in the level of wealth of the society, contributing to the development of services which constitute space for women's entrepreneurship;
2. cultural factors associated with the perception of women as entrepreneurs;
3. institutional and demographic factors, such as a fertility rate.

The barriers – de-stimulating entrepreneurial activity of Polish women – include:

1. barriers in access to financing;
2. a lack of entrepreneurial skills;
3. cultural barriers: lower self-esteem, less faith in success, a greater fear of failure, a lack of self-confidence and faith in the effectiveness of the objectives of the organisation;
4. educational barriers (a lack of information and knowledge on how to start, run and successfully develop one's own company);
5. traditional socialisation (strengthening the traditional division of social roles by gender), the difficulty of reconciling work and the role of the wife/mother;
6. institutional barriers, such as poor access to childcare.

Thus, comparing the results of analyses of national and international research on stimulants and destimulants of women's entrepreneurial activity, one can conclude that depending on the level of economic development, their decisions are guided either by pull or push factors. Hence, in developing countries with lower GDP per capita, push factors dominate and additionally there is a lack of other alternatives for women to provide the minimum subsistence level for themselves and their families. In developing countries with higher GDP per capita, one can talk about the combination of these two groups with a predominance of pull factors. In developed countries pull factors dominate.

According to a study carried out in 2015 on a group of 353 respondents from Lodz<sup>1</sup>, the main determinants of setting up one's own business included: striving for independence – independence in decision-making (23% of the respondents) as well as the desire to achieve higher income/financial independence (18% of the respondents). Unfortunately, the factor associated with the ease of obtaining financing for new and growing businesses was identified by respondents as marginal (2% of the respondents) (Figure 1). Such a distribution of responses may be due to either ignorance of the available programmes for new and growing businesses (a lack of interest on the part of the respondents or a wrong method of information provision and promotion used by institutions that provide this kind of support) or complicated procedures for obtaining support for new or developing businesses run/managed by women.

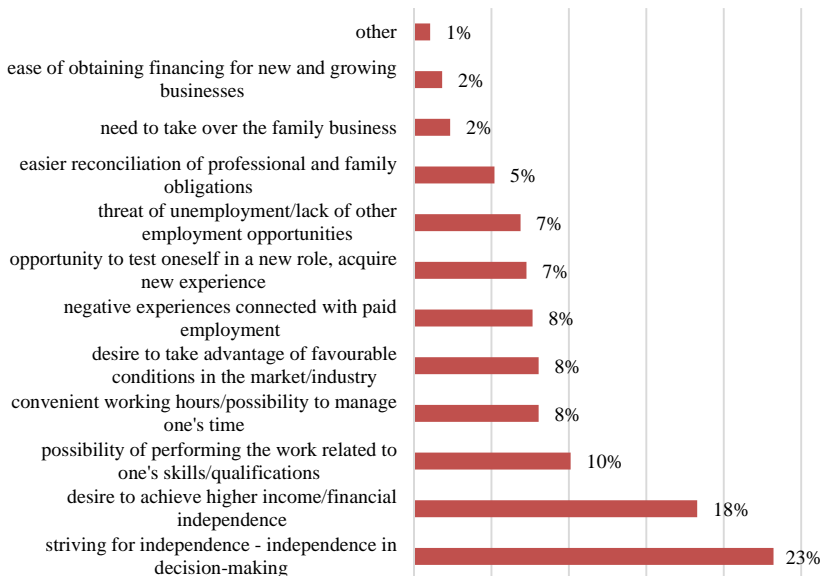
The barrier to making the decision about taking up entrepreneurial activity most frequently mentioned by the respondents was the lack of self-confidence/the fear of failure (24.07% of the respondents) and the lack of their own financial resources (18.17% of the respondents). Other destimulants of women's entrepreneurship included, among others: the tax system, strong competition in the market and difficulties in finding customers. Importantly, sporadically the respondents indicated a lack of support from family as a factor that constituted a barrier to making the decision to start their own business (Figure 2).

In terms of barriers that the respondents had to overcome on the way to their present professional positions, the following held the first three positions in the ranking: difficulties in reconciling work and family life (30% of the respondents), the lack of self-confidence/the fear of taking risks (18% of the respondents) and the stereotype indicating that men are better managers (13% of the respondents). In the minority were the respondents who pointed to a reluctant attitude to motherhood on the part of their superiors (only 3% of the respondents), or the lack of support from family and the blocking of opportunities for promotion by men/women occupying senior positions (4% of the respondents) as barriers to their professional development (Figure 3).

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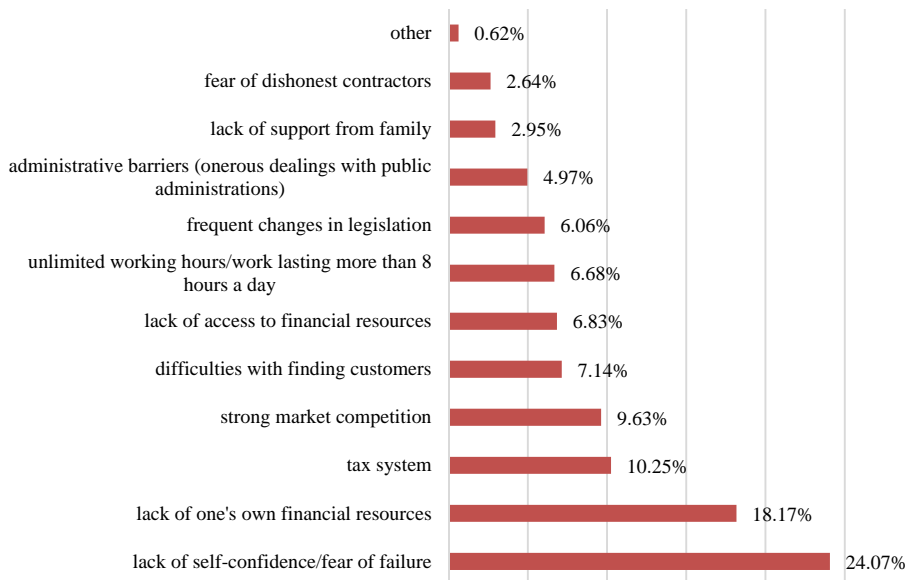
<sup>1</sup> The study was conducted in 2015 in the framework of the project entitled "Kobieta w biznesie. Sukces kobiet na łódzkim rynku pracy" ("A woman In business. Women's success in the Łódź labour market") coordinated by the Regional Labour Office in Lodz in cooperation with the Centre of Excellence for Teacher Training and Vocational Education as well as Agency for Economic and Statistical Analysis "Anstat".





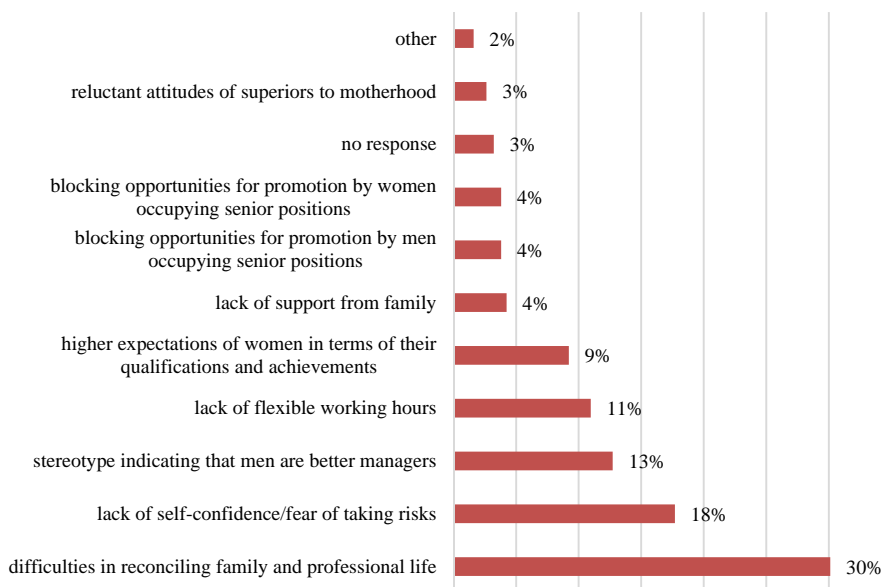
**Figure 1.** Factors encouraging women to become entrepreneurs

Source: own compilation based on the study carried out in the framework of the project entitled “Kobieta w biznesie. Sukces kobiet na łódzkim rynku pracy” (n=353).



**Figure 2.** Factors inhibiting women's decision to undertake economic activity

Source: own compilation based on the study carried out in the framework of the project entitled “Kobieta w biznesie. Sukces kobiet na łódzkim rynku pracy” (n=353).



**Figure 3.** Barriers to women's professional career

Source: own compilation based on the study carried out in the framework of the project entitled "Kobieta w biznesie. Sukces kobiet na łódzkim rynku pracy" (n=353).

### **3. THE POLICY ON THE EQUALISATION OF OPPORTUNITIES FOR PROFESSIONAL DEVELOPMENT IN THE CONTEXT OF GENDER IN THE LIGHT OF INTERNATIONAL AND NATIONAL RESEARCH**

In the framework of the policy on the equalisation of opportunities for professional development in the context of gender, there are two basic types of action taken:

1. Financial – providing funds dedicated to women.
2. Non-financial – providing various forms of support for women in the form of training, consulting, mentoring and access to international cooperation networks.

In developing countries with lower GDP per capita, reforms of financial policies and regulatory frameworks are still necessary to increase women's access to external capital and enable them to run their own economic activities.

At the European Union level, the framework strategy on gender equality is one of good practices in the policy of equalisation of opportunities for professional development in the context of gender (Kupczyk, 2009). It is a programme to promote equality between men and women by coordinating and funding of horizontal initiatives in the field of: (1) providing support for national organisations dealing with equalisation of opportunities, (2) providing equal access to training, vocational education etc., (3) increasing women's participation in the labour market through

the use of resources under the ESF for the expansion of services offering childcare and care for dependent adults.

Other good practices in the framework of the policy of equalisation of opportunities for professional development in the context of gender in the European Union can be divided into three types of initiatives (Beltran & Ursa, 2006; Kupczyk, 2009):

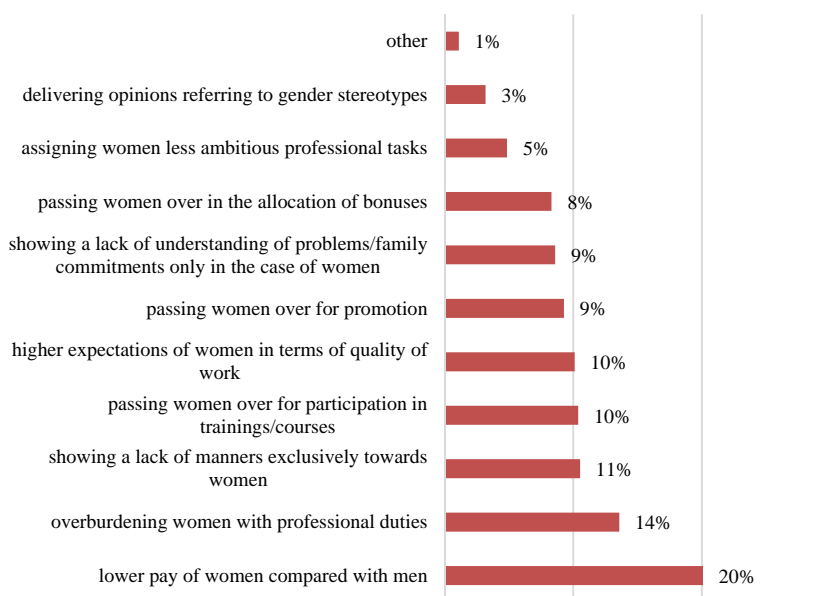
1. Legislative – regulations on the equalisation of opportunities for women in the labour market (quotas).
2. Institutional – centres/committees supporting professional activity of women and supervising the observance of the principle of equal opportunities in the labour market.
3. Information and training – integrated educational and information systems addressed to women and supporting their entrepreneurship.

The good practices indicated in the framework of the policy for the equalisation of opportunities for professional development in the context of gender are at the same time the demands listed by the surveyed Polish women who indicated the following solutions which might help in the development of entrepreneurship among women (Balcerzak-Paradowska et al., 2011):

1. Lower taxes and contributions (labour costs).
2. Increased access to capital (an effective system of obtaining assistance for the development of enterprises, expanding a network of consultation centres).
3. The development of care for young children and better access to technical infrastructure (increased employers' interest in the development of the network of care providers as well as providers of educational, recreational and sports services for children and adolescents).
4. Simplified procedures (easier and shorter).
5. A better social image of women-entrepreneurs (actions taken to change stereotypes about perceiving the roles of men and women and the development of partnership relations in the family, promoting the partnership-based model of the family).
6. The promotion of research and development.
7. Customised support for women-entrepreneurs (coaching, mentoring) and individualised school education for women (developing characteristics and forming appropriate attitudes favourable to women's entrepreneurship).

According to the study conducted, the opinions of the respondents on the manifestations of unequal treatment of women in the workplace were divided. Thus, 34% of the respondents answered that they had not heard of such cases, while 32% indicated that they had personally not experienced it but had heard of such cases from their friends. However, the analysis of the total value of the responses regarding the lack of this phenomenon or its occurrence, whether directly experienced or encountered in the environment, indicates that the majority, i.e. 60% of the respondents, have encountered personally or not manifestations of unequal treatment of women in the workplace. This was primarily manifested in lower wages of women

compared with men (20% of the respondents), voicing the views of referring to gender stereotypes (14% of the respondents) and passing women over for promotions (11% of the respondents) (Figure 4).



**Figure 4.** Unequal treatment of women in the workplace manifested

Source: own compilation based on the study carried out in the framework of the project entitled “Kobieta w biznesie. Sukces kobiet na łódzkim rynku pracy” (n=353).

The surveyed women also voiced their opinions on the methods of the equalisation of opportunities for professional development in the context of gender that companies and the government could introduce.

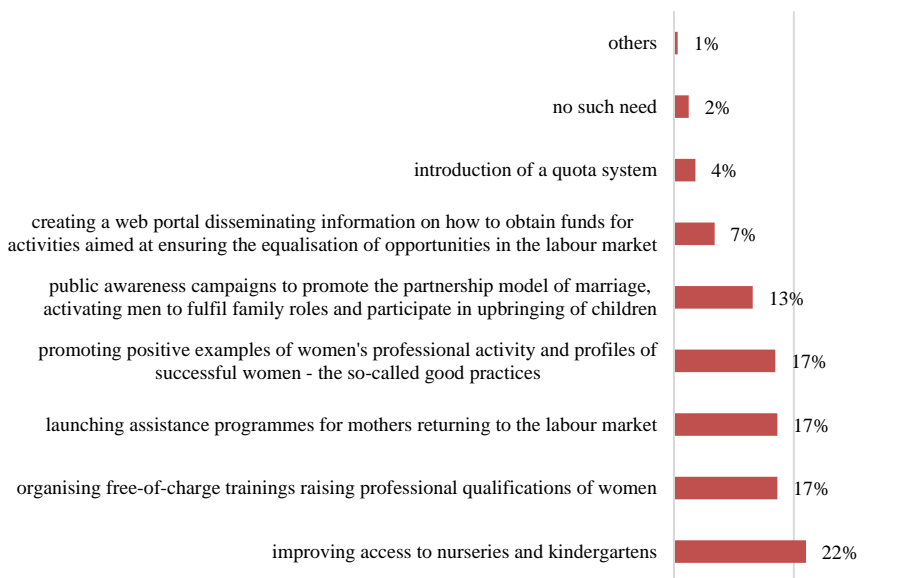
Among the demands concerning the actions that companies should take in terms of the equalisation of opportunities for professional development in the context of gender, the most frequently mentioned by the respondents was the demand regarding the establishment of nurseries and kindergartens attached to their workplace (19% of the respondents). The women surveyed deemed important also the activities related to the organisation of trainings improving vocational qualifications of women (16% of the respondents) and the introduction of flexible working hours, including managerial positions (16% of the respondents) (Figure 5).

In terms of means to support the policy of equal opportunities for professional development in Poland in the context of gender, the respondents' demands were consistent with the actions that should be taken by companies. For the surveyed women, the improvement in the access to nurseries and kindergartens (22% of the respondents) ranked first. The next positions in the ranking were occupied ex aequo by: organising free-of-charge trainings raising professional qualifications of



**Figure 5.** Means of the equalisation of opportunities for professional development in the context of gender recommended to companies

Source: own compilation based on the study carried out in the framework of the project entitled “Kobieta w biznesie. Sukces kobiet na łódzkim rynku pracy” (n=353).



**Figure 6.** Recommended solutions for the support of the equal opportunities policy for professional development in Poland in the context of gender

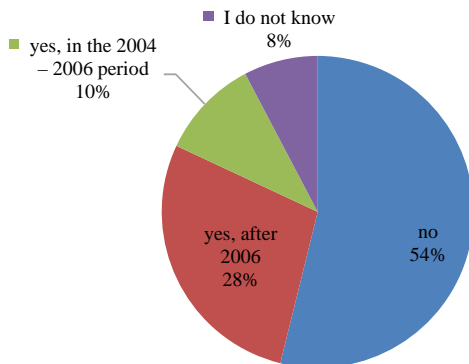
Source: own compilation based on the study carried out in the framework of the project entitled “Kobieta w biznesie. Sukces kobiet na łódzkim rynku pracy” (n=353).

women; launching assistance programmes for mothers returning to the labour market; promoting positive examples of women's professional activity and profiles of successful women – the so-called good practices (17% of the respondents in each case) (Figure 6).

#### 4. SUPPORT IN THE FRAMEWORK OF THE EU FUNDS AND THE SITUATION OF WOMEN IN THE LABOUR MARKET

According to studies carried out at the EU level, still fewer women than men benefit from support under the Structural Funds, especially in terms of support for establishing and developing economic activities (Beltran & Ursa, 2006).

National studies indicate that women's opinions (n = 400) concerning the improvement of the situation in the context of the use of EU funds are divided. Thus, 26% of the respondents noticed a significant improvement in the situation of women in management, and another 22% said that the situation had improved only slightly. On the other hand, 25% of the respondents felt that “women continue to be discriminated against, and their access to positions is more difficult, they earn less and are promoted more slowly. Women at the medium levels of management feel most strongly discriminated against. The largest group of women who perceive some improvement in the situation are company owners/co-owners” (Kupczyk 2009, pp. 81-82).



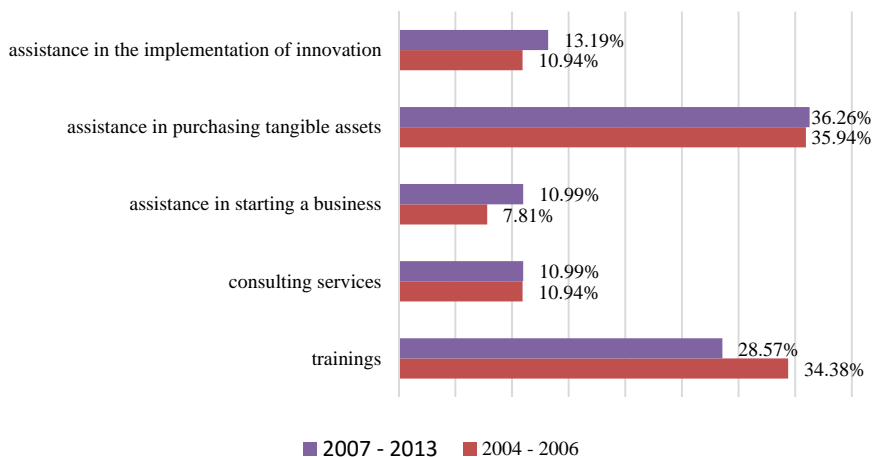
**Figure 7.** The percentage of businesses run by women benefiting from the support of the European Union funds

Source: own compilation based on the study carried out in the framework of the project entitled “Kobieta w biznesie. Sukces kobiet na łódzkim rynku pracy” (n=353).

What is disturbing in the research conducted is the fact that most of the women surveyed have not benefited from the support of the European Union funds (54% of the respondents) (Figure 7). However, compared to the first period of assistance (2004-2006, after Poland's accession to the European Union), the share of the use of the EU funds in the next programming periods (after 2006) increased (10% of the respondents declared their participation in the 2004-2006 programmes and 28%

indicated the use of that assistance after 2006). Therefore, it can be concluded that awareness of the opportunities associated with the support provided by the EU funds is increasing (this may be partly due to the appropriate promotional and informational campaign), and the ability of the respondents to use this kind of support is growing (which can be a result of appropriate training and consulting programmes).

Due to the nature of the support from which the respondents benefited, both in 2004-2006 and in 2007-2013, most of the responses were related to the assistance for the purchase of tangible assets (35.94% of the respondents and 36.26% of the respondents respectively). The women surveyed indicated training next in the ranking. In this case, the share of the respondents benefiting from this form of assistance in 2007-2013 fell compared to the first programming period 2004-2006 (from 34.38% to 28.57% of the responses). However, the share in the use of the support for the implementation of innovations increased (from 10.94% to 13.19% of the responses) (Figure 8). That result may be due to a change of emphasis in terms of the areas covered by the assistance, i.e. the transition from the support focused on basic company operations to the support for innovativeness of companies.

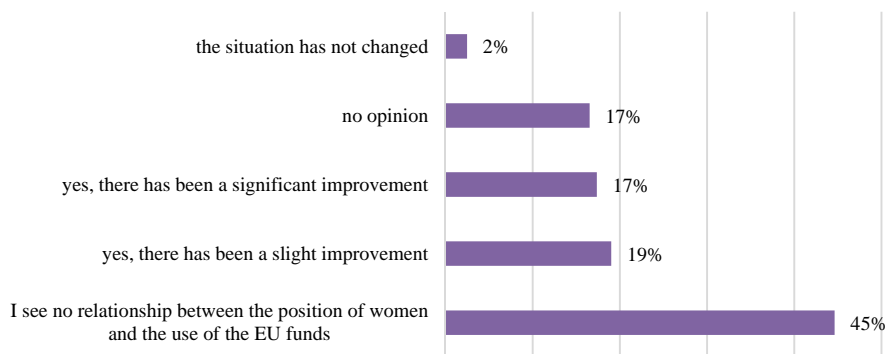


**Figure 8.** The forms of the EU support used by companies managed by women since 2004

Source: own compilation based on the study carried out in the framework of the project entitled “Kobieta w biznesie. Sukces kobiet na łódzkim rynku pracy” (n=353).

A large number of the surveyed women did not see the connection between the situation of women in the labour market and the use of the EU funds (45% of the respondents). Only 17% of the respondents indicated that there had been a significant improvement, and 19% that there had been a slight improvement in the situation of women in the labour market associated with the use of the EU funds (Figure 9). Such a distribution of the responses provided by the women surveyed can be caused, among others, by: a lack of awareness of the impact that projects

implemented may have on the situation of women, low awareness of the main objectives of the principle of equal opportunities in the context of gender and opportunities for conducting activities in accordance with the equality principle among project designers and institutions responsible for the implementation of these programmes.



**Figure 9.** Changes in the situation of women in the labour market, including management, through the use of the European Union funds available since 2004

Source: own compilation based on the study carried out in the framework of the project entitled “Kobieta w biznesie. Sukces kobiet na łódzkim rynku pracy” (n=353).

## 5. CONCLUSIONS

Analysing the results of research and reviewing national and international literature, it can be concluded that in countries/regions where the GDP per capita rises, differences regarding issues related to stimulants and destimulants of the “feminine” and “masculine” entrepreneurship become slowly blurred. Owners of MSMEs have similar hopes, expectations and concerns, face similar institutional barriers and economic fluctuations. Cultural norms that do not see women as company owners become a thing of the past and women-entrepreneurs do not signal any major concerns in terms of the challenges they face. The next generation of women is characterised by great openness to changes and willingness to take risks. Similarly to men, they perceive the personal qualities that facilitate entrepreneurship: industriousness, patience, creativity and innovativeness. Women's knowledge about entrepreneurship is equal to men's. There are also gradual changes in the family model towards the partnership-based model.

Still, however, due to the fact that the situation of equality between men and women engaged in business/managing companies/teams has not reached its “optimum” yet, it is necessary to take action to achieve it in the form of:

1. Ensuring better functioning of the existing laws – taking measures to inform and raise awareness how to implement legislation in the field of equal opportunities policy in practice (e.g.: by promoting the exchange of good practices



in the indicated area, organising appropriate training programmes and information campaigns to strengthen the role of women in management/running their own business). In order to encourage and motivate women (graduates of various types of schools) to start business activity, schools should introduce workshops/trainings (at the stage of early childhood education) which would help women overcome their own weaknesses and believe that they are able to run their own businesses in the future. Workshops and seminars on building women's confidence about their own self-worth, not lower than men's, in relation to taking on managerial roles should be organised.

2. Developing by the state in collaboration with business companies the care and educational system, as well as recreational and sports services for children and adolescents. In addition, school classes providing demonstrations (e.g.: in a form of workshops) in the area of partnership-based family planning or the division of responsibilities in order to reconcile family and professional life should be introduced.
3. Creating possibilities for shortened/flexible working time or remote work for women. Among flexible forms of work organisation, teleworking can play a significant role in professional activation of women. This is mainly due to the possibility of performing this work in the recently rapidly developing occupations related to the IT, financial, commercial, legal and human resources areas. Studies show that women are increasingly better educated and often work in the indicated areas.

In addition, due to the fact that the current 2014-2020 programming perspective (especially the Regional Operational Programmes) provides an opportunity to implement solutions that were requested by the women participating in the study (e.g.: increased access to childcare and educational infrastructure; capital for business start-ups, training and consulting services dedicated to women), all possible dissemination, training and consulting actions should be taken to fully exploit the existing opportunities (to increase the proportion of female applicants successfully applying for the assistance from the new perspective programme 2014-2020).

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# Feminist theory and its influence on female entrepreneur's growth intentions

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## Abstract:

Existing results suggest that entrepreneurs vary considerably in their intentions to grow their businesses; that men have more success in pursuing growth than women. Prior investigations on entrepreneurship also suggest female business owners might deliberately choose to keep their business from growing. However, these studies have been conducted in developed countries. Diversity in context and theories could vary by gender, business sectors and regions of the world. Scholars maintain that feminist perspectives theories are necessary to provide some insights in understanding the phenomena. The goal of this paper is to analyse research findings on the growth aspirations of the female entrepreneurs and offer alternative views of understanding, by employing feminist theories, in explaining why women behave differently in their adaptation of reduced growth intentions. In an attempt to understand the tendencies that might lead to reduced growth intentions in female entrepreneurship, literature was extensively reviewed on female entrepreneurship and growth intentions. The study uses a desk-based approach to data collection. An overview of the main issues concerning female entrepreneurs growth intentions is presented. The conclusions drawn from the literature provide foundations for policy measures assisting women to overcome their low growth aspirations and measures required to encourage women to grow their businesses. The paper identifies research gaps that continue to exist in female entrepreneurs growth intentions research with the aim of encouraging further research in this field.

**Keywords:** female entrepreneurs; growth intentions; feminist theories

**JEL codes:** D24, J7, J24, O1, L26

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## 1. INTRODUCTION

Research in OECD countries consistently shows that job growth in the entrepreneurial sector is higher than for established (corporate) organizations. Implicitly, women play a significant part of this activity; recent business statistics identify women as the drivers of economic growth in many of the world's economies (Minniti *et al.*, 2005). It is undisputable that when more women work, economies grow; women's economic activity, managerial and entrepreneurial activity have a signif-

ificant impact on economic growth and prosperity (Global Entrepreneurship Monitor, 2004). Countries with high total entrepreneurial activity rates are associated with high female entrepreneurial activity rates (Verheul & Thurik, 2004).

Since the 1970s and 1980s, there has been growing interest in studying women entrepreneurs mostly from United States and Canada as a result of the high growth in the number of enterprises created by women (Neider, 1987). The Center for Women's Business Research (2006) of the United States offers some insights on the estimates of the impact of women enterprises on the economy of the United States. Women's enterprises contribute 1.9 million dollars in annual sales and hire 12.8 million people. Majority of women-owned firms employ 9.2 million workers and generates 1.2 trillion dollars in sales revenues (National Women's Business Council, 2004). Estimates of the total cost of salaries and wages in women's enterprises was 546 billion dollars in 2006. Between 1997 and 2006 women's enterprises grew twice as fast as other enterprises (42.2% versus 23.3%) in United States. Interestingly, in a more recent statistics self-employed females in Canada increased from 513 300 to 953 000 between 1987-2011. That is an increase of 85 %. In a similar manner, in the U.S. female owned firms were estimated to have reached 7.8 million in 2007, representing 28% of the total number of companies across the nation.

Some investigations show the prevalence rates of female entrepreneurship tend to be relatively higher in developing than in developed countries (Minniti & Naùde, 2010). For instance studies in female entrepreneurship in Latin America and Caribbean countries found very high rates of female entrepreneurship in the poorest region estimated to be up to 35% in Peru. Global Entrepreneurship Monitor (GEM) (2010) established that Ghana is the only economy with more female than male in entrepreneurship, where women conduct 55% of entrepreneurial activity. This broad observation simply implies that women are important for growth and entrepreneurship. However, in other areas of the world few female entrepreneurs have indicated their aspiration to grow even when they have the abilities and knowledge (Minniti & Naùde, 2010). Taking into account the potential role of women entrepreneurs in generating economic growth, investigating the relationship between female entrepreneurs and growth intentions seems to be highly recommended.

The aim of the paper is to explore female entrepreneurship and in particular to understand the complexities that are related to reduced growth intentions of female entrepreneurs. The research is exploratory in nature and has used a desk-based approach to data collection. Initially an overview of the issues concerning gender, entrepreneurship and female growth intentions was reviewed mostly from developed countries. However to have a more rounded perspective, research regarding developing countries was also reviewed. The feminist liberal and social theories were employed to provide an alternative perspective on why women behave differently in their adaptation of growth objectives. The paper further provides directions for further research, identifying the research gaps and provides recommendations for policy making.

## 2. OVERVIEW OF RESEARCH LITERATURE

Growth of enterprises is generally perceived as a significant measure of success and a key driver to the creation of wealth, employment and economic development in every country (Bosma *et al.*, 2000). Dobbs and Hamilton (2007) asserted that growth is closely related to the creation of jobs and that rapidly growing small enterprises create employment opportunities in society, which is vital for the success of the economy. Women entrepreneurs make a substantial contribution to national economic growth by their participation in entrepreneurship especially in high growth business, which boost the economies of most nations. Previous studies on growth of entrepreneurial firms have mostly focused on the entrepreneur's motives towards growth (Davidsson *et al.*, 2010) and literature on entrepreneur's growth intention mostly directed on individuals and graduate students intent to start businesses (Fatoki, 2013). This study includes feminist theory in this academic debate.

### 2.1. ENTREPRENEURSHIP AND GENDER

Ahl (2006) identifies that financial growth with its inferred and expected contribution is the single most common rationale of entrepreneurship, and that entrepreneurship research is thus legitimized in the business and economic literatures. However the enactment of entrepreneurship as growth-oriented behaviour is culturally masculine specifically tied to particular forms of masculinity (Galloway *et al.*, 2015). Different authors have identified masculinized approach most often taken in studies of entrepreneurship (Petterson, 2004). If entrepreneurship requires the pursuit of growth then, successful entrepreneurship must be defined as business activity that has resulted in growth (Galloway *et al.*, 2015). However, this overwhelming direction on firm growth does not reflect most business activity as it occurs in reality. Not only it ignores the diversity of business in the real world (Hamilton, 2006; Morris *et al.*, 2006), but it also does not correspond with the majority of business experience, as most businesses are not growth oriented (Ahl, 2006).

Furthermore, entrepreneurship understood as an individualized, growth-oriented activity marginalizes other ways in which entrepreneurship is enacted (Ahl & Marlow, 2012; Petterson, 2004). It also limits entrepreneurship as a concept by limiting constructions of the entrepreneur despite the fact that most businesses are created and operated by partners or teams, and in fact in most countries the most common business model is family owned enterprise (Drucker, 1995). In spite of this, the "Entrepreneur" prevails as a construction, and has become normalized as male, he is the man who creates growth firm or what leads an organization to financial growth (Franco & Matos, 2013).

### 2.2. FEMALE ENTREPRENEUR'S CHARACTERISTICS

Given the important role of female entrepreneurs and their enterprises, it is noteworthy to understand female entrepreneurs characteristics as well as the motiva-

tions behind their entrepreneurial activity, for as much as it has been emphasized the success of an enterprise depends on the person's initiatives to create a viable business (Mitchell, 2004). Hisrich and Brush (1986) established that women-owned enterprises are more dissimilar than similar to those owned by men. They showed that women and men entrepreneurs have similar personalities and background, except for the fact that most women are older when they get involved in an entrepreneurial venture: 35 to 45 years old instead of 25-35 years old in the case of men. There are differences, however, in their motivations, the process of starting their enterprises, their administrative and entrepreneurial skills and professional background as well as the problems they face.

Brush (1992) observed that differences between male and female business owners have been found in educational and occupational background motivations for business ownership, business goals, business growth and approaches to business creation. Other researchers have noted fundamental similarities between male and female entrepreneurs, most notably in terms of key motives, such as the desire for independence or self-achievement or the tendency to have an internal locus of control (Sarri & Trihopoulou, 2005). The most noteworthy difference is that female entrepreneurs may tend to face different domestic parallel to their entrepreneurial activity. Despite their role as business owners and entrepreneurs, they are more likely to be "the primary parent, emotional nurturer and house keeper" (Unger and Crawford, 1992, p. 474). Thus in most cultures being an entrepreneur is not an excuse for being relieved of her domestic responsibilities (Goffee & Scase, 1985). Maybe that is why women business tends to be smaller, with less capital, has lower revenues and fewer employees and resides in lower profit industries (Bird, 1989).

Zapalska (1997) studied women entrepreneurs in Poland and found that they are significantly different to men in important dimensions; therefore they require assistance, plans especially developed for their specific needs. She found that there are significant differences in obstacles they face, the reasons they have to start a business, their goals and the factors they consider important for success.

Findings regarding to three countries (in Africa), Ethiopia, Tanzania and Zambia, noted that majority of the female entrepreneurs were pushed into business as a 'no choice' option for escaping from poverty (Zwede & Associates, 2002). This category of entrepreneurs is also referred as lifestyle entrepreneurs (OECD, 1998). Much of the evidence supports the view that the majority of women in business are seen to be engaged as micro entrepreneurs and consequently have become the stereotype women entrepreneurs as observed in regions of Africa (Richardson *et al.*, 2004). Mitchell (2004) studied the motivation of women entrepreneurs in South Africa and established that starting an enterprise involves a significant amount of risk and effort for an entrepreneur. For women, however, the risk is higher because they have problems related to the enterprises, but they also have to solve the problems of being a woman in society dominated by men. He concludes and suggests that modern research studies indicate that women face different problems to men entrepreneurs and that it is an imperative that a better understanding of women entrepreneurs and the specific constraints they face in starting and operating a business

is made, so as to develop appropriate assistance programs and policies. It is however argued that most of the knowledge on entrepreneurial activity is based on studies about men entrepreneurs (Hisrich & Brush, 1983). That theories on creation of organizations have been generalized and tested on men entrepreneurs, for men, these approaches do not necessarily reflect women's processes and organizational styles because women and men manage their enterprises in different ways, they use different strategies and organizational structures.

### 3. THE FEMALE ENTREPRENEURS GROWTH INTENTIONS

Growth of a business is widely recognized as a choice and most business owners choose not to grow (Wiklund & Shepherd, 2003). Conversely, the intentions of the entrepreneur have been identified as "being the entrepreneur's goals or aspirations for growth trajectory, he/she would like the venture to follow" (Dutta & Thornhill, 2008). The distinction between the actual growth of a business and growth intentions according to Toivonen *et al.* (2006) are that intentions are only one of the fundamentals for small business growth. Given the significance of growth intention in entrepreneurship and small businesses, the pursuit of growth is a deliberate individual decision of the entrepreneur, which depends upon his/her perceived opportunities, skills and the entrepreneur's willingness to do so (Wiklund & Shepherd, 2003). So, it is possible to describe growth intention as a combination of what entrepreneur wants with what is possible given the critical resources and skills of the entrepreneur and available opportunities (Terjesen & Szerb, 2008).

However, while some entrepreneurs are determined to grow their business into larger businesses and attain substantial growth (Neneh & Vanzyl, 2014), some small business-owners don't aspire to grow or they deliberately refrain from pursuing growth (Gundry & Welsch, 2001; Wiklund, Davidsson, & Delmer, 2003). Sexton (1989) was of the view that growth of a new venture does not occur naturally but instead is determined by the owner of the business. Those in control of the firm may initiate, foster, nurture or prune growth in accordance with their own prosperity for growth as the degree to which he/she can obtain resources and develop the organization. Sexton (1989) further defines propensity for growth as an entrepreneur's intent to expand the organization, and the ability to manage growth as the degree to which he/she can obtain resources and develop the organization. Many studies indicated that men are assumed to have success in this regards (Lerner *et al.*, 1997; Still & Timms, 2000).

Some studies, mentioned women to be less effective in growing sales turnover and profitability and with deliberate reduced growth intentions (Cliff, 1998; Fasci & Valdez, 1998), and that "women start and operate ventures that grow at a lower rate than those of men" (Hisrich and Brush, 1984). Investigations on women-owned enterprises suggest that female business owners deliberately choose to keep their businesses small (Goffee & Scase, 1985; Lee-Gosselin, 1990) or have conservative growth expectations (Chaganti, 1986; Lee-Gosselin, 1990). Some studies suggest that expansion is at least partially determined by entrepreneur's motivations and



intentions (Bird, 1989; Sexton, 1989; Kolvereid, 1992; Cooper, 1993). Some scholars established that women are less likely to desire to grow their business since expansion may interfere with other aspects of their lives (Cliff, 1998), while others argued that women in running their business would not wish the interest of their immediate family conflict with the interest of their business (Carter & Cannon, 1992).

Some of these views are considered as negative misconceptions concerning women entrepreneurs (Brush *et al.*, 2004) as some women entrepreneurs are portrayed as favouring life-style businesses, balancing work and family or seeking opportunities to supplement household income. While other researchers asserted that female entrepreneurs tend to be sole owners and have less managerial experience, lack self-confidence in their enterprises (Hisrich & Brush, 1983; Birley, 1989), and their businesses are smaller on average, both in terms of sales, revenues, number of employees and resides in lower-profit industries (Loscocco *et al.*, 1991; Bird, 1989). What is more, women-owned enterprises are also described to be especially affected by conflicts between the home and family demands which may advertently have implications on the growth of their business (Stoner *et al.*, 1990).

Several authors observed that differences also exist between male and female business owners in educational and occupational background, motivations for business ownership, business goals, business growth and approaches to business creation (Brush, 1992; Welter, Smallbone & Isakova, 2006). These differing observations and misconceptions concerning women entrepreneurs may lead to tendencies in ventures that might reduce their growth prospects. However, studies comparing the performance of male and female owned firms have noted some obstacles that are specifically experienced by females. Some of these hindrances are attributable to the complexity of small business itself rather than the gender-based factors women face to enterprise growth and some are specifically self-imposed by culture (Morris *et al.*, 2006). The prominent reasons are associated with difficulties in accessing and obtaining institutional or venture capital due to negative perception. Women are assumed to be less focused and lack the drive for success in business than their male counterparts (Brush, 1992). Such perceptions directed at women-owned ventures as, women are not as good in leadership and management of large-scale ventures, and other generalized gender-based perceptions, can make it difficult for women-owned ventures to obtain growth capital (Morris *et al.*, 2006). However, Brush *et al.*, (2004), opined that these perceptions are due in theory to the way that data about women-owned ventures is presented and that the fact that women are later entrants to the entrepreneurial game. Hisrich and Brush (1984) and Scott (1986) asserted that gender stereotypes along with limited access to networks and mentoring may create barriers to effectively run a business (Still & Timms, 2000). Some studies also have shown that cultural imposed attitudes regarding gender remain constraining barriers for women in achieving financial rewards and status in business (Calás *et al.*, 1992). Some scholars observed that female entrepreneurs find time with family as primary and ventures were sometimes specifically founded to allow for more quality time with family (Gundry & Welsch, 2001), attempted to

maintain equilibrium between economic goals such as profit and growth and non-economic goals such as personal fulfilment and helping others (Brush, 1992). These are all empirical studies, which offer insights into different situational variations that consistently bother the female entrepreneurs in starting and operating businesses. However, scarcities of other comparative investigations do exist. Although these studies make up a consideration on literatures of female entrepreneurs, it is also important to note that there is virtually no empirical research on women in growth enterprises in Africa, or if any research has in some way assess women enterprises similarity or its difference from that headed by male.

Few perspectives that are known on female business owners in most developing countries like Africa are that most women do not have the same opportunity as men in job acquisitions, business contacts, and opportunities to accumulate savings as men. In spite of all development and organizational activities in favour of women over the past years, gender gap in women's equality has not narrowed very much. The nature and scale of an enterprise growth and development is influenced and shaped by a range of traditional norms that are embedded in social, cultural and economic context (Richardson *et al.*, 2004). The prevailing social norms affect the ability of women-owned enterprises to function and grow bigger like the male-dominated businesses do. These challenges with many others are rooted on the socialization processes for both sexes (Black, 1989) and this one way or the other influences the kind of economic activities that women find themselves. For instance women in Ghana are perceived as homemakers and therefore, cared and reared for home and childcare. This contributes to their low self-esteem. These factors and others tend to diminish the importance of women aspiration economically and socially. Consequently, these impact on women's enterprises negatively in varying degrees.

In view of the fact that, findings and theories might not be totally applicable to all varied contexts, distinct differences exist between developed and developing countries regarding female entrepreneurs and their growth intentions. Studies have found that the rate at which women are forming and operating indigenous, micro and small businesses has increased in developing countries (Richardson *et al.*, 2004; Minniti & Naude, 2010). The few studies that were recorded from developing countries like Africa, these studies apply small sample and there is no way of knowing to what extent their findings reflect the overall pattern of women's entrepreneurship. Given the important role of women as owners of various micro- and small business enterprises in developing countries (Richardson *et al.*, 2004) an attempt to identify their varying growth needs and its constraints will be particularly important.

#### 4. FEMINISM THEORIES

In explaining the systematic differences why female entrepreneurs adopt a reduced growth intention and the smaller size of their businesses we employ two theoretical perspectives, consistent with Holmquist and Sundin (2002). These are the liberal

and social feminism to explain why women behave differently in adaptation of the varying degree of growth aspirations. First, some scholars maintain that gender theory and feminist perspectives are necessary to understand this phenomena. Secondly, others argued that differences and similarities between men and women should be considered within the conventional theories relating to entrepreneurship research field. Holmquist and Sundin (2002) conclude that contributions from both perspectives are needed to provide insights behind these imbalances of gender and entrepreneurship. Feminist theoretical perspective address the questions of women's subordination to men, how it arose, how and why it is perpetuated, how it might be changed and what life would be like without it. Each perspective of the theories (social and liberal) offers differing views.

The liberal feminist theory according to Fischer *et al.* (1993), asserted that the liberal feminist tradition goes back to feminism's earliest days (the first wave of feminism) and argues for the necessity of social reform in order to give women the same status and opportunities as men. The fundamental basis of the liberal theory assumes that men and women are equal and that rationality not sex is the basis for individual rights. It emphasizes the existence of discriminatory barriers and systematic biases facing women (for example restricted access to resources, education, business experience), which must be eliminated. Liberal feminism is outgrown of political views of equality, entitlement, and individual rights, the liberal feminist perspective has been the basis for many legal changes that have been used to bring about greater equality for women. Liberal feminist theory in the articulation of this theory in the context of women's entrepreneurship posits that if women had equal access to the opportunities available to men such as education, work experience and other resources, they would behave similarly (Unger & Crawford, 1992).

Social Feminism theory- assumes that men and women are seen to be or have become different (Ahl, 2006), social feminism emphasizes that there are differences between male and female experiences through the deliberate socialization methods from the earliest moments of life that results in fundamentally different ways of viewing the world (Fischer *et al.*, 1993). Female's socialization creates different perspectives, goals and choices for women (Brush, 2006) and they choose their business field accordingly. The relationship between family and work has been stronger for women, rather than seeing their business as a separate economic unit in a social world. Brush (1992) adds that women view their business as an interconnected system of relations (family, community and business). These differences do not imply that women will be less effective in business than men, but only that they may adopt different approaches which may not be equally as effective as the approaches adopted by men (Watson & Robinson, 2003).

While the outcome of past findings is relevant to the question of if and how female and male entrepreneurs differ, there are still large gaps in knowledge. Some scholars (Kalleberg & Leicht, 1991; Cliff, 1998), have systematically explored whether or not potential differences related to discrimination or socialization affect business performance or growth intention. Notwithstanding, the notion that differ-

ences do exist between male and female entrepreneurs, researchers fail to investigate uniquely female entrepreneur's growth intentions of their enterprises. Liberal and socialist theories provide socio-cultural reasons for expected gender differences. Sexton (1989) argued that there are no psychological reasons to believe that female entrepreneurs will have lower propensity for business expansion. Accordingly, there is suggestive evidence that factors associated with growth intention, may vary by gender. Even if intent to grow does not vary by gender the process that leads to the decision may vary (Orser & Hogarth-Scott, 2002).

Given the important role of female business owners and their different structural variations, it follows that women may make decision related to growth of their businesses using different process by weighing the social risk and reward differently from men. In view of these literatures, the liberal and feminist theories provide reasons for expecting gender differences and why female entrepreneurs and female business owners behave differently in their adaptation of low growth intentions. Many studies that were explored (Kalleberg & Leicht, 1991; Lee-Gosselin & Grise, 1990; Cliff, 1998) identified female entrepreneurs to have less experience in managing employees, less industry experience, prior start-up experience in businesses. Furthermore, women's firm also was found to be smaller than men's and have lower growth and income over some years, and to have lower sales per employee (Kalleberg & Leicht, 1991). Cliff (1998) speculates that women who lack relevant experience may question their ability to manage quickly growing enterprises and may therefore purposely limit the expansion of their firms and these might contribute to their modest growth expectations (Lee-Gosselin & Grise, 1990).

Female entrepreneurs growth intention may also differ in terms of attitudes and values. Birley (1989) posit that sources of culture, behavioural norms, professional networks and family relationship all affect the attitudes of women entrepreneurs. Most women held positive attitudes towards achievement and success, self-preservation, self-worth expressiveness, freedom, health and education as well as to economic profits and growth (Jacobson, 1993). Empirical studies indicate that men tend to place a greater value on economic values and non-ambiguous measures of achievement and success such as status and wealth (Unger & Crawford, 1992).

This offers us a compelling argument for anticipating gender differences in growth intentions. As noted further, female entrepreneurs' position should not be generalized, as they are complicated with varied characteristics and motivations (Sarri & Trihopoulou, 2005). Theories of motivation posit that values influence intentions (Locke, 1991). The value placed on business expansion by female business owners will in no doubt contribute to their growth intentions. More specifically, it is expected that women will be less likely to express a desire to grow their enterprises, since expansion may interfere with other equally cherished goals (Orser & Hogarth-Scott, 2002). Female entrepreneurs have so many roles to play in their lives, and tend to face different domestic demands to their male counterparts and therefore may not follow the normal expected growth cycles based on stereotypical male-owned business cycles (Still & Timms, 2000). Managing households may

significantly add to women's capabilities in business (Stevenson, 1986). But can also create demands on their life-styles, which would threaten the pattern of family and conjugal relationships (Goffee & Scase, 1985). Thus, due to the many conflicting demands between female entrepreneurs businesses and their personal lives (Buttner & Rosen, 1992; Stoner *et al.*, 1990; Goffee & Scase, 1985), they may tend to adopt a reduced growth intention (Cliff, 1998) in their businesses, despite the fact that female entrepreneurs are unique, have the skills and competencies to manage business effectively and intentionally (Sarri & Trihopoulou, 2005). Moreover, it is perceived that female entrepreneurs have inadequate resources, specifically in terms of business and managerial experience and access to finance. Lee-Gosselin and Grise (1990) added that female entrepreneurs deliberately adapt to this situational constraints by adopting lower growth expectations (Cliff, 1998).

## 5. CONCLUSIONS

In summary the paper shed light on gender perspective in entrepreneurship, feminist theories and growth intentions of female entrepreneurs. The findings shows that most women entrepreneurs compared to their male counterpart are dissimilar than similar in their characteristics of their business endeavours. Studies noted differences in their motivations in starting their enterprises, their administrative and entrepreneurial skills, and professional background and the problems they face. Some of these identifiable differences concerning female entrepreneurs in their growth intention were explored in order to find out if they were related to discrimination or socialization process.

According to analysed studies female entrepreneurs hold small, slow and modest expectations about their businesses and growth prospects are as a result of situational constrains. These were on account of differences in attitudes, different ways of thinking, the values place on growth and the socialization process. While others could be owing to the fact that they lack adequate resources specifically, in terms of business and managerial experience and access to finance (Cliff, 1998), which are prerequisite of a growing entrepreneurial business and lacking such qualities and requirements may limit the expansion of female firms. More so, the desire to expand may interfere with other cherished goals for example family demands and conjugal life.

These observed differences do not imply that women will be less effective in business than men, as affirmed by feminist theories that offer some perspectives to these variations. The liberal feminist view affirms that women entrepreneurs may adopt different approaches due to their lesser access to resources, education, business experience and as discriminatory should be eliminated. The social feminist theory posit that even though gender differences are recognized it should be acknowledged that it stems from the socialization process. In conclusion, women if given equal access to the opportunities available to men such as education, work experience and other resources they would equally grow their businesses. This research also identified that in developing countries there prevails paucity of research

on growth aspirations of women entrepreneurs. It has been identified that they face higher barriers to entry into the labour market. They are forced into entrepreneurship as an only option out of poverty and way out of unemployment. However, majority of the female entrepreneurs fail to express their growth expectations.

To fully understand the importance of growth intentions of women entrepreneurs, and why they deliberately pursue a low growth expectations is critical. Identifying ways and removing those barriers, and negative misconceptions that women face requires initiatives. It is imperative to understand that the essence of entrepreneurship is seeking growth and it must reflect as a business that has achieved growth. Central to these issues is the suggestions by some studies that women entrepreneurs are unique. However, those who aspire to build high growth businesses require unique skills, competencies to manage effectively and intentionally. Policy makers should also acknowledge and consider the growing number of businesses that wish to stay small and respond to both economic and personal motives of the entrepreneurs. The provision of sustainable business support infrastructure which might better meet the needs of these female entrepreneurs and which is appropriate to their needs should be provided. Some of the female entrepreneurs slow growth orientation could change if assistance in coaching, training, experience, support service, information in business is provided.

Another barrier identified by reviewed studies is associated with difficulties in assessing and obtaining institutional finance due to negative perception. The attitude of bankers and business professionals towards these female entrepreneurs has to be positive and should be more cooperative. Some institutions may not take enterprises of women seriously, considering they are not growth oriented. Some constraints that are gender-based factors which women face to enterprise growth are also specifically imposed by culture. Government policy and programs aimed at improving perceptions of aspiring women to grow their enterprises to higher growth and economic prosperity should be encouraged. There should be policies and programs in favour of women's growth enterprises, which remove barriers in start-up and growth, improve access to resources, strengthen social protection and inclusion, foster a supportive culture and conducive environment for business growth.

There should be capacity building of research and knowledge, consideration of the context, comparison of findings of both female entrepreneurs growth intentions in developed and developing countries. This is needed in order to determine, if these results are gender specific, socialization function or just discrimination. This would further benefit our understanding of both male and female entrepreneurship. Growth of women's enterprises is acknowledged to have positive impact on job creation and economic growth.

This research has identified that in case of female entrepreneurs issues on how and why women create and manage their small business is still not well understood. Small and stable business owned by female entrepreneurs is described as 'good and real business' (Lee-Gosselin & Grise, 1990). Most female entrepreneurs value the loose organization; the proximity to employees, customers, suppliers and obtain

mostly experiences offered by small organizations. These businesses stay small and respond to both economic and personal motive of the female entrepreneur. Research is still not conclusive if intent to grow might vary by gender and why women entrepreneurs don't aspire to grow their firms. However, we need some answers and understanding on women's growth intentions. A greater consideration should be focused on developing economies, as its women entrepreneurs are indispensable for economic development. Research in this direction will contribute and enhance the female entrepreneurship stream of research. In view of the fact that developing countries have limited access to affordable business development services, business management, technical training and operate within cultural environment that reflects stereotypes much work remains to be done both academically and policy wise. Policy makers would benefit from new research results that are focused on eliminating barriers faced by women in their aspirations to grow their enterprise in a more demanding environment.

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# Role of entrepreneurship education in higher education institutions in the process of business development in Poland

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## Abstract:

The aim of this article is to evaluate the range and methods of teaching entrepreneurship in higher institutions in Poland in fields of studies related to business, economics, finance, accounting, or management. The paper presents results of an analysis of curricula and of the carried out qualitative researches (FGI) among university students. Findings present that universities teach entrepreneurship on multiple types of courses and in different ways. Contents which shape entrepreneurial attitudes are taught in various courses. In curricula most courses teach entrepreneurship, by being applicable to particular spheres of business activities, but mostly shaping those competences that are useful in large firm environment. Recommendations suggest that higher education institutions should emphasize the teaching of practical skills, which support business development. Universities, through teaching entrepreneurship, are supposed to encourage their students to undertake business activities, including the ones which aim at opening own business by students which is why universities should emphasize the teaching of practical skills and entrepreneurship should be taught based on real-life examples.

**Keywords:** business studies; entrepreneurship; teaching; competences

**JEL codes:** I250

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## 1. INTRODUCTION

Entrepreneurship is an element of the economy and it influences the level of innovation in the economy. The level of business development in a given country depends on many factors, but it also depends on the business attitude. A big role in building a positive attitude towards entrepreneurship is played by activity that promotes entrepreneurship and entrepreneurial attitudes, as well as by competences which are acquired during studies (Wach & Wojciechowski, 2016). According to the European Commission entrepreneurship is a skill which can be learned and

therefore it is necessary to support this type of education in all EU countries (European Commission, 2016). European Commission has recognized entrepreneurship education as a basic feature of education system in Europe (European Commission, 2016; Sadowska, 2016).

Research conducted by the Amway and carried out together with the Technische Universität München (TUM) and the Institute GfK SE in several dozen of countries all over the world show that most of the respondents (in 2005, 3 out of 4 respondents in the world and 71% of the respondents in Poland) have a positive attitude towards entrepreneurship (Amway, 2015). At the same time, a little less of the respondents thought that entrepreneurship can be taught (among all the respondents it was 63% and 68% of Polish respondents). The respondents indicated that entrepreneurship should be taught by schools, including higher education institutions, but also that there should be special programmes led by non-profit organisations, chambers of commerce, or government and private companies (Amway, 2014).

The aim of this article is to evaluate the range and methods of teaching entrepreneurship in higher institutions in Poland with reference to the fields of studies which seem to be preparing for business practice, such as economics, finance and accounting, or management. The paper presents results of an analysis of curricula and qualitative research among university students.

## **2. ENTREPRENEURSHIP TEACHING IN HIGHER EDUCATION**

Entrepreneurship is one of key competences which is being taught on different levels of education, including higher education. Teaching entrepreneurship in higher education institutions is supposed not to only develop various skills, but also to develop students' competences in the spectre of entrepreneurship, as well as it should inspire the business spirit (Komisja Europejska, 2008, pp. 8-9). The necessity of development of students' business competences and, related to that teaching of business in its' multiple aspects, is connected with the realization of several strategies accepted in the time perspective of 2020 within the European Union (Europe 2020) and within particular countries (in Poland the National Development Strategy 2020, the Strategy of Human Resources Development, the Social Capital Development Strategy, the Strategy of Innovation and Economic Efficiency), which highlight the significance of entrepreneurship with regard to socio-economic development of a country. Simultaneously, the National Qualifications Framework for Higher Education (NQF), determined by the Minister of Science and Higher Education by way of regulation in most of fields of study learning outcomes for the general academic profile and for practical profile on first and second-degree studies show the outcomes that concern entrepreneurship (Rozporządzenie Ministra ..., 2011). In the NQF, the entrepreneurship education usually emerges among knowledge outcomes and in the frame of social competences. The first ones refer to the knowledge of rules of starting and developing different forms of enterprises, while the second ones refer to thinking and acting in an entrepreneurial way. In the

rest of the descriptions of the discipline learning outcomes (in humanities, art, and in the description of engineering competences) do not include extended content regarding entrepreneurship. Entrepreneurship education is limited to the studied field and refer to running a business activity within that field (Nowak, 2016).

Entrepreneurship education, in particular education for entrepreneurship, seems to be strongly connected with teaching economics or business. However, entrepreneurship itself is of interdisciplinary character, and its research ranges of from economics, management, finance to sociology, psychology, pedagogy, law and other scientific disciplines (Wach, 2014, pp. 20-24).

### 3. ANALYSIS OF CURRICULA IN ECONOMICS FIELDS OF STUDIES

According to Valerio, Parton and Robb (2014) the field of studies and related profile of the graduate are the key factors affecting interest in entrepreneurship. Simultaneously a positive correlation between attending entrepreneurship courses and new venture creation was found. Thus a positive correlation between entrepreneurship education and future entrepreneurial behavior was determined (Valerio, Parton & Robb, 2014). For the above reasons this study is focused on the curricula of business studies. For the purpose of analysing the range of business studies in higher education in the economic fields of studies, 15 curricula were analysed in 5 higher education institutions, both public and private, on first and second-degree studies in management, economics, and finance and accounting. The researched sample covered:

- 2 curricula on first-degree studies in economics,
- 1 curriculum on second-degree studies in economics,
- 5 curricula on first-degree studies in management,
- 3 curricula on second-degree studies in management,
- 2 curricula on first-degree studies in finance and accounting,
- 2 curricula on second-degree studies in finance and accounting.

The conducted analysis found that all the analysed curricula provided knowledge and shaped competences connected with entrepreneurship education. On average, courses corresponding to entrepreneurship education constituted almost one fifth of all the courses taught in a given field of study and made it possible to gain 16 ECTS credits. Range of courses, form of classes and purpose of those courses were quite different. The smallest number of entrepreneurship courses was found in finance and accounting and in economics. In the curricula of finance and accounting and the ones of economics on both first and second-degree studies there were no courses directly connected with the entrepreneurship education, that is to say courses which would enable their students to gain knowledge in, for example, starting a business or which would shape entrepreneurial attitudes. Entrepreneurial competences were shaped, among others, during courses in the fields of:

- economics – management, accounting, market surveys, or business communication,

- finance and accounting – management, accounting, business finances, cost accounts, or risk management.

Those types of courses represented 17% of all the courses and enabled gaining 15% of ECTS credits in economics; in finance and accounting – 14% of courses and 11% of ECTS credits.

In management the situation was different. In this field of study, contents shaping business competences among students constituted around one fifth of both the number of all courses and the number of ECTS credits. At the same time, in the curricula of the universities having this field of study on first and second-degree studies, there was always at least one course that directly corresponded to the entrepreneurship education, such as business studies, introduction to business studies, or business training. Along these courses students were required to develop a small enterprise management or business-plan, which shapes skills that are helpful with newly established business activities. During those courses there are usually carried out such issues as, for example:

- role of entrepreneurship,
- pros and cons of owning an enterprise,
- entrepreneurial personality – qualities and predispositions of an entrepreneur,
- developing ideas for one's own business,
- shaping organization's identity,
- communication between an enterprise and the market,
- business resources,
- analysis of available sources of financing of new enterprises,
- making business-plans,
- starting an economic activity,
- organizational and legal forms of enterprises,
- taxation rules of economic entities.

In management programmes curricula include courses connected with management, human resources management, project management, accounting, enterprises' finances, economics, marketing, and marketing strategies, market research and analysis, civil and commercial law, leadership, creative thinking in an organization, motivating oneself and other people, communication, and negotiations.

Comparing these results with analyses by Płaziak and Rachwał (2014) for a non-economic study program (geography), one can conclude that the focus on entrepreneurship education in economic study programs is greater than in non-economic study programs. Nevertheless one must also admit that the scope of entrepreneurship education in study programs related to economics and business is small and insufficient for the development of entrepreneurship in Poland. Thus, changes are needed to overcome barriers which according to Pietrzykowski (2011) hinder the development of entrepreneurship education, particularly in economics and business oriented study programs.

#### **4. ENTREPRENEURSHIP EDUCATION STUDIES IN HIGHER EDUCATION ACCORDING TO STUDENTS OF ECONOMIC FIELDS**

The main purpose of the presented research was to identify the most important skills which should be possessed by students of economics and which will help them to start their own enterprises and to identify which forms of classes are best of use in teaching entrepreneurship. Furthermore, the influence of entrepreneurship education to students on shaping entrepreneurial attitudes and on supporting entrepreneurial initiatives undertaken by students on regional, national, or global level was diagnosed. Moreover, the purpose was to collect opinions and suggestions of changes that can be made by universities in order to better prepare young people for entrepreneurship. The research was conducted with qualitative research methodology, using the Focus Groups Interviews technique, which involves a discussion of respondents on a given topic. The research was conducted between June and September of 2015. The FGI scenario GGI was prepared in cooperation with experts from V4 countries and drawing upon literature in the field of entrepreneurship education (Cope, 2007; Shinnar, Pruett & Toney, 2009; Bell, 2015; Sirelkhatim & Gangi, 2015). 39 students of full and part-time economic studies met in a study of 4 focus groups in four Polish cities. Students of management and economics took part in the study. 4 students who are currently running their own enterprises took part in the study, as well as 3 students who help their relatives to run their enterprises. Other students were either common employees or unemployed (only studying).

In relation to the growing amount of voices speaking about the necessity of even greater commercialization of scientific research and their usage in business, it is natural that students of all the fields should be equipped with competences related to undertaking economic initiatives. There still is a lack of studies which would research the influence of the entrepreneurship education on the amount of new enterprises that are set up by university graduates who have passed a business course. However, such a dependence seems natural and this is why an attempt to diagnose that problem had been undertaken on few focus groups.

The tested students of economic studies, highlighted that business studies are necessary, especially in economics, because this field is studied by a group of students who is supposed to engage in business in the future. According to the respondents, entrepreneurship education should be treated as a priority at all the universities, because implementing knowledge of this kind in other fields of studies could result in greater supply of new enterprises. All the tested groups indicated that entrepreneurship education, even though it is taught as early as secondary schools, focuses mainly on learning different notions and rules, rather than on shaping an appropriate attitude among young people. According to the respondents, the same situation occurs during studies and although they are all studying economics, they do not share the feeling that they are being taught 'practical business studies'.



This notion raised by two focus groups and the tested students understand it as knowledge and skills enabling them, after finishing the course entitled 'business studies', to start their own economic activity. The students indicate shortcomings in their competences and in their knowledge when it comes to filling in documents or tax and legal matters, which are indispensable when setting up a new enterprise. 'Even though we take up business studies as early as secondary school, I still do not know what to do first when starting my own business. We are given different examples and definitions of particular legal forms, but if I was to start an online shop right now, I would not know where to start and this itself is an obstacle for me.'

Students who run their own economic activities indicated that it is necessary to teach entrepreneurship, because it is an only way to encourage new people to take up individual initiatives and to stimulate them towards greater economic activity. Entrepreneurship education should be present at every level of education and, as far as economic studies are concerned, it should be compulsory and universities' authorities should take special care of it, as on its level depends taking up decisions about starting own economic activities by students.

According to the respondents, knowledge about setting up your own enterprise is very important, as well as the skills to run it. The students underlined that they are taught with great detail on how to start an enterprise on different courses, but most of the students indicate lack practice connected to it. The students indicated that they do not know to which departments they have to go, which documents they have to fill in, where and who to ask for advises, or which form of activity to choose. A few other highlighted problems as planning of actions, analysing competitors' offers, product's or service's marketing operations, personnel and financial part.

Among the students who gave the aforementioned answers there were none who already run their enterprises, because the latter already knew the answers to the asked questions and they implicated that while setting up their businesses they used other people's help – they turned to external companies or to people who had already taken that road and who could be their guides and be of help. Most of the students indicated family help in this field. Among other answers concerning entrepreneurship education, some pointed to universities and professors as those who should guide, motivate, and strengthen them in aspirations to set up new businesses. In two groups there were suggestions that lecturers do not motivate their students to actions in real business, but very often just pass on their knowledge. Furthermore, the students often mentioned lecturers' purely theoretical preparation, pointing out that without practice in business, they are neither prepared to sufficiently interest students with that subject, nor to motivate them to set up own enterprises, because they themselves often have no such experiences. 'I should finish my studies and graduate being highly motivated, believing in my skills. Professors should guide students so that they leave the university and think: yes, I can do this, I am ready to have my own enterprise, I am strong, I can and I will be able to set it up.'

The respondents highlighted that the knowledge of management (of human resources, costs, revenues, and time), accounting, finance, or law fields is important, but the practical knowledge, through which observations can be drawn, is

no less important. The students indicated that visiting companies, meeting successful people or people who have their own enterprises and are willing to share their experiences are all very valuable to them, because it provides practical knowledge and it teaches them how to act in various situations. The students pointed out that being successful on the market not only requires knowledge and ideas, but also time-planning skills, time management skills, creativity, ability to work in a group, stress management, and risk-taking. The students indicated that during their studies they had very few possibilities to practice the above-mentioned skills during courses, they indicated more theoretical character of their studies, where greater emphasis was put on definitions and calculations rather than on creative problem solving. The respondents pointed out lack of courses during which they could use their knowledge and skills from various other classes – what is, in fact, happening while setting up own business – ‘we manage people, finances, information, we do not act alone, but we cooperate or compete with our environment’. Each group paid attention to the risk connected with running an enterprise and to the responsibility for made decisions in the context of running a company. ‘An entrepreneurial person, when starting an economic activity, is aware of consequences resulting from it. And aware people also realize risks to which companies are exposed. That is why the feeling of responsibility is connected to business. A person running their own enterprise has to be responsible, they have to know that by becoming an employer they also take up the responsibility not only for themselves, but also for their employees, clients, and suppliers.’

Students who are currently running their own business activities stated that if they attended only business courses and if they took advantage only of them, they would not had made the decision to set up their enterprise. In their opinion, those courses only provide information, but they do not make it possible to practice the whole process. The information acquired during courses were, according to them, too theoretical and those courses did not explain step by step how from having an idea a person can start a business. The students also implicated that the number of course hours was insufficient to make such an exercise. Moreover, the subjects stated that the knowledge required to run a business is divided between several or even a dozen or so courses, but there were no courses which would put together all the information.

Most of the students, when asked about whether or not they are ready and whether or not they plan on setting up their enterprises after graduating, answered no. Among the arguments against starting an enterprise they indicated lack of appropriate finances, fear of the unknown, and the ‘easy way’ – it is better to work as someone’s employee and not to have any worries, to do the work and to have some free time. The students also mentioned that they do not have the support of their families or friends (who already have a full-time job), who advise them against taking up such initiatives. Some students responded that they are too young to run their own business, because they want to have the time to relax and to lead a social life. The presented attitudes point towards irrational excuses and resentment to take

up a new initiative. Looking for disadvantages can be analysed as looking for an excuse for some kind of laziness, to which young people condemn themselves.

Respondents already running enterprises did not speak on that subject; they, however, discussed the arguments for and against setting up own enterprise. People who already run their companies pointed out the possibility to decide about themselves, to build something lasting for their families, the flexible working hours and the finances as the most important factors which motivated them before they started a business.

All the students who are currently helping their relatives with running a company were thinking about setting one up on their own. From among the tested group, 7 people want to start a business, but firstly they want to gain some experience while working for somebody else; part of them indicate that they want to save some money for their enterprises.

Students whose relatives or friends are running their businesses can count on help from their families and friends. Good practices and examples of people who were successful with starting their companies and with running them are very motivating for the subjects. The latter very often indicated that they talk to and watch people run their enterprises and from those experiences they take the motivation to set up their own business. 'I consider starting my own enterprise, because my parents and my uncle have their own companies and I already have the basics to set one up (an idea and a plot). I am not afraid to analyse what would be if. I found an area which suits me in every aspect. The knowledge acquired at the university revealed an idea to start my own business.'

All students who do not run a business alone when asked if they have enough information to start a company answered no. As main information sources, where they would look for information on this subject, they indicated the Internet, books, workshops, courses, and training, as well as family and friends' experience. Only two groups answered they would contact their university lecturers while setting up a company.

Among the respondents, opinions about ideas on how to improve the entrepreneurship education at universities and how to inspire entrepreneurial spirit in students were divided. One group indicated a greater number of exercises which students should carry out on their own at the university in order to learn on 'live' examples how to work on particular tasks and how to make decisions, whose results they could discuss during classes. Another idea was to make a course about running a small enterprise, either in a paper form or in a form of a computer game. The second group mentioned making study visits in different companies and institutions, as well as meeting entrepreneurs who could talk about running a company, with the possibility to ask questions. 'There lacks a typical practice during classes, so that we could perform particular tasks on our own, and not only to listen, look at the blackboard, and write down the given solution.'

It seems that a combination of the two above-mentioned forms should give the best results when it comes to the entrepreneurship education. Students who would have a possibility to combine the theoretical knowledge with practice and exercise,

supported by meetings with entrepreneurs, could take up initiatives concerning starting companies more eagerly. In reality, it is quite difficult to persuade good managers or companies' owners into sharing their experiences with students, because they are very busy and it is difficult for them to find some spare time for this kind of activities.

## 5. CONCLUSIONS

The results of the presented analysis of curricula and Focus Groups Interviews show that higher education institutions should emphasize the teaching of practical skills, which support business development. Courses dedicated to entrepreneurship education are a very good solution, but they have to be made more practical. Besides, a greater emphasis can be put on functioning of the aforementioned areas in small enterprises on different courses, such as planning, communication, negotiations, finance, accounting, marketing, or even management. It is recommended that all possible active forms and methods of teaching, which are focused on practice such as: meeting with successful entrepreneurs, lessons with experts from business, projects and simulation of fictitious business, case studies etc. should be applied. Moreover, entrepreneurship should be taught on real-life examples, maybe even in reference to the graduates who already set up their own business activities. Only thank to such actions and a proper motivation of students universities can, through their lecturers, motivate students to start companies and to try their hands at business. Without a proper stimulation on the part of the university, the percentage of students (graduates) who will be willing to decide to set up their own enterprise will always be low. This is because according to substantial part of students they do not feel ready to become entrepreneurs. Young people will be full of fear of the unknown and instead of entrepreneurial students we will be educating students who are afraid of taking the risk to run a business. If someone is afraid of risk-taking, then their path onto their own company can be very long. University's great responsibility is to motivate their students to take up challenges connected with setting up new enterprises, and at the same time, to develop innovative solutions in business.

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# Creating the environment for innovation and entrepreneurship

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## Abstract:

Innovation generation and diffusion have been widely acknowledged as hinging upon the complex set of institutional, social and psychological processes. The objective of the paper is to examine the need and possibilities of creating the environment for innovation and entrepreneurship in the university setting. In particular, this paper focuses on interrelationships and roles of specific groups of university members: the administration, faculty and students. The study is exploratory in character, based on observations and literature review. It starts with defining modern-day university as home of innovation emphasizing the need for interdisciplinary and interinstitutional approaches. The paper discusses the need of faculty to learn to reach across the institution and beyond to work with others, working across silos of academia and meeting with others from very different disciplines. Second it examines ways the university administration support can encourage innovation among its faculty, staff and students. Third, it draws on existing research to identify key dimensions of change. The study proposes pathways that may activate the mechanisms of climate and infrastructure for innovation. The proposed dimensions and analyzed areas of change can potentially form the foundations of a framework for universities seeking to diagnose their existing condition and use such findings to enhance the generation and diffusion of innovation. The university quest to break down the barriers and reach across the disciplines to generate innovation takes commitment which needs to be coupled with administrative change such as the reward structures lined up with the vision and changes regarding the teaching and learning practices as well as the physical environment for the classes, the class rooms and meeting spaces of students and faculty.

**Keywords:** innovation, environment for innovation; interdisciplinary; culture of innovation; tools of innovation

**JEL codes:** M14, I25, O21, O31, O35

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## 1. INTRODUCTION

While innovation can happen accidentally anywhere one or more minds are together, if a university considers it to be part of its vision and mission it has to plan to encourage its growth. The University needs to create the atmosphere that will help with the growth of innovative and entrepreneurial thinking. The University must consider different types of leadership in innovative thinking, including the

current focus on the design thinking. This paper examines creating the environment for innovation and entrepreneurship in the university setting. It draws on experience of two very different academic environments: US and Latin American Universities. In the US are 50 of the top 100 most innovative universities and in Latin America there are none (Thieveau, 2015).

The paper is exploratory in character and formulates important questions. It explores the potential of business or engineering schools as the right place to create the innovation environment through engaging interdisciplinary, and interinstitutional logic. The paper analyzes the problem of supporting teams functioning across departments, campuses and colleges and mentoring them with faculty from different areas. The paper also discusses student engagement: how early in the process should students be encouraged to participate? Is it better to start with first year students or seniors?

The first section of this paper addresses the location of the home of innovation in the university including the need for some schools that are single themed to work with other universities. Second it examines ways the university administration support can encourage innovation among its faculty, staff and students. In order for succeeding generations of students to learn the innovative process, the current generations of faculty must also learn the process. Third, the paper discusses the need of faculty to learn to reach across the institution and beyond to work with others, working across silos of academia and meeting with others from very different disciplines. This is necessary as hearing the different perspective opens one mind to new ideas, which is the first step in innovation. Fourth, the paper identifies the necessary environmental support for innovation; offering support for the culture of innovation on the campuses of the university. The conclusions suggest that instead of letting innovation happen apparently randomly, Universities can work hard to get them into a coherent stream of cross sectional cross institutional activities based on exchange and cooperation to encourage, facilitate, foster and thrive on innovation.

## **2. HOME OF INNOVATION: THE NEED FOR INTERDISCIPLINARY APPROACH**

One can label any department or institute with the word innovation, but unless it is actually providing a nurturing environment for people across the disciplines it is probably not achieving its goal. Business and Engineering may not be the right or only place for innovation in the university. Traditionally universities have tried to work with business schools and engineering schools or colleges. Theoretically the engineers know how to build the idea and the business people from marketing and entrepreneurship should know what is needed. New Product texts often relate the two areas slowly adding on other business areas like Finance for cost of capital, Accounting for product cost, and operations for how to manufacture or put into process the new item. It is one thing to go to the store and pick an item that exist and suggest that your organization should have one as well. It is another to try and come up with a new solution to problems that face people in our world, country or

region. Problems can be well defined such as, how do you make it easier to have a really good cup of coffee in the morning, or how do you feed 9 billion people? Therefore Universities need at least two key elements to generate innovation. First universities must encourage teams that reach out across the institution to include different disciplines in the most vibrant and creative ways. Second extensive research must be done into defining the gap or the need to be resolved. This requires.

Since ancient times universities have separated faculty into different disciplines forming silos. These disciplines have often ended up in their own building such as the medical building, or they are grouped with similar disciplines such as the sciences building, containing biomedical science, chemistry, physics and more. In the United States as campuses were built the style of separation became more and more popular as donors were sought to fund the Anthropology building, the Communications building, or the Theater building. The practice of sprawling campuses with separate buildings for different disciplines led to much deeper scholarship in each discipline. When you spend all day with people in the same department you are not likely to easily pick up ideas from someone across the campus.

As disciplines get department heads and deans with their own reward structures they become more and more insulated from other departments and interdisciplinary thinking. Add to this separate accrediting agencies for business, engineering, and other disciplines and universities lose the important cross disciplinary, or anti disciplinary thinking that is needed to encourage creative innovative thinking. In *Innovative Pathways for University Entrepreneurship in the 21st Century*, it is pointed out that for entrepreneurship and innovation the working across the disciplines, especially across the silos is very threatening to administrators (Hoskinson & Kuratko, 2014). University wide programs are silo busters and the question is the administration as ready as is the faculty to advance change? From a corporate perspective, Smith (2012) says that silo cause problems in three major areas, the priorities are not aligned, silos block information flows, and there is often a lack of coordinated decision making.

Many of the problems that the world faces today needs to be looked at across the disciplines. There are some large problems which have been labeled in the past wicked problems (Rittel & Melvin, 1973). Such a problem is that of feeding the world. This is a problem that requires multidisciplinary approaches: the demographers to show the rate of urbanization, the agronomist to show the amount of arable land, the ecologist to inform on the degrading ecosystems, big data experts to look at problems in new ways, the biologist, chemist and many more to help with solutions, as it is not only what is grown, but how much is lost in the ground, in handling, transport and storage. Add to this smart phones in the hands of farmers, apps, and the world of technology and problems can be more manageable working across disciplines (Carlson, 2015). Listed below is a long but not inclusive list of disciplines that would work well as part of an interdisciplinary innovation or entrepreneurship cohort:



- |                            |                                  |
|----------------------------|----------------------------------|
| i. Anthropology            | xvi. Kinesiology                 |
| ii. Art                    | xvii. Library Science            |
| iii. Biomedical Sciences   | xviii. Languages                 |
| iv. Chemistry              | xix. Mathematics                 |
| v. Communications          | xx. Medicine                     |
| vi. Computer science       | xxi. Nursing                     |
| vii. Cultural studies      | xxii. Occupational Therapy       |
| viii. Dance                | xxiii. Physical Therapy          |
| ix. Design                 | xxiv. Physics                    |
| x. Education               | xxv. Psychology                  |
| xi. Environmental Sciences | xxvi. Recreational Therapy       |
| xii. Ethnography           | xxvii. Research or Investigation |
| xiii. Geography            | xxviii. Sociology                |
| xiv. Graphics              | xxix. Social Work                |
| xv. History                | xxx. Special Education           |

Defining the gap, the problem, the opportunity that might be focused on is a very important issue for any innovative process. Universities have research institutes and faculty performing research all capable of helping to define the gap or the need. The problem definition or theme is a key to starting the innovation process. There is an art deciding on the opportunity of focus. If you think you can end poverty in the world you have no definition or focus. The United Nations in their millennial goals provided some distinct gaps to work on which led to much creative work on the problem of poverty (United Nations, 2015).

Design thinking can be a starting point in identifying and framing the problem. In Design thinking this is done with Empathy; trying to understand the experience of the segment of the population you are trying to serve. What is the problem? How many people experience this problem in the community, the regions, or the world? What are the people like who experience this problem? What do they feel when they experience the problem? Is this a problem that you see as a problem because of your culture? Maybe it is not perceived by the people you are observing. This is where those who are good at investigation and research can help. The challenge of the university is to be sure that these kinds of people are a part of innovation teams.

At the CIIC in New Zealand in 2015: There is no simple fix to the education system. The problems in the education systems of many countries are symptoms of a bigger cultural dysfunction. Acquiring knowledge must not be confused with memorizing information and acquiring beliefs. The goal of teaching must change from transmitting factual information to the cultivation of thinking tools. Knowing how to ask useful questions and knowing how to reason and use the scientific method is much more important than memorizing answers (CIIC, 2015).

Radjou *et al.* (2010) discuss the idea of, “reframers”, those who reframe a problem from a different perspective. Examples include, Indra Nooyi reframing Pepsi has a provider of health solutions, Jeffrey Immelt’s reframing GE Medical to focus on more for more people for less environment and economic cost and Ratan Tatta reframing the up and coming from low earners to high earners. Universities

can encourage these alternative ways of reframing problems. One clear method to at least increase the perspective is to include more disciplines in the mix as people than will address questions from different perspectives.

### **3. ENCOURAGING AND SUPPORTING INNOVATION ACROSS THE DISCIPLINES AND INSTITUTIONS**

There is a number of factors which can contribute to faculty exchanging ideas and working together across disciplines. Mentoring is one way to encourage the development of interdisciplinary work and potentially innovation. Most mentoring is done within colleges, and departments. In the case of Innovation, within the university reaching out across departments for those who think differently, possibly the reframers who can mentor others to think about problems in new ways holds great potential. If we take a look at a problem like the above mentioned feeding the 9 billion people in 2050 you can begin to think about how this interdisciplinary approach might help all the faculty involved to advance.

In order to expect outcomes, the right actions need to be rewarded. A reward structure for any of the interdisciplinary innovative activities sends a clear message. In most schools the rewards are passed out through the provost to the Deans and to the departments on some kind of rational system, (research, teaching, service), that supports the work of the departments and the schools or colleges and thus the university. This encourages the fiefdom, the territoriality or what is called in the United States the silo approach. Universities that really want to encourage looking at the world in new ways across the disciplines. Several options appear here: direct compensation as in traditional pay boost, some kind of indirect compensation such as the opportunity to participate in retreats that are workshops on innovation, or innovation in practice; and finally the opportunity to participate in some kind of innovative challenges. An example, might be ten faculty each given a portion of the cost of a travel some place in the world. As a team they must select where they are going, how much each of them will need to pay, what larger problem they hope to work on, and finally what will each discipline organize something in the country of focus relevant to the problem? This is just an idea of how this might work.

Reaching across institutions for interdisciplinary teams is another important concept. A typical early level example was a university that had a business school but did not have an engineering school would seek out an engineering college or university as a partner. This raises all sorts of challenges but also a vast array of opportunities.

If the goal is to create an environment where innovation can flourish than having faculty and students from different backgrounds can truly enrich the process and the potential for making the product real. Business students, and many others today can develop an idea. In order to take that idea to reality they need engineers, designers, and people from many of the careers mentioned above. University administrations need to be open to the idea of including other universities that have complimentary organizations, careers and students.

When the author was working in another country with a colleague and they had only a generalized regional university branch of one of the nation's main universities they reached out to find other universities to work with. The author's colleague scoured the regional city looking at public, private, church controlled, universities trying to find one that could contribute engineering and more to the mix. He was successful and most important the administrations on both sides were willing to let this odd relationship of a public regional campus, and the local campus of a private national competitor work together. It got things moving.

Today in a similar effort in the United States two universities four colleges and one giant of innovation in the corporate world are working together to try and understand how best to do these look at problems in new and different ways as they seek to make innovation happen amongst their students and faculties. Administrations need to dare to explore new areas, encourage faculty members to try relationships that might not have been considered before. Leaders need to look at their own campuses and the disciplines and majors taught but what else is available in their city and in their region. In this technical age it may be that through software platforms teams from very different approaches can work together possible even in different languages.

#### **4. SYSTEMATIC SUPPORT FOR THE CULTURE OF INNOVATION**

There are many ways in which a university can begin to support innovation and innovative thinking amongst students and faculty. Some are focused on providing opportunities for students and some are focused on providing opportunities for faculty members to grow and change. It is interesting how many universities tend to focus on throwing money at the idea by hiring new staff, creating new units and other big plans. In fact, a little creative support may generate some rapid interdisciplinary activity and idea development.

An easy start up solution is to make available to students and faculty all the things that are going on in the region that are related to developing innovative thinking. In the United States there are many. There are programs like Business Plan Competitions, Idea Pitches, the Rally, Start-Up Weekend, and the Hult Prize that are occurring all the time. In many states and countries there are competitions, government, educational, industry, or artistic events related to innovation that could be put on the calendar. People are often surprised at how much is going on in their area that they never looked at before they started to put together a calendar.

Encouraging students to participate in innovation related events is important. Students do not require much of an incentive to enter competitions if the university will help to pay their entrance fee. Just the awareness that they can go to an office and have the potential of support for an entrance fee will be motivating. Of course once they are enrolled in a competition students become competitive and want to generate the best ideas they can. They use whatever resources that they can tap into. Many of them will either seek out a mentor or mentors, or run around the university

getting people to help with each part of the project. This in itself generates interest and more of an innovation culture.

The students with their smart phones are so much more empowered today. In only a matter of minutes after finding out they have support they have a team and are working on the problem. They can reach out to the community quickly but with the apps now available they can contact people all over the world and if they can get over the language barrier they can get them moving as well. It only takes a little support and a little interest to get students highly motivated.

There are many excellent conferences that can help people advance in their thinking about innovation. These exist in different disciplines (SEA, Self-Employment in the Arts, CEO, Collegiate Entrepreneurs Organization which is interdisciplinary, Start Up Weekend which is interdisciplinary, interinstitutional, and engages the community) and in the professional world. While the ones listed above tend to be US based there are many all around the world. Sustainability issues and the strength of technology have led to many interdisciplinary conferences and participating in them is a valuable source of inspiration, meeting new people and new ideas, for both faculty and students.

## **5. ROLE OF PEDAGOGY AND INFRASTRUCTURE IN ENCOURAGING APPLICATION**

One can quickly make the argument that one should work with the most advanced students. They have the most discipline knowledge, the most experience, and the maturity to follow a process. However that might not work. The more advanced the students the more likely that they are well schooled in their disciplines. This is likely to impact their ability to be open to new ideas and to creativity. In contrast students who have little experience are much more open to ideas but may not have the technical skills. Some universities including the author's university have experimented with working on innovation with first year students. These students do not have defined approaches to problem solving that you might find in a specific discipline. They can focus on a general process of developing an idea without focusing on a discipline.

Faculty plays a central role in supporting innovation and encouraging new ideas generation. If a professor arrives at class with notes on the computer or in hand that they have been using for ten years it is doubtful that they are changing rapidly. Similarly if a professor is not willing to let the students challenge what they are saying the class is probably not encouraging innovative thinking. Academics need to give a lot of thought as to how you encourage innovation and entrepreneurial thinking. Sadly many of those teaching were taught under one of the great systems of memorization that existed in the 20th century. Even until the end of the twentieth century the focus had to be to learn, to know, and memorize, or work with the same things repetitively so that a student would know it for a life time.

In the 21st century all knowledge is easily accessible through a device we can carry on our person or in a hand bag. Ericsson estimates that 70% of the world's

population will be smart phone users in 2020 and this is a game changer (Ericsson Mobility Report, 2015). The world's knowledge is accessible by almost everyone from almost anywhere. So what does a university do with her students? The idea of the sage on a stage or the lecturer in front of the class room or auditorium may be outdated. The challenge may be to help students to learn how to use the technology they are holding to access good information, and then how to apply it in a meaningful way. The university that wants to encourage innovation and entrepreneurship will be prepared to change pedagogies rapidly. This shift requires adaptation of administrators, reward systems, evaluation systems, and all the players in and around a university space.

There is much that one can do to encourage creativity, encourage innovation and entrepreneurial thinking but it requires university administration to think beyond traditional facilities. Most classrooms are arranged in some kind theater fashion with everything focused forward and that is what students are used to. They walk in sit down face the professor listen to a lecture or a presentation and leave. Some university introduce rooms in which everything points to the center. There are three screens and three projectors and ample whiteboard space both fixed and movable. Students from their seats can control a screen as well as the professor. First the setup of the room discourages a front helping the professor to think in new ways. The students who suddenly are empowered as well begin to think differently. The room is amazingly flexible and in that way supports flexibility, creativity, and that helps with new thinking for entrepreneurship and innovation.

One has to wonder how many university administrators send their class room designers and furniture purchasing people out to see what is possible. In one of the university systems the author works with the faculty complained about their traditional armed chairs. However, when I suggested that maybe the buyer should join the group the faculty were surprised. How will the designers and buyers learn if they cannot see what is today and what may be coming tomorrow? Sadly it is often not the innovative professors, or the young that are asked to help with the design of new buildings. Instead the administration counts on the senior faculty and administrators they have known for a long time. So there are knew things but not the set up for whole new ways of thinking to create innovative learning communities.

The same problem exist with laboratories and workshops. How many laboratories or workshop are there in business colleges? Where is the space, and what needs to be in maker labs? Change is occurring rapidly and a few 3 D printers of different sizes are needed. Also needed are spaces to build with wood and material and to experiment. These are not present in most business colleges as they were built. Creativity flourishes when nurtured. What can the university do to create maker or creativity labs?

Along with labs advisors or people with know how are invaluable. How do you sew this? How to you make this out of wood? How do you create a 3D printed model with more strength? Having the technology is part of the issue and then having the people who can lead in its use, who can help students and faculty figure

things out in the labs and workshops is important. In the United States good examples of these laboratories and workshops can be found in design schools and colleges.

There are a lot of things that University Administration can look at in order to support either or both innovation and entrepreneurship. Starting from the top does the university vision include innovation and entrepreneurship? Are there reward structures in place for those who are doing these kinds of activities? Do faculty who participate in programs of this sort expanding their skills and learning, and abilities get university rewards? This is admittedly problematic as innovation and entrepreneurship do not fit neatly into classes, they do not fit neatly into service, and the same is true with research. The standard areas for evaluation. Do universities need a culture change to reward these activities? Does the university support administration with spaces for innovation activities? Getting a space where you can put keep ideas on the walls, where you can do pictorial histories of ethnographic studies, where you can maintain the results of brainstorming it is original format can be important. Are the spaces suitable for model building, maintenance as students and faculty explore ideas?

Faculty who have ideas are often not the right people to transfer them to the market place. Does the university have some kind of tech transfer program? This would help the pure scientist evaluate their ideas and decide which ones may belong in the market place of the country or the world. Often faculty research develops obscure parts of something greater and others need to help them see that their ideas are only parts of a whole. A technology transfer program could be an important part of a whole innovation and entrepreneurship push at a university. Faculty need to think differently if they are to learn with their students in the 21st century.

If the administration is committed to creating an environment for innovation and entrepreneurship it needs to offer a variety of programs to its students, but most importantly to its faculty. Technology is changing the ability to do things rapidly. Faculty need to rethink individual class meetings, whole classes, majors, or careers. How do you begin to create true interdisciplinary thinking and classes in a University? If you are working on entrepreneurship you have to recognize that it will draw from many disciplines and students will feel that classes are somewhat repetitive as they work on a market plan in marketing, a business plan in entrepreneurship, a strategic plan in management, a promotional plan in advertising or communications, a financial plan in finance. These challenges take time to work out and it requires novel approaches. The more support there is from administration the better.

Faculty programs can be offered in short programs as they are on some universities. Longer programs give faculty a chance to get away from their classes and to think on three important levels. First what is this thing that is innovation or entrepreneurship? By participating in a program they can increase their learning tremendously. Second what is the role of my discipline from Anthropology to Zoology in this kind of thinking? Lively moderated discussions can bring out the questions about how does this thinking work in biology to therapy. In the authors experience

faculty from across the disciplines are at first puzzled as to why the university administration included them in such a program. Third, how do you use this in a course in medicine or social work? Some who are engaged in innovation or entrepreneurship believe that everyone should see the way immediately.

Change is not easy as faculty members have spent years and years getting more and more specialized. The larger and older the university the harder it may be to change the culture. Kirpatrick (2014) points out that being big and venerable is not good for innovation in the corporate world. The same may be true for universities in many countries. Even the rubrics for submitting papers to academic conferences can be quite restrictive in terms of open thinking. This is what faculty do. A university administration that wants to change that to look at the future differently must be willing to spend time educating and helping its faculty.

## 6. DISCUSSION

There is not readily apparent literature on creating climates for innovation within the university environment. Issaksen and Akkermans (2011) provides a good literature review demonstrate the importance of leadership on the climate for innovation. Issaksen *et al.* (1999) through their work at the Creative Problem Solving Group, Inc., point to Creativity Research Unit technical reports on specific organizations. For example they used their Situation Outlook Questionnaire (see dimensions below), to investigate the innovation climate in a global health care company. They found differences in climate perception with differences in empowerment and in risk. They went on to make recommendations to industry. Are universities similar enough on a global basis to develop such a measure to help determine climate?

**Table 1.** Dimensions of fostering innovation at universities

Ekvall's 10 dimensions adapted from M1 Creativity	Groupings adapted from M1 Creativity	As seen by author applied to Universities adapted from the author's writings above
Challenge	Resources	Challenges of administrative fiefdoms.
Idea Time		Mentoring across the disciplines, Tools for innovation across the campuses, Design thinking.
Idea Support		Defining the Gap, Innovation Challenges, Support for out of discipline conferences and interdisciplinary attendance.
Trust and openness	Motivation	Working across institutions.
Playfulness and Humor		Leadership style.
Conflicts		Conflicts over resources, and territory?
Dynamism		Developing a calendar of events. Design Thinking? Applied teaching.
Risk Taking	Exploration	Experimenting with different levels of students. Support for competitions.
Debates		Is debate welcome?
About the Issues		
Freedom		Interdisciplinary

Source: own evaluation based on (Ekvall & Ryammar, 1999).

In most universities every college and institute has its own climate through observation, which does not support innovation goals.

Similarly from an Engineering perspective Panuwatwanich *et al.* (2008) emphasized the important role of leaders in creating a culture of support for innovation. Ekvall and Ryammar (1999) looking at a Swedish University found that the university climate and resources appeared to be the strongest influence on creativity. They identified 10 dimensions that affect creativity. These were organizational and not focused on educational institutions or more specifically universities (Table 1). Further they were focused on creativity and not on innovation. Table 1 was created using Ekvall's 10 dimensions as found in M1 creativity and then trying to place the issues advanced above in this paper (M1 Creativity, 2016). There seems to be merit in university administrations taking a look at the organizational creativity work as a basis for creating an environment more encouraging and supportive of innovation.

Looking in the opposite direction at industry, Day (2016) of Idea Scale advances ten qualities of great innovators:

1. Encourage Risk Taking. In the universities this author has known we do just the opposite with young faculty.
2. Teach others.
3. Start Somewhere. This is the concept of lean startups, but is not the traditional advice or academics. Failure is ok, but what about in academia?
4. Look for Patterns.
5. Stay Positive. This is not necessarily the strength of faculty at most major institutions who feel limited, or restrained, this is not to say there are not many positive faculty.
6. Incentivize Innovation. This is mentioned above. Universities are willing to pay for potentially profitable patents but how much are they willing to invest in innovation, and innovative thinking?
7. Team players. A great example of this is team teaching, which unfortunately is often considered expensive.
8. Connect. Creating and supporting collaboration where it appears. Some universities actually punish those who reach outside their disciplines to work with others, to experiment, to try new pedagogies.
9. Value Culture. Day says that "57% of CEO's believe the most important factor for successful innovation is the culture. How many Chancellors, Rectors, and Presidents see as their job to create an innovative culture?"
10. Value Innovation.

Specifically looking at the Innovation Climate Educause Center for Applied Research found in 2004 that almost 2/3s of It departments had low or low average support for innovation (Katz *et al.*, 2004). This gets more interesting when you look at their break out by type of institution where you see the highest support for innovation at BA granting institutions and it goes down steadily as you move up through Masters, Doctor Int. and Dr. Ext. Carnegie classes. While old, and limited, it does



give some measurement of support for the innovation climate. Once again you think where IT reports and as in the case of creativity you end up looking at the role of the top administration in creating the environment.

From the literature it is clear that there the question of climate for innovation has been more important to corporations and other organizations. In this time of great change is it time for university administrations to think about assessing climate and then with knowledge making purposeful changes in the direction favoring innovation.

## 7. CONCLUSIONS

Innovation and Entrepreneurship in a university requires change from top to bottom and in each individual. It may actually be very threatening to some. Many have worked long to become a professor and know how to give a lecture in one discipline, know how to perform research in one discipline, and know how to be a professional in one discipline. When university wants to change to be more innovative more entrepreneurial what does that mean to an individual faculty member?

The third decade of the 21st century will be a time of even faster change than the second decade. More people will have useful access to the internet through smarter and cheaper devices. Students who have been brought up on technology will want to learn differently. In the United States preparations are being made for generation Z and how will they learn in contrast to the Millennials. Universities may have to wrestle with the idea that the human brain will be used less to store information and more to connect and apply information in new ways to advance humanity.

Universities that want to lead their nations forward will need to transform themselves from repositories of knowledge to centers of application of knowledge for the betterment of the human community, for the betterment of their nation, for the betterment of communities. Pure research will continue to be needed in all kinds of areas, but the ability to help students to think through how to connect and apply information in new ways will become increasingly important in the very near future.

Further areas of possible investigation could be the following issues: (i) what is the perception of administrators regarding innovation at universities?; (ii) is there a difference in approach in the market driven countries versus countries driven by humanism?; (iii) could one of the tested organizational climates questionnaires be adapted to the universities to help administrators?

University administrations will need to craft a vision of what they hope their university can become and then work to transform their university in that direction. If the vision is to be innovative and entrepreneurial the administration needs to be prepared to help transform the faculty as only through that process can they begin to transform the thinking of their future generations of students. As pointed out in the paper, the administration has to take action and introduce changes for the creation of an environment that supports innovation and entrepreneurship.

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# Entrepreneurship ecosystem evolution strategy of Saudi Arabia

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## Abstract:

In majority of times when a potential start-up strikes a brilliant business idea, he/she has little knowledge of 'how to move from there'. They lack information on the stakeholders of entrepreneurship ecosystem who can help and assist these startups in numerous ways and help them materialize their concepts. Availability of this information will help the ecosystem stakeholders to avoid replication and duplication of efforts. Similarly, knowledge of status quo helps identify opportunities and supports plan development to endeavor through right strategy for the start-up. Critical review of existing initiatives of Saudi Arabia for entrepreneurship growth and identification of the existing stakeholders of the entrepreneurship in the country is conducted. Similarly their work and potential for practicable interventions to further entrepreneurship reflecting country's economic development process is examined. This paper benefits from a cross sectional basic study of Saudi Arabia that utilized primary and secondary sources to discover the initiatives, understand entrepreneurship growth and then map the national entrepreneurship ecosystem. A number of interviews from CEO's, General Managers and other senior executives were carried out to know the role of the different organizations in entrepreneurship growth. It was coupled with a detailed secondary research from existing resources. It has been identified that the ecosystem is swiftly expanding but yet under development and infancy stage where the institutions are prospering. The research is based on country analysis. The paper also shows that the Saudi Arabian government has taken proactive stance in developing the entrepreneurship ecosystem and startup landscape and highlights the transformation of the ecosystem strategy.<sup>1</sup>

**Keywords:** entrepreneurship; ecosystem; ecosystem evolution; strategy; startups; Saudi Arabia

**JEL codes:** L26, M13, Q57

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<sup>1</sup> This study is based on Rahatullah (2013). There have been numerous changes since that study and this paper incorporates a variety of new literature, information, stakeholders and their activities besides others, providing evidence of the evolution of entrepreneurship ecosystem in Saudi Arabia. The initial period of study had been September 2012 to June 2013. Then the study for the current work spanned from July 2014 to September 2014. However, there could be a case that a particular stakeholders on map is missing it is because of the research period or the non-availability of secondary data.

## 1. INTRODUCTION

This section familiarizes with the concept of eco system strategy for entrepreneurship growth and its practice in different parts of the world. It also refers to the purpose and the research questions based on the gaps and helps understand the contribution of the paper to both academia and the practice.

The aim of this paper is to identify the existence of an entrepreneurship ecosystem as well as to show that the use of this ecosystem helps energize and organize the sector and explore a deliberate or otherwise strategy of Saudi Arabia to strengthen the eco and enable entrepreneurship. The paper further endorses a need for an entrepreneurship ecosystem map and shows the evolution of Saudi Arabian map and its evolution over years. It underscores an entrepreneurship ecosystem development strategy to address some of the less stressed upon issues and policies essential to toughen entrepreneurship and generate economic development. It is pertinent here to understand the status quo and identify the evolution of the ecosystem by mapping the role of different stakeholders of entrepreneurship in the kingdom. This would help in understanding the strategy and then becoming an example for the mapping strategy itself. The maps provide a one page snap shot of the ecosystem at the respective level. It will provide the understanding of evolution through a map of both strategic and institutional levels since 2013. It will then point out the changes that have happened over the years. The achievements of the strategic level's strategy become clearer as we move on to conclusion. It is a cross sectional basic study and through the help of secondary sources maps the ecosystem of Saudi Arabia and then identifies the evolution of the ecosystem over three years.

## 2. LITERATURE REVIEW

Zimmerman (2007) suggests that “Entrepreneurship is the recognition or creation of an opportunity, coupled with action by an individual or group of individuals, to form a social, intrapreneurial, lifestyle, middle-market, or highly-liquid venture”.

Looking at the importance of SME and entrepreneurs it is evident through the management academics and practitioners that successful new ventures contribute to employment, political and social stability, innovation, and competition (Dunkelberg, 1995; Hoffman *et al.*, 1998; Zedtwitz, 2003; Thurik & Wennekers, 2004). Similarly the success of SME's is also largely attributed to entrepreneurs' abilities and role of different organizations and institutions to enable the entrepreneurship (Covin & Slevin, 1989; Szabo, 2006; Dyer & Ha-Brookshire, 2008; Isenberg, 2011).

Malhi (2004) contends that the Government of Canada underlines the important contributions made by entrepreneurs and distinguishes them as a dynamic group vital to the progress and growth of the country, hence puts the emphasis on entrepreneurs. He also suggests that the entrepreneurs are the backbone of the Canadian economy and generate employment opportunities for thousands of job seekers. He further identifies that there is a need to further foster the entrepreneurial

activity by the government initiatives as it is a positive force contributing to the economy. The Canadian success is tangled with that of entrepreneurs.

On the other side in the UK, its secretary for the business, enterprise and regulatory reform (2007) argues that number of businesses in UK has grown by more than half a million as a result of the entrepreneurial activity guaranteeing thousands of jobs. This helped the UK remain Europe's leading destination for inward investment. Its competition regime has been ranked third in world while welcoming the creation of a department to equip Britain to seize new opportunities in the changing global economy. Across the Atlantic Congressional documents report on entrepreneurship for 2012 provided by the Kauffman Foundation suggest that fast-growing nascent firms comprise less than 1% of all companies but generate roughly 10% of new jobs in any given year. Over the last three decades, young firms less than five years old have created 40 million new jobs.

America's booming entrepreneurial sector is responsible for much of today's economic prosperity and the largest economy of the world (Abid, 2007) provides the entrepreneurs' opportunities to take advantage of new wealth-creating prospects that regularly arise from constant change. This phenomenon of "creating opportunity from change" has been part of the American culture since the 19th century Industrial Revolution. Zimmerman (2007) argues that today, an entrepreneurial renaissance is transforming American business and society.

This discussion has evidenced that the governments of developed countries emphasize the entrepreneurship and SME development and distinguish them as growth engines. Governments evidently stride and promulgate business friendly laws, rules and regulations. It identifies the underlying importance of entrepreneurship in creating prosperity and developing living conditions of the society.

### 3. UNDERSTANDING AN ECOSYSTEM

The oxford dictionary at describes ecosystem as a complex network or interconnected system. In general, we can distinguish:

- Biological ecosystem – In the new shorter oxford English dictionary (1993) a biological ecosystem is explained as "a system of organisms occupying a habitat, together with those aspects of the physical environment with which they interact". Whereas, the Merriam-Webster Third New International Dictionary of the English Language (1986) defines biological ecosystem as "a community of living organisms with air, water and other resources". This definition underlines and emphasizing the community aspect of an ecosystem. However, furthering this definition the World Resources Institute (2000) adds that ecosystems do change. Kauffman's stipulated similarly, saying that cells, ecosystems and economic systems are also "real equilibrium systems" and thus behave in ways that are their "own shortest descriptions" (Kauffman, 1995, p. 22).

- Business ecosystem – Peltoniemi and Vuori (2004) define business ecosystem as “a dynamic structure consisting of an interconnected population of organizations”. They suggest that these organizations could be of any size, business sector or public or private in nature and influencing the system. They further argue that business ecosystem develops through self-organization, emergence and co-evolution and provides it much needed adaptability, hence in such a system there is both competition and cooperation prevailing.
- Entrepreneurship ecosystem – Wiklund *et al.* (2008, p. 5) underscores that producing entrepreneurship firm growth is a complex phenomenon and cannot be completed as standalone but needs support of numerous players in the economy. They require a serious and cohesive action for its growth and development. Complexity research tries to find applications in social and economic systems (Peltoniemi & Vuori, 2004).

The literature on entrepreneurship ecosystems and entrepreneurship ecosystem strategy is scarce. There has been very little information available on the ecosystem. Rahatullah (2013) provides a comprehensive look at the ecosystem strategy and maps the Saudi Arabian entrepreneurship ecosystem. This provides an initial and pioneering look and evidence that ecosystems in entrepreneurship do exist. However, there are seminal work carried out in the entrepreneurship and its growth and development like Zimmerman (2007), Szabo (2005, 2006) and Isenberg (2011).

#### **4. PIONEERING MAP OF ENTREPRENEURSHIP ECOSYSTEM OF SAUDI ARABIA**

Rahatullah (2013) provides a detailed look at the mapping of an entrepreneurship ecosystem. The study develops an understanding of the entrepreneurship and its role in economic development. Then deliberating on the Szabo (2006) and Isenberg (2011) studies on the levels and domains of entrepreneurship ecosystem the study develops a measurement in line with levels and domains narrated by the Szabo and Isenberg in a cross sectional basic study.

Szabo (2005, 1995) and Isenberg (2011) assert that public / government leaders including the elected representatives, professional and private sector responsible to work cohesively and on several inter-related principles to form an ecosystem for entrepreneurship growth.

In Szabo (2005, 2006) and United Nations Economic Commission for Europe (UNECE) suggested that development of the SME's in the countries in transition materializes with the activities and assistance from an integrated and three distinct levels. These levels they argue are 1) strategic level (*policy making*); 2) institutional level (*support institutions*) and 3) enterprise level (*entrepreneurs and business entities*). Szabo studies on “Business Incubation as Element of Business Service Institution and SME Development Infrastructure for Creation of New Enterprises in CITs” provided a more comprehensive account of these three levels. These are adapted in table 1.

Isenberg (2011) on the other hand identifies 3 domains of ecosystem adding to Szabo perspective. The domains show that the ecosystem requires stakeholders who can develop certain skills and services for enterprise growth arguing for Culture, Support Services and Strategic Domains. The support activities of the Isenberg include the expertise and networking opportunities at the market level made available and possible through the governmental policies. These are shown in table 2 below.

**Table 1.** Levels of entrepreneurship ecosystems

Level, Responsibility and Requirements	Why
<p><b>Strategic level</b></p> <ul style="list-style-type: none"> <li>- Governments are responsible for execution of this level where a clear Government policy is required</li> <li>- Creating a conducive political environment which is favorable to accept private business undertaking</li> </ul>	<p>To Develop Sustainable Environment and to promote and then creating the entrepreneurial activity through SME development and growth. It requires the following:</p> <ol style="list-style-type: none"> <li>1. Legal entrepreneurship instrument</li> <li>2. SME Support programs by the governments</li> </ol> <p>Government sponsored financial resource commitments</p>
<p><b>Institutional level</b></p> <p>The following are responsible to enable enterprise</p> <ol style="list-style-type: none"> <li>1. Government institutions.</li> <li>2. Chambers of commerce.</li> <li>3. Professional and trade associations.</li> <li>4. Training institutions.</li> <li>5. Enterprise development agencies at both the national and regional levels.</li> <li>6. Banks and financial intermediaries, and</li> <li>7. Non-governmental organizations including professional bodies, consultants and universities etc.</li> </ol> <p>Information on how to start up a business is required.</p>	<p>To promote SMEs by providing effective business support services including support and information on:</p> <ol style="list-style-type: none"> <li>1. how to prepare business plans</li> <li>2. Organization and dissemination of information on business formation and licensing etc.</li> <li>3. Marketing intelligence</li> <li>4. Access to financial resources and credit guarantees</li> <li>5. Human resources</li> <li>6. Real estate</li> <li>7. innovation and facilitating cooperation</li> </ol>
<p><b>Enterprise level</b></p> <p>Entrepreneurs and enterprise is responsible</p> <p>Strengthening entrepreneurial and managerial skills is required</p>	<p>It will require practical interventions such as</p> <ol style="list-style-type: none"> <li>1. Consulting Services</li> <li>2. Business Information Hubs and Centers</li> <li>3. Incubators, techno-parks and industrial estates.</li> <li>4. Access to technology and technology transfer.</li> <li>5. Quality awareness</li> <li>6. Management systems</li> <li>7. Awareness for consumer protection.</li> <li>8. Intellectual property right.</li> </ol> <p>SME internationalizing</p>

Source: adapted from <http://www.unece.org/indust/sme/sme-role.htm> (13.01.2012).

Szabo (2005, 2006) and UNECE 1997 report accounts the public or government leaders including the elected representatives, professional and private sector responsible to work cohesively and on several inter-related principles to form an



ecosystem for entrepreneurship growth. He also suggests an ecosystem strategy to addresses some of the less stressed upon issues and policies essential to toughen entrepreneurship and generate economic development. Isenberg identifies 3 domains of ecosystem forming a little different perspective than Szabo. He argues for Culture, Support Services and Strategic Domains of the ecosystem.

**Table 2.** Isenberg’s domains of entrepreneurship ecosystem

Strategic		Support			Culture
Policy	Human Capital	Markets	Finance	Support Services	
<b>Government Institutions:</b> - Financial Support - Laws and rules, e.g. tax benefits - Developing research institutions - Business friendly laws - Contract enforcement, - Labor rights	<b>Labor:</b> - Skilled and Unskilled - Serial Entrepreneurs - Colleges and Universities - Entrepreneurship Training	<b>Expertise:</b> Expert knowledge and information for dissemination to enterprise	<b>Micro loans:</b> Essential loans for survival of micro scale businesses that generate jobs	<b>Infrastructure:</b> - Telecoms - Transportation - Energy - Industrial zones - Incubators - Clusters	<b>Success Stories:</b> - Visible Success - Wealth generation - for founders - International reputation
<b>Leadership:</b> - Clear support - Society support by recognizing the - SME/Micro business as viable and respectable work		<b>Networks:</b> - Personal networks of entrepreneurs - Diaspora networks around the markets - Multinational corporations	<b>Investment (by):</b> - Angel investors - Crowd Investors - Institutional Investors - Venture Capital - Private Equity - Pubic Capital - Markets	<b>Support Professions:</b> - Legal - Accounting - Investment - Advisors <b>Non-Government Institutions:</b> - Business planning contests - Conferences	<b>Societal Norms:</b> - Tolerance of Risks, Failures and mistakes - Innovation, Creativity and Experimentation - Social Status of Entrepreneur - Wealth Creation - Ambition, Drive, Hunger

Source: adapted from Rahatullah (2013).

Rahatullah (2013) reported furthering Szabo and Isenberg’s studies and suggested the following flow in ecosystem.



**Figure 1.** Ecosystem proposal

Source: own elaboration.

Based on these findings from literature a cross sectional basic study was carried out in 2012-2013 (Rahatullah, 2013) and here it continues to understand the evolution and reporting in real time.

In Rahatullah (2013) each of the levels and domains is identified with different types of organizations and at each level required for enterprise development. Hence all the services, actors and stakeholders of entrepreneurship fit at these different levels. The study maps the services of the strategic level organizations which necessarily are the government institutions and explains their work. Similarly, it then

identifies the services provided by different companies to entrepreneurs, including incubators, accelerators, research, skill development, copyrighting and patenting and many more and identifies that who provides these services. Once that is provided the study mapped the organizations of both the strategic and institutional levels to their organizations and services respectively.

Then taking through the ecosystems it maps Saudi Arabian entrepreneurship Ecosystem based on Szabo (2006) and Isenberg (2011) levels and domains of entrepreneurship ecosystem respectively.

## **5. THE EVOLUTION OF ENTREPRENEURSHIP ECOSYSTEM OF SAUDI ARABIA**

This section will examine the entrepreneurship and SME growth initiatives and activities in the Kingdom of Saudi Arabia on the basis of Szabo (2006), United Nations Economic Commission for Europe (UNECE), Isenberg (2011) and Rahatullah (2013) mapping of ecosystem.

### **5.1. BACKGROUND OF SAUDI ARABIA**

Saudi Arabia has been the home of business leaders since pre-Islam era. Word Jeddah (economic hub of the kingdom) means 'ancestral'. It remained center of international trade and a notable business route between Europe, Mediterranean and Africa. The Prophet Muhammad and many of his early supporters were international traders and merchants. Khadija, his wife, was a highly successful businesswoman even before she met the Prophet.

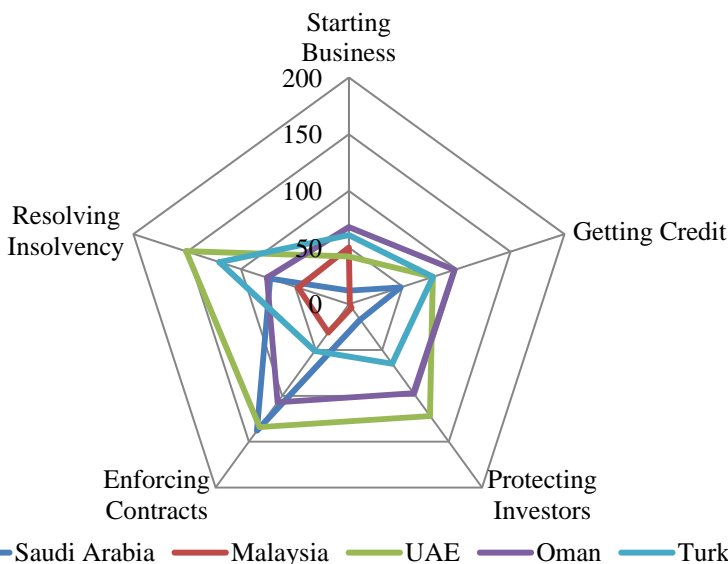
The SMEs' play increasingly vital role in Saudi Arabia's economic growth by helping to diversify its economy, generate employment, contribute to Saudization (a term used where majority of workforce would be Saudi). Currently there are more than 8.8 million expatriates working in the country; whereas total population is around 29 million) trigger regional development, enhance technical innovation and expanding the export market. According to the CIA world-fact book, Saudi Arabia has a population of 26,534,504 (July 2012 est.) including 8 million expatriates. It has a GDP per capita of \$24,000 (2011 est.) and country comparison to the world is 55. With an unemployment rate at almost 11% the sectorial composition of GDP is 2.1% coming from agriculture whereas, 67.6 and 20.4 is generated by industry and services sectors respectively. The country ranks 17 in global competitiveness index (SUSRI, 2011) and provides crucial data regarding the SMEs in Saudi Arabia. It shows that though Saudi Arabia is the largest economy in the GCC and over the last eight years, the country's budget has risen from \$69 billion to \$170 billion. Despite this growth, SMEs contribute mere 25% of total employment and only 33% to the country's GDP, though the SMEs makeup 92% of the businesses in the country (National U.S.-Arab Chamber of Commerce, 2016). This is in stark contrast to most developed economies like in Spain SMEs contribute to 64.3% of GDP, or Austria with SMEs contribution of 44%. Realizing the importance of the

SMEs sector the government has taken numerous steps to boost the entrepreneurial activity to trigger economic growth.

**Table 3.** Some distinct features of Saudi Arabian entrepreneurship and business sector

Ease of Doing Business 2011*	Global Competitive Index 2010/11 (GCI)	Economic Freedom Score 2010	Information and Communication Technology Index (ICT) 2009	Innovation System Index 2009	Human Development Index (HDI) Value 2010	Education and Human Resources Index 2009	Knowledge Economy Index (KEI) 2009
12	21	64.1	6.43	3.97	0.752	4.89	5.31
1 Ranked among 183 Economies <a href="http://www.doingbusiness.org/rankings">http://www.doingbusiness.org/rankings</a> accessed on March 11, 2012							
2 GCI Index - ranked among 139 Economies							
3 Economic Freedom Score - 0 to 100, where 100 represents the maximum freedom							
4 The ICT value falls on a scale of 0-10 and is calculated from three key indicators: number of telephone lines per thousand of the population, number of computers per thousand of the population, and number of internet users per thousand of the population. The top 10 per cent of states score in the range 9-10, the next highest 10 per cent of states score in the range 8-9 and so on.							
5 Innovation System Index - The index value falls on a scale of 0-10 and is calculated from three key indicators: Total royalty payments and receipts in US\$ per person, number of patent applications granted by the US Patent and Trademark Office per million people, and the number of scientific and technical journal articles published per million people.							
6 HDI - Calculated based on data from UNDESA (2009d), Barro and Lee (2010), UNESCO Institute for Statistics (2010a), World Bank (2010g) and IMF (2010a).							
7 Education and Human Resources Score - The index value falls on a scale of 0-10 and is calculated from three key indicators: adult literacy rate, secondary enrolment, and tertiary enrolment							
8 The Knowledge Economy ranking index ranks the countries endeavoring to build the knowledge economies on a scale of 0-10							

Source: : Selected indicators of economic attraction & stability for entrepreneurship growth; adapted from [http://en.wikipedia.org/wiki/Entrepreneurship\\_Policies\\_in\\_Saudi\\_Arabia](http://en.wikipedia.org/wiki/Entrepreneurship_Policies_in_Saudi_Arabia) and World Factbook, <https://www.cia.gov/library/publications/the-world-factbook/> (23.01.2016).



**Figure 2.** Selected indicators relating to entrepreneurship assistance and economic growth in Saudi Arabia

Source: adapted from Wikipedia (2016), The World Factbook (2016), National U.S.-Arab Chamber of Commerce (2016).

Saudi Arabia is the largest economy in the GCC and over the last eight years, the country's budget has risen from \$69 billion to \$170 billion. Despite this growth, SMEs contribute to only 25% of total employment and only 33% to the country's GDP, though the SMEs makeup 92% of the businesses in the country. It is in stark contrast to Spain SMEs contribute to 64.3% of GDP or even Austria where SMEs contribute 44%. Results of following table 3 show that Saudi Arabia is well placed on selected indicators for economic growth when ranked on different initiatives.

In the figure 2 below some selected indicators relating to entrepreneurship assistance, economic growth and Saudi Arabia's position viz-a-viz other countries is shown.

The index placements for the KSA is in stark contrast to most developed economies. In Spain for example SMEs contribute to more than 64% of its GDP. In Austria SMEs contribute 44%. Saudi Arabia and its ranking in different initiatives is also revealing. The results by no means are discouraging and Saudi Arabia is well placed against many other countries.

## **5.2. GAPS, QUESTIONS AND POSSIBLE CONTRIBUTIONS**

The above discussion shows that there is some basic information available regarding the Saudi Arabian initiatives on entrepreneurship growth based on some indicators and initial studies. However, there is a lack of detailed information on the entrepreneurship ecosystem that is contemporary strategy for the growth of the entrepreneurship in the world. Therefore, following questions are raised.

1. What is the status quo of the entrepreneurship eco system and who are the stakeholders in this eco?
2. In order to further the ecosystem what initiatives the Government of Saudi Arabia has taken? Identifying the strategy.
3. How is the eco-system evolving?

Once the above questions are answered and the gap is filled in, there would be a set of recommendations developed to address the gaps that exist in the entrepreneurship ecosystem of Saudi Arabia. There would be a set of recommendations made.

The map of the latest ecosystem showing the status quo and identifying the evolution by showing the changes that have occurred over years and recommendations would help understand and identify the strategies and policies required in order to have an evolved and fuller ecosystem for the cohesive growth of entrepreneurship in any country. However, one important factor has to be kept in mind that some of the ecosystem contributors could be culture or country specific, whereas, others would be applicable universally.

This should assist the strategic, institutional and enterprise level stakeholders of Saudi Arabia immensely in knowing the challenges and developing strategies to defy issues and difficulties.

The following methodology is adopted in order to answer these questions.

## 6. METHODOLOGY AND DEVELOPING THE MAPPING STRUCTURE AND THE MEASUREMENT

This section identifies in detail the research methodology used, and develops the entrepreneurship ecosystem map structure based on the ecosystem components as envisaged by the literature. Keeping the above information in view it is evident that Saudi Arabia has huge potential for the growth of SME sector and entrepreneurship can play massive role. In order to explore the Saudi Arabian entrepreneurship ecosystem a cross sectional basic study for a cluster investigation through primary and secondary resources is adopted. Zimmerman (2007) suggests that “Entrepreneurship is the recognition or creation of an opportunity, coupled with action by an individual or group of individuals, to form a social, intrapreneurial, lifestyle, middle-market, or highly-liquid venture”.

All the organizations and services provided by the organizations that fall under the levels and domains envisaged by Szabo and Isenberg are classified and categorized under specific services, hence these become constituents under each level. In order to identify and understand the numerous services that the strategic and institutional level stakeholders provide to entrepreneurs at different levels a rich body of literature exists. The services identification forms the basic measurement. The examination of this seminal work by numerous scholars such as Praag and Versloot (2007), Koga (2005), Acs and Audretsch (2005), Acs and Varga (2005) were conducted. They posit the importance of the research and development facilities to foster innovation in entrepreneurial firms. Hence it formed an element of measurement in the study. Numerous studies including Mohamed and Alexandre (2010), Moensted (2010), Maritz (2010) or Klyver and Grant (2010) narrate the need for the networking as important tool for SME and entrepreneurship growth. These works also highlight the innovativeness the networking and networking opportunities bring about. Rahatullah (2014) also posited that the networking of the potential partners is important for success. Therefore, the networking opportunities available to stakeholders were be examined.

Various studies of both female and male business startups put the mentoring and coaching programs by the governmental and private stakeholders of entrepreneurship growth under perspective. These studies include but are not limited to Chautin (2011) and King (2010). They identify the importance of mentoring programs by professionals and existing successful entrepreneurs and suggest that such programs play vital role in the success of the startups. Otto (2005) identifies numerous planning activities as essential in building an effective strategic plan. These include components such as Business drivers-why is this being undertaken?, objectives and scope of business, underlying assumptions, quality assurance plan, issue resolution plan, change management plan, risk management plan, project milestones and dates, project cost estimates, risk/benefit analysis, resource requirements. Whereas, Nickols (2006) puts forward a goals grid to effective planning and providing direction to the business. These are consulting services providing expert

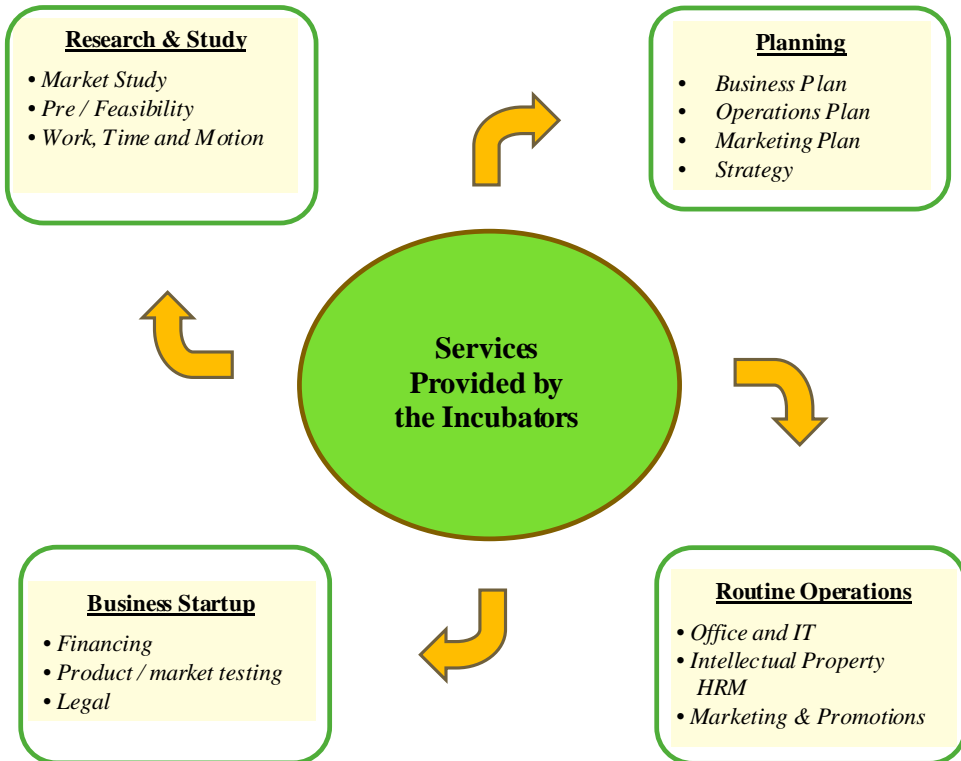
services (Isenberg 2011) by professional firms. Szabo (2006) also laid emphasis on this institutional support. This study will identify role of such firms if any. Mazanai and Fatoki (2011) argue that the business development services including the business startup are essential for entrepreneurship growth and survival of such forms for longer term. Similarly, Drnovsek *et al.* (2010) suggest that entrepreneurial self-efficacy is related to business startup assistance. Szabo (2006) and Isenberg (2011) also identified business startup assistance and role of such organizations providing the service as critical and important. Green & Ouellette (2007) showed that intellectual capital is positively linked to start-up company success, market value, innovativeness, marketplace agility and adaptability. They concluded that value creation potential is enhanced by incubators and they play vital role to assist start-ups by diffusing knowledge, ideas, technologies, etc.

Groups like Small Business and entrepreneurship Council exist (Covel & Kelly, 2009). Ahl (2011) suggests importance and success of lobbying. The U.S. boasts a tradition of supporting small businesses where the Small Business Administration (SBA) was created in 1953. The National Association of Women Business Owners (NAWBO) was formed in 1975 by a number of women entrepreneurs. As a result of the association's successful lobbying, in 1979 President Carter created the Office of Women's Business Ownership in the SBA (Weeks, 2002; Ahl, 2006). The National Women's Business Council (NWBC) was established in 1998. Its 15 members are appointed by the Small Business Association (SBA), and its chairman is appointed by the U.S. president. Special assistance for women in business was initiated in 1994. There are 160 local and regional resource centers for women (Ahl, 2011). Importance of lobbying and creating awareness for welfare of members is reinforced. A study of business services incubators led to websites of numerous incubators operating across the world. In order to identify services of these incubators and to explore whether the stakeholders in Saudi Arabia offer the similar services or not, a number of incubator services were randomly identified from across the world and their services examined. These incubator services can be categorized into following four areas as shown in figure 3 below.

A two part map structure was created, i.e. strategic and Institutional (Rahatulah, 2013). Through secondary research organizations were identified for each of these levels. Then these were mapped on respective level. A particular color is assigned to each service to strategic level organizations. Whereas, the institutional level services discussed above were placed column wise and organizations providing particular services were color coded under them row wise. For example, in strategic level Human Resource Development Fund (HRDF) provides five services whereas, some services of Centennial Fund and Ministry of Industries overlap. On the other hand a number of institutional level organizations provide similar services, e.g. start-up assistance is provided by more than 6 different companies.

This map helps to recognize the efforts of strategic and institutional stakeholders to develop a sustainable environment of entrepreneurship growth, business support services and progress of SME's to trigger entrepreneurship augmentation. In

the first instance the websites of different organizations working for the entrepreneurship growth were identified and thoroughly investigated, wherever information was not complete an effort was made to contact relevant manager / head of the organization to secure more inputs.



**Figure 3.** Business soft skills incubator services

Source: own elaboration based on the literature discussed above.

Keeping all these studies in view, the services at the strategic and institutional level consist of following services as revealed in table 4.

In the first study 48 organizations were identified and formal / informal interviews with the managers, general managers, or other senior executives of 21 stakeholder institutions of Entrepreneurship and SME development in Saudi Arabia were carried out. More than 100 magazines, periodicals and academic and managerial literature were sifted to complete the mapping. Then 5 interviews were conducted to verify the results and two workshops of the stakeholders were attended where the secondary data was presented, was discussed and substantiated. In 2014 number of organizations identified and in 2015 the services at the institutional level increased. The number of service providers swelled as well.

This mixed methodology including qualitative and quantitative means was used intentionally to achieve better results and triangulation. The information from

news sources and websites was also collated to realize the role of the government at strategic level in the economy. Analysis of the information available was also conducted. Secondary sources used were public sources such as websites of the organizations. On the other hand the commercial sources included the use of ABI/INFORM Global websites. The names of officers interviewed and their affiliations will not be divulged as the permission was not granted.

**Table 4.** Isenberg’s domains of entrepreneurship ecosystem

Strategic Level Services		Institutional Level Services	
Celebrating Entrepreneurs	SIC classifications	SME networking opportunities	Collaboration services
Regulating the competition	Helping international partnerships	Coaching and Mentoring	Training and Education
National & Int’l Collaborations	Laws related to institutional level support organizations	Business Consulting	Research
Financial Assistance	Laws relating to construction, Properties, Investor security, contracts, Insolvency etc.	Market Research for Data accumulation (R&D)	Financing and Investment Banks
Developing Law, Policies and Regulations for Business	Research and Development	Start-up Development Skills	Web based -Enterprise & SME Development Platforms
Industrial Surveys	Developing technical incubators	Lobbying, Soliciting, Awareness	Venture Capitalists and Funds
		Soft skills	Incubators and Accelerators
		Market Research for start-ups	
		Technical Consulting	

Source: Szabo (2005, 2006), Isenberg (2011), Rahatullah (2013).

**7. THE EVOLUTION: 2013 TO 2015 STRATEGIC LEVEL OF THE SAUDI ARABIA ENTREPRENEURSHIP ECOSYSTEM**

The evolution of strategic and institutional levels would be discussed separately year wise.

In 2013 study it was evident that there were 9 strategic level organizations working (Figure 4). However, it was also seen that some of the work of the institutional level as asserted by the literature was being carried out by the strategic level. For example, the HRDF was providing salaries to the individuals who were planning to start a business for a specific period of time. This was to help startups consolidate and establish the business without feeling the financial burdens. However, the modus operandi could be altered and funds paid to entrepreneurs through banking channels. Similarly, the Kafala (SIDF) and SCSB had been holding events to establish collaborations and hold events and seminars. This also signifies that in the



absence of the institutional level support the responsibility was shouldered by the strategic level thus showing a more proactive role.

SAGIA	HRDF	SIDF	SCSB	WAED	MOL	MOI	CF	KACST
Saudi Arabian General Investment Authority	Human Resource Development Fund	Small Industries Development Fund	Saudi Credit and Savings Bank	WAED Aramco	Ministry of Labour	Ministry of Industry	Centennial Fund	King Abdullah City of Science and Technology
SFG100 – To recognize the SME Entrepreneurs	Financial assistance to entrepreneurs till they succeed	Financing		Ecosystem development	Law for Saudization, Training and Skills development	Business Support Regulations	Financing	BADIR – The technical and engineering incubator
NCC – National Competitiveness Center	Training and development support for entrepreneurs	Workshops and Seminars		Prefunding support to entrepreneurs	Laws relating to Business startup, Construction, Utilities, Property, Credit, Investor protection and Insolvency		Business Stratup Training	R & D
National and International Collaborations	Strengthening institutions to provide entrepreneurial support	National and International Collaborations		Post funding support to entrepreneurs	National and International Collaborations			Research Grants
Business Stratup Training		Industrial Survey			Lobbying, Soliciting and Creating Awareness			
Lobbying, Soliciting and Creating Awareness								

**Figure 4.** The 2013 Strategic level of entrepreneurship ecosystem in Saudi Arabia  
 Source: own elaboration and map development.

The 2014 strategic level reveals that the WAED – Aramco was shifted from strategic to institutional level owing to their mandate and having further understanding of the ecosystem. The number of services was also increased by many

organizations like MOI, MOL, KACST, HRDF and SAGIA. KACST started to develop policies and training for the ecosystem, whereas, CF embarked to develop international collaborations and implementing the governmental policies and systems. SDF and SCSB commenced the policy drafting and recommendation and HRDF initiated the work on the policy development regarding the human capital development in the kingdom (Figure 5).

Strategic Level of Entrepreneurship Ecosystem of Saudi Arabia							
SAGIA	HRDF	SIDF	SCSB	MOL	MOI	CF	KACST
Saudi Arabian General Investment Authority	Human Resource Development Fund	Small Industries Development Fund	Saudi Credit and Savings Bank	Ministry of Labour	Ministry of Industry	Centennial Fund	King Abdullah City of Science and Technology
SFG100 – To recognize the SME Entrepreneurs	Financial assistance to entrepreneurs till they succeed	Financing		Law for Saudization, Training and Skills development	Business Support Regulations	Financing	BADIR The technical and engineering incubator
NCC – National Competitiveness Center	Training and development support for entrepreneurs	Workshops and Seminars		Laws relating to Business startup, Construction, Utilities, Property, Credit, Investor protection and Insolvency		Business Stratup Training	R&D and Grants for research
National and International Collaborations	Strengthening institutions to provide entrepreneurial support	National and International Collaborations		National and International Collaborations	New Laws, rules and regulations to develop the entrepreneurial businesses	SME Networking	Policies Development
Business Stratup Training	Pay salary to startups till they succeed	Industrial Survey	Research and Dissemination of Information to all stakeholders	Lobbying, Soliciting and Creating Awareness	SME Support Programs	International Collaborations	Training
Lobbying, Soliciting and Creating Awareness	Develop Policies regarding the Human Resource development in the Kingdom	Policy Recommendations		Development of enablers	Policy implementation		R&D and Grants for research
Develop new and enable the institutions to provide more and more services to diverse range of entrepreneurs and startups							

**Figure 5.** The 2014 Strategic Level of entrepreneurship ecosystem in Saudi Arabia  
 Source: own elaboration and map development.

A high end engineering incubator ‘BADIR’ has been developed by Kacst. It serves the engineering and technology startups from across the kingdom. BADIR also provides the technical assistance to the startups and office space and other facilities cater to the growing needs of the startups.

SAGIA	HRDF	SIDF	SCSB	MOL	MOI	CF	KACST	CSC	MODON	GASME
Saudi Arabian General Investment Authority	Human Resource Development Fund	Small Industries Development Fund	Saudi Credit and Savings Bank	Ministry of Labour	Ministry of Industry	Centennial Fund	King Abdullah City of Science and Technology	Council of Saudi Chambers	Saudi Industrial Property Authority	Public Authority for Small and Medium Enterprises
SFG100 - To recognize the SME Entrepreneurs	Financial assistance to entrepreneurs till they succeed	Financing	Law for Saudization, Training and Skills development	Business Support Regulations	Financing	BADIR - The technical and engineering incubator	Bar coding services	Development of industrial cities with integrated infrastructure & services	New Laws, rules & regulations to develop business	
NCC - National Competitiveness Center	Training and development support for entrepreneurs	Workshops and Seminars	Laws relating to Business startup, Construction, Utilities, Property, Credit, Investor protection and Insolvency	Business Stratup Training	R&D and Grants for research	Export Development	Multi stakeholder coordination			
National and International Collaborations	Strengthening institutions to provide entrepreneurial support	National and International Collaborations	National and International Collaborations	New Laws, rules & regulations to develop business	SME Networking	Policies Development	SME Development	Creating the ideal environment for growth and development of technology zones	Oversee the SME growth and Development	
Business Stratup Training	Pay salary to startups till they succeed	Industrial Survey	Research & Dissemination of Information to stakeholders	Lobbying, Soliciting and Creating Awareness	SME Support Programs	International Collaborations	Training	Family Facilities		
Lobbying, Soliciting and Creating Awareness	Develop Policies regarding the Human Resource development in the Kingdom	Policy Recommendations	Development of enablers	Policy implementation	R&D and Grants for research	Conferences & Research				
Develop new and enable the institutions to provide more and more services to diverse range of entrepreneurs and startups										

**Figure 6.** 2015 Strategic level of entrepreneurship ecosystem in Saudi Arabia  
Source: own elaboration and map development.

A massive shift in the governmental policy has been witnessed in the year 2015 where three more organizations have either been established or existing institutions have been granted further responsibilities (Figure 6). Long awaited SME authority has been established which will oversee the SME growth and development in the Kingdom. It will develop coordination among numerous stakeholder and identify the challenges and develop solutions through new laws, policies and regulations. It seems that future might witness this authority taking over these tasks from other organizations.

## **8. THE EVOLUTION: 2013 TO 2015 INSTITUTIONAL LEVEL OF THE SAUDI ARABIA ENTREPRENEURSHIP ECOSYSTEM**

In 2013 few of the services required to be carried out at institutional level were being provided by even fewer organizations (Figure 7). The eco at this stage seemed to be in its infancy where the private sector seemed to start to embrace the challenge of the consolidating and sustenance of the eco. The soft skills development initiatives were limited and so was the effort in the teaching and training. However, the number of organizations was notable comparatively in the areas of research and creating awareness. Effat university became the first university in the kingdom to offer an entrepreneurship degree at the bachelors' level and conduct research in the domains of women enterprise, startups, family businesses, challenges etc.

The year 2014 witnessed the eco grow considerably, new organizations started to mushroom up and brand new services introduced (Figure 8). The universities understanding the requirement and obligation launched their own programs. Many organizations expanded the portfolio of their services and a number of new organizations started brand new services. More investors started to come but the environment remained hazy to their classification. It seemed that many organizations started many services without specializing in some and or developing niches. This is quite understandable as the transition and transformation of the sector had been happening. Strategic level and Institutional level organizations started to build coordination.

However, with in next one year, 2014 to 2015 a huge transformation of the eco took place. New services added, eco became more filled up and almost started to provide all services. A number of more organizations filled in the gaps in the support services and expansion took place both qualitatively and quantitatively. It became easier to categorize the funding services into banking, venture capitalists and funds. Web based services and groups also launched services and specialized organizations to hold events and competitions etc. emerged. Existing stakeholders like Bab Rizk Jameel entered into collaboration with Grameen bank and large public and private sector organizations like Saudi Telecom, Mobily, SEDCO and Dalah Al Baraka begin assistance through their CSR and other community development projects (Figure 9).

Institutional Level of Entrepreneurship Ecosystem of Saudi Arabia											
SME Networking	Coaching and Mentoring	Business and Technical Consulting	Startup Training	Lobbying, Soliciting and creating Awareness	Soft Skills	Market Research	Collaborations	Incubator - Accelerator	Training and Education	Research	Financing / Investment
Chambers of Commerce & Industry	Injaz	RIM (Research in Motion with SAGIA only for IT related projects)	Chambers of Commerce & Industry	Chambers of Commerce & Industry	Injaz	AlZamil Group - Feasibility and Recruitment	Chambers of Commerce and Industry	ARAMCO-Shoaiibi Group, Kaufman Foundation - R&D Hub at Khobar	NCB PC Labs, Educational Development and Job Opportunities	King Saud University	SIDF
	Business Development Centers and different committees at CCIs										Price Water House Coopers
Khadija Bint Khuwailed											NCB
MILE Madinah Munawwara	Chambers of Commerce - Trainings, conferences, workshops, seminars and exhibitions etc				Qotuf	Chambers of Commerce & Industry	NCB CSR Department	BADIR	Chambers of Commerce & Industry	KFUPM	KAUST
	Qotuf	Deloitte	NCB CSR department		NCB CSR Department						Umm Al Quraa University
NCB CSR Department	Effat University		CCIs SME Dev. Centers	CCIs CSR Centres			KAUST	KFUPM	Bab Rizk Jameel		Al Rajhi Bank
KAUST	Riyadah	Alvarez & Marsal	Riyadah	CCIs Young Businessmen	Effat University	WAED - Aramco	KAUST	KAUST	Effat University	WAED - Aramco	Prince Sultan Fund
WAED - Aramco	Bab Rizk Jameel	Arthur D Little	Bab Rizk Jameel	CCIs Young Business Women	SIDF	Umm AL Qura University	Qotuf	Qotuf	RIM - SAGIA	Umm Al Quraa University	Qotuf
Wadi Jeddah	KAUST	Charles River Associates	Effat University	WAED - Aramco			KFUPM	KAUST	BADIR	KFUPM	
	WAED - Aramco	Ernest & Young	Qotuf		KAUST	Umm AL Qura University			Princess Noura University		Al Zamil Holding
	Umm AL Qura University	BADIR			Riyadah	KFUPM			WAED - Aramco		
	KFUPM	KAUST							KAUST		

Figure 7. 2014 institutional level of entrepreneurship ecosystem in Saudi Arabia  
Source: own elaboration and map development.

SME Networking	Coaching and Mentoring	Business and Technical Consulting	Startup development Skills	Lobbying, Soliciting and creating Awareness	Soft Skills	Market Research	Collaborations	R&D Incubator)	Training and Education	Research	Financing / Investment by Banks	Web based - Enterprise & SME Development Platforms	Venture Capitalists and Venture Funds	
Chambers of Commerce & Industry	Injaz	RIM (Research in Motion with SAGIA only for IT related projects)		Chambers of Commerce & Industry	Injaz	AIZamil Group - Feasibility and Recruitment	Chambers of Commerce and Industry	ARAMCO-Shoabi Group, Kaufman Foundation - R&D Hub at Khobar	NCB PC Labs, Educational Development and Job Opportunities	King Saud University	SIDF	Angel Investors network	Amwal AlKhaleej	
	Business Development Centers and different committees at CCLs	Price Water House Coopers	Injaz								Khadija Bint Khuwailed		Bab Rizk Jameel	Women business database
Khadija Bint Khuwailed	Price Water House Coopers	Injaz	Khadija Bint Khuwailed	Bab Rizk Jameel	Women business database	Effat University	Chambers of Commerce & Industry	Umm Al Quraa University	Princess Noura University	KFUPM	Dallah Al Baraka	iMENA	Jadwa investment	
MILE Madinah Munawwara	Chambers of Commerce - Trainings, conferences, workshops, seminars and exhibitions etc				Qotuf	Chambers of Commerce & Industry	NCB CSR Department	Umm Al Quraa University	Chambers of Commerce & Industry	Princess Noura University	KFUPM	iMENA	Aramco Energy Ventures	
	Qotuf	Deloitte	NCB CSR department		NCB CSR Department								Umm Al Quraa University	Princess Noura University
NCB CSR Department	Effat University	CCIs SME Dev. Centers	CCIs CSR Centres	NCB CSR Department	Chambers of Commerce & Industry	KAUST	Umm Al Quraa University	Princess Noura University	KFUPM	Bab Rizk Jameel	Venture Capital Bank	Grofin	Prince Sultan Fund	
KAUST	Riyadah	Alvarez & Marsal	Riyadah	CCIs Young Businessmen	Effat University	WAED - Aramco	Umm Al Quraa University	King Saud University	RIM - SAGIA	Umm Al Quraa University	Umm Al Quraa University	Grofin	STC Ventures	
WAED - Aramco	Bab Rizk Jameel	Arthur D Little	Bab Rizk Jameel	CCIs Young Business Women	SIDF	Umm AL Qura University	King Saud University	RIM - SAGIA	Umm Al Quraa University	Umm Al Quraa University	Umm Al Quraa University	Grofin	CGI Capital	
Wadi Jeddah	KAUST	Charles River Associates	Effat University	WAED - Aramco	KAUST	Umm AL Qura University	Wadi Jeddah	SIDF	Qotuf	Wadi Jeddah	ArabNet	Wadi Jeddah		
	WAED - Aramco	Ernest & Young	Qotuf	Effat University	KAUST	Umm AL Qura University	Wadi Jeddah	SIDF	Qotuf	Wadi Jeddah	ArabNet	Al Zamil Holding		
	Umm AL Qura University	BADIR	Effat University	Wadi Jeddah	KAUST	Umm AL Qura University	Wadi Jeddah	SIDF	Qotuf	Wadi Jeddah	ArabNet	Grameen-Jameel		
	KFUPM	KAUST	Effat University	Riyadah	KAUST	Umm AL Qura University	Wadi Jeddah	SIDF	Qotuf	Wadi Jeddah	ArabNet	Malaz Capital		
												ArabNet	MBC Ventures	

**Figure 8.** 2015 institutional level of entrepreneurship ecosystem in Saudi Arabia  
Source: own elaboration and map development.

One very special strategic level organization has been noted and that the mandate of HRDF is extraordinary and the literature lacks many such examples of an elaborate, unique and comprehensive program for potential entrepreneurs in a developing economy as it is in Saudi Arabia.

Saudi Arabia has registered 147 patents in 2011 and tops the Arab countries (Market Information Trading, 2012). However, there seems dearth of innovation houses. If a country can produce such number of patents without state of the art facilities spread across country it may perform better with a number of high tech labs available throughout the kingdom.

According to Isenberg (2011) the research institutions are important and fall under the Policy domain and Governmental initiatives. Similarly, Szabo (2006) also underlines the importance of research institutions at Enterprise level. Literature also argued for information centers development, access to and increase in technology use and awareness, developing consumer protection and intellectual property rights. Organizations like KACST, Waed and KAUST provide such facilities in the kingdom. This shows another huge potential activity for the kingdom.

As regards the SME networking both Isenberg (2011) and Szabo (2006) establish the need for networking. Isenberg identified three factors, i.e. entrepreneurs', scattered but organized and multinational networks. Whereas, Szabo taking a more qualitative look argue for networking at enterprise level. This study points out to chambers of commerce and SAGIA providing these opportunities at national level even if the number of such events may be less though. Khadija Bint Khuwailed center at JCCI create opportunities for Saudi women and help them with their routine operational problems and issue.

The importance of coaching and mentoring, business consulting and startup training has been a centre point of entrepreneurial development. The findings reveal that these services are provided by some of organizations in Saudi Arabia. These include Centennial Fund which provides business startup training through its partner organizations. Research in Motion (USA) and SAGIA will provide this training to potential IT entrepreneurs. KAUST offers the services to potential technology and engineering industry entrepreneurs. In the private sector chambers of commerce, BADIR, Al Zamil group and Bank Al Ahli's CSR department have programs for startup training. However, business consulting is provided by the chambers of commerce, private sector consulting firms and RIM. KAUST and Chambers of commerce have coaching and mentoring programs.

Lobbying, soliciting and creating awareness are considered important tools and mechanisms to solicit to the governmental bodies for grant of rights, privileges and ease of laws etc. to boost a particular sector. The Kingdom has taken initiatives in this regard. However, there are not enough number of associations and representative bodies who can effectively put up their stand point to the relevant authorities and help create networks and raise exposure of its members.

According to Isenberg (2011) the research institutions are important and fall under the Policy domain and Governmental initiatives. Similarly, Szabo (2006) also

underlines the importance of research institutions at Enterprise level where the information centers, access to technology, consumer protection and intellectual property rights play vital role. However, the findings have revealed that KACST and KAUST provide these facilities. Whereas, the private and governmental universities are now commencing such nurturing activities.

As regards the SME networking both Isenberg (2011) and Szabo (2006) establish the need for networking. Isenberg lays importance on entrepreneurs', Diaspora and multinational networks. On the other hand Szabo lays importance of networking at enterprise level. The findings reveal that the chambers of commerce and SAGIA provide such opportunities at national level. The number of events may be limited though. Khadija Bint Khuwailed center at the JCCI provides opportunities for Saudi women. However, these initiatives may be enough in short term but will require more concerted effort to realize the goals of the government.

The research shows that SIDF, KAUST, Bab Rizk Jameel, Khadija Bin Khuwailed Centre, BADIR and Injaz provide some selected services of business incubation. However, none of the organizations provide complete and full services as envisaged by the academic, applied and practice literature and discussed in methodology above. These efforts along with other endeavors seem fragmented and there seems a clear need to help the potential entrepreneur.

## 9. CONCLUSIONS

The paper has met the aim of its study by providing a comprehensive look and understanding on the entrepreneurship ecosystem, its need, evolution and strategy implications. It has shown as the following conclusions reveal that an ecosystem exists of entrepreneurship development exists. The organisms for development are the stakeholders both at the strategic and institutional levels. The knowledge of existence of an eco energizes all stakeholders as we witness the change in the eco and new institutional stakeholder additions offering new services to stage 1 and 2 entrepreneurs. The evolution also provides evidence that there is a deliberate or otherwise strategy of the Saudi government to strengthen the ecosystem.

The findings were also discussed with five industry experts and senior academics to validate the findings and understand their perspective. The names and titles are not revealed as per advice of the interviewees. The discussion below is also then generalized as researcher was not allowed to divulge personal information of the experts.

The question related to understanding the status quo has been amply answered and it shows the existing status of both the strategic and institutional levels of the ecosystem. The work has also underlined that the Saudi Arabian government has taken huge steps diligently and effectively. A deliberate effort of the institutions development both at the strategic and institutional levels of the ecosystem seems to be in place. The ecosystem is evolving rapidly evidencing that the eco is responding to dynamic needs of the enterprise, startups and entrepreneurs of first, second and



or the third stage. All these answers to the questions are discussed in more detail below and further conclusions are drawn.

The government of Saudi Arabia and the private sector together have taken numerous steps in keeping with the national priority of generating employment for young Saudis in particular and create economic activity and private wealth. The findings and discussion reveal a potential to further develop of institutions and create planned interventions needed at strategic, institutional and enterprise levels. This will develop a movement to further the entrepreneurship growth with snowball effects and put on mass. It is estimated that this will assist in institutionalizing the policy, human capital development, support professions, culture, markets and, micro loans, angel investors networks, financing, venture capital and public capital markets which are essential for enterprise growth.

However, an issue has come to surface, i.e. some organizations at strategic level are providing services that they are perhaps not supposed to and fall under institutional. This is may be because of the lack of and potential in institutional capabilities strengthening. For example a very important stakeholder, Centennial fund, providing coaching and mentoring and trainings to their loaned customers. They might not have had to invest time, effort and money if there were enough private sector organizations existing and offering these services. It shows that ecosystem requires specialist institutions for each of the 10 services including incubators. The strategic level financial institutions work for the entrepreneurs, SMEs, and provide financing to any level / stage entrepreneurs. Their services range from business consulting and conducting the research and providing the feedbacks. Here also it is evident that some of these banks provide loan facilities at comparable terms and conditions. There are banks and other financial institutions that do not specify the loan limits and leave it to percentages of their own equity that can jeopardize the liquidity situation of the concerned bank when they need to finance very large-scale projects.

It can be concluded that such studies should be carried out on continual basis and ecosystems evolution mapping be carried out in other countries so that the deficiencies, efficiencies and proficiencies in the ecosystem could be identified and necessary action could be taken accordingly.

It is also inferred that there should be a virtual entrepreneurship ecosystem evolution observatory that maps the eco in real time. The stakeholders should be able to update their details by logging on to a virtual observatory. Whereas, the entrepreneurs at different stages, by looking at the maps and clicking can get access to the required organization(s). The observatory is further explained below.

In the study websites of more than one hundred and fifty organizations were identified and searched again to identify any changes from previous maps. Based on the new study a new website is being developed [www.effatuniversity.edu.sa/entrepreneurship\\_ecosystem](http://www.effatuniversity.edu.sa/entrepreneurship_ecosystem). This will house a virtual observatory and store the yearly updated maps. Any stage entrepreneur may log into the website and search for suitable organization(s) to get assistance from.

It has been seen that when the potential startups struck an idea and are in initial, early or later stages of the startup development, majority of times they do not know where to get what kind of assistance. Similarly, they have little idea on the sources of funding, intellectual property rights and legal framework of the country. At times they get trapped and sometimes due to difficulty in finding the right organization for assistance they simply give up the idea.

Therefore, in order to make informed effective decisions it is important to have a knowledge of the prevailing conditions in the marketplace of the essentials of the startups. These include, coaching, mentoring, venture capital, training and development, consulting, personal development, soft skills, incubator or accelerator facilities required, research and development, patent and copyrighting, legal and others. This will avoid replication and duplication of efforts. Similarly, knowledge of status quo helps identify opportunities and supports plan development to endeavor through right strategy.

The names of organizations on the maps are clickable and the upon the click a brief profile opens up showing the services and contact details thus helping the start-up and later stage entrepreneurs to reach to the concerned stakeholder more efficiently. It also provides a marketplace for the companies to compete on the basis of services provided.

Like any other research this investigation also had limitations as outlined below:

- It is a tough ask to conduct the research in the kingdom as the culture is developing for investigation and there is a huge scope for it.
- As the national language is Arabic, majority of websites are in Arabic and a number of other organizations do not have the internet presence, making it difficult to reach out to the information.
- It is difficult and time consuming to get the information not available on the websites from different sources within organizations.

SME authority is a great initiative introduced at the strategic level and would notably enhance the SME sector in the Kingdom and act as catalyst of entrepreneurship growth in Saudi Arabia. It is recommended the authority works to:

- Start support professions' training and development programs needed and help them implement these programs nationwide.
- Celebrate entrepreneurship to encourage and motivate the first stage entrepreneurs to turn their ideas into reality.
- Develop Business Format Franchising in the Kingdom.
- Develop Soft Skills incubators at educational institutions.
- Develop Consulting organizations in Financing and Feasibility studies.
- Develop and implement programs for jailed inmates.
- Develop research to propose recommendations for energy, business, engineering, medicine, business research, SME development cities and SME industrial zones to the Government.

- Develop Common Facilities Centers.
- Develop and implement awards for outstanding entrepreneurs in.
- Launch Business research at educational institutions.
- Launch and market academic and applied journals and periodicals.
- Organize and launch academic and applied conferences.
- Organize and implement networking conferences on Social business, Women related businesses, Medicine and engineering

This catalyst should also:

- Develop and encourage associations of different industrial sectors.
- Develop and initially supervise franchise association. Upon completion of memberships and enforcing the laws, let it become an independent institution.
- Develop Innovation enablers.
- Develop patents and copy righting institutions.
- Carry out regular SME Census.
- Develop and implement business friendly laws on partnerships specially between local and international, forex repatriation, employment in a company where shareholding is also held by foreigners.
- Classify the businesses according to SIC codes.

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# Review of network research in scientific journal 'Entrepreneurship Theory and Practice'

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## Abstract:

This article aims at presenting a systematic review of publications that verified the network theory and the theory of networks empirically, published in the entrepreneurship journal with the highest Impact Factor: "Entrepreneurship Theory and Practice". We present how publication frequency evolved over time, and classify papers into major streams of entrepreneurship research. Our findings suggest the theory of networks is an under-researched area promising for further advancing the theory of entrepreneurship. We also find increasing publication frequency of network related research over time. Results oriented research were most often present in reviewed articles, while relationship among network variables and innovation was only tested in two articles so far which suggests that more research is needed in this direction in the future. We believe that verification of theories of networks in entrepreneurship and verification of relationship between network variables and innovation within the network theory are most promising. The originality of this work lies in identification of research opportunities and dynamics of empirical verification of network studies in the field of entrepreneurship.

**Keywords:** network theory; theory of networks; literature review; entrepreneurship; network society

**JEL codes:** L26, D85

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## 1. INTRODUCTION

Entrepreneurs and organisations established by them operate in a complex mix of relationships. To explain antecedents of these relationships, find patterns that enable to understand their complexity, and inquire into consequences of observed patterns, Entrepreneurship scholars increasingly use network theorizing. The study of entrepreneurship through network lenses has been increasingly visible, as indicated by earlier review of the field (Hoang & Antoncic, 2003). This review identified 70 papers that have been published on the role of networks in the entrepreneurial context in scholarly journals specializing in entrepreneurship, sociology, and strategic

management already in 2003. Since that time number of publications that use network approach in organization science has increased substantially, that enabled clarification on network related theorizing in social science (Borgatti & Halgin, 2011). Building on advances in network theory we decided to apply two major categories of network theorizing: the theory of networks and the network theory in systematic review of network research in the leading journal in the field – Entrepreneurship Theory and Practice.

Network theorizing raised out of a metaphor that was creatively used and turned into rigorous theoretical propositions, *inter alia*, by Harrison White, the founder of Harvard Revolution in sociology, and Bruno Latour, the author of the actor-network theory. Harrison White (1992) put forward a general sociological theory based on organisations (and individuals) seeking to control their identities through embeddedness in networks. Bruno Latour (1988) wrote that the network metaphor indicates concentration of resources in few network nodes. His actor-network theory treats both machines and humans as actors of social processes, emphasizing the key importance of their interactions in today's organisations and societies. That theory anticipates phenomena that have been recently called the Internet of things or the Internet of everything, visions of a global network connecting not only people but also objects. In the world where hundreds of millions of Internet users are constantly exchanging huge amounts of information, the network metaphor seems to be commonly comprehensible. Thinking about social networks, we imagine the world entangled by relationships among exchange participants who use modern information technologies.

The network metaphor usefulness is not confined to explaining the Internet phenomena solely or even those that occur in social systems. The widespread existence of networks is evidenced by a growing number of studies and theoretical proposals developed by physicists, mathematicians, computer scientists, biologists and epidemiologists. Also artists are interested in networks, as exemplified exquisitely by Mark Lombardi's drawings collected by the Museum of Modern Art (MoMA) in New York. Understanding the rules of information and resources flow within a network structure also has crucial practical implications. For example, it allowed for designing Google PageRank algorithm (Brin & Page, 1998), reducing costs and improving effectiveness of the fight against addiction to nicotine (Christakis & Fowler, 2008), detecting and combating terrorist networks (Krebs, 2002), and effectively placing innovations in the market (Valente, 1996).

In institutional economics, Powell (1990) points to networks as the third mechanism of economic organisation, along with markets and hierarchies. White (2001) and Granovetter (1985) argue that markets are theoretical concepts separated from reality, whereas, in fact, economic processes unfold primarily in social networks of exchange and cooperation. Granovetter's (1985) theory of social embeddedness of economic processes contrasted with classical economic theories that disregarded the social aspect and were dominated by individualistic, transactional explanations of economic mechanisms. Castells (1996) writes about an emerging network society that develops as modern communication technologies become

widespread and global actors become more and more interconnected. The network metaphor allows him to reveal a comprehensive picture of the organisation of modern societies that are being constantly reconfigured. The network society processes cannot be effectively regulated by national laws since the network extends beyond the borders of a single country. Citizens of the network society smoothly switch between organisations, associations or coalitions of interests.

In the network society, where interrelated individuals are involved in the exchange of resources and information, an entrepreneur's success inevitably depends on his or her position and characteristics of the network in which he or she operates. Position in the network structure determines opportunities and imposes restrictions on freedom of action. Network characteristics govern dynamics and possibilities of exchange and access to resources and information.

Our article aims at presenting a systematic review of publications that verified the network theory and the theory of networks empirically and were printed in the entrepreneurship journal with the highest Impact Factor: "Entrepreneurship Theory and Practice". Our literature review outlines key theoretical proposals for a network approach: the network theory and theory of networks. To introduce this theoretical approaches we briefly introduced their key assumptions and illustrated each by example of a seminal study conducted in these traditions. Then, we introduce methodology of our study and present the results of our systematic literature review of "Entrepreneurship Theory and Practice" publications in 1995–2015. Resorting to the Scopus database, we selected 71 articles published in the last 20 years that use the word "network" in their abstracts. Subsequently, we divided the articles into those addressing theoretical proposals and those reporting empirical research to verify the theories. Since our review seeks to establish how advanced empirical research into links between networks where entrepreneurs operate and their performance is, the next step left out articles aimed at examining other relationships. We do not analyse in detail theoretical articles that contain no empirical research results, either. We selected 38 articles for our final analysis, considering them as an attempt to verify two broad theoretical traditions that we introduced earlier. Our literature review indicates popularity of these two approaches in the journal when mainstream entrepreneurship research is presented. We also describe changes in the number of publications in question in the studied period of 20 years. In conclusions, we identify promising areas of future research that strives to verify the network theories in the field of entrepreneurship.

## **2. NETWORK THEORY AND THE THEORY OF NETWORKS**

The growing importance of the network approach in the organisation and management theory was mentioned by Borgatti and Foster (2003), who indicated that its popularity increased exponentially, as measured by the number of publications in scientific journals. A network may be made up of any set of objects connected by relationships that form analysable patterns. Objects may be alternatively referred to



as actors, nodes or vertices, and their interrelations may be termed ties, lines, connections or edges of a network. A network analysis highlights the fundamental importance of relationship patterns that form the ground for explaining the phenomena addressed by social sciences and for the entrepreneurship theory developed based on such sciences.

A social network analysis aims at clarifying links between the structure of relationships and connections and characteristics of the social system. It comprises two key aspects: mechanisms governing the formation of the social system and its characteristics, and consequences of network configuration (Tsai & Ghoshal, 1998; Rowley, Behrens & Krackhardt, 2000). Borgatti and Halgin (2011, p. 1168) point to the distinction between those two theoretical network issues that are analytically separate, defining them as the theory of networks and the network theory.

The theory of networks explains the origins and characteristics of an observed network, for example its non-scalability, i.e. the fact that the relationships between network nodes are distributed exponentially. Such a distribution may result from preferential connections, namely the tendency of nodes to establish relationships with popular network objects (Barabasi & Albert, 1999). Another research project, in line with the theory of networks, would define network properties, for instance its density as a measure of network relationships in proportion to all possible relationships. Networks where entrepreneurs operate are expected to have different densities, depending on the culture of a country. If entrepreneurs tend to be driven by more individualistic values, the network density is expected to be low, resulting in slower dissemination of practices and innovation and greater differentiation of entrepreneurs' attitudes. Empirical studies under the theory of networks are, therefore, conducted as macro-analyses of entrepreneurship determinants described by measurements of global network properties.

Research under the theory of networks is also exemplified by analyses of the extent to which the structure examined has the characteristics of a small-world network. The concept of small-world network refers to the classical theoretical proposal put forward by Milgram (1967), who stated that actors of even very extensive networks are separated by only a few direct connections, usually not more than six. A small-world network is a specific class of networks with many strongly interrelated subgroups and a relatively short path of connections between nodes (Watts & Strogatz, 1998). Uzzi, Amaral and Reed-Tsochas (2007) discussed the applications of small-world network research methods, pointing to the existence of such networks in a wide variety of organisational systems, for instance networks of relationships between musicians and actors, networks of alliances, research networks examined through mutual citations, inter-organisational networks built through personal relationships among board members, patent cooperation and energy networks. The fact that small-world networks prevail in different types of inter-organisational and personal networks proves high efficiency of network action coordination mechanisms and resilience of those systems to disruptions.

The network theory aims at explaining the consequences of network variables such as centrality, operation in structural holes and characteristics of ties for the

performance of network participants (Granovetter, 1973; Freeman, 1979; Burt, 1992). Granovetter used the characteristics of ties to develop the theory of strength of weak ties (SWT) (Granovetter, 1973). He was directly inspired by research into the job seeking process that found that weak ties provide valuable information about job offers. It is the information from acquaintances weakly tied with job seekers, rather than from closely related friends, that increase the probability of success in the labour market. This is because persons closely related with job seekers live in the same environment and usually have access to similar information. Valuable information is communicated by people who have access to multiple groups with different information. Weak ties accelerate flows in a network and provide fast access to its remote parts.

Examination of links between the effects of action and the quality of relationships is also well illustrated by one of the most frequently cited scientific articles addressing networks (Uzzi, 1997). Its author investigated women's fashion companies in New York and found that two distinctive types of relationships existed between those companies and their suppliers. Those types are also included in the SWT theory described above. Respondents talked about them in different ways. The first type includes relationships marked by social embeddedness and called "close" or "special" by CEOs of examined companies. Such relationships are based on reciprocity, emotional involvement, intensive exchange of information, trust, joint problem solving and a longer time horizon. The second type comprises market transactions (arm's length ties), individual agreements where suppliers were selected chiefly according to the lowest price criterion. Uzzi stated that embeddedness was associated with saving time (economies of time), i.e. the ability to seize emerging market opportunities quickly. Embeddedness also reduces transaction costs because partners having a long-term relationship tend to trust each other. He also highlighted that excessive embeddedness restricted access to information about changes outside the network of a company's close relationships.

The theory of structural holes is a perfect example of reasoning in the context of the network theory, which states that the positions of nodes affect their performance. It was developed by Ron Burt (1992) on the basis of research into issues similar to those that became the foundation for Granovetter's theory of strength of weak ties. Burt focused on the impact of a diversified egocentric network structure, i.e. a network of people directly related with candidates, on the speed of promotion. He put forward the hypothesis that promotion is linked with structural holes in egocentric networks. Holes also exist where two people tied with a candidate for promotion do not have mutual relationships. Structural holes allow the candidate to control information flow between unrelated contacts and access knowledge from many sources. This affects his or her expert position and should be positively correlated with promotion likelihood, as confirmed by that author's research. In his argumentation, he does not focus on the quality of relationships but on their structure and the position of candidates for promotion.

We have drawn a distinction between the network theory and the theory of networks in this section. We introduced the essence of each of these theories and

discussed seminal studies that illustrate both. In order to achieve this we have chosen the most frequently cited works that examined network structures and effects of network actors' positions. In the next chapter, we analyse those two types of theories in the entrepreneurship literature based on a review of texts published in "Entrepreneurship Theory and Practice" during 20 years. We were curious how often in mentioned journal the issue of network was the topic of articles and, considering the entrepreneurship field, in what context it was analysed. The aim was to determine what areas were taken into consideration in the analysis of the network in ETP.

### 3. MATERIALS AND METHODS

In this article, we report preliminary research that we want to develop into a systematic review of entrepreneurship literature. We intend to provide a comprehensive review of publications aimed at verifying network theories empirically. We would like to include more scientific journals addressing entrepreneurship and expand the scope of our analyses. At the present stage of preliminary research, we have chosen to analyse the entrepreneurship journal with the highest IF: "Entrepreneurship Theory and Practice". Based on the Scopus database, we limited our selection of articles to 1995–2015.

Initially, we tried to look for texts addressing the network theory and the theory of networks. However, regardless of the search phrase, the results comprised the same 16 articles. We, therefore, decided to broaden our search and selected articles that contained the word "network" in their abstracts. This resulted in more texts, namely 71. Thus, we were able to prepare a broader analysis of the issue in question and verify which theory is actually used for data analysis.

Following the initial selection, we rejected 9 thematically irrelevant articles that contained the word "network" in a meaning different from "a network of relationships" or that concerned, for example, citation links between entrepreneurship researchers (Grégoire, Noël, Déry & Béchar, 2006). One article covered a literature review of research into networks in entrepreneurship (Slotte-Kock & Coviello, 2010). 23 publications presented studies on the impact of a network on a selected phenomenon. The objective of our review was to identify articles that verified empirically the network theory and the theory of networks described in the previous chapter. We wanted to find out how researchers analyse networks, what they research and what network characteristics are described, which helped us to outline the research programme in the conclusions. Based on the review of abstracts and an overview of the methodology and methods of analysis of the collected data, we classified 38 articles for final analysis.

When reviewing publications on networks, we wanted to answer the following questions:

- Which theory is mainly used to do research into networks in entrepreneurship (theory of networks vs. network theory)?

- In which context of entrepreneurship are networks most frequently researched?
- Which network characteristics are most often analysed in research into networks in entrepreneurship?

We divided the selected articles according to the area researched, network theory used and the method of network analysis, and matched the articles to network characteristics that were described in the studies: size, density, relationship type, centrality, structure or content. We also identified 6 themes that were discussed in the articles in the entrepreneurship context of research: innovation, company development understood also as company growth, resources and resource accumulation, achievement understood also as the number of agreements concluded, effectiveness, etc., financing – all methods of financing, collaboration with banks, lending and cooperation including texts describing cooperation between companies, suppliers, entrepreneurs and institutions. Above themes arose from the grouping of articles in the thematic area. Reviewing articles enabled us to define the main topics which were discussed, and categorize them into thematic categories. Our main analytical frame was to distinguish papers as either fitting concepts of network theory or theory of networks as proposed by Borgatti and Halgin (2011). At more detailed level we assigned papers according to specific measures and network concepts used by their authors. We have looked for commonly used network concepts such as: density, centrality, type of relationship, structure and content. Some articles are classified in several categories as the use of concepts and measures is not mutually exclusive.

#### 4. RESULTS AND DISCUSSION

The analysis of abstracts of 39 articles selected for review allowed us to classify them to two theoretical areas mentioned in the preliminary literature analysis and to one of 6 research area categories. We classified them independently, and when opinions differed, we read whole articles in order to assign them to appropriate categories. The results of our review are provided in Table 1 below.

It appeared that most studies – as many as 14 or 37% of all articles on network research published in the journal that we chose – focused on business achievements. As illustrated in Table 1, researchers concentrated primarily on analysing the type of relationship and its impact on entrepreneurs' achievements, hence used the network theory more frequently, although network structures and sizes were also examined. Among the selected texts, the article by Greve and Salaff (2003) has most citations and describes networking patterns among entrepreneurs and their impact on business operations, exemplified for 4 different countries. The second most frequently cited article is that by Louise, Althanassiou and Crittenden (2000), who presented the influence of the founder's central position on strategic business management, and thus on company performance. Based on the concept of social network and the founder's central position, they developed a model for further examination of strategic business management. The third most often cited (150) text by

Hite (2005) builds on case studies and analyses embeddedness of entrepreneurs in the context of recognising opportunities, seeking resources and effective management. The next most often cited (121 citations) study presents the network structure of academic entrepreneurs managing companies in various stages of development (Mosey & Wright, 2007). The research involved interviews with academic entrepreneurs who were asked to describe the structure, content and management of their networks at the beginning of the research and again after one year. In his text, cited 82 times, Westhead (1995) addresses achievements depending on the type of high-technology company managers and the type of their relationships. A quite often cited article (70 citations) by Lester and Cannella (2006) is about building social capital by family businesses and its impact on their survival. Other articles in this group focused mainly on the type of relationships, type of persons in the network and their impact on achievements (Godwin, Stevens & Brenner, 2006; Wu, Wang, Chen & Pan, 2008; Huse & Swartz, 2010; Scarbrough et al., 2013; Sautet, 2013; Ebbers, 2014), also with reference to success achieved by transnational entrepreneurs (Wenhong & Tan, 2009).

**Table 1.** Division of articles by area, theory and network analysis area

Area	No. of articles	Network theory	Theory of networks	Size of network	Density of network	Type of relationship in the network	Centrality	Structure of the network	Content of the network
Innovation	2	1	1		1	1	1		
Company development	4	2	2		1	3		1	1
Resources	5	4	1	2		4	1	1	1
Achievements	14	9	5	5		9	2	5	3
Financing	7	6	1			6		3	1
Cooperation	7	6	1	3		7		3	1
Total	39	28	11	10	2	30	4	13	7

Source: own elaboration.

We assigned seven texts to the thematic area of cooperation and seven articles to the topic of raising funds by entrepreneurs.

As regards articles describing research into the impact of networks on cooperation among entrepreneurs, investors etc., it can also be noted that the researchers concentrated chiefly on studying types of network relationships (Webb et al., 2010; Karra, Tracey & Phillips, 2006), then the network structure (Ring, Peredo & Chrisman, 2010) and the network size (Kuhn & Galloway, 2015; Patel & Conklin, 2009). Only one article used the theory of networks (Ring, Peredo & Chrisman, 2010) and others employed the network theory (i.a. Bartholomew & Smith, 2006; Daspit & Long, 2014).

That was also the case for articles on the impact of networks on the search for financing by entrepreneurs where the authors also primarily analysed relationship types, chiefly using the network theory (i.a. Chen & Tan, 2009; Du, Guariglia & Newman, 2015), with only one article resorting to the theory of networks (Fiet, 1996). The research mostly concerned methods of building networks in order to gain easier access to loans (Saparito, Elam & Brush, 2013; Du, Guariglia & Newman, 2015) or generally to raise funds more effectively (Jonsson & Lindbergh, 2013; Kreiser, Patel & Fiet, 2013).

Another group of five articles (13%) presented networks in the context of resource accumulation. Again, what could be noticed was the popularity of network relationship type analyses with account being taken of those relationships that allowed for successful use of resources (Haugh, 2007; Khayesi, George & Antonakis, 2014), then the popularity of network size analyses (Semrau & Werner, 2014), and finally centrality (Keil, Maula & Wilson, 2010) and generally network structure and content (Sullivan & Ford, 2014). No article assigned to the topic of resources and their accumulation used the theory of networks.

Four articles were categorised as addressing company development and the fewest texts dealt with innovation (2 articles). In analysing networks in the context of company development, the first study examined the impact of relationship types on company operations in different stages of development (Arregle et al., 2015), whereas the second one focused on the role played by networks and their densities in internationalisation of companies (Musteen, Datta & Butts, 2014). In their research, De Carolis, Litzky and Eddieston (2009) attempted to find out what type of networks and network relationships has a positive effect on company development. Their research results are quite often cited – 70 citations. They analysed the types of people involved in entrepreneurs' networks. Hansen (1995) studied growing organisations with a focus on the types and frequency of interactions among their members.

In the area of innovation, one article addressed network density and centrality and their consequences for business innovation (Tan, Zhang & Wang, 2015). The authors of the second study analysed the type of network relationships and commercialisation of innovations (Partanen, Chetty & Rajala, 2014). Tan, Zhang and Wang's (2015) publication used both network theory and theory of networks.

To summarise, based on our analysis, we noticed that research into networks in entrepreneurship mostly concentrated on types of relationships and their effects on achievements, financing, cooperation and resource accumulation. The fewest studies addressed density, centrality and other network variables. Researchers least frequently referred to studies related to the theory of networks, which means that there is a gap in the entrepreneurship literature.

What we also found interesting was an analysis of the number of articles based on network research over the last 20 years, as presented in the table below.

As can be observed, articles reporting network analyses are not very popular in "Entrepreneurship Theory and Practice". By 2005, only single or no texts were actually published. It was only after 2005 when we can notice an increased interest

in research into networks in the field of entrepreneurship. Especially over the last 5 years, this subject seems to have been attracting more and more interest, although the number of publications has remained more or less the same since 2010. In recent years, roughly since 2006, such topics as cooperation, financing, search for resources have earned recognition, and since quite recently, innovation and company development have become more popular.

**Table 2.** Distribution of 39 selected articles in 1995–2015 by year and popularity of the topic

Year/thematic area	1995	1996	2000	2003	2005	2006	2007	2008	2009	2010	2013	2014	2015
Innovation								1				1	1
Company development	1											1	1
Resources							1			1		3	
Achievements	1		1	1	1	2	1	1	2	1	2	1	
Financing		1							2		3		1
Cooperation						2			1	2		1	1
Total no. of articles	2	1	1	1	1	4	2	2	5	4	5	7	4

Source: own elaboration.

## 5. CONCLUSIONS

Our analysis allowed us to answer the questions that we asked. It turned out that research to verify the theory of networks empirically is much less frequently published in the entrepreneurship literature than research aimed at verifying the network theory. This offers a huge potential for exploring that scientific branch and looking at entrepreneurship from a different perspective than before. It is worth reflecting on projects intending to describe global network structures among entrepreneurs, examine network density and other characteristics and reasons for the formation of networks whose importance cannot be overemphasised in modern entrepreneurship. It seems interesting to study the differences in relationship types and other characteristics across individual countries and examine them in the context of cultural differences. Cultural differences, for example individualism versus collectivism, should be relevant to the characteristics of networks of entrepreneurs operating in different countries. A promising research field should also cover analyses of transnational networks of entrepreneurs and their adaptation to various structures that determine dynamics of the flow and exchange of resources and information. It is noteworthy that studies of embeddedness-initiated in economic sociology by Granovetter (1973) are very promising in the field of entrepreneurship. In particular, exploring effects of weak and strong ties (Granovetter, 1973; Burt, 1992) on entrepreneurial behavior in different context and across geographies could extend our knowledge of determinants of success.

Studies based on the network theory are rarely published in the journal “Entrepreneurship Theory and Practice”, although the dynamics of publications that we have presented indicates their growing popularity. Particularly promising research

directions that will verify the importance of entrepreneurs' position within networks seem to be those that will explore links between networks and innovation processes. Network models explaining the dynamics of innovation spread indicate different roles of network nodes, depending on their position (Valente, 1996). The small number of articles could be caused by the fact that that issue is still under researched. Other reason could be that researchers from the entrepreneurship field consider this area as a not very suitable for entrepreneurship research. The biggest problem is that our review is narrowed to one journal and this topic could be not very suitable for the journal requirements.

Another promising direction of such research where we have seen relatively few publications so far is an analysis of correlations between constraints and opportunities for company development, ensuing from the position in the network structure. Although researchers mostly paid attention to relationship types and their impact on achievements, that topic has not been exhausted. Investigation done by Uzzi (1997) should be useful for researchers in these area. Few of the studies presented use standard measures of centrality, density and occurrence in structural holes that were operationalised as part of the social network analysis. This suggests that this discipline may be developed by applying social network analysis methods in entrepreneurship.

The biggest limitation of our review is probably the focus on only one scientific journal. However, the goal of our article was to highlight the fact that network analysis is very useful and interesting and to indicate a possible direction for entrepreneurship research development. We are aware that the issue of networks in innovation may be more frequently addressed in journals focused primarily on innovation, hence the small number of texts on this topic, though perhaps network analyses are not conducted in that direction. This requires verification. A weakness of our analysis also lies in confining it mostly to reading abstracts, with hardly skimming whole articles. This makes information incomplete. Nonetheless, it is a good suggestion for in-depth analyses.

Our literature review shows that the network theory and the theory of networks are becoming important approaches that make it possible to look at key and unchanged issues of entrepreneurship from a new perspective. In the network society, where the importance of relationships for the results achieved by individuals seems to be growing, we expect further dynamic expansion of entrepreneurship research resorting to theoretical perspectives discussed in this article. Our classification of articles could be helpful in identifying areas where the network approach is rarely used.

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The contribution of co-authors is equal and can be expressed as 50% each of the authors: Michał Zdziarski prepared the literature review, while Agnieszka Brzozowska prepared the literature analysis.



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# Social capital impact on entrepreneur's innovation: A test of Chinese entrepreneurs in Italy

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## Abstract:

According to the theory of Burt (2005), brokerage and closure are two main features of social network and metaphor of social capital. The purpose of this research was to investigate how immigrant entrepreneur's social network may affect entrepreneur's innovation. The relationship between social capital and entrepreneur's innovation can be mediated by trust and information diversity. These relationships are especially relevant in the case of immigrant entrepreneurs, which function in multiple groups and networks. The hypothesised relationships were examined with data from 91 Chinese entrepreneurs in Italy (Rome, Milan, Venice and Florence). This research aimed to prove the relationship between entrepreneur's social network and innovation. This research distinguishes two types of social network which are closure and structural hole, and two components of social capital which are trust and sharing diversity information. Through applying Burt's theory about types of social network and dimensions of social capital, it shows the two types of entrepreneur's social network is all positively associated with innovation. The obtained results confirm prior hypothesis. The value added of this research is an indication that in the case of immigrant entrepreneurs social capital which derives from social networks positively impacts entrepreneur's innovation.

**Keywords:** social capital; trust; tacit knowledge; innovation; Chinese entrepreneur

**JEL codes:** L31, O35, D83

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## 1. INTRODUCTION

Innovation is nature to entrepreneurship and its fundamental feature according to Schumpeter's definition (1934). From the point of competition, innovation puts the firm in the lead. Incremental innovation, which continues to improve existing products and services, can extend the product life cycle. Radical innovation, has the potential to fundamentally drive down costs (Zaltman *et al.*, 1973; Henderson & Clark 1990). Innovation in SMEs is of particular interest because of the key role SMEs play in creating jobs, new firms, products and industries and often expanding the market beyond its domestic boundary (Bloch & Bhattacharya, 2016). On the social side, innovation, especially radical innovation, also facilitates knowledge spillovers improving quality of living and resolving social problems. Therefore, in the interest

of both economic and social benefits, it is important to foster innovation in entrepreneurship.

One route toward increasing the level of entrepreneur's innovation authors point to extending their vision through receiving more diversified information. Diversity is the key to creativity. Living in a new culture, connecting with local people, exchanging information can make entrepreneurs more creative. Many research tested that diverse teams produce more creative results than teams in which all members are from a similar background (Fitzsimmons, 2013; Giridharadas, 2010; United Nations Statistics Division, 2011). Diversified information come together in a mental process to create a new and useful idea.

Another route is to build trust based relationships in entrepreneur's social network. Trust facilitates informal relational contacts enabling people to exchange their informal information and tacit knowledge which in turn can facilitate to create new ideas. At the same time, the innovation process involves risk both for the R&D running the process and employees participating in the process.

Based on these two routes, this study address the following three research questions: first, do social networks improve innovation of immigrate entrepreneurs? Second, does social capital increase innovation of immigrate entrepreneurs? Third, is this effect the same for women and men entrepreneurs? To address these questions, this study relied on OLS regression based on statistical data, which was collected from 91 Chinese entrepreneurs in Italy, to test the relationship between social capital and entrepreneur's innovation.

## **2. LITERATURE REVIEW AND HYPOTHESES**

### **2.1. SOCIAL CAPITAL: CLOSURE (TRUST) AND BROKERAGE (INFORMATION DIVERSITY)**

Capital is a necessary condition of everyone economic and social activity and a result of human labour, as human labour can increase the capital. It was classified in the past as economic capital, human capital, intellectual capital and social capital. The notion of social capital can be traced to Marx who saw capital as part of the surplus value captured by capitalists or the bourgeoisie based on the exploitive social relations between two classes (Lin, 2001, p. 4, 19). Others see social capital as a social asset by virtue of actor's connections and access to resources in the network or group of which they are members. This social asset in view of Bouedieu and Wacquant (1992) is the sum of the resources, actual or virtual that accrue to an individual or group by virtue of possessing a durable network of more or less institutionalized relationships of mutual acquaintance and recognition (Burt, 2005, p. 5). Social capital come from and can be increased by social connections and relations. Social capital is the contextual complement to human capital in explaining that the people who do better are more able individuals, intelligent, attractive and skilled. Social capital explains that people do better also result from better connection with other people (Burt, 2005, p. 4 ). This connection as a function of prior contact, exchange and attendant emotions form formally or informally a social

structure. There are defined two features of social structure by Burt: closed network within the group and structural holes as the empty spaces beyond the group.

Relationships are the fundamental elements in any network. They can be measured for strength and context. Granovetter (1973) defined the strength of a tie as a combination of the amount of time, the emotional intensity, the intimacy (mutual confiding), and the reciprocal services which characterize the tie. A bridge is a (strong or weak) relationship that spans a structural hole (Burt, 2005, p. 25). Relations can be measured for strength and context such that they can be sorted into three categories: bridges, bonds, and something else (more than a bridge and less than a bond). A strong relationship in a closed network is a bond between the people connected (Burt, 2005, p. 25).

Brokerage is the action of coordinating across the hole with bridges between people on opposite sides of the hole (Burt, 2005, p. 18). Social capital of structural holes comes from the opportunities that holes provide to broker the flow of information between people, and shape the projects that bring together people from opposite sides of the hole. People whose networks bridge the structural holes between groups have an advantage in detecting and developing rewarding opportunities. Information arbitrage is their advantage, they are able to see early, see more broadly and translate information across groups. Burt (2005, p. 38) provided evidence through supply-chain managers that managers whose network spanned structural holes tended to enjoy salaries higher than peers, had more positive performance evaluations than their peers, and odds of promotion higher than their peers. Brokerage across structural holes provide a vision of options otherwise unseen. New ideas emerge from selection and synthesis across structural holes. The social capital of structural holes comes from the opportunities that holes provide to broker the flow of information between people, and shape the projects that bring together people from opposite sides of the hole.

Burt (2005, p. 25) described that bridges are valuable for creating information variation, they separate non redundant source of information. Bonds (a strong relationship connected in a closed network) are valuable for eliminating variation and protecting connected people from information inconsistent with what they already know. Relations within closed network are more dense than beyond the group. The higher the density of relations within groups, information circulates more within than between groups, more greater homogeneity within than between groups. However closure increases the odds of a person being caught and punished for displaying belief or behaviour inconsistent with preferences in the closed network. In so doing, closure reinforces the status quo, protects against decay in new relations between friends of friends, and amplifies strong relations to extremes of trust and distrust. Bonds can facilitate the trust and collaborative alignment. Trust is a fundamental feature of closed networks.

Immigrant community, because of language, culture, education, and economic condition are usually closed networks relying on family, kin, fellow villager and friendship. Newcomers can get emotional and cultural support and various information for example initial housing, job opportunities and legal aid. Within this



closed network, they communicate redundantly the same information and stories repeated by different members in their community. The more consistent the information and story one hears about, the more certain one can be about trusting later. The more members' behaviour illustrates shared beliefs and reflect the story, the higher member's social identity. The more a person is predicted to behave in a way consistent with shared beliefs, the less risky it is trust to this person.

## 2.2. TRUST VERSUS TACIT KNOWLEDGE IN INNOVATION

Innovation is an outcome of learning and thus knowledge acquisition or knowledge accessing via the utilization of knowledge assets (Grant & Baden-Fuller, 2004). However, innovation is something more than the acquisition or generation of knowledge. Knowledge must be put into action to make a genuine difference (Nielsen & Nielsen, 2009). Human knowledge is usually classified into two types (Nonaka & Takeuchi, 1995, p. 8). One is explicit knowledge, which can be articulated in formal language and thus can be transmitted across individuals formally and easily. A more important kind of knowledge is tacit knowledge which is hard to articulate with formal language, is personal and embedded in individual experience and involves intangible factor such as personal belief, perspective and the value system. Tacit knowledge is hard to formalize, making it difficult to communicate or to share with others. Transmission of tacit knowledge requires strong relationship and contacts during long time to. Nielsen and Nielsen (2009) pointed that trust not only directly facilitates learning, but also conditions the effect of knowledge tacitness on innovative outcomes. Thus innovation depends on the quality of relationship (trust) between partner in team or community.

Burt held the point that there were reasons why closed network could create trust. You trust someone when you commit to a relationship before you know how the other person will behave (Burt, 2005, p. 93). Anticipated cooperation is implicit in this definition. The more unspecified, taken-for-granted, the terms, the more trust is involved. Granovetter (1973) defined that trust is strong relations. Trust builds over a period of years. Trust more easily take place within closed network. Within closed network people have reliably early and low cost to protect the innocent providing scarecrow warning about abusive people or squeeze them out of the network (Burt, 2005, p. 105). Putnam (1993, 2001) also preserved the focus on action facilitated by social structure: "Social capital here refers to features of social organization, such as trust, norms, and networks, that can improve the efficiency of society by facilitating coordinated action" (Putnam, 1993, p. 167). Gossip in the closed network is the sharing of news. Wong and Ellis (2002) describe the tendency for Hong Kong companies entering China to more quickly decide between alternative venture partners when their information comes from family or close friends rather than casual friends or acquaintances.

The closed network occurs where a set of people have contacts through whom they are strong directly or short connected. Burt (2005) evidenced, by a manager citing a colleagues as someone with whom he or she would discuss potentially damaging personal information, that older relationships are more likely to be cited for

trust or distrust, however brokerage requires trust within a much shorter time frame even minutes (Burt, 2005, p. 104).

Immigrant community is a closed network, because of the problem of language and culture, they meet more difficulty in the living and working, they have more contact and exchange information in the hosting country, therefore their reciprocal helps produce the mutual confiding. Within this closed network, redundant communication enables numerous stories of entrepreneur get around quickly, further, one learns from stories repeated by different members a richly detailed account of entrepreneurs' behaviour, at the same times, detecting misbehaviour. Redundant contacts ensure reliability. Smallbone *et al.* (2005) also have studied trust in an immigrant business community. Hans-Hermann, Höhmann and Welter (2005) investigated that trust has a decisive impact on entrepreneurship from a West-East perspective.

### **2.3. INFORMATION DIVERSITY VERSE EXPLICIT KNOWLEDGE IN INNOVATION**

Knowledge comes from information, information come from data. Information is a flow of messages, knowledge is created by that very flow of information, anchored in the beliefs and commitment of its holder (Nonaka & Takeuchi, 1995, p. 58). Cleveland (1982) stated that information is the sum total of all the facts and ideas that are available to be known by somebody at a given moment in time, knowledge is the result of somebody applying the refiner's fire to the mass of facts and ideas, selecting and organizing what is useful to somebody, wisdom is integrated knowledge – information made super-useful by creating theory. In the theory of DIKW pyramid, "wisdom in terms of knowledge, knowledge in terms of information, typically information is defined in terms of data" (Rowley, 2007)

Drucker (1985, p. 23) described entrepreneur's innovation as "doing something different not doing better what is already being done". But, Nonaka and Takeuchi (1995, p. 6) believed that innovation was not a one-act drama for successful Japanese companies. Rather continuous improvement and upgrading (continuous innovation) leads to competitive advantage of Japanese companies. These companies accumulate knowledge from the outside and share widely within the organization, stored as part of the company's knowledge base, and utilized by those engaged in developing new technologies and products.

Burt (2005, p. 16) pointed that structural holes are gaps between social groups in the structure of information flow. It means that the people are focused on their own activities such that they do not attend to the activities of people in the other group. The value potential of structural holes is that they separate non redundant sources of information. People on either side of a structural hole can access to a wider diversity of information. Brokerage is the action of coordinating across the hole with bridges between people on opposite sides of the hole.

A "small world" structure coined by Milgram (1967) is the tendency for people at different geographic locations to be connected through a few intermediaries. Grannovetter (1973) drove the point home with respect to "weak ties" providing

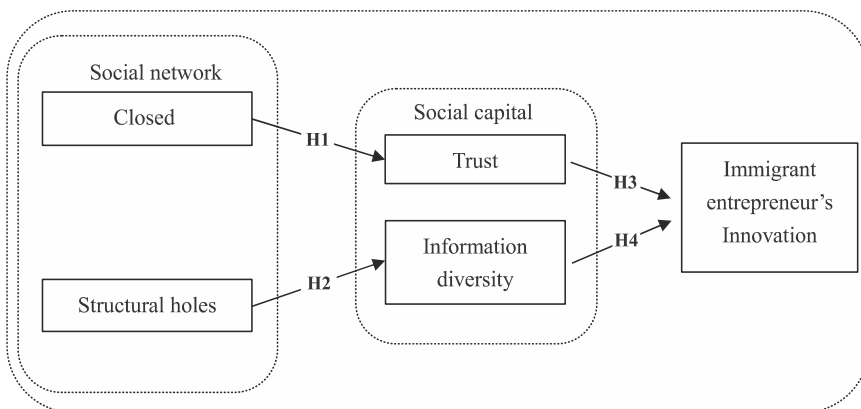
the key intermediary. This weak ties can take more diversity information than your closed network.

Immigrant entrepreneur is a broker who is on both sides of a structural hole between the immigrant community and the local people. Through their brokerage they remain aware of interests and need of the local group and create value for them. Immigrant entrepreneur is familiar with activities in the community and local groups. They are more likely to see new beliefs and behaviors that combine elements from both groups. For example it is primarily an import-export business. Burt (2005, p. 62) believed that people whose networks span structural holes have early access to diverse, often contradictory information and interpretation gain a competitive advantage in seeing and developing good ideas. Immigrant entrepreneur's creativity by brokerage involves moving an idea mundane in one group to another group where the idea is new and valued.

## 2.4. CONCEPTUAL MODEL AND HYPOTHESIS

Just as mentioned above, social network is classified into closed network and structural holes, which can create social capital. Trust within closed network and sharing diverse information through brokerage can have positive impacts on immigrant entrepreneur's innovation. Therefore, this study construct following conceptual model (Figure 1). consistent with the conceptual model, this paper make some hypothesizes as follows:

- H1: Closed social network has a positive impact on trust derived from the social capital of closure.
- H2: Structural holes in a social network have a positive impact on sharing diversity information.
- H3: Trust derived from the social capital of closure has a positive impact on innovation of immigrant entrepreneur.
- H4: Diversity information derived from the structural holes has a positive impact on innovation of immigrant entrepreneur.



**Figure 1.** The conceptual model: network of entrepreneurs

Source: own study.

### 3. METHODOLOGY

#### Sample and data collection

For the purpose of testing the hypothesized relationships, data was collected by means of questionnaire interviews among Chinese entrepreneurs in Italy. The author conducted structured interviews with 121 entrepreneurs, in which 91 valid interviews took place in Rome, Milan, Vince and Florence. 64% of the respondents were men, 20 were from Rome, 35 from Milan, 14 from Vince, 22 from Florence. These data was collected in summer of 2014.

#### Dependent variables

According to Schumpeter's conceptualization (1934), this paper consider immigrant entrepreneur's innovation including the following items: (1) introducing new products; (2) exploring new client/market; (3) taking new methods of management.

#### Independent variables

Second the degree of relations, social network are classified by closed and structural holes (Burt, 2005). This paper consider Chinese community as a closed network, in which there are strong relations based on kinship-fellow village based network, and consider Chinese entrepreneurs interact with their hosting country as structural holes, where there are weak relations based on work relationship. The questionnaire employee a five-point Likert scales to indicate the social relations, 1 = interact with Italian business partner, 2 = with Italian friends, 3 = with Italian classmate, Chinese friends, 4 = with fellow villager and classmate, 5 = with kin and family members, the later three type are defined to a closed network, other two to structural holes.

#### Mediator variables

Trust is metaphor of social capital of a closed network, brokerage is metaphor of social capital of structural holes where there are flow of diversity information (Burt, 2005). On this base, this paper use five of five-point Likert scales to measure trust and sharing diversity information. To measure trust, the paper used two items: (1) if there are no third guarantee, do you trust him/her? (2) would you introduce your friends who need help to him/her?

#### Control variables

According to relevant prior researches, this research select the amount of years when immigrant entrepreneur live in Italy, level of education, Italian language and gender as control variables.

### 4. RESULTS

This research relied on OLS regression to test above hypotheses. Three models were estimated. Model 1 is the baseline model including only the control variables.

Model 2 adds to the control variables two independent variables: close network and trust. Model 3 adds to independent variables of structural hole and sharing diversity information (Table 1).

Hypothesis 1 states that the closed social network has a positive impact on trust derived from the social capital of closure. As shown in model 2 in table, the coefficients of closed social network and trust are positive and statistically significant ( $p=0.000<0.001$ ), suggesting that entrepreneur's closed social network is positively associated with trust. Model 2 is statistically significant ( $F=54.264$ ;  $p=0.000<0.001$ ). Therefore, this sample support this hypothesis regarding the positive effect between closed social network and trust.

**Table 1.** Regression analysis: effects of social capital on IE's innovation

	Model 1	Model 2	Model 3
<i>Control Variables</i>			
Gender	1.123	-.259	1.346
Years in IT	-.737	-.611	-.461
Language	.090	.957	.133
Education	.181	.383	2.587*
<i>Independent Variables</i>			
CN→Trust(T)		7.366***	
T→IE's innovation		7.075***	
SH→Diversity information(DI)			2.749**
DI→IE's innovation			3.034***
<i>Model Statistics</i>			
R square	.102	.488	.156
Adjusted R square	.007	.497	.135
F	1.078	54.264***	7.559***

Note: Values represent unstandardized B coefficients.  $p<0.1$ ; \* $p<0.05$ ; \*\* $p<0.01$ ; \*\*\* $p<0.001$   
Source: own calculation.

Hypothesis 2 states that the structural holes in a social network have a positive impact on sharing diversity information. As shown in model 3 in table, the coefficients of structural holes and sharing diversity information are positive and statistically significant ( $p=0.004<0.01$ ), suggesting when entrepreneurs are in structural hole with their Italian social network, they can share more diversity information. Model 3 is statistically significant ( $F=7.559$ ,  $P<0.001$ ). Hence, this result support the hypothesis regarding the positive effect between structural hole and sharing diversity information.

Hypothesis 3 states that the trust derived from the social capital of closure has a positive impact on innovation of immigrant entrepreneur. As shown in model 2 in table, the coefficients of trust among entrepreneur and their innovation are positive and statistically significant ( $p<0.001$ ), suggesting that trust derived from the social capital of closure is positively associated with their innovation.

Hypothesis 4 stated diversity information derived from the structural holes has a positive impact on innovation of immigrant entrepreneur. As shown in model 3 in table, the coefficients of sharing information with Italian and entrepreneur's innovation are positive and statistically ( $p < 0.001$ ), suggesting that entrepreneurs share diversity information with local people is positively associated with their innovation.

## 5. DISCUSSION

The purpose of this research was to investigate how immigrant entrepreneur's social network may affect entrepreneur's innovation. This research aimed to prove the relationship between entrepreneur's social network and innovation. Through applying Burt's theory about types of social network and dimensions of social capital, it show the two types of entrepreneur's social network is all positively associated with their innovation. The result confirm prior hypothesis. This research distinguish two types of social network which are closure and structural hole, and two components of social capital which are trust and sharing diversity information.

Results suggest that trust has a positive effect on innovation. That is to say trust can enhance entrepreneur's innovation. Trust can trigger strong emotions in entrepreneur's social network and commit to a relationship before they know how the other person will behave (Burt, 2005). When entrepreneurs create revolutionary products or technologies, they take on the great risk because they create new markets. Therefore building trust also in entrepreneur's social network is essential to successfully bringing new products and services to market. In the closed social network, there is more trust among members. Past cooperation is a basis for future cooperation such that trust is correlated with the strength of a relationship. In a closed network, interconnected people tell stories and nonessential (often trivial) news. A closed network provides wide bandwidth for the flow of stories as packets of people data. Detection is the trust-relevant feature of the flow. The omnipresent hydra-eyes of a closed network makes it difficult for misbehaviour to escape detection (Burt, 2005).

Results also suggest that diversity information sharing has a positive effect on entrepreneur's innovation. That is to say immigrant entrepreneur can enhance their innovation through contacting with host people and can get more diversity information which is source to creative thinking and innovation. There are holes in the structure of information flow between clusters where entrepreneurs contact. These holes usually happen in contacting with hosts, because of language and blood relation, immigrant entrepreneurs live within their community network and not focus on relationship with host people. They attend seldom to the activities of host people in their group. Thus, it builds some structural holes between immigrant community and host community. Host on either side of structural hole circulate in different flows of information. These information are usually non redundant and diversified.

However, as the result show, there is two control variables, language and education, which also positively affect entrepreneur's innovation. However these are

seldom statistically significant except entrepreneur's education when testing diversity information sharing effect on innovation. Better host language which entrepreneur can speak, more performance of entrepreneur's innovation; higher education which entrepreneur have gotten, also more performance of entrepreneur's innovation. When entrepreneur speak well the host language, they can communicate deeply to exchange information. At the same time, their knowledge helps them to discover useful new information and also trust.

But, there is no positive relationship between years when immigrant entrepreneur live in host country and their innovation. That means if entrepreneur can speak well host language and have a higher education, they could discover quickly useful diversity information when they contact with host people.

## 6. CONCLUSIONS

Entrepreneur's social capital is one condition and challenges to their creative thinking and innovation. This research enhances some understanding which social network through trust and diversity information sharing can improve entrepreneur's innovation. Although social capital and trust are concepts widely studied in business and management, the existing studies did not connect social capital to innovation.

Based on data from Chinese immigrant entrepreneurs in Italy, the results show that closed social network within their community and structural holes with host people all contribute to entrepreneur's innovation. Immigrant entrepreneur span more structural holes with host people, exposes the individual to more diverse information and perspectives, which can then be brought together in new ways to yield a creative insight. But closure is a complement to brokerage such that the two together define social capital in a general way in terms of closure within a group and brokerage beyond the group (Burt, 2005). Facilitating the trust and collaborative alignment need to deliver the value of brokerage.

And the results also suggest that more trust and sharing diversity information, the more performance of entrepreneur's innovation, and that the level of immigrant entrepreneur' language and education are all important to build social network which contribute to their innovation. This study explains how innovation benefit from diversity information and trust in the social networks. But this paper did not study how entrepreneur build their the social network which provide trust and diversity information. Therefore the advanced study should be involved in building social network and network services which provide lucrative or emotionally rewarding relationships and make immigrant entrepreneurs not "bowling alone" and more contribution to innovation and human life.

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# **Main and ancillary proceedings in the light of the EU Insolvency Regulation 1346/2000 on international insolvency law and innovative companies**

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## **Abstract:**

The activity of advancing research in entrepreneurship in the global context cannot disregard insolvency law. Insolvency and entrepreneurship are different sides of the same coin. For this reason the objective of this paper is to draft the main features of the EU regulation 1346/2000 on international insolvency law. The European Union attempts on insolvency situation deeply changed during the last decades. Nowadays insolvency is considered as a possible event which may occur, and it is not considered anymore as the unfortunate end of an entrepreneurship experience, consequently the EU regulated the cases when an insolvent company has creditors or assets across the European Union. The author drafts the main problematic concerning the coordination concerning international insolvency cases within the EU and shows which is the road map that the EU commission is tracing, demonstrating that entrepreneurship is too an important value not to be sufficiently protected.

**Keywords:** internationalisation; EU; insolvency; innovation

**JEL codes:** K33, G33

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## **1. INTRODUCTION**

Nowadays we are witnessing vast changes in the insolvency contest. It is impossible not to notice that an insolvency procedure may not just focus on the creditors satisfaction. In other words an insolvency procedure shall not be just considered as a procedure for assets liquidation. When circumstances make it possible, Insolvency must aim as well at the company's restructuring in order to protect company's intrinsic value. Periodic economic downturns may often result in creditors chasing the assets of their distressed debtors. The insolvency's aggressive function shall not be sublimated. It may occur that at certain conditions the company's survival is crucial as well.

The common market is a pillar of the European Union (EU). Nevertheless the EU is not yet a federal country but is a group of countries which tenaciously try to keep intact their spheres of competences and jurisdiction. For this reason the article main goal is to describe how the EU legal system deals with international insolvency cases within the EU borders itself (Wessels, 2010).

The article's main goal is to examine the characteristics of the ancillary procedures and the changes occurred due to the new recast of the regulation. In order to reach such result the two versions of the regulation will be compared. In addition, the analysis refers to some of the most interesting sentences of the European Court of Justice, which anticipated the recast, and prepared the path to the recast itself.

Sometimes an insolvency procedure may trespass country's border, sometimes an insolvency procedure's relevance may reach such an international extent to suddenly become sort of modern Hydra. The Hydra in Greek mythology, was a very famous monster resembling a serpent that possessed many heads so powerful that could only be defeated by Hercules. When an insolvency procedure has an international extent usually produces a plurality of insolvencies procedures. Trying to coordinate all of them sometimes may resemble the famous second labour of Hercules.

The article is divided in three sections: it starts with a general part on the main issues arising from international insolvency cases, then it proceeds with an analysis of the European regulation on Insolvency (reg. 1346/2000). Finally in the conclusion of the article I draft recommendations for the future.

## 2. LITERATURE REVIEW

The concept of entrepreneurship in the global context needs to be supported by a knowledge of international insolvency law. Insolvency and entrepreneurship are sides of the same coin. we may compare a company to a ship and the market to the ocean. As a ship crossing the ocean, and the ocean's water are not always calm and perils may appear at every moment. Market's waters as the ocean's waters which the ship and the company have to go across maybe not always calm and quite. A financial crisis as a sea storm may expose the company to huge perils and threats. A company may overstep just a momentary lack of liquidity.

For example if an healthy company is the main supplier to a public hospital, whose financial provisions represents more than 50% company's introits; and let's imagine what would happen if the Health Ministry postpones *ex iure* all the payments of all the hospitals for six months or more, due to an international financial crisis.

The mentioned company is not *in decotio* and does not seem to deserve an insolvency procedure. *Decotio/onis* is a Latin word expressing the state of company whose destiny is irremediably signed.

Nowadays market confidence is vital, restructuring mediation, can be a good solution toward preserving company's reputation. In fierce times like those we are living, companies have the utmost interest in keeping firm their reliability in the

market; it is evident as the discretion assured by mediation is crucial when the moment for choice comes. Restructuring mediation proves itself to be efficient and satisfactory. It does not need a tribunal or public moments, mediation may be conducted with the maximum degree of confidentiality, speed and agility (Lai, 2012).

A problematic approach arises from the confrontation of two main insolvency theories the universalistic theory and the territorial theory. The universalistic theory affirms that there is only one procedure and only one *massa activa* and *massa passiva*. This theory tries to concentrate all the disputes under the knowledge of one single authority independently if the bankrupt assets are spread among Europe; in such a sense all creditors will have to make a legal claim in front of the same authority. The universalistic theory believes in a form equality between all creditors. A relevant question mark is if the Universalistic approach truly guarantees an equal treatment among all the creditors or if *a contrario* fosters the creditors from the Country where the claim has been filled (Daniele, 2004).

The territorial theory instead starts from the belief that only a national procedure may truly guarantee an equal treatment among creditors. For this reason under this theory a plurality of insolvency procedures are possible, each of them independent from the other. A negative effect of such a theory is the different treatment of creditors living in countries where the bankrupt company has a smaller subsidiary. Often such subsidiaries are undercapitalized and for this reason they represent an obstacle to a true equal treatment of creditors (Daniele, 2004).

The entry into force of Regulation No. 1346/2000 on 31 May 2002 marked the end of a prolonged vacuum marked by the absence of coordinated international regulation of insolvency proceedings. The Regulation, rather than attempting to harmonize substantive laws or purporting to be a first step to an all-encompassing pan-European insolvency regime instead aimed at improving the efficiency and effectiveness of insolvency proceedings having cross-border dimensions by removing the formalities which had previously been associated with recognition and enforcement. Its goal was to establish common rules on cross-border insolvency proceedings, based on principles of mutual recognition and co-ordination. It sought to achieve this goal by harmonizing the rules regarding the jurisdiction, aiming at restoring creditors equality, introducing uniform rules of conflict of laws and disincentivising companies from seeking forum shopping.

Member States have been unwilling to accept a competences handover to the European Union. It has occurred, when the competencies to be transferred were considered by Governments sort of direct countries sovereignty expression. It took almost 40 years to arrive to the emanation of the regulation No. 1346/2000. In the light of the EU regulation No.1346/2000 and its new recasting. It is very interesting to analyze the main differences between the previous text of the regulation and its new recasting.

### 3. FIRST REGULATION ON INSOLVENCY PROCEEDINGS

A secondary procedure could be open in a foreigner country only in presence of dependence. A dependence is not just a belonging good. This would not be enough for opening a secondary procedure. A dependence is an organization of men and goods allowing a production<sup>1</sup>. Such secondary procedure shall be limited to the country where the dependence is located. This limitation has a relevant importance, in fact in some countries an insolvency procedure has a universal attempt, so this secondary procedure pits some limits to the universalistic principle. The authority of the main procedure had not jurisdiction on the ancillary procedure, in such way posing an insurmountable bastion to the universalistic theory. Another indispensable element for a secondary procedure to start was to have a previous open main procedure. But the more interesting characteristic was that the basis on which the secondary procedure could be open relied on the legal system of the main procedure (Omar, 2013).

This is a quite peculiar characteristic because it could happen that a secondary procedure was open on the basis of foreigner rules, so if under the law of the country of the main procedure it was possible to open an insolvency procedure therefore would be possible to open a secondary procedure also if the legal system of the country where should be open the secondary procedure does not consider such a possibility.

So for example if in the alfa country (country of the main procedure ) also an agricultural entrepreneur (i.e. farmer) could fill for bankruptcy, so also in other countries could be open a secondary procedure also if the legal system of the country beta did not contemplate such a possibility. A limit to what expressed before was represented by the public order clause. If a bankruptcy sentence was against the public order clause, it could not be implemented in the “receiving” country.

The function of the secondary procedure was to create a balance to the universalistic power of the main procedure. The European legislator in such way tried to limit the power of the main procedure and protect the local interest<sup>2</sup>. An excess of complexity of the bankrupt assets could lead the Insolvency Office Holder<sup>3</sup> to ask for the opening ancillary procedures. Also deep legislative differences could lead to new ancillary procedures. The EU Legislator was very pragmatic during the drafting of the 1346/2000 regulation and during its recasting.

The hierarchy between the main and the ancillary procedure before the recasting sometime was not clear. It could happen that an ancillary procedure was more relevant than the main procedure. Art. 29 of the regulation affirmed that every legitimate subject could ask for the opening<sup>4</sup> of an ancillary procedure. This opening “de facto” limited to a cert extent the main procedure. To the secondary procedure

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<sup>1</sup> A production can consist of a production of services or products.

<sup>2</sup> In this case intending creditors.

<sup>3</sup> We are talking about the Insolvency Office Holder of the main procedure.

<sup>4</sup> Only when the requirements objective and subjective are met.

was to be applied the law of that country and not the law of the country where the main procedure was. This was an impressive tool in order to stop the power of the main procedure; this tool did not functioned the other way round. The Insolvency Office Holder (IOH) of the main procedure could not avoid or block the opening of a secondary procedure. For these reasons was appropriate to affirm that the presumed hierarchy was valid up to a point. The main procedures still lead but were balanced by the possibility to open ancillaries ones. Sometimes having to cope with different legal systems could create quite a quantity of problems and inefficiencies to the IHO. So that it could happen that opening several ancillary procedure lead to a better management (Lai, 2011).

An interesting ancillary procedure was represented by the Daysitek case. The Daysitek was a French holding with the head company located in London. However the head company was sort of empty box, but the financial core of the company assets were located in France. However the main procedure had already been opened in London causing the impossibility of opening a true main procedure in France. Luckily it was possible to open an ancillary procedure<sup>5</sup>. Similar cases were the Rover case between France and England and the Illochroma case in Italy where the main procedure was opened in France but concretely was the Italian procedure<sup>6</sup>. In the Illochroma<sup>7</sup> is due to be noticed as the French IOH opposed the opening of a secondary procedure<sup>8</sup>.

From these examples is possible to understand as the secondary procedure was considered as a tool allowing to correct possible mistakes or a way to avoid forum shopping<sup>9</sup>. It could happen that, taking into account the economic assets, the relevant procedure was the ancillary one; and this could modify the practical hierarchy between the procedures.

Setting “a priori” hierarchical rules may lead to quite difficult practical situations whose solution is not simple; for this reason the EU Legislator in the article 31 established an obligation for a reciprocal cooperation amidst the Insolvency Office Holders (Wessels, 2009). This cooperation is not a under a hierarchical order, it means that under certain conditions the two procedures are equal. However, it has to be noticed that:

- the Insolvency Office Holder of the main procedure had the right to ask for a 3 months suspension of the procedure;
- the secondary procedure consisted in a liquidation of the asset; no recovery was possible under the secondary procedure;

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<sup>5</sup> Even if formally was a ancillary procedure, “de facto” the French procedure was treated as the main procedure even if was limited to the French territory.

<sup>6</sup> Even if it was the procedure with the most relevant assets, it was a secondary procedure.

<sup>7</sup> The reader may find the Illochroma sentence looking in the general database of the Italian ministry of Justice writing App. Torino, 10 marzo 2009.

<sup>8</sup> Notably very often Insolvency Office Holders are reluctant to let open ancillary procedures. Even if the regulation 1346/2000 furnishes tools for a better coordination, there is still some resistance.

<sup>9</sup> Forum shopping is the informal name given to the practice adopted by some litigants to have their legal case heard in the court thought most likely to provide a favorable judgment.

- In the hypothetical case that the secondary procedure produced an active residual, that active residual has to be passed over to the main procedure.

As an example on how the Regulation was not clear in explaining if there was a hierarchy, it is important to analyze art 32 of the regulation pre casting. Art 32 expressed that a creditor had the right to lodge a claim in any of the procedures in so far as the lodging was concretely useful and was not used as a dilatory tool.

An interesting aspect of the integration between the procedures is the credit insinuation. In any country there is a classification of the credits which makes some of the privileged. This classification may look like a pyramid where it means that some credits<sup>10</sup> will be satisfied before than other. A real estate mortgage owned by a bank is without any doubt a privileged credit. On contrary an unclassified credit will be at the bottom of the mentioned pyramid.

Such classification differs from Country to Country. A credit privileged in a Country could be not or less privileged in another Country, the regulation 1346/2000 does not mention any tool in order to avoid superposition or other problematic situations which could create sort of procedural impasse.

#### 4. THE RECAST ON INSOLVENCY PROCEEDINGS

The recast has slightly changed the secondary proceedings. Nevertheless those changes had quite interesting repercussions. The recast specifies the new version of the regulation will lift this restriction and allow secondary proceedings to be rescue as well as liquidation proceedings. There will therefore not be any distinction in the types of proceedings that can be used as main or secondary proceeding.

The Recast regulation also recognizes that secondary proceedings may represent a risk and thus hamper the efficient administration of an insolvency estate. The Recast regulation provides different means to avoid the need to open secondary proceedings altogether. Main proceeding international office holders will be able to give an undertaking in respect of assets located in a member state where secondary proceedings could be opened that they will respect local distribution and priority rules. This would ensure that local creditors are not disadvantaged by not opening secondary proceedings.

The undertaking is to be approved by the “known local creditors”. A “local creditor” is a creditor whose claim against the debtor arises from or in connection with the operation of an establishment situated in a member state other than the one where the debtor has his centre of main interests. It will also empower officeholders in other jurisdictions to use this mechanism (Omar, 2013).

The undertaking needs to be approved by local creditors. The Recast regulation sets that “the rules on qualified majority and voting that apply for the adoption of restructuring plans under the law of the member state where secondary proceedings could have been opened shall also apply for the approval of the undertaking” (Regulation (EU) 2015/848, Art. 36). Each member state will have to specify what

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<sup>10</sup>The credits at the top of the pyramid are the most secure, the ones that will be satisfied at first.

the required qualified majority voting rules are. However, for member states where there is more than one restructuring plan regime with different majority thresholds this may be more difficult. Recital 42 recognizes this and states that all member states need to designate the specific procedure which is to apply.

Where an undertaking has been approved, the court seized of a request to open secondary proceedings may still proceed. This is the case where the court is not satisfied that the undertaking adequately protects the general interests of local creditors – although, as recital 40 states, the court should take into account the fact that the undertaking has been approved by a qualified majority of local creditors. The main proceeding officeholder is to be given notice of a request to open secondary proceedings and have an opportunity to be heard. Where a temporary stay of individual enforcement action has been granted to allow for negotiations between the debtor and creditors, the court may stay the opening of secondary proceedings for a period of up to three months (provided suitable measures are in place to protect the interests of local creditors).

Secondary proceedings are strictly connected to group insolvencies and group coordination proceedings. The recast had introduced an innovative new chapter dealing with groups providing for additional co-operation between officeholders. Where more than one member of the group is in insolvency proceedings, an international office holder appointed in any proceeding will be able to request the opening of group coordination proceedings. For the purposes of the recast regulation, a “group of companies” is a parent undertaking and its subsidiary undertakings. A parent undertaking is an undertaking which controls (either directly or indirectly) one or more subsidiary undertakings. Where an undertaking prepares consolidated financial statements in accordance with the EU Accounting Directive it is deemed to be a parent undertaking.

Where the opening of group coordination proceedings is requested at a number of member state courts simultaneously, the court first seized will have jurisdiction to consider the request. This avoids a determination of where a group’s most crucial functions are performed in favour of a much simpler “court first seized” approach.

## 5. CONCLUSIONS

Understanding the main characteristics of the regulation 1346/2000 represents a very important tool for advancing research in entrepreneurship. In fact insolvency does not have to be understood as the end of entrepreneurship, on the contrary nowadays insolvency has to be treated just as a moment of an entrepreneurial experience, but not necessarily its last.

A limit to this research is the focus in the differences amid the ancillary procedures ante and post the recast. In the next future the author will analyze the main procedure aspects, after the recast. In fact few months have passed since the recast has been published in the journal of the European Union and we are still waiting for the its first application.



In this article the author summarized some of the main aspects of the regulation 1346/2000 which were and still are source of problematic issues. The Legislator tried to avoid interpretative doubts, however such a task is far away from being completely accomplished. Too many are the differences among the different legislative systems to permit a complete integration.

Too many times judges were not informed about pending claims in other countries and other judges did not know how to inform about the starting of a procedure. A recommendation for the future would be the following : Avoiding dangerous conflicts between authorities with a true strong cooperation. Often when an international insolvency procedure is open, the related information is not spread among the authorities of the interested countries. The judges too often avoid to truly cooperate amid them in international insolvency cases; covering themselves under the lack of written procedures; reaching an effective cooperation is an absolute need. For this reason a method of cooperation is needed to be implemented by the EU legislator; so to provide judges with tools allowing a fast and effective communication among the courts in Europe.

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# Entrepreneurial activities of communes in creation of competitive advantages at regional investment markets: Entrepreneurial organization model

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## Abstract:

The objective of this paper is to present entrepreneurial activities of local regions represented by communes (local regions in Poland) that enable to create competitive advantages at regional investment markets resulting in increase of local regions' attractiveness for investors, tourists, and inhabitants. It was decided to perform multilayer research on 50 communes in Poland: electronic audit research of official website portals and Bulletins of Public Information of the communes; surveys with representatives of the communes using a structured questionnaire, mystery client research method, and case study method. 565 entrepreneurial activities of Polish communes were identified within 50 electronic audits performed, 19 mystery client method replies received, 8 surveys filled in by communes' representatives. Identified activities were represented by communes of different type and investment resources. Basing on identified activities an entrepreneurial organization model for local regions was proposed. The model indicates activities possible to implement by local regions of different location, size, administration type, potential investment attractiveness, and investment resources. The originality of this work lies in economically practical character of the research results, which might support local public administration.

**Keywords:** competitive advantage; competitiveness; local development; local government; public sector reform

**JEL codes:** H11, O38, R58

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## 1. INTRODUCTION

The objective of the paper is to present entrepreneurial activities of local regions, represented in the study by Polish communes that enable to create competitive advantages at regional investment markets resulting in an increase of local regions' attractiveness for investors, tourists, and inhabitants. Local development studies outline the role of competitive advantages needed for effective competition of territorial units such as local regions. Competitive advantages of local regions enable them to stimulate internal resources and to attract external resources interested in

regional investment market, what is the basic condition of local development process (Osborne & Gaebler, 1992; Pollitt & Bouckaert, 2011).

To present entrepreneurial activities of local regions in the paper, a multilayer research on 50 communes in Poland was performed with usage of both non-reactive and reactive research methods. Methods included electronic audit research of official website portals and Bulletins of Public Information of the communes; surveys with representatives of communes using a structured questionnaire; a mystery client research method, and the case study method.

The first section presents state of the art literature that covers the discourse relating to public sector reform paradigms, transaction cost economics, new institutional economics, and aspects of local regions management deriving from private sector domain. Later, empirical research methodology has been presented, describing the approach toward research sample selection and research performed in Poland in years 2013-2014. Results and Discussion section provides synthesis of research performed presented in form of typology of entrepreneurial activities of local regions with concrete, possibly practical examples. Paper concludes with implications of the study for the economic practice, and indications for further research.

## **2. LITERATURE REVIEW**

### **2.1. PUBLIC SECTOR REFORM PARADIGMS**

Attracting resources by the local regions and impact of new investments on their development is the topic that gained on significance in recent decades due to increasing efforts of local regions in attracting new investors, tourists, and inhabitants to their locations. Scott (1998) argues that contemporary local development requires the existence of a complex coordination and control system consisting of public sector representatives, private entities, non-government bodies, public-private, and public-social partnerships.

Pollitt and Bouckaert (2011) elaborate on contemporary discussed public sector reform paradigms relating to local development, which in terms of competitiveness implies learning from the private sector practice. For example in the new public governance paradigm focus is on the stakeholder, and implementation of private sector operations method in public sector unit is underlined. In the neo-Weberian state paradigm a particular focus is given to lean and modest approach in creation of formal rules and hierarchic organizational culture in order to respond to organization's stakeholders effectively. Networks and joining-up paradigm indicates on the need for participation in networks with other organizations representing various sectors of the economy to be flexible and inclusive in globalising world. The last – governance paradigm indicates that effective decision making process requires inclusion of wide spectrum of organization's stakeholders.

In the 21st century in order to achieve competitive advantages it is essential to be able to adjust to evolving organizational environment quickly, while minimizing organizational losses at the same time. This argument, made by Doz and Kosonen (2008), relates to private sector entities, and inspired questions whether

and how the local regions governed by public sector units can achieve competitive advantages while competing for investors, tourists, and inhabitants that will bring financial, and non-financial resources to the communes.

## **2.2. IMPLICATIONS OF TRANSACTION COST ECONOMICS FOR LOCAL REGIONS**

In the context of economics, local regions attracting new development resources such as external investors can be analysed within the transaction costs theory, also known as transaction costs economics, which is a modern economics school that had been developed, among others, by Williamson (1979, 1981), Klein, Crawford and Alchian (1978). Within the transaction costs economics transaction costs are costs incurred in making economic exchange. They usually increase the total costs of transactions. Transaction costs within this theory include costs of search and information, which relate to determination of availability, costs of goods and services looked for; costs of negotiations of the contract, which relate to establishing acceptable agreement by exchange parties; and costs of contract enforcement, which relate to securing fulfilment of the terms of the contract by transaction parties. Considering the competition for development resources between local regions the theory has particular implications for new market entrance and search for new investment location by the investors.

Availability of information about costs of goods and services looked for by the parties of economic transaction is impacted by asymmetry, and imperfect nature of information for both sides of the transaction. Such information disequilibrium impacts costs, time needed to finalize a transaction, and general attractiveness of the exchange. They might be equalized by an intermediary - local government - using traditional and modern information policy tools to communicate with external stakeholders, and to provide information looked for. Level of transaction costs of economic entities in the local region depend on information management and approach toward public communication of local region administration. Subject-matter literature indicates Internet as the main mean of communication of local region administration with local region stakeholders, because of its global reach, interactivity enabling two way communication and dialogue, low costs of usage, and speed (Piotrowski *et al.*, 2009). Therefore entrepreneurial activities of local regions related to management of information need to be classified as one of the basic factors impacting creation of their competitive advantages.

## **2.3. IMPLICATIONS OF NEW INSTITUTIONAL ECONOMICS FOR LOCAL REGIONS**

New institutional economics is a school that indicates the role of policy making process, public sector institutions, legal, and cultural system on economic development. North defines institutions in economics context as formal rules (including constitutions, laws, and property rights), but also informal constraints impacting economic exchange, such as sanctions, customs, traditions, or cultural taboos (North, 1991). New institutional economics extends the perspective of economics

on institutions enumerated by North, and underlines that economic activity is impacted by institutions existing prior to circumstances and context of parties interested in economic exchange. It also opens a research ground for comparative institutional analysis focused on comparison on defined institutional aspects impacting potential transactions to formulate concrete recommendations for economy improvement (Coase, 1960). In differentiation to classic economics, new institutional economics provide additional spectrum explaining transactions related to decision making process.

In new institutional economics, the entities taking up decisions not always take only the rational, or effectiveness-related criteria into account. New institutional economics complements transaction costs economics, and explains that if the costs of access to information exceed the costs of economic entity operations, the economic activity can be stopped or ended. In that context new institutional economics examine the role of institutions in nurturing or preventing economic growth.

In this paper, the institutions are intentionally narrowed down to domain of local region administration, including local policy making process, local legal and tax system, and public sector institutions per se, including its official website portals, which in the era of information are the first sources of information looked for by local region stakeholders.

#### **2.4. COMPETITIVE ADVANTAGE AT REGIONAL INVESTMENT MARKET**

Contemporary literature on local development points out the role of competitive advantages in creation of competitive advantage at regional investments market. Inflow of development resources is considered as the basic conditions of new investments, which initiate and contribute to local development process. Development resources enabling new investments in local regions include: investors, tourists, inhabitants, and financial and non-financial capital they bring with them to local regions (Olszewska, 2001). These resources create the supply side of the regional investment market, whereas the demand side is created by local regions creating advantages of a place in context of attracting investors, tourists and inhabitants (Godlewska-Majkowska *et al.*, 2013). In such regional investment markets, local regions develop and demonstrate competition ability that is a long term ability to be able to match and outperform other regions (Olczyk, 2008). Modern public sector reform paradigms - such as new public governance paradigm, neo-Weberian state paradigm, networks and joining-up paradigm, or governance paradigm – outline the process of learning from private sector by the public administration, including the administration of local regions in context of their competition (Pollitt & Bouckaert, 2011).

Contemporary activities aimed at attracting investors, tourists, and inhabitants by local regions are additionally stimulated by preparation and publication of rankings benchmarking local regions toward their attractiveness for business activity, quality of life, or other measures. Griffinger *et al.* (2010, p. 310) in the discourse of publication of rankings referring to local regions represented by cities argues that

“(...) it is highly recommended that cities should learn from cities that are relatively similar in their strengths and weaknesses.” Rankings benchmarking local regions that are prepared and published in academic environment include “European Competitiveness Index” by University of Cardiff, „Europas attraktivstes Metropolen fur Manger” by University of Mannheim, or “EU Regional Competitiveness Index” prepared by Joint Research Institute affiliated with the European Commission. Rankings benchmarking local regions that are prepared by business environment, which conduct the research with investments focus, include “The Atlas of Regional Competitiveness” prepared by Eurochambers, “European Cities & Regions of the Future” by fDi Intelligence, “Hot Spots” by Economist Intelligence, “How the world views its cities” by Anholt City Brands, and “Canada’s most sustainable Cities” issued by Corporate Knights – Canadian magazine for responsible business (Godlewska-Majkowska *et al.*, 2013). Common quality of rankings prepared by both academic and business environment differs in research methods used and result in different position of the same local region in different rankings. Although the empirical approach is far from consistent, rankings stimulate competitiveness at regional investment market, and might provide inspiration for redesigning the approach of local regions (Giffinger *et al.*, 2010).

## **2.5. ENTREPRENEURIAL ORGANIZATION IN THE PUBLIC SECTOR**

The concept of entrepreneurial organization in public sector has emerged in the middle of 20th century. One of its definitions has been proposed by Harbison, who calls entrepreneurial organization “an organization which comprises all of the people required to perform entrepreneurial functions (...) The functions of modern entrepreneurial organization, whether it be privately or publicly owned, may be categorized as follows: (1) the undertaking or managing of risk and the handling of economic uncertainty; (2) planning and innovation; (3) co-ordination, administration and control; and (4) routine supervision” (Harbison, 1956: 365). The author suggests that entrepreneurial activity of local region administration focused on local development process exceeds its role and responsibility clearly defined by the legal domain. It is argued that local regions that undertake additional activities which are in line with legal regulations, but require additional, effort, and/or resources can widen the offer of local region toward its stakeholders, create competitive advantage needed to attract new resources for local development.

In defining the role of institutions of local region administration in context of attracting new development resources, it is proposed to take from J. Schumpeter, who defined entrepreneurial activity as showing initiative, searching and implementing solutions perceived as new, unconventional, or risky when compared to general solutions functioning in the reference group (Schumpeter, 1934). The objective of taking up entrepreneurial activities by the local region administration is to achieve competitive advantage over other local regions; to become a more attractive place for investments, visits and accommodation. Entrepreneurial activities of the local region should be referred to the sphere of local administration activities, not the local region itself, which as an abstract term, cannot be personified.

The most important competitive advantages of local region for their stakeholders relate to (1) costs of setting up and conducting economic activity, (2) advantages of economy of scale (access to additional markets, and investment locations), and (3) advantages of economy of scope (access to goods, and services, and possibility of satisfaction of differentiated demand of many market participants). These are the classic, competitive advantages in the position school of strategy, and resources and competences school of strategy in the theory of organization that, because of competitive positions of local regions, can be related to them (Obłój, 2007; Porter, 1998).

In relation to public sector reform paradigm, implications of transaction cost economics, and new institutional economics for the purpose of this study it was decided to search in local region activities for entrepreneurial activities of the following nature: (1) management of information and knowledge, (2) creation and promotion of investment, tourism and residential product, (3) stimulation of local entrepreneurship, and (4) support of cooperation and creation of network organizations resulting in emergence of competitive advantages at regional investment market. Based on these measures a synthesis of researched entrepreneurial activities can form a model, which as a hypothetic, phenomena-simplifying construct can provide practical arguments on improving competitive position by local regions of different location, size, administration type, potential investment attractiveness, and investment resources.

This study examines whether and how local regions, based on examples of Polish communes, demonstrate the activities identified within public sector reform paradigms, attract development resources, and create own, unique competitive advantages. It is examined how in context of conclusions of transaction cost economics new institutional economics, and competition at regional investment markets local regions respond to market failures, and inefficiencies relating to its imperfect self-regulation mechanisms.

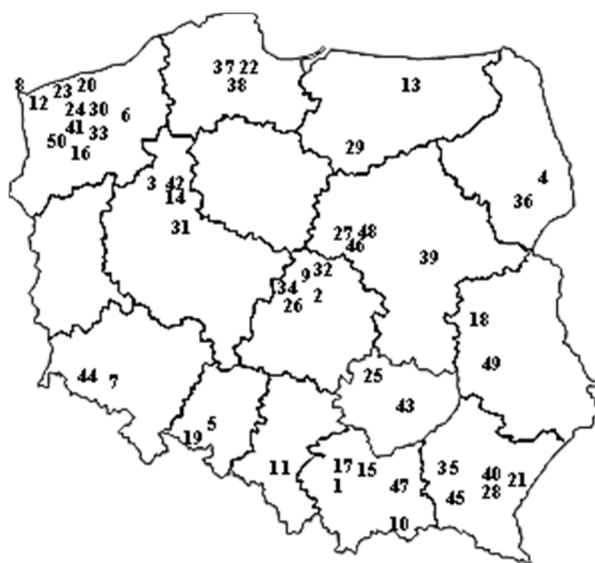
### 3. MATERIAL AND METHODS

During the research the focus was given to local regions, which are NUTS V level classification territorial units within the system of spatial hierarchy in European Union. Local regions are the smallest territorial units in spatial hierarchy of the European Union. In Poland they are represented by communes (in Polish – “gminy”), in Austria by “Gemeinden”, in Denmark by “sogne”, in Portugal by “freugesias”, whereas in Italy by “comuni”. By regional investment market are understood NUTS II level classification territorial units, which are called basic regions (in Polish – “województwa” translated as voivodeships)<sup>1</sup>. In case of Poland, there are 2479 local regions located within 16 regional investment markets.

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<sup>1</sup> System of spatial hierarchy in European Union (in French - Nomenclatures des Unites Territoriales Statistique) enumerates the following types of territorial units: (1) macroregions – (NUTS I level), which are the biggest units of territorial division, (2) mezzoregions – (NUTS II level), which are also called basic regions, in case of Poland the mezzoregions are voivodeships (16 major administrative territorial units), (3) submezzoregions – (NUTS III

It was decided to perform a multilayer selection of the research sample to identify local regions demonstrating entrepreneurial activities. Therefore to narrow down the population of 2479 local regions in Poland it was decided that two additional conditions were needed to be demonstrated by a local region to be included in the sample. Each local region selected to the sample needed to cooperate and create networks with their stakeholders; and also create and promote its investment product, defined as location, and its advantages ready for inflow of investors looking for greenfield or brownfield investment possibilities. To perform above mentioned selection two external, central government databases registering local region



1. Krakow	11. Katowice	21. Medyka	31. Ujscie	41. Ploty
2. Strykow	12. Wolin	22. Pszczolki	32. Zychlin	42. Wysoka
3. Pila	13. Olsztyn	23. Kamien Pomorski	33. Golczewo	43. Lagow
4. Bialystok	14. Budzyn	24. Gryfice	34. Krosniewice	44. Przemkow
5. Rybnik	15. Szczurowa	25. Konskie	35. Debica	45. Jaslo
6. Wegorzyno	16. Nowogard	26. Karnice	36. Turosn Koscielna	46. Slubice
7. Polkowice	17. Drwinia	27. Ilow	37. Trabki Wielkie	47. Moszczenica
8. Swinoujscie	18. Ryki	28. Przemysl	38. Zblewo	48. Bodzanow
9. Kutno	19. Jastrzebie-Zdroj	29. Dzialdowo	39. Dabrowka	49. Belzyce
10. Krynica-Zdroj	20. Koszalin	30. Brzezno	40. Orly	50. Przybiernow

**Figure 1.** Research sample of Polish local regions in their regional investment markets selected for the study

level), which are also called subregions, (4) microregions – (NUTS IV level), and (5) locoregions – (NUTS V level), which are called local regions, their example in case of Poland are communes. Within the system units of higher rank include the units of lower rank. For example mezzoregion (NUTS II) includes several submezzoregions (NUTS III), (Pilewicz, 2013).



Source: own elaboration based on research sample selection criteria.

activities in Poland were used: National Information System of Monitoring and Financial Control of Structural Funds and Cohesion Funds (NIS SIMIK) 2007-2013. NIS SIMIK registers all local regions undertaking investment projects with external funds of European Funds, including partnership investments in particular. Within the NIS SIMIK database it was looked for local regions that as of 30th of June 2013 had the status of being beneficiary of investment project delivered in form of local regions partnerships or local regions associations. At this stage 166 local regions fulfilling this criteria were identified. Next it was decided to investigate which of those 166 local regions demonstrate activities related to creation and promotion of its investment product. For selection of such local regions the database of Polish Information and Foreign Investment Agency was used. The database is of national character, and gathers non-clustered information on all available investment products of Polish local regions to promote them among potential investors, including international investors, as the database is led in English. Out of 166 local regions identified using first selection criterion, there were 50 local regions informing about at least one investment product as for 27th of August 2013. Final research sample included 50 local regions fulfilling 2 indicated sample selection conditions. Geographic distribution, and names of local regions in the sample are presented below (Figure 1).

In relation to the administration type of local regions within the research sample there were 18 rural, 18 urban-rural, and 16 urban local regions. Considering the number of inhabitants, 30 local regions were of small size (up to 20 000 inhabitants), 14 local regions were of medium size (above 20 000 up to 100 000 inhabitants), and 6 local regions represented a large size category (above 100 000 inhabitants). In terms of potential investment attractiveness measured by potential investment attractiveness indicator prepared by College of Business Administration at Warsaw Scholl of Economics, 20 local regions were of high, 21 of medium, and 9 of low potential investment attractiveness. Details of the local regions in the sample had been presented in the below (Table 1).

A set of reactive and non-reactive research methods and techniques had been used. In relation to researching entrepreneurial activities of local regions I assumed that in the second decade of 21st century, the basic, comprehensive and trustworthy source of complex information for local region stakeholders is the official website of the local region, together with online Bulletin of Public Information, which existence for each local region is required in Poland by law. Thus the electronic audit method basing on structured questionnaire for each official website of local region in the sample was applied (structured questionnaire consisted of 20 questions). Content available at official websites of the communes was analysed, including archives of sections dedicated to commune current news for the period of 12 consecutive months prior to the day of the electronic audit.

**Table 1.** Name, size, functional type, and potential investment attractiveness category of local regions within the research sample

No.	Name of local region	Size of local region as per Local Data Bank of Polish Central Statistical Office	Functional type of local region as per TERYT typology	Potential investment attractiveness class from A (for the highest) to F (for the lowest)*
1	Krakow	big	urban	A
2	Strykow	small	urban-rural	B
3	Pila	medium	urban	A
4	Bialystok	big	urban	A
5	Rybnik	big	urban	A
6	Wegorzyno	small	urban-rural	E
7	Swinoujscie	medium	urban	A
8	Katowice	big	urban	A
9	Kutno	medium	urban	A
10	Wolin	small	urban-rural	C
11	Olsztyn	big	urban	A
12	Polkowice	medium	urban-rural	A
13	Krynica-Zdroj	small	urban-rural	A
14	Nowogard	medium	urban-rural	A
15	Jastrzebie-Zdroj	medium	urban	A
16	Kamien Pomorski	small	urban-rural	B
17	Budzyn	small	rural	C
18	Szczurowa	small	rural	E
19	Ryki	medium	urban-rural	C
20	Koszalin	big	urban	A
21	Gryfice	medium	urban-rural	C
22	Drwinia	small	rural	E
23	Medyka	small	rural	C
24	Przemysl	medium	urban	A
25	Pszczolki	small	rural	C
26	Konskie	medium	urban-rural	C
27	Karnice	small	rural	E
28	Zychlin	small	urban-rural	D
29	Ilow	small	rural	E
30	Dzialdowo	medium	urban	A
31	Brzezno	small	rural	D
32	Ujscie	small	urban-rural	C
33	Golczewo	small	urban-rural	D
34	Debica	medium	urban	A
35	Turosn Koscielna	small	rural	D
36	Trabki Wielkie	small	rural	D
37	Zblewo	small	rural	D
38	Dabrowka	small	rural	D
39	Ploty	small	urban-rural	D
40	Krosniewice	small	urban-rural	C
41	Wysoka	small	urban-rural	D
42	Lagow	small	rural	E
43	Przemkow	small	urban-rural	B
44	Jaslo	medium	urban	A
45	Orly	small	rural	C
46	Slubice	small	rural	E
47	Bodzanow	small	rural	E
48	Belzyce	medium	urban-rural	C
49	Moszczenica	small	rural	D
50	Przybiernow	small	rural	E

\* Indicator constructed by Collegium of Business Administration at Warsaw School of Economics  
Source: Own elaboration based on research sample selection criteria, Local Data Bank of Polish Central Statistical Office for 31st of December 2012, and data of Collegium of Business Administration at Warsaw School of Economics. for 31st of December 2011.

Within the study mystery client method was also used in form of sending electronic communication to the local region public administration from the position of potential investor interested in setting up economic activity, asking specific questions and expecting support (electronic correspondence regarding investment offer, investment incentives available, factors distinguishing local region among other of similar size in regional investment market, and possibility of direct meeting). Response time, and quality of the answers received were measured.

Another reactive research method was a survey questionnaire, sent to official representatives of local regions (questionnaire consisting of 8 open questions)<sup>2</sup>.

Timeline of research performed refers to the following stages: (1) electronic audit research of official website portals of communes and their Bulletins of Public Information – 7th of October 2013 – 3rd of November 2013, (2) mystery client method research – 1st of September 2014 – 15th of September 2014, (3) survey with representatives of local regions using structured questionnaire – 25th of August 2014 – 3rd of November 2014. Within electronic audit research all official websites of 50 local regions were analysed. In mystery client method research 19 letters of potential investor were replied<sup>3</sup>. In survey with representatives of local regions 8 surveys were filled in by local administration representatives.

The research objective is to explore, classify and present entrepreneurial activities of local regions that might result in creation of competitive advantages at regional investment market of the following nature: (1) management of information and knowledge; (2) creation and promotion of investment, tourism, and residential product; (3) stimulation of local entrepreneurship, and (4) support of cooperation and creation of network organizations. It is planned to identify both cost-efficient and cost-intensive entrepreneurial activities and present them in the manner reflecting the costs absorption.

#### 4. RESEARCH FINDINGS

As a result of the research on sample of 50 Polish local regions following examples of entrepreneurial activities have been identified: (1) 145 examples of entrepreneurial activities related to informing about investment and development possibilities; (2) 122 examples of entrepreneurial activities related to creation and promotion of local investment, tourism and residential product; (3) 173 examples of entrepreneurial activities related to stimulation of local entrepreneurship; (4) 125 examples of entrepreneurial activities related to support of cooperation and creation of network organizations.

Detailed analysis of identified activities led to creation of entrepreneurial activities catalogues classifying activities possible from cost-effective to cost-inten-

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<sup>2</sup> Filled surveys were received from Białystok, Katowice, Krakow, Kutno, Olsztyn, Pila, Rybnik, and Strykow.

<sup>3</sup> Replies in mystery client research method were sent by Białystok, Bodzanow, Debica, Działdowo, Kamien Pomorski, Koszalin, Krakow, Krosniewice, Lagow, Pila, Przemyśl, Przybiernow, Pszczollik, Rybnik, Strykow, Szczurowa, Ujście, Zblewo, and Zychlin.

sive ones, which altogether create a model of entrepreneurial organization at regional investment market.

#### **4.1. ENTREPRENEURIAL ACTIVITIES RELATED TO MANAGEMENT OF INFORMATION AND KNOWLEDGE**

Entrepreneurial activities focused on management of information and knowledge aim at equalizing the asymmetry of information looked for by local regions stakeholders that impact transaction costs of the exchange at regional investment market, and therefore impact attractiveness of local regions. Within this study the following frequently demonstrated activities of management of information and knowledge by local regions have been identified:

- regular publication of information relevant for stakeholders of local region in official website of the local region, including information on events and initiatives taking place outside the location of the local region, but possibly relevant for the stakeholders, as in case of vocational trainings, or investment project's financing initiatives. Examples of local regions with more than 500 communicates published within 12 consecutive months at their official websites: Swinoujście, Jastrzebie Zdroj, Krakow, Polkowice, Kamień Pomorski, Nowogard;
- providing information to the stakeholders of the communes in reply to electronic correspondence sent by them in possibly time-effective, and content-wise manner. Examples of local regions, which replied to electronic correspondence of potential investor in less than 5 working days, and were included content asked for: Krakow, Strykow, Zblewo, Białystok;
- providing electronic geographic information system (GIS) supporting decisions related to new investments, tourism, or residential activity on official website of the local region. Examples of local regions providing GIS services for their stakeholders: Rybnik (“Rybnik Geographical Information System”), Krakow (“The Observatory”);
- communication of local development plan or local development strategy through the official website of the local region (for example by locating electronic version of the document in official website of the local region). Examples of local regions sharing their development plans or strategies with their stakeholders via their official websites: Krakow (Development Strategy of Krakow), Przemysl (Strategy of Success of City of Przemysl), Krynica–Zdroj (Strategy of Promotion of Krynica-Zdroj);
- organization of initiatives supporting self-development of local region stakeholders, including usage of knowledge sourcing tools available in local region, for example by organization of information meetings on how to use resources (including knowledge sources) made available by the local region. Example of local region organizing such initiatives – Krakow;

- organization of direct information meetings with potential investors in reply to their need for information related to potential investments, for example by initiation of direct meetings in reply to electronic correspondence sent by potential investor. Examples of local regions engaging external stakeholders in that approach – Bialystok Pila, Strykow, Zblewo, Kamien Pomorski. Kamien Pomorski provided distinguished example on how to build and nurture the relationships with potential investors. Although the local region did not have any investment land at the time of mystery client research, local administration proposed a direct meeting in order to learn the investor's needs better, and to possibly propose an investment product in neighbouring location.

#### **4.2. ENTREPRENEURIAL ACTIVITIES RELATED TO CREATION AND PROMOTION OF INVESTMENT, TOURISM AND RESIDENTIAL PRODUCT**

Activities related to creation and promotion of investment, tourism, and residential product at local regions derive from private sector practice. In context of local region its basic good offered to its stakeholders is the location, which perceived qualities, and usefulness can be actively shaped by the local administration. Number of regularly demonstrated activities related to creation and promotion of investment, tourism and residential product were identified. The catalogue of activities identified included:

- identification and inventory of information on existing or future local investment, tourism, and residential product, and communicating it via official website of the local region. Example of local region actively identifying, inventorying, and communicating their investment, tourism, and residential products for different type of stakeholders: Katowice, Pila;
- providing information to stakeholders of local region in reply to electronic correspondence relating to investment, tourism and residential product, including attachment of promotion materials and local contact data. Examples of local regions providing tailored investment offers in reply to electronic communication sent: Krakow, Bialystok, Strykow, Pila;
- promotion of local region investment, tourism, and residential offer by dedicated place in official website of the local region, for example by dedicated sections. Examples of local regions demonstrating this activity: Grudziadz, Krynica-Zdroj, Katowice, Krakow;
- promotion of local region investment, tourism, and residential offer through electronic profile of the local region in electronic social media, including popular at the time of research electronic social media Facebook, Youtube or Twitter. Examples of communes using social media for promotion of their investment, tourism, and residential products: Swionoujscie, Nowogard, Olsztyn, Pila, Rybnik, Szczurowa, Zychlin, Strykow;

- creation of individual local region promotion and stakeholder engagement products such as electronic post card, which local region stakeholders can send from the official website of the local region, virtual walks presenting the view of the location from perspective of location visitors from the level of official website of the local region, or own mobile applications engaging into discovery of local region created by the local region. Examples of local regions creating own local region promotion and stakeholder engagement products: Wegorzyno (electronic post card), Koszalin (virtual walk), Bialystok (mobile application);
- promotion of the local region by professional public relations activity, including public relations dedicated section in the official website of the local region. Example – Strykow;
- participation of local administration in national and international events promoting territorial units investment offers. Examples of local regions actively exhibiting their investment, tourism, and residential offer within such event – Swinoujscie, Katowice, Konskie, Rybnik;
- promotion activities using big format advertisements (such as billboards in promotion of tourism products). Example of local region promoting their offer through billboards – Rybnik;
- activities focused on creation and promotion of the brand of local region, and the brand promise. Examples of local regions creating, and promoting their brand and brand promise – Kutno (brand “City of roses”). Pila (brand “Here visions assume concrete shape”), Rybnik (brand “Rybnik – city with spawn”), Bialystok (brand “Rising Bialystok”), and Krakow (brand “Magic Krakow”);
- activities related to direct promotion adjusted to needs and expectations of local region stakeholders by creation of dedicated local region promotion unit within the local public administration structures. Example: Kutno, and activity related to delivery of bunches of fresh roses to women entrepreneurs by Kutno promotion unit representatives at the occasion of International Women’s Day.

#### **4.3. ENTREPRENEURIAL ACTIVITIES RELATED TO STIMULATION OF LOCAL ENTREPRENEURSHIP**

Activities related to stimulation of local entrepreneurship by local region administration exceed their responsibilities (as it often is the domain of territorial units of higher rank), however they directly impact economic situation, created tax base, and therefore local development process of the local region. Number of regularly demonstrated activities related to stimulation of local entrepreneurship was identified within the study. Activities identified form the following catalogue:

- promotion of information on job places created by economic entities located in the local region through official website of the local region (for example via dedicated section within the official website of the local region, and being

- a job intermediary by local region between employers and employees additionally to other job intermediation bodies). Example of local region leading local region job portal – Krakow, example of local region informing on local job offers and foreign internships for local students – Polkowice;
- organization of competitions promoting entrepreneurial attitude aiming at stimulation of local economic entities (for example through competitions for the best business plan). Examples of local regions organizing such competitions – Dabrowka, Kamien Pomorski, Golczewo, Medyka, Pszczolki;
  - organization of trainings dedicated to founding, financing and increasing competitiveness of economic activity (often as a reward in competition promoting entrepreneurial attitude). Examples of local regions providing trainings on above subject: Pila, Ryki, Szczurowa;
  - activities relating to creation of local administration incentives for setting up and conducting economic activity – for example in form of creation and publication in official website of the local region a guidance on setting up and conducting economic activity, or provision of new investments advisor within the local region administration unit. Example of local region demonstrating this kind of activity – Krakow.

#### **4.4. ENTREPRENEURIAL ACTIVITIES RELATED TO SUPPORT OF COOPERATION AND CREATION OF NETWORK ORGANIZATIONS**

Activities focused on support of cooperation and creation of network organization are essential in one of modern public sector reform paradigms, which is networks and joining up paradigm. According to M. Castells (Pollitt & Bouckaert, 2011) in economy basic on knowledge and times of rapid changes economic entities are able to function effectively if they function as network enterprises, build connections, and participate in networks enabling them to minimize economic risks and maximize their utility. Within the entrepreneurial activities related to support of cooperation and creation of network organizations number of activities were identified within this study. Activities identified include:

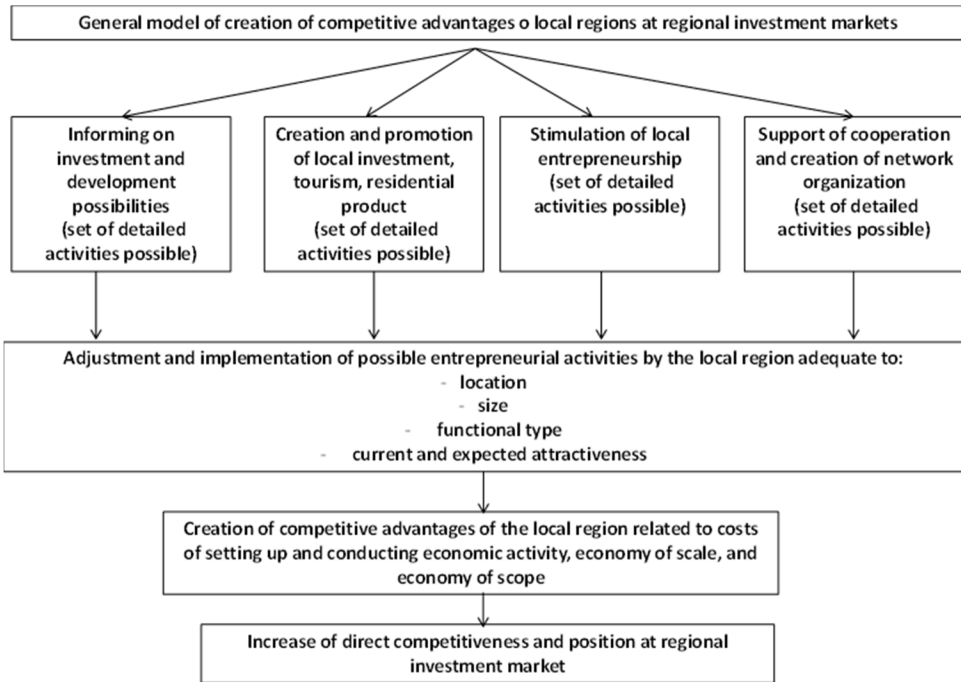
- continuous identification of needs and expectations of local region stakeholders in order to react appropriately, for example in form of electronic survey, or pool available for local region stakeholders available in its official website. Example of local region leading continuous survey, or pool on needs and expectations of their stakeholders: Bodzanow, Budzyn, Drwinia, Gryfice, Ilow, Konskie, Koszalin, Kutno, Przemysl, Strykow, Swinoujscie;
- organization of regular, specific-topic-dedicated meetings or by local region administration and stakeholders of specific needs, for example local investors. Examples of local regions organizing regular investors' needs dedicated meetings – Pila, Strykow;

- developing cooperation incl. exchange of knowledge, know-how, and best practices by local administration with local region stakeholders, for example in form of memoranda of understanding or declarations of cooperation with other local regions, economic entities or expert organization. Examples of local region demonstrating such activity: Pszczolki (declaration of educational cooperation with higher education institutions in Gdansk for inhabitants of Pszczolki), Krynica-Zdroj (declaration of educational cooperation with local public library on open foreign languages educational courses for inhabitants of Krynica-Zdroj);
- developing cooperation based on declarations for pursuing common economic goal by local administration and its development stakeholders, for example by applying together with other local regions, or private stakeholders for external funds for investment of common interest. Examples are Trabki Wielkie cooperating with local region Uhlefeld from Germany to increase the know-how of their crisis management authorities both on Polish and German side, or Polkowice cooperating with local region Bischofschofen from Germany to increase the know-how and qualifications of employees from Poland working in Germany.

#### **4.5. ENTREPRENEURIAL ORGANIZATION MODEL OF LOCAL REGION**

Findings of this study are of novel character, as identified that studies of similar methodology approach (electronic audit, mystery client method), and research focus (local regions in Poland) had not been performed before. Entrepreneurial activities presented within this section enable to propose original, general entrepreneurial organization model, which might be supportive in diagnosis, planning and implementing of activities related to increasing attractiveness and competitiveness at regional investment market by local regions. The model has been presented below (Figure 2). Sets of detailed activities possible are enlisted together with examples of concrete local regions within detailed sub-sections of this section.





**Figure 2.** General model of creation of competitive advantages of local region at regional investment market

Source: own study.

## 5. CONCLUSIONS

Analysed modern public sector reform paradigms, implications of transaction cost economics, and new institutional economy and contemporary literature in competition of local regions at regional investment markets led to conclusion that activities exceeding traditional role and responsibilities of local region public administration are justified. Performed research proved that entrepreneurial activities, defined as additional activities of local regions in line with legal regulations, but requiring additional, internal effort are demonstrated by numerous local regions effectively. Identification of 565 examples of entrepreneurial activities based on the research of 50 Polish local regions (communes), including electronic audit, mystery client, survey, and case study method enabled to classify identified activities and propose typologies related to: (1) informing about investment and development possibilities, (2) creating and promoting local investment, tourism and residential product, (3) stimulating of local entrepreneurship, and (4) support of cooperation and creation of network organizations. Identified entrepreneurial activities impact the costs of setting up and conducting economic activity, take advantage of economy of scale and advantage of economy of scope. In effect they increase perceived attractiveness of local region at regional investment market. Identified activities were undertaken by local regions of different location, size, functional type and potential investment

attractiveness proving that taking up additional activities by local administration is not determined by these factors. It has been observed that size of local region in terms of number of its inhabitants impacts on type of entrepreneurial activities demonstrated. In case of local regions of small size in terms of number of inhabitants the most popular entrepreneurial activities were related to informing about investment and development possibilities and stimulating of local entrepreneurship. In local regions of medium and big size in terms of number of inhabitants the most popular entrepreneurial activities were related to creating and promoting local investment, tourism and residential product support of cooperation and creation of network organization. The latter type of entrepreneurial activities is also more cost-intensive.

Each typology of entrepreneurial activities presented starts from the activities, which are cost-effective and end with the ones, which are cost-intensive, and which implementation might depend on additional resources of local region. The findings present both cost-efficient and cost-intensive entrepreneurial activities, starting from the cost-efficient and ending with cost-efficient one, what complemented the main objective of the research, which was to explore, classify and present entrepreneurial activities of local regions that might result in creation of competitive advantages at regional investment market.

Position school of strategy, and school of resources and competences provides an argument that in context of limited resources and lack of market leader status a local region should not focus on the all entrepreneurial activities possible, but rather concentrate on one or a couple of them to create competitive advantages and differentiate from local region of similar size, functionality type, and potential investment attractiveness at regional investment market. The proposed general model of creation of competitive advantages of local region at regional investment market together with detailed sets of activities possible might support both preparation and execution of strategy, and operations of local region administration aiming to improve their competitive position. Basing on selection of the sample and entrepreneurial activities identified, results of the study might be particularly supportive for the local regions of small and medium size, as majority of them were represented in the study.

Due to the intentionally narrowed in the study types of examined entrepreneurial activities of local regions and major focus on non-reactive research method related to electronic audit of official website portals of local regions, and activities related to management of information, and knowledge further direction of the studies are proposed. In view of exploration of research theme of entrepreneurial activities of local regions require quantitative, and qualitative, in-depth studies focused on their effectiveness on attraction and maintenance over time development resources of local regions such as investors, tourists and inhabitants. It also seems to be justified to study the impact of entrepreneurial activities on potential, and also real investment attractiveness of local regions over time, reflected by new investments, inflow of tourists, and inhabitants, which might supported with official, and comparable statistical data.

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# Innovation policies and SMEs development

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## Abstract:

Small and medium-sized enterprises are the backbone of the European economy, states create policies to foster research. These mentioned policies changed in the time and it is possible to observe that the national policies of the European Union (EU) member states are interconnected at an EU level. In the science field, the European Union is generally moving towards a multilevel governance. The central issue of this paper is to show the systematic importance of an effective government policies and institutional interaction in the field of R&D. The article will show that a well framed policy is essential and furthermore it fosters a better cooperation between the private and public sector.

**Keywords:** internationalisation; EU; innovation; innovation policy

**JEL codes:** O3, K33

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## 1. INTRODUCTION

This paper will show the importance of public policies and institutional interaction in the field of R&D public finance. Such policies are also significant for the small and medium-sized enterprises (SMEs).

This article takes into consideration three countries: France, Spain and Italy. They have similar legal systems based on almost identical civil codes and constitutions, clearly influenced by the French one. About the constitutional aspects, the main characteristics in common are: a strong central power and regional entities which are gaining in the time a stronger position in the state structures.

The European Union is heading to a multilevel-governance which has repercussion in the R&D field as well. The study aims to demonstrate that even in the presence of a strong regionalisation of R&D public funding, it is still crucial an effective national coordination. I will argue that the relation between state and regional R&D funding policies can be expressed in the Latin phrase *divide et impera*. The process of weakening state's direct control of the R&D activities (*divide*) needs to be followed by a stronger coordination (*et impera*), in order to control the R&D by other means, so as to avoid the effects of an uncontrolled "law anomie".

The article's main criteria is to examine the macro-law aspects connected with public innovation policies; i.e. why and how a given government has enacted a specific policy and the macro-effects produced by such policies on the main G.E.R.D. statistics; in the belief that political choices strongly influence the R&D environment. For the above mentioned reasons the methodology contains the analysis of the main pieces of institutions/legislation of France, Spain and Italy and observation of the main consequences on the fundamental G.E.R.D. statistics.

The paper is so divided: it is given to every state a section of the paper. The analysis of the countries systems starts with France, being France the country with the strongest state control; then Spain and Italy. Spain presents the most interesting approach to R&D considered the percent of GDP dedicated to R&D and the obtained results. Spain deserves the main part of the paper because thanks to the Inter ministerial Commission on Science and Technology, in the opinion of the author, Spain is an example of good practice in an R&D environment characterized by means deficiency. Italy instead lacks of any comparable system dedicated to R&D. This does not mean that there is a total absence of a national strategy, but it means that the Italian system lacks of unity and strong coordination as in France or Spain. In such a sense the Italian experience can be used as *litmus test*. In fact it shows that the absence of an effective state coordination gravely influences R&D macro results; because the *Distretti Produttivi* system produced excellent results in some R&D sectors, but the national R&D results stayed below expectations. The time lapse object of this research is the same for the three countries. The analysis is focused on the R&D policies between the 90's and 2000's, except for some aspects of the French experience.

## 2. LITERATURE REVIEW AND METHODOLOGICAL APPROACH

Historically, R&D projects were a direct emanation of governments' projects or policies. The state directly decided which project to implement or carry out. For example the nuclear projects or the concorde project in France (Laredo & Mustar, 2001). This demonstrates that the general theory of law defines the "state supreme power" (Kelsen, 1991) or "state imperium". The state used its unconditioned power (imperium) to determine the most profitable decisions in the R&D field. Currently, states tend less to directly exercising this sort of supreme decisional power and leave more "self-determination" to R&D players. A collateral effects of uncontrolled freedom of choice in the R&D field poses a threat. For example a proliferation of similar projects which subsequently risk being under financed (in such a case I would use the aforementioned Latin word *divide*).

The state may find a remedy to this perilous proliferation through the implementation of its "coercive power". The state's authority determines R&D policies in a more subtle way. For this reason the phrase *divide et impera* is still a valid description of the state's coercive power. The state cedes power of choice to individual institutional actors. At the same time, the coercive power allows the state to balance the proliferation and preserve its authority over the R&D field.

This paper will focus on the analysis of French, Spanish and Italian experiences in the R&D field. More specifically this article will focus on the Spanish experience because in the opinion of the author, the evolution of the Spanish R&D system is an example of positive achievements produced by an excellent capacity of adaptation.

It is common knowledge that the European Union is gradually implementing a certain kind of multilevel governance. Although this concept mainly concerns political-administrative aspects, nevertheless it influences a vast amount of different fields, among them the R&D field. Multi-level governance is a concept with more than two decades of history (Draetta, 2015), it is a notion very popular in many fields. To better understand this specific concept and its relevance in the R&D field, a short discussion of its major components is needed.

The idea of multilevel governance was created in regard to the European integration process (Adam, 2014). It starts from the consideration that the “state imperium” i.e. authority is shifting not only from states up to the European Union, but also down to sub-national authorities. Multilevel theory is strongly connected to polycentrism, as a way to stay closer to the real need of the society (Piattoni, 2009). Multilevel governance is generally understood as sharing responsibilities and cooperating between the various levels of governance and it is often associated with the principle of subsidiarity (Draetta, 2015). It is not possible to completely understand multilevel governance without introducing the subsidiarity concept.

Subsidiarity is based on the belief that the decision chain should be as short as possible in the meaning that the decision making process should be as close as possible to the citizens, so that the implementation of the decision process could be the utmost effective, and related to the real needs of citizens. For example, if a given social policy is to be implemented, it should be decided, thought and implemented from a decisional entity as close as possible to the beneficiaries (i.e. a construction of a school should be decided by a regional government and not by a ministerial meeting). In practice, multilevel governance is based on the idea that the best policies are chosen and implemented when decisions are taken with the participation of the final beneficiaries of such a policy.

An effective multi-level governance has to contain a quantity of subsidiarity, but at the same time coordination cannot be missing. In fact, the policy results depend on good coordination between all levels of government, both in the decision making process and in the implementation process. In such a sense, “*mutatis mutandis*” an efficient plan for financing R&D has to be based on a previous deep knowledge of the current condition of R&D sector in a particular state.

France, Italy and Spain have dealt with developing an R&D public funding system. All three of those states had a slightly different approach which hugely effected the characteristic of public policies implemented in their respective countries. The analysis is concentrated on these three states because they share a very similar constitutional/administrative systems and civil codes all based on the French one. Moreover these three states have similar social structures, languages and a shared history.

History influences the future, hence Spain and France had a system definable as very centralistic. Both countries have been, for a period, the centre of vast empires; those empires were characterized by a strong centralisation and control over possessions. Phrases as *L'État c'est moi* allegedly mentioned by king Luis XIV or the phrase, *el imperio en el que nunca se pone el sol* related to the vast amount of the dominions of the Spanish empire. Those phrases are much more than simple expressions; these phrases are a representation of an immaterial concept which transcend the words and explain what kind of political and administrative systems they represent. These systems were mainly hierarchical, i.e. decisions came from the political centre and were implemented by local authorities. Therefore, taking into account all the aforementioned, it is true (as we will see) that French and Spanish system shifted from a state centric system to a more “shared system”. Nevertheless in this new system there are visible traces of “centralised control” (Reppy, 2000).

An efficient plan for financing R&D has to be based on a previous deep knowledge of the R&D situation in the State. Taking inspiration from architectural jargon, it is possible to affirm that architectural and components knowledge are key elements for understanding the organisational capabilities of the system to create.

The article is based on the analysis of the pieces of legislation and the analysis of the main R&D institutions in France Italy and Spain, in the belief that political choices directly influence the R&D field and not vice-versa. The research results will show that French and Spain, except of Italy, had and have a better R&D system. This superiority is given by the stronger supervision and control that France and Spain have on R&D policies. Nowadays this control consists in a soft control, but nevertheless it is still a mechanism crafted to direct R&D efforts. Italy in this paper is used as *litmus test a contrario*. In fact Italy is missing a comparable R&D national control system. The Italian R&D financing system is based on two main pillars: *Distretti Produttivi* and an irregular funding based on historical data disconnected from any analysis of efficiency. This divergence in managing R&D funding affects the quality of the R&D efforts and results. Italy has less important results than France and Spain on the R&D field, even if Spain has a lower GDP than Italy. Hence this disproportion of results demonstrate that state control on R&D truly matters and it is a *condicio sine qua non*, whose the comparison between Italy and Spain is an example. The article is based on examination of the main pieces of legislation and comparison with economic results obtained.

### 3. ANALYSIS OF THE MAIN INSTITUTIONAL ASPECTS OF R&D SYSTEM IN SELECTED COUNTRIES

#### France

France with “Colbertism” was the first state to codify state intervention in the economy. “Colbertism” was an economic and political doctrine of the seventeenth century, created by Jean-Baptiste Colbert<sup>1</sup>. Colbert's central principle was that the wealth and the economy of France should serve the state. Hence today France with other European countries is an example in the field of state intervention in crucial national fields (Rich & Cole, 1964).

In France, during the 1960's a new vogue for “Colbertism” started in every field of economic activities. This “neo Colbertinism” did not remained without pronounced effects on the French R&D sector too<sup>2</sup>(Laredo & Mustar, 2001). The French government often directed public policies to promote R&D among the so called “champion national”<sup>3</sup>. Moreover it is worth noting that the national defense and military sector is still today considered a key field in R&D policy and the national defense expenses are used as a lever for growth (Guichard, 2005). In other words, the French R&D system is based on strong state coordination, which is expressed by the construction of the French national innovation system (NIS). This concept emerged over the past decades as a response to the recognition that innovation within a national economy needs a plan so to increase positive R&D outcomes (Piettre, 1986).

Traditionally, French technology and innovation relied on the targets of the central state, performed and implemented in the framework of grand programmes (Piettre, 1986)<sup>4</sup>. The main industrial actors have been the national champions<sup>5</sup>. However, this general pattern has changed over the last years. Technology transfer nowadays focuses on the validation and transfer of research results generated in universities, public scientific and technological research organisations, and research organisations. A national innovation system is based on the assumption that the better planned the system is, the better results will be reached (OECD, 1997). R&D stakeholders, are part of the same system, and as part of a same system they are equally needed altogether as no part of the body can live separated. In such a sense it is the French national innovation system, which has to connect the R&D stakeholders so to underline the interdependence between the national R&D stakeholders; moreover the stakeholders play the main role thanks to their linkage, mu-

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<sup>1</sup> French Minister of Finance under Louis XIV.

<sup>2</sup> In such a sense it is possible to use the term “technological Colbertism” (Laredo & Mustar, 2001).

<sup>3</sup> A national champion is a firm chosen by the state to become the dominant producer or service provider on the national market and overtake or hinder foreign competitors in this market.

<sup>4</sup> It is admissible to consider that the grand programmes spirit is still present in the nowadays in the so called “La stratégie nationale de la recherche”.

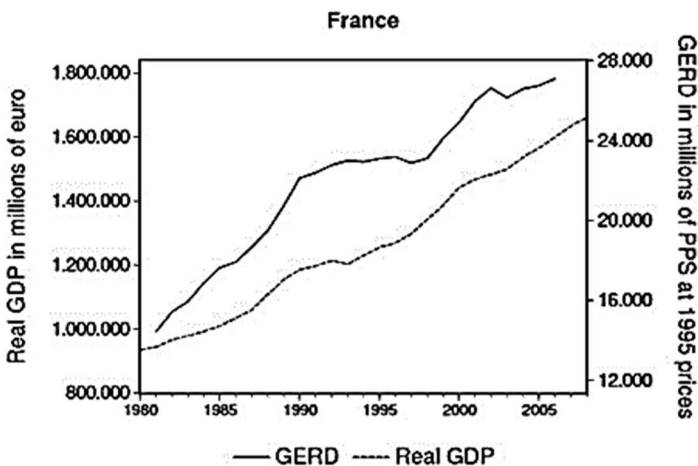
<sup>5</sup> In French: “champions nationaux”.



tual commitment and their own interactions. France had set a national R&D intensity in 2012 of about 2.29<sup>6</sup> percent of gross domestic product, which conferred a top position within the EU states.

As expressed above French technology and innovation relied on the targets of the central state, performed and implemented in the framework of “grands programmes”. These programs were mainly concentrated in and implemented by the national champions (Laredo & Mustar, 2001). The state created a mechanism which had to support the national champions in an effort to maintain or gain an international leadership role in the given field of activity<sup>7</sup>. During the last decades of the 20th century the aimed result was to some extent reached. In fact France has always had a gross domestic product intensity proportionally higher than other direct competitors (European Commission, 2014a), and the fields on which French R&D sector was the utmost significant were those fields whose national champions companies were operating in (European Commission, 2014c)<sup>8</sup>.

France reached such positive results during the last two decades of the 20th century thanks to the fact that two main changes occurred: the political side created new agencies, entities devoted to fostering an increment in R&D<sup>9</sup> (Figure 1). France, keeping a centralised form of power, opened the way to a feeble regionalisation<sup>10</sup> (Boudon, 2014).



**Figure 1.** The real GDP and GERD in France  
Source: National Institute of Statistics and Economic Studies (INSEE).

<sup>6</sup> Research and Innovation performance in the EU Innovation Union progress at country level 2014 edited by Directorate-General for Research and Innovation.

<sup>7</sup> The Government set special legislative and financial aid in order to defend the national champions against the international concurrence.

<sup>8</sup> E.g.: Aeronautics, energy, transport and defence.

<sup>9</sup> E.g.: Agence Nationale de la Recherche, Agence d'Evaluation de la Recherche et de l'Enseignement Supérieur, Pôles de Recherche et d'Enseignement Supérieur.

<sup>10</sup> Please notice that regionalisation doesn't have to be understood as a federalisation of the state.

The second occurrence which significantly changed French R&D “modus operandi” was the importance the regional level acquired in the French political system, the so called “regionalisation”<sup>11</sup>. The 26 French regions (which do not have legislative power), receive part of the national tax income and have a budget to bestow in their priority areas. Regions negotiate their priority fields with representatives of the state and they have an elected council (conseil régional) which is responsible for the regional administration. Regions are competent for social questions, transport, education, culture, local development, for this reason, to a certain extent Regions have competence for R&D (Office of the Prime Minister, 2012)<sup>12</sup>.

Nowadays French R&D is characterised by an unequal dichotomy between central government and regional government. France passed from a *dirigiste* form of R&D to a new form of governance where the function of the state is to facilitate<sup>13</sup> the R&D development. In this cooperation between central and regional authority the so called “contrat de plan État-région” (CPER) has a salient importance. CPER is in a state-region plan contract, a document in which the state and region are committed to a multi-year programming and funding major projects (among which R&D projects as well)<sup>14</sup>.

In this path of regionalisation via state-region plan contract, many centers for scientific research<sup>15</sup> were created. The fundamental idea of such a policy was to create over the country a fertile soil for R&D, so those centres were established not in a single city or in the capital, but in different cities of the country. It is quite interesting that although these national centres had to spread R&D over the state so to foster a diffused pro R&D environment,

The obtained results of this regionalisation were not adequate to the central government’s expectations; important differences in results within regions were observed (Beatson, 2007). In 2005 a shift in French R&D *modus agendi* occurred. Previously there was the so called principle of regional equality (it consisted in sharing the same quantity of funds to all the regions). Nevertheless this drive for equality brought extreme differences in results. Therefore, the central government shifted towards rewarding networks and clusters of scientific excellence. It was set as an R&D System, which had as common base the fact that to the regions were given an equality of opportunity to compete for scientific resources, and not a simple equality in resources. The regions were given the possibility to compete for obtaining higher financial means. This reflected a more gradual evolution in French policy towards equity rather than equality as a precondition for competitiveness. In

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<sup>11</sup> It is important to clearly express that regionalisation is something different from the so called devolution federalisation or power devolution. Federalisation has never been in the French political agenda.

<sup>12</sup> It may be of some interest that in 2014, the French Parliament passed a law that will reduce the number of regions in Metropolitan France from 22 to 13. The new regions will take effect on 1 January 2016.

<sup>13</sup> Also known as *Etat facilitateur* “State facilitator”. In such a sense it is possible to affirm that from the 70’s definition *l’Etat entrepreneur* we passed to *l’Etat facilitateur*”.

<sup>14</sup> Along with the CPER are there other different project where regions have a key role in the R&D implementation, nevertheless due to unity matters this paper concentrates on the CPER importance.

<sup>15</sup> In French: Centre National de la Recherche Scientifique.

such a sense the system drifted towards the so called “Pôle de compétitivité” technology clusters characterised by the presence of a given zone of highly qualified R&D players (i.e. research centres, universities, highly specialised factories).

## Spain

Despite the low gross domestic product percentage on R&D, Spain concentrated its financial means on specific technological fields, obtaining among others important results in the field of new sustainable sources of energy. The Spanish R&D's incentive system is composed of two major elements:

- national plan (which changed consistently in time);
- incentives tools which we may define as a group of combined law provisions.

The national plan is a direct expression of the government's guidelines, instead the group of combined provisions of law, is an instrument orientated forward creating a common ground which is created to foster R&D financing, beyond the limits set by government guidelines. In Such a sense Spain created two parallel systems for financing R&D, which under different paths had to provide the same result; augmenting R&D quality and quantity (Muñoz, 2006). The 1986 science act set the base for a very important institutional reform aimed at modernising the Spanish Science and Technology system: the creation of the Inter-ministerial Commission for Science and Technology (CICYT), with a mandate to define national plans for research and technological development, and a redefinition of public research bodies looking at strengthening their scientific competitiveness and bonds (Muñoz, 2006).

The “Plan Nacional de Investigación Científica y Desarrollo Tecnológico (National Plan of Scientific Research and Technological Development) has to be considered as the main instrument used by the Spanish government to coordinate and encourage scientific and technical research.

The 1986 science act, created a better coordination among the different R&D players. The Spanish government, developed science and technology policies; these policies were and still are carried out in accordance with the national scientific research plan. In order to reach the desired results many important administrative bodies were set out by the Science Act. The inter ministerial commission on science and technology (CICYT) is the leading national agency for scientific and technological policy and the angular stone on which the national plan system is based. The CICYT is responsible for planning, drafting, coordination and follow-up. The CICYT is presided by the office of the prime minister and includes the ministries<sup>16</sup>involved in scientific and technological policy (Muñoz, 2006). The CICYT is assisted by the following bodies:

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<sup>16</sup> Minister of Economic Affairs and Competitiveness; Minister of the Treasury and Public Administrations; Minister of Foreign Affairs and Cooperation; Minister of Defense; Minister of Public Works; Minister of Education and Culture; Minister of Employment and Social Security; Minister of Agriculture, Food and Environmental Affairs; Minister of Industry, Energy and Tourism; Minister of Health, Social Services and Equality.

- a general council for science and technology, which is the CICYT's consultative body devoted to promote coordination among the different Autonomous Communities and the central administration;
- a support and monitoring committee which is led by the prime minister's Economic Office and it is responsible body for inter-ministerial coordination in planning the follow-up policy on R&D;
- the Spanish Foundation for Science and Technology (FECYT), which part of the ministry of science and innovation, it is the responsible body for providing technical support to the scientific and technological decision-making bodies in Spain.

The 1990's mark a turning point in the R&D System in Spain. The pursued idea by the Spanish government was to strength a set of laws to promote R&D activities outside the National Plan. It is possible to affirm that with this reform the Spanish government tried to implement in Spain what in France is defined as *etat facilitateur*<sup>17</sup> in the meaning that the state had to maintain a role, but this role had to be less evident. The state had to prepare fertile conditions allowing an independent but at the same time controlled “R&D blossom”. The main idea was that the state showed the path to succeed but at the same time the state left more freedom on how to implement R&D activities.

The Spanish system during the 1990s appeared well framed, with pieces of legislation, providing a system on research more reliable; this system was based on a strong legal basis (Gutiérrez Lousa, 2008).

It is worthy of attention the combined provision of Law 43/1995 after modified with the law 55/1999 on corporate tax.

It is extremely significant that Spain shifted to a science financing system characterised by vigorous tax incentives; in such a sense the Spanish government tried to limit its direct “imperium”, desisting from imposing government central will as occurred before. It is possible to affirm that the choice carried by the Spanish government was to leave more decisional space to the R&D player and to the market (Navarro, 2009).

The reform was based on the principle that the state had mainly to set the R&D framework but the national plan tool had to be to some extent less invasive; for this reason R&D tax incentives were implemented as well through a broadening of fiscal incentives in accordance with the mentioned laws (Gutiérrez Lousa, 2008). The base principles applied to this regulation, deserve to be mentioned:

- the deduction application had to be neutral, it could not radically modify the conditions of the company subject to incentive, unless it contributed to overtake market inefficiencies;
- tax deduction had the main intent to increase the competitiveness of the Spanish Economic System;

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<sup>17</sup> State with a “facilitating role”.

- the main fiscal ease concerning the R&D consisted in what was generally known as “Amortization freedom” (Libertad de Amortization).

The difference between tax reduction and amortisation freedom lies in the slight distinction that tax reduction reduces tax debt settlement. Instead amortisation affects tax base, allowing a “tax deferral”, but not a reduction. It entails that it was possible to amortise the R&D expenses qualified as intangible assets; but it is important to notice that it was not possible to extent such ease to expenses relating to innovation matters. Tax reduction had a very large extent, depending on the investigation activity set. According to corporate law, development may be defined as follows: application of the research results in order to produce new materials or commodities.

It is important to underline the words “application of the research results”. This affirmation implicates a strong connection with the research result, which had to be classifiable as positive. Hence it was obligatory that the antecedent research, gained a positive result so that the new product or material could be defined as a direct consequence of research. Because it was not clearly defined, if a development process consisted in something that could be defined as new; a closer contact was set between the research institution and the ministry for research and the tax administration (Muñoz, 2006).

The Law 55/1999 set a change in the Spanish R&D panorama, it surly represented a turnaround compared to the Law 43/1995. Before 1999, technological development was quite peculiarly not considered a part of R&D activities. It was connected to industrial activities more than R&D activities. In this regard, only from the beginning of this century, the words *investigación* (research), *desarrollo* (development) y *innovación* (innovation) were used together to express the Spanish R&D policy, earlier the words *Investigación*, *desarrollo* were used and the so called *innovación tecnológica* was a concept treated separately.

It is possible to define technological innovation as the activities whose result is a step forward in the technological field, which help in obtaining new products, new productive procedure or consistent improvements in the existing ones.

Discerning simple R&D activities from activities involving technological innovation is not always possible; it may occur that technological innovation is a positive final step of an R&D process.

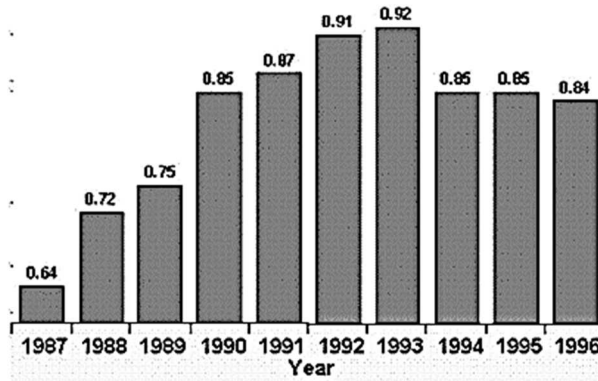
Under the earlier Spanish law provision, research activities, were not conditioned by the result reached. This means the research could even not reach a positive result but still the activity carried out would be qualified as “research”.

Instead technological innovation required new products or innovative procedures or consistent improvements in the existing ones, and reaching a positive result was obligatory (Muñoz, 2006).

The R&D activities, producing a positive result, can be defined as an objective innovation, instead the TI (technological innovation) activities may produce a result which may be defined as a “subjective Innovation”. The innovation has to be new in regard to the subject which has promoted and supported the TI research. Incentives on technological innovation activities are a further implementation of what

was already set throughout the R&D legislation. Technological innovation activities are now compared to all other R&D activities with no additional distinction provided, reaching a positive result is not anymore a *condicio sine qua non*.

The Parliamentary strongly believing in the *État facilitateur*<sup>18</sup> against the concept of *État dirigiste* characterised by a strong economic planning (Miguel & Galindo, 2003), increased the size of the tax deduction percentage. However this decision did not produce the expected results. It did not reached a concrete improvement in the Spanish gross domestic product percent dedicated to R&D (Figure 2). Unfortunately the expectations before set, were not entirely met.



**Figure 2.** Evolution of R&D expenditure (% GERD) in Spain  
 Source: National Institute of Statistics and Economic Studies (INSEE).

In 2006, the Spanish government started to make relevant change on Spanish R&D policies. The change was as vast that it is possible to define it as revolutionary. It was decided to leave the deduction system, which was characterised by large freedom given to the R&D players. The government created a new R&D policy once again based on National Programs set by the government itself. The emanation of this new Law 35/2006 represents a fundamental change in the R&D field. This is very well explained in the law preamble which in few words explain the limits of the previous R&D policy. Citing the exact words is due to the semantic significance of the text *”en muchos casos, los estímulos fiscales a la inversión son poco eficientes, presentan un elevado coste recaudatorio, complican la liquidación y generan una falta de neutralidad en el tratamiento fiscal de distintos proyectos de inversión”* (BOE, 2015), which says *”In many cases the fiscal stimulus to investments is not cost effective; high collecting costs complicate settlements and generate a lack of neutrality in the fiscal treatment of different investment projects”*.

This new policy consisted in leaving “the incentives era”. The government focused on developing a system based again on national and regional programs (Buesa, 2006). There are great differences between the two approaches. The incentives form is more market respectful, creating new national and regional programs

<sup>18</sup> Please see the note above.

allows the government to address the efforts in financing R&D activities. In such a sense the government decided, through national plans, which R&D fields were worth to be financed. This new policy was generated by the government belief that a R&D system, more based on national plans, is capable of reaching far better results. Through this new national plan the government set the goals to be achieved and the priorities to be followed in the R&D field.

The 2008/2011 R&D National Plan introduced a new structure and new way in managing the R&D issue. It was decided to create a new version of the Comisión Interministerial de Ciencia y Tecnología (CICYT), which is possible to define as a reinforced CICYT. This new version of CICYT entered into service in 2006. The pyramidal structure of the commission, formed by the R&D key actors, allowed to set a better performing national plan, the commission was formed as follows: a chairing body responsible for the elaboration processing of the plan. This sub commission had the key role to supervise all the procedure, and a group responsible about the concrete elaboration of the plan. The first group is a group formed by experts of administration having the main task of policy coordination. The second group formed by science and technology experts.

- three consulting sub commission designed to analyze specific problems;
- a commission for institutional and budgetary matters;
- a commission on financial instruments.

This commission is responsible for finding the financial means to be used in order to implement the national plan. That group has a core function; it is designed to discover and analyze if what set in the previous 20 years in Spain was successful and to which extent a commission on key topics, devoted to determine the main topics to be discussed.

The purposes of the National R&D&I Plan (2008-2011), which was set up in line with the provisions of the National Strategy for Science and Technology, were: placing Spain at the European cutting edge of knowledge, and creating a favourable environment for investment in R&D&I (European Commission, 2013). This new form of national plan for R&D has a structure based on three areas directly related to the plan's general objectives and linked to instrumental programs which pursue specific objectives:

- generating knowledge;
- fostering cooperation in R&D;
- strategic actions.

## **Italy**

Although Italy is trespassing a period of economic austerity, the Country is still among the ten most developed Countries in the world for gross domestic product and it is the third market for magnitude in the Euro Area, this makes it possible for Italy to have a discreet R&D national system which needs to be improved (European Commission, 2014b).

The Italian R&D legal system is based on two main pillars, the national research plan (Piano Nazionale per la Ricerca now on PNR) and productive clusters (distretti produttivi) (Italian government, 2014). The PNR is set by the Parliament and the Council of Ministries. Its coordination within the government is under the responsibility of inter-ministerial committee for economic planning. The Ministry for Education, University and Research (MIUR) coordinate national and international scientific activities, distributes funding to universities and research agencies, and establishes the means for supporting R&D. The Ministry of Economic Development supports and manages industrial innovation (Italian government, 2014).

The PNR<sup>19</sup> defines the objectives and modes of implementation of specific interventions in priority areas, disciplinary sectors, actors involved, and projects which qualify for funding. The goal is to ensure the coordination of research with other national policies, bringing Italian research into alignment with the strategic vision defined at European level and creating the conditions necessary for a progressive integration of public and private research. The PNR is formulated by the Ministry of Education, Universities and Research (MIUR), after extensive consultation with the actors of the innovation systems (e.g. scientific and academic communities, economic powers and competent administrations). It is implemented after approval by the Inter-ministerial Committee for Economic Planning. The first PNR was formulated during the period 2001-2003. Assessments have indicated that in order to obtain tangible effects on the country's R&D environment, simultaneous action on several levels were necessary. To achieve its objectives, the first PNR proposed a set of integrated actions, each of which involves various initiatives over the short, medium and long term. The main objective was to simplify funding mechanisms, rationalise the administration *modus operandi*, and identify forms of monitoring to ensure that funding is efficiently applied in pursuit of the stated objectives<sup>20</sup>.

A weakness of the first Italian PNR was a lack of a permanent scheme or structure comparable to the Spanish or French ones, meaning for that, a general lack of a steady plan and continued in the time (Belussi, 2004). This fact does not mean that Italy was gravely lacking on R&D, but it means that Italian R&D was different in the approach, not based as much as French and Spanish on a national R&D plan<sup>21</sup>. For many years the PNR hugely changed in scopes and terms, moreover before 2014 The Italian national PNR was an instrument through which the government substantially performed a very light and inconsistent activity of fund distribution. Based on historical data the Government was distributing "R&D" funds for generic projects or studies<sup>22</sup>. Those funds quite often were used for covering personnel costs, which had very little in common with R&D.

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<sup>19</sup> The new PNR: [http://www.istruzione.it/allegati/2014/PNR\\_online\\_21feb14.pdf](http://www.istruzione.it/allegati/2014/PNR_online_21feb14.pdf).

<sup>20</sup> PNR aims too at encouraging technology transfer between the actors in the innovation system.

<sup>21</sup> The Italian PNR structure highly changed during the years, not allowing a consistence in the long run.

<sup>22</sup> Projects which often coincided with regular Universities programs and funds were used to support the universities.



Beside the national plan, the Italian R&D system is strongly based on the so called “Distretti Produttivi” productive districts (Bertamino, 2016). These Districts are characterised by a virtuous circle formed by the elements learning, linkage and investment. These districts are sort of self-sufficient system where, leading R&D players have a direct linkage within universities and schools established in the mentioned district. This represents a sort of virtuous linkage that fosters positive cooperation. Companies need research activities which are performed by universities/research centres in the districts with which the mentioned companies have a “trust linkage”. At the same time companies take specialised labour work force from the territorial schools.

The so called productive districts for all intents and purposes are to be considered as public policy instruments to foster innovation (Coletti, 2007). Based on the theory “the closer it better” it implements competitiveness of local production systems by creating synergies between companies, universities, research centres and “local authorities”<sup>23</sup> located within limited territorial boundaries. A quite important characteristic is that often these districts are “self-created”, in the meaning that R&D players located in the given zone, start a stronger cooperation and the local authority recognising such stronger cooperation try to assist through a better administrative cooperation (Italian Government, 2014)<sup>24</sup>.

#### 4. CONCLUSIONS

This article examined the main institutional aspects of the R&D systems in France, Spain and Italy, which determine R&D policies. It showed as in France and Spain, except of Italy, state control is present in a higher degree. This state control has nowadays a different form then in the past; some decades ago the state control was more direct, and to some extent absolute. Nowadays the mentioned control has the aspect of a soft power, in the meaning that it is more subtle and less evident.

An initial analysis could produce in the reader the sensation that the R&D French system is characterised by a multilevel governance, where R&D actors have to play in a multilevel system without a state control but under a more prudent analysis, it is perceptible how the central government’s hand is still strong and powerful. In terms of forms of public interventionism; new modes of steering and management are noticeable. In such a direction the French government is creating frameworks leading to more selective action and leading to a resources concentration. In other words the central government still uses its steering, power (Imperium); this power is now put into use in a less *dirigiste* way, but still is visible a quite strong hint of *neo Colbertinism*. At the same time both in Spain and in Italy even if to a less degree than France, are going into the same path of a modern “Etat facilitator” where the state while letting freedom to the R&D players at the same

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<sup>23</sup> To be interpreted in lato sensu. Territorial administration is divided between, Regioni, Provincie and Comuni, and often they have a concurrent competence on R&D matters.

<sup>24</sup> Other times are regions that a priori propose the creation of productive districts so to foster investments in the territory.

time create a framework where is the state who directs the main line of the R&D policy through a “moral suasion” given by the national plan; because it is the national plan which encourages the R&D players to follow a determined path.

The evolution of the Spanish R&D system is remarkable. Even if exiting from a dictatorship, the Iberian country started a very interesting implementation of national plans which had as main function augmenting the R&D activity. No doubt the result was to some extent achieved. Afterwards the Spanish government in the 1990's, tried without the expected results, to swift to a system characterised by incentives. This incentives were planned to be sort of a neutral tool in the meaning that the market had, in the idea of the legislator, to determine the path on which proceed. At the beginning of the century Spain came back to a stronger implementation of the national plan demonstrating in this way that the state cannot completely dismiss its leadership in the R&D field.

Italy with its R&D financing system is an example a contrario. The Italian R&D polices lacked of consistency, hence the soft state power was and is still missing, expecially when compared with the French and Spanish experiences. Italy has a quite interesting system based on the “Distretti Produttivi” idea; nevertheless these cluster system is not enough to foster R&D policies on the entire country and it shows how in absence of a strong state coordination R&D is far less efficient. It may take different name or forms but state soft power is still very needed to better allocate the R&D efforts.

In conclusion, if a given state trespasses a period with limited R&D funds, this given state should craft a system similar to the Spanish one. In fact the Spanish system has two characteristics “information and direction” which are indeed useful and produce a better efficiency in the R&D system. The inter ministerial commission on science and technology (CICYT) has the power and competence to obtain and process the data on the ongoing and future research in the country, this amount of information are then used by the Spanish government to better direct and concentrate the R&D financial efforts. This would be a good approach for Italy, because the Italian R&D system is missing a central entity with a true power of coordination. Every region or national institute in Italy is formally disconnected from the other R&D players; R&D cooperation works thanks to personal contacts instead of a formalized info-system as in Spain. This situation has implication on the lower R&D results of Italy.

The limitations to the research which may had a potential impact were represented by the difficulties in finding the relevant pieces of legislation. The legislation often changed quite rapidly without leaving lasting traces. This problem created some jeopardy in the time frame analysed. Nevertheless the article examines the most important pieces of legislation which definitely influenced R&D activities. In fact when the pieces of legislation were not easily reachable, the research was based on articles covering the relevant topics written by national authors. The next step of the research would be to extend the comparative analysis to the regional level in

order to analyse the R&D regional policies and the R&D cooperation between regions of the same state and other states so to observe the main differences in the results and policies.

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# High-Tech SMEs in the concept of intelligent organizations: The reconstruction of the approach in the light of empirical research

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## Abstract:

The objective of this paper is to present the concept of intelligent organizations, which is nowadays believed to be the highest developed form of a company and to check if high-tech small and medium enterprises (SMEs) from Greater Poland region are run according to the concept of intellectual entrepreneurship. Verification whether the high-tech SMEs meet the criteria of intelligent organizations was tested on a sample 44 SMEs using a survey CATI tool. Data analysis consisted of comparing the values of three statistical measures (dominant, median, arithmetic average) of seventeen items. The survey results confirm that these enterprises base their actions on intellectual capital, which becomes the most important element of business management in the strategic perspective. Thus, their actions are consistent with the concept of intellectual entrepreneurship. The originality of this work lies in studying the concept of intellectual entrepreneurship taking into account companies from high-tech industry. Up till now companies from Greater Poland region were analysed just for their level of innovations, not intellectual capital. It is important to encourage more companies to be run according to the intellectual entrepreneurship concept due to unstable circumstances worldwide.

**Keywords:** globalization; intellectual entrepreneurship; intelligent organization; human capital; social capital

**JEL codes:** O31, O32

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## 1. INTRODUCTION

It is difficult to find an example of a wealthy country with a closed economy. Open borders and free movement of the means of production, final goods and services until recently guaranteed both economic development and technological progress around the world (Geenhuizen & Ratti, 2001). Ideal examples of this are the economies of such countries as South Korea, Singapore, Hong Kong, Taiwan, and China. And although the literature points to numerous indisputable advantages of the internationalisation of markets, institutions and outcomes, and their aggregated

form of globalization, its disadvantages must also be pointed out. It can undoubtedly be attributed with the following negative traits: the lack of global coordination, the impairment of authoritarian state in the economy, the accumulation of negative externalities, the dominance of microeconomic interest and the relaxation of rigor in terms of risk-taking by managers (Harrison, 2007). These aspects "contributed to a violation of the fundamental economic balance between the need for growth and profitability and the pursuit of security. The other side of the disturbed balance between profitability and security is economic instability" (Szymański, 2011, p. 15). Obvious examples of such instability can, in turn, be found in such countries as Greece and Cyprus, where the disregard for economic security has shaken not only their economies, but – given the high degree of dependence – also the entire European Community.

Economic reality is now characterized by the scarcity of confidence, trust and stability. Modern enterprises do business in an environment of generalized insecurity that hinders strategic planning in the long term, but promotes opportunistic behaviour (Cook & Kramer, 2004; Roubin & Mihim, 2011). As a consequence, verification, or adjustment activities have become increasingly difficult in observed high complexity of modern world, and it forces a new look at entrepreneurship and competitiveness. In literature one may find new concepts for understanding entrepreneurship in terms of new ideas, knowledge management, intellectual capital, innovation diffusion, as well as the ways of organizing the company (Ismail, Poolton & Sharifi, 2011; Teece, 2007).

The main purpose of this article is to point out the concept of an intelligent organization, which conducts its activity based on intellectual capital, and the synergy of human, social and organizational capitals. Bendkowski (2012, p. 21) states that the idea behind an intelligent organization "is to use its resources of knowledge with their simultaneous restoration and renovation. Thus, allowing for high flexibility and smooth adaptation to the environment and the anticipation of external conditions". The theoretical background of the problem has been further enhanced by the prospect of research on the high-tech SMEs sector in Greater Poland. The participation in the study (using CATI technique) was confirmed by 44 entities of which 32 were small, and 12 medium-sized companies. By using statistical measures (like dominant, median and arithmetic average) the sample companies were analysed and results have been presented.

## **2. THE CONCEPT OF AN INTELLIGENT ORGANIZATION**

More than thirty years ago Peter Drucker proclaimed that global societies had entered the era of discontinuity and uncertainty (Drucker, 2015). For this reason, as described by Szymański (2011), a critical reflection on classical and neo-classical approach to the analysis of reality made sense not just 50, 30 and 20 years ago, but also makes sense at present. It is even more apparent knowing that these schools recognize any fluctuations as normal economic phenomena, which should not cause unrest, because they are temporary. At the same time, the well-functioning market

mechanism will ultimately lead to balance. The author adds, however, that today "qualitative transformations require substantial revision of the guidelines" (Szymański, 2011, p. 37). Also Joseph Stiglitz notes that "science quite often so strongly believes in assumptions or they are so firmly entrenched in our thinking that no one realizes the fact that these are only assumptions. (...) Economists assume that information is excellent, although they understand that it is not the case. Theorists hope that the world of imperfect information works very similar to the world of perfect information" (Stiglitz, 2010, p. 297).

The range of current changes resulting from the opening of economies and their internationalisation, complex phenomena of offshoring, industrial and even economic relocation, force one to reject the classical concept of full rationality, and thus the idealized model of homo oeconomicus. According to Janasz, "progressive globalisation will increasingly affect development prospects for individuals, organizations, cities, regions, countries and even continents" (Janasz, 2012, p. 61). Moreover, some authors claim that a new kind of society is now forming, namely "homo globalis" (Strenger, 2011).

In such a dynamic environment where the extrapolation of past experiences and the anticipation of foreseeable trends are impossible, and where the culture of insecurity and mistrust is constantly growing, the unmistakability of resources is gaining importance (Jashapara, 2006). In particular such resources that allow constant adaptation to a changing reality. According to Ratajczak-Mrozek (2010, p. 45) "under hypercompetition permanent competitive advantage is replaced by a series of instantaneous states of comparative advantage. This means that companies, instead of trying as long as possible to keep their well-established competitive advantage, should constantly search for new ways to maintain their dominant positions, which means to constantly question and demolish their current advantage and the advantage of their competitors". Thus, contemporary management paradigms need to be gradually redefined and broadened with such strategic, and at the same time, intangible elements as: knowledge, skills, experience and leadership, human capital, as well as trust, loyalty and credibility – collectively referred to as social capital (Libertowska, 2014, p. 96). Moreover, the importance of creativity and innovativeness has been growing along with high flexibility and seamless adaptation to the environment (Brilman, 2012; Easterby-Smith, Lyles & Petraf, 2009; Eisenhardt, 1989; Kogut & Zandar, 1992).

The concept of intellectual entrepreneurship with intellectual capital at its foundations is an answer to these new, difficult conditions. As observed by Baron and Armstrong (2007, p. 9) "the concept of intellectual capital composed of three elements points out that while individuals (human capital) create, maintain and use the knowledge, which is multiplied by the interactions between them (social capital) and consequently it generates institutionalized knowledge which is owned by the organization (organizational capital)". According to Love, Fong and Irani (2005, p. 1), this specific type of entrepreneurship involves "establishing a basis of material wealth of intangible knowledge". Janasz (2012, p. 31) adds that natural



features of this type of enterprise are creativity and innovativeness. Intelligent organizations are thus identified as the highest stage of enterprise improvement. The table below presents the main differences between a traditional organization, and an intelligent one.

**Table 1.** The features of traditional and intelligent organizations

<b>Traditional Organization</b>	<b>Intelligent Organization</b>
Work fully utilizes only the knowledge of a small part of employees	Work is based on the knowledge of all participants
Hierarchical structure	Network structure
Functional management system	The dominance of intellectual capital management
The dominance of routine work, repeatability and procedures	The dominance of activities involving innovative solutions
Individual or group work	Teamwork
Work involves the performance of duties	Design work
The use of individual skills	Synergy in teamwork
Strong position of managers	No typical managerial positions, and if they exist, a manager acts as a coach and an inspirer
Orientation inside the company to maintain internal balance	Orientation on the outside and creating a global value
Top-down coordination	Coordination by team participants

Source: (Mikula & Ziębicki, 2000) quoted in (Bendkowski, 2012).

In the context of intellectual entrepreneurship particular significance is attributed to human capital, including knowledge as a strategic element, which allows the creation of competitive advantage (called knowledge-based view) (Kogut & Zander, 1992, p. 391). There is no doubt that knowledge is rare and it depends on context. Each enterprise produces appropriate knowledge, which means that it is difficult to forge (Bendkowski, 2012, p. 21). Thus, the willingness of companies for creative and innovative solutions to new problems and undertaking an entrepreneurial approach with a simultaneous risk appearing in connection with new, uncertain and revolutionary changes "remains associated with the intelligent use of knowledge aimed at creating new knowledge and new skills, which lead to the realization of unique projects. All this allows one to unlearn routine, traditional and customary behaviours" (Janasz, 2012, p. 30).

Moreover, it is worth noting that the literature emphasizes particular importance of tacit knowledge, which arises within organizations and becomes subject to rapid transfer between the employees of a company and between the company and its environment (Nonaka, 1995). This knowledge can become an important source of innovations, and thus can contribute to gaining competitive advantage in the future. It allows giving up the strategies of imitation. It means moving away from technological approach to knowledge popular in the 80s and 90s and taking up a social approach in which knowledge is created as a result of mutual interaction and group learning (Janasz, 2012). According to Czop (2001, p. 98), "[...] it is thanks to the many interactions occurring between the participants of organizations,

the processes of transferring information and knowledge and the learning processes, that an organization is able to survive on the market. A modern organization inspires and supports the learning of all its members, constantly transforms itself, expanding its creative possibilities for the efficient creation of the future".

Thus, the second element of intellectual capital – social capital grows in importance. "Focusing on people creates an atmosphere of harmony within a company and facilitates the use of wealth and originality of employee personality traits, filling a wider social and cultural role. This makes the people and the relationships between them the greatest good of a company" (Grzanka, 2009, p. 10). This suggests that in an intelligent organization the appropriate selection of employees in terms of skills and qualifications should go hand in hand with social skills. The concept of intellectual entrepreneurship emphasizes the role of cultural factors and the system of fundamental values in the process of decision-making.

### **3. THE CHARACTERISTICS OF THE STUDY AND THE ANALYSED SAMPLE**

Within the framework of the project undertaken in the period between May 2013 and November 2014, titled "The role of intangible assets in shaping competitive advantage of high-tech companies in Greater Poland," a survey of small and medium-sized enterprises from the high-tech sector<sup>1</sup> was conducted. All the participants were located in the Greater Poland region. The basic research problem was to identify the extent to which these entities use soft factors of production in acquiring their superior position over their competitors. The questions in the survey also made it possible to assess the extent to which these companies are aware of new trends in the management of modern enterprises and whether they are guided by the concept of intellectual entrepreneurship. The essence of the study stemmed from the fact that "companies predominantly attach importance to current efficiency and represent the traditional approach" (Janasz, 2012, p. 35), while too little number of business entities chooses a strategy based on change, innovation and flexibility (Brilman, 2012; Easterby-Smith, Lyles & Petraf, 2009; Liu & Liang, 2014).

For this reason, the undertaken study focused on the high-tech enterprises (industry approach), which are generally the units focused on pro-innovation activities. According to the governmental report titled "Competitiveness of high-tech companies", "industry of high technology, due to high intensity of the processes of research and development, is a specific sector, the analysis of which provides not only information on the impact of R&D, but also on competitiveness and the ability of the economy to absorb the results of the work in the fields of science and technology" (Ministry of Economy, 2009, p. 3). These companies are characterized by specific features, which allow them to achieve competitive advantages over their

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<sup>1</sup> The classification of advanced technology industries was adopted in accordance with Polish Classification of Activities (PKD 2007) and included the following: (C 21), (C 26), (C 30.3), (J 59), (J 60), (J 61), (J 62), (J 63), (M 72).

large counterparts. It is possible to distinguish, amongst others, the following (Glinka & Gudkova, 2011):

1. More flexible management structure than in the case of large companies.
2. Less bureaucracy, which provides greater freedom of action for businesses and the possibility of an easier assignment of innovative activities as priorities in the development strategy.
3. The possibility of freezing a much smaller share in earlier generations of technology than in the case of large companies.

The choice of the territorial scope was due to the fact that the region of Greater Poland during the period 2008-2012 significantly differed in comparison to other provinces in the country in terms of the size of investment in innovative activities and R&D activities of small and medium-sized industrial and service enterprises, as well as in terms of the largest number of significant concentration of the people employed in high-tech industries (PARP, 2006).

The analysis of data obtained from the statistical office indicated that 215 entities had met the criteria for selection defined in the project. The study was complete for the given population. Finally, the participation in the study (using CATI technique, i.e. Computer-Assisted Telephone Interview) was confirmed by 44 entities (maneuverability at 20%), of which 32 were small (10-49 employment level), and 12 medium-sized (50 to 249 employees) companies.

The main research tool was a survey consisting of 27 questions divided thematically into two parts. The first part concerned the degree of innovation and competitiveness, the other – social capital in the organization.

#### **4. INTELLECTUAL ENTREPRENEURSHIP IN LIGHT OF EMPIRICAL RESEARCH**

The basic premise of the study was the statement that "the challenges faced by today's organizations highlight the need to take into account not only quantitative factors but also qualitative indicators of competitiveness while creating competitive advantage" (Machaczka, 2014). Enterprises predestined to build such an advantage, especially by means of intangible assets, are companies belonging to the high-tech sector. Therefore, the questionnaire consisted of 17 questions about the resources and skills, which in the opinion of managers of these companies, allow one to gain competitive advantage. The distribution of replies is presented in the table below.

From the above set of resources (skills) constituting competitive advantage of companies respondents on a scale of 1 (lowest rating) to 5 (highest rating) most appreciated the following:

- human capital ( $m_e=5$ ,  $d=5$ ,  $\bar{x}=4,63$ );
- tendency of a company to learn ( $m_e=4,5$ ,  $d=5$ ,  $\bar{x}=4,18$ );
- social capital of employees ( $m_e=4$ ,  $d=5$ ,  $\bar{x}=4,13$ ).

These factors can therefore be considered as a set of determinants, which allow the creation of competitive advantage for small and medium-sized enterprises

in the high-tech sector of Greater Poland region. In addition, these results indicate that the analysed entities primarily value intangible resources so difficult to imitate and emulate and so crucial for the concept of intellectual entrepreneurship. The first tangible factor in the form of company's finances has been positioned sixth.

**Table 2.** The importance of resources and skills to shape competitive advantage

Assets	Median	Mode	Arithmetic mean
1. Human capital	5	5	4.63
2. Company's eagerness to learn	4.5	5	4.18
3. Social capital of employees	4	5	4.13
4. Social capital in relation to business partners	4	5	3.95
5. Flexibility of organizational structures and activities	4	5	3.63
6. Know-how and corporate image	4	4	3.95
7. Research and development activity	3	3	2.86
8. Shortening the period of the commercialization of results	3	3	3.13
9. The processes of organizational learning	3	3	3.30
10. Patents and licenses	3	1	2.63
11. The state of company's finance	4	4	3.95
12. Implemented innovations	4	4	3.95
13. Quality management system	3	3	3.50
14. Company's location	3	4	3.04
15. Machines, production equipment	3	3	3.18
16. Logistics	3	3	3.00
17. Others	3.5	4	3.16

Source: own study.

The highest importance attributed to human capital – the aggregate of knowledge, skills and experience, clearly shows that these elements are treated by the analysed companies as a strategic resource in which it is necessary to invest. This approach is consistent with the concept of a knowledge-based economy which, from a microeconomic perspective, assumes that knowledge remains an undisputed source of competitive advantage for most businesses, including those of small and medium size (Koźminski, 1996). Moreover, according to Edvinsson and Malone (1997, p. 34), human capital embodies the dynamics of an intelligent organization through its creativity and innovativeness. It is worth noting that among the 44 surveyed units there are 32 innovative entities, i.e. those which have introduced innovations in the past three years.

In the opinion of the respondents the second most important factor (also in this case an intangible production factor) is a company's eagerness to learn. This resource becomes crucial in the context of the acquisition of competitive advantage in a situation where "sustainability has been devalued, while transience is rapidly gaining value" (Bauman, 2001, p. 161). Therefore, a specific challenge faced by enterprises today is the relentless "creative destruction" in thought and action, as addressed by J.A. Schumpeter (2014, p. 192), who identified it with the impact of the implementation of innovations, when "better behaviour forced the destruction

of the old". Thus, Schumpeter played a significant role in the rejection of the neo-classical approach to equilibrium and stability. As Szymański (2012, p. 169) aptly adds, "the market is changing in an erratic and turbulent way. On the other hand, the company itself faces difficulties in adapting to changes, and it regards especially its leadership, which does not demonstrate an adequate capacity to change and remains in with its behaviours in the old era of continuity. [...] As a consequence, it causes an imbalance between the market reactions and the reactions of enterprises". Therefore, the importance of organizational learning also increases. It is a process in which the acquired knowledge increases the ability to both solve current problems, as well as undertake more effective actions (Wang & Ahmed, 2007; Zott, 2003). Thus, this process facilitates a high flexibility of action (Brett, 2002). Similar conclusions have been reached by Senge (2006), who stated that organizations that are able to build competitive advantage in the future are those which can take a fresh look at the place and importance of social capital of a given organization, and those, which will learn to use the involvement of employees and their ability to learn in a right way (Chen, 2008; Wang, Cheng & Lin, 2013).

The third important factor that managers of the analysed companies recognize is the importance of their employees' social capital – their mutual relationships based on, *inter alia*, trust, loyalty, or even credibility in the process of gaining competitive advantage. Entrepreneurs should, therefore, take measures to strengthen trust (which constitutes a fundamental resource of social capital) between employees and their superiors as well as among employees themselves. This fact is especially important in the light of a very low trust of employees towards their superiors observed in Poland. As becomes clear from the research of the Institute Great Place to Work Poland, less than 50% of workers share the opinion that business is conducted in an honest and ethical way, and that they feel appreciated in their work environment (Forum Odpowiedzialnego Biznesu, 2015). For this reason, the fact that social capital is valorised in the analysed companies is encouraging. The more so with the fact that a number of studies confirm its positive impact on economic activity (Adler & Kwon, 2002; Coleman, 1990; Fukuyama, 1996; Granovetter, 1973; Lin, 2000; Nahapiet & Ghoshal, 1989). It is now seen as a pro-development factor affecting the success of an organization and the achievements of individuals, because it reduces opportunistic behaviours, incites greater accountability in economic interactions, and provides access to resources, including tacit knowledge and its faster diffusion between employees (Gajowiak, 2010). As noted by Grzanka (2009, p. 126), social capital allowing access to important information and other strategic resources has a significant impact on the ability of companies to adapt to both challenges and opportunities that emerge in the environment. The more possibilities for interaction between employees, the more social capital is created, "which results from the fact that new knowledge accumulated by a company creates new opportunities in the environment". Thus, it seems true that knowledge and values shared by people slowly replace three elementary principles of competitiveness, namely cost advantage, higher quality of goods and services and the speed of response to customer needs (Grzanka, 2009). Moreover, as stressed by F. Fukuyama,

social capital is the driving force for innovative behaviour, and its absence may act as a drag for such a behaviour (Fukuyama, 1996). Entrepreneurship, including the intellectual one, is based on the phenomenon of social interaction and the methods of operation of business entities are the result of "a game of interinfluence and negotiation" (Gajowiak, 2013, p. 62).

It should also be added that in the context of intellectual entrepreneurship it is worth pointing to organizational capital. And so, according to the study, the representatives of high-tech SMEs from Greater Poland (over 80% of them) attach importance to the development of organizational capital by introducing, inter alia, the latest quality systems and software for data storage and processing.

## 5. CONCLUSIONS

Over the last few years a model focused on continuity and evolutionariness has been created among entrepreneurs. This model, however, is becoming inadequate in a situation of discontinuity of the modern world. As rightly pointed out by Szymanski (2011, p. 164) "the unsuitability of enterprises for non-linear change is an expression of insufficient capacity for creative destruction in thinking and action". Therefore, it becomes necessary to use the resources (particularly the intangible ones) intelligently, and aim at increasing pro-innovation behaviour. The role of intangible values continues to rise, as the existence of modern organizations is conditioned by innovations mentioned herein as well as by gaining the trust of customers, by creating brand and by effectively responding to changing reality. Baron and Armstrong (2007, p. 11) conclude that "the success in these areas depends precisely on the people". Thus, organizations aspiring to be "intelligent" must base their activities on intellectual capital representing the following three basic elements: human capital, social capital and organizational capital. It remains undisputed that in addition to extensive knowledge and highly skilled employees, crucial to further development of a company are social skills, which determine the acceptance common values and common culture, and sharing them (Hayes & Upton, 1998; Teece, Pisano & Shuen, 1997). Thus, social capital becomes a resource enabling the transfer of knowledge between employees, as well as between a company's closer and farther surroundings. Taking it into account contributes to the reduction of transaction costs and increases the innovativeness of business entities. Therefore, it can be equated with the common good worth investing in (Lauzikas & Dailydaite, 2015). As aptly noted by Będzik (2010, p. 15), "in the face of the depletion of cheap resources and easy ability to achieve economic growth, the socio-economic development regarding all aspects of life in highly developed societies would not be possible without strengthening ties and trust among the members of society. Whatever the next step in evolution will be called, civil and information society, knowledge-based economy, each form requires cooperation, ties, the flow of information and trust".

The survey conducted among high-tech SMEs from Greater Poland confirms that these enterprises base their actions on intellectual capital, which becomes the

most important element of business management in the strategic perspective. Thus, their actions are consistent with the concept of intellectual entrepreneurship. The managers of these companies are aware that human capital, the willingness of a company to learn, and social capital created among employees are the most important factors influencing company's position on the market. These three elements are crucial in the context of the creation of their innovative attitudes and behaviour.

The main limitation of the study is its sample size. 44 entities from the total group of 215 companies, which met the criteria of the project, took part in a survey. As a fact, the results may not be generalized in regard to the level and kind of competitiveness of high-tech sector. Secondly, as discovered while conducting the study, not all companies were not "high-tech", as they have not created so far any innovations and the level of expenditures spent on R&D is less than 5%. That problem is commonly and strictly connected with "industry approach" to high-tech sector, which was assumed in the study.

It should be also emphasize here, that it would be interesting to conduct in the future comparative study taking into account small and medium high-tech companies with the biggest ones and getting to know which of them base their functioning more on intellectual capital and in how the managers approach the developing this crucial resource.

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# Relations between country R&D expenses and startup IPO in Europe: Empirical research of startup IPO activities from 2005 to 2014

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## Abstract:

This paper put an attempt to find the impact of money supply, specifically in promoting research and development, of EU countries contributes in successes of startup IPO process. The paper is formulated to prove the hypothesis that the number of money supply in R&D affect the number of IPO within EU countries. This hypothesis comes from the previous research about the impact of patent in reducing asymmetric information of the firm before going to IPO. The model comes from Schumpeter assumption that economic growth is an effect of knowledge accumulation. The data come from 17 countries in Europe. The model is a data panel regression. The variables that used are number of IPO as dependent variable and number of money supply in research and development as independent variable. We use 10 years' data range period from 2005 until 2014. The paper finds the robust relationship between countries research and development expenses and the number of IPO activities in 17 European countries. This research will contribute in providing empirical research about the relationship between favourable research environment (proxied by money supply in R&D) and firms IPO. The expectation is a government will promote and allocate more fiscal project in research and development.

**Keywords:** IPO, startup, FDI, investment, Schumpeter

**JEL codes:** C33, G24

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## 1. INTRODUCTION

The discussion related the importance of innovation toward the growth of company economic values has been discussed for years (Schumpeter, 1934, Brown *et al.*, 2009, Amess *et al.*, 2016). The existence of patent and research record has been proved as one of important factor that contributes in success of Initial Public Offering process (Useche, 2014; Nanda & Rhodes-Kropf, 2013). The purpose of having patent is to reduce the asymmetric information, especially in the company that related to technology. In the ecosystem of startup, the proportion of startup that able to find exit strategy in initial public offering is in the one to one hundred proportion,

which means that within 100 startups, only 1 that finally able to make an IPO process. While in macroeconomic level, innovation is also considered as the foremost factor in countries economic development (Schumpeter, 1934; Aghion & Howitt, 1992).

Apart from that, problem related to investment in innovation is the higher probability that the investment in technology firm will give zero return value (Galindo & Mendez, 2014). It is due to the fact that most of investments in innovation are categorized as risky or bad investment, which in a matter of yield, some of this investment will give zero value exit (Nanda & Rhodes-Kropf, 2013). The impact is, innovation either from a relatively small or new company, that does not have any experiences in business, will struggle to get funds. Moreover, most financing institution such as banks do not eager to put investment in such risky institution (Nanda & Rhodes-Kropf, 2013). Therefore the favourable environment in research and development is believed to be able in contributing to the success of IPO.

In terms of macroeconomic perspective, European macro financial situation in terms of GDP growth has been weak since the period of world crisis in 2008. One of the foremost factors is the low expanding in private consumption (Ptacek *et al.*, 2015). European central bank has been promoting a monetary policy that trigger the activities in micro level such as expanding its quantitative easing program and cut the interest rates, in order to increase the number of money supply in the market. Both of these policies are showing the intention of ECB in promoting any micro economic activities that giving economic value in micro level. Furthermore, European Capital Markets Union are becoming more open in last couple years and actively endorsing capital mobilization, including private investment, to be more accessible. By China economic slowdown, the swing investment is giving benefit to more developed market such as European countries. Moreover, the FED policy in United States 2015 has raised appreciation of dollar against euro, which also means that more investment abroad from US market. This entire dynamic macro environment has steamed the state of venture capital activities shifting into European region.

The main objective of this paper put an attempt to find the impact of money supply, specifically in promoting research and development, of EU countries contributes in successes of startup IPO process. The object of the research is a startup, the company object that potentially has a chance to grow rapidly and globally. The research takes this object instead of well establishing companies. Based on the report of European committee, startup is believed as the important factor of European economy. The flexibility and agility in facing the market demand is considered as the basic factor of the startup.

The paper is formulated to prove the hypothesis that the number of money supply in R&D affect the number of IPO within EU countries. This hypothesis comes from the previous research about the impact of patent in reducing asymmetric information of the firm before going to IPO. The model comes from Schumpeter assumption that economic growth is an effect of knowledge accumulation. The data

come from 17 countries in Europe. The model is a data panel regression. The variables that used are number of IPO as dependent variable and number of money supply in research and development as independent variable. We use 10 years' data range period from 2005 until 2014. The paper find the robust relationship between countries research and development expenses and the number of IPO activities in 17 European countries.

## 2. LITERATURE REVIEW

### 2.1. RESEARCH EXPENSES AND KNOWLEDGE ACCUMULATION

The development and alteration of the business environment grow tremendously fast in last decades. The rapid technology improvement, deregulation, and globalization have forced companies to go through the process of reinventing (Garanina & Pavlova, 2011). The investment, which companies put in creating their competitive advantage, will be recorded in two ways. One is a tangible asset, which has physical evidence, and another is R&D and technology development expense, which in opposite, does not have physical evidence. The success in constructing company R&D and technology development expense helps company in seeing 'roots of company value creation' (Garanina & Pavlova, 2011). Moreover, researcher believe that intangibles asset are "major drivers of company growth and value in most economy sector" (Lev, 2001).

R&D and technology development expense are the proxy to define the policy in the company which related with financial and corporate governance (Martins & Alves, 2010). Research and technology development expense has thin in a different way with goodwill and sunk cost. However, it can be seen in the future as giving the benefit for the company (Petkov, 2011). The characteristic of R&D and technology development expense, which is identifiable, make the expense is visible in terms of asset identification. Even though R&D and technology development expense are appraised as positive investment but the character of intangible that does not have physical substance makes this investment expecting high risk in nature.

Even though R&D and technology development expense bring so many advantages to the company, but all in all this particular asset is also close with a factor that trigger agency cost and end lead to the bankruptcy of the company. It is due to large sunk costs can generate a high level of returns in the future if the innovation succeed, but a null return if it fails (Martins & Alves, 2010). Align with an explanation above; many economists put allegation that the wrong way of manager in valuing and treating R&D and technology development expense also led to the world to the economic crisis in 2008 (Petkov, 2011). One interesting occurrence, which happened, is a bubble phenomenon. The condition where the price of asset going up, but later on going down and find the real price (White, 2011). Economists believe that bubble can be happen because of some asset that does not have the ability to be identifiable (Petkov, 2011).

The effect was that the prices of the asset not reflect the real number of intrinsic value. The increasing gap between market and book value of companies spurred reflections on the importance of R&D and technology development expense and the way they are measured (Garanina & Pavlova, 2011). From microeconomic point of view, intangible assets were significantly influencing the market value of the company (Garanina & Pavlova, 2011; Elveness & Widiatoro; 2012, Widiatoro, 2012). Neil Gross mentioned that, “The shifting from brick and mortar to patent and knowledge are the new realities that grow in latest Modern business competition” (Gross, 2001). From Corporate finance perspective, research expense remains governance’s problems such as agency conflict and high liquidity risk, which triggers bankruptcy. The knowledge about managing this expense has been analyzed by many researchers in the latest business academic environment. Both of advantage and disadvantage are proven exist. Research about the relationship of R&D and technology development toward market value added in UK and Russian Company has proved that these expenses have positive relation with market value added (Garanina & Pavlova, 2011). Another research also proved that corporate governance was raised when company put high intensive investment in research and development (Alves & Martins, 2010).

## **2.2. INITIAL PUBLIC OFFERING**

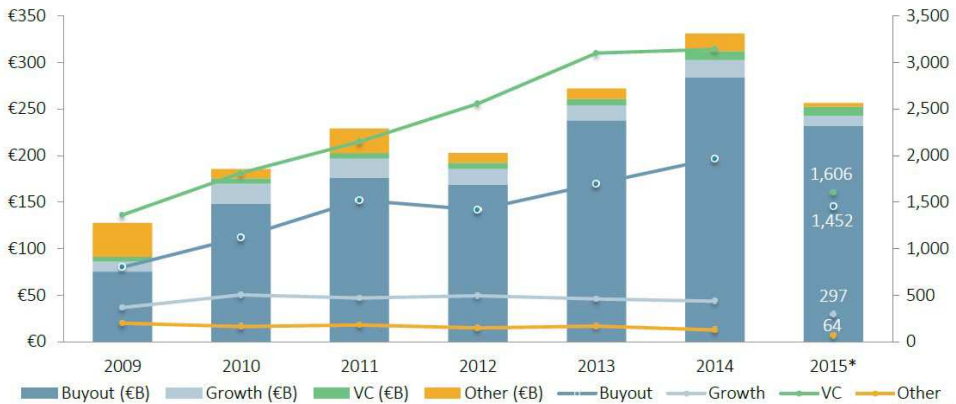
Initial Public Offering is the moment where the company registers their entity into public market. The purpose of initial public offering is to generate cash for company operation. For any kind of company, the moment of IPO is one of the most crucial moments in the company life cycle. It is due to so many determinants that categorized as shady information (Useche, 2014). Such as the information whether the company has potential future to grow or not. For investor the moment of IPO is also aligned with their investment in startup, which is gaining the capital gain.

As it mentioned before in previous paragraphs, the empirical evidence that a startup could finish and find exit strategy in IPO is 1 among 100. The high probability that startup will fail make the research in IPO become one of most interested subject to be conducted.

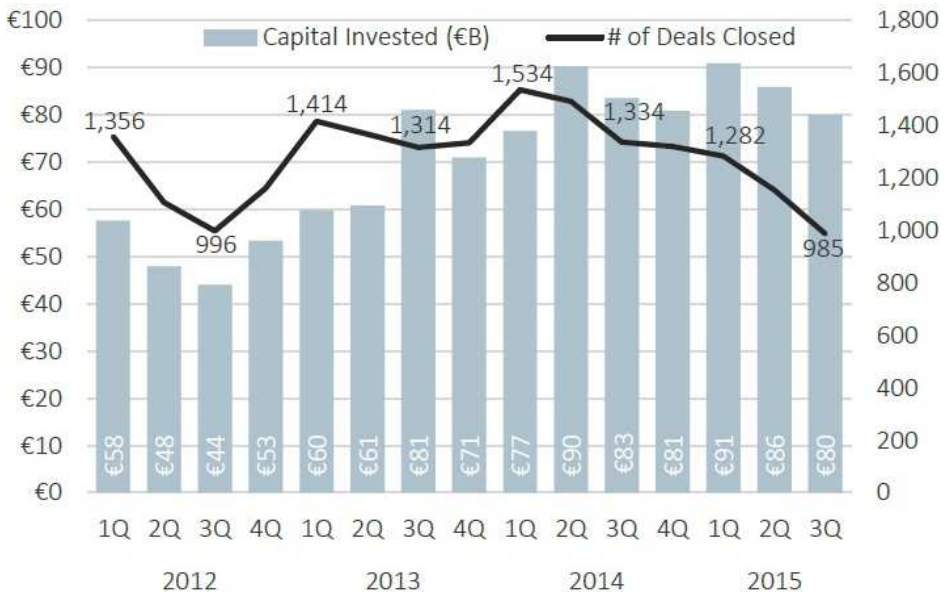
## **2.3. PRIVATE INVESTMENT IN EUROPE**

The development of Private investment in European countries has been showing a great development in last couple decades (Figure 1). The establishment of Private Investment committee in European Union has made the atmosphere toward economies are more open for private investment. In Europe, startup investment, including venture capital and private equity buyout, has rose 14% to 41.5 Billion Euro (InvestEurope, 2015). The amount is a bit smaller in comparison with 50.75 Billion US dollar investment, which was conducted by Venture Capital firms in United States (Pofeldt, 2015).

The number of deal has reached the peak at first quarter 2014 by having 1534 deals. Unfortunately, the situations in 2015 have been not so swell like a year before, deals and volume has been declining since 2014 (Figure 2). The tight regulations in some countries are still becoming an obstacle to the more dangerous types of loaning and financing. More over European lending market are not as complex as the those in US, therefore the availability from alternate lenders when it comes to buyout is considerably less (Pitchbook, 2015).



**Figure 1.** The flow of Private Investment in Europe  
Source: Pitchbook (2015).



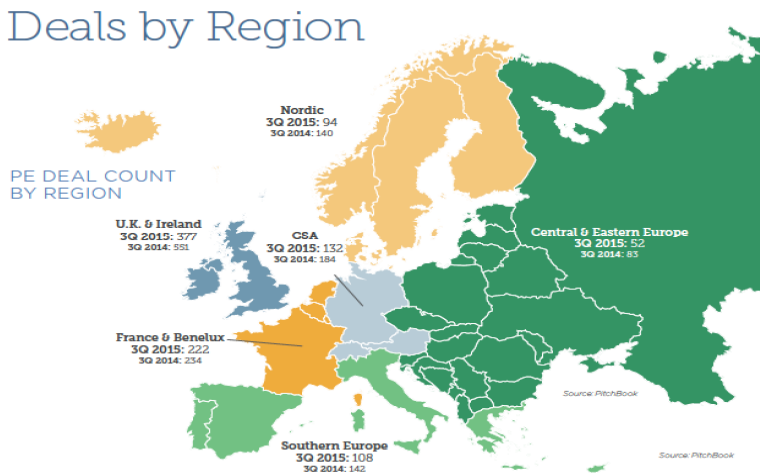
**Figure 2.** Number of Deal and Private Investment Volume in Europe  
Source: Pitchbook (2015).



Apart from those decline trends, the supply of organizations in the business sector stays significant on a segment by regions. Furthermore, the length of the euro dollar difference stays appealing to US financial investor, American PE firms may well help buyout numbers. For funding financial specialist, Europe startup biological system is generally a system of genuinely dynamic centers, such as Stockholm, London and Berlin. In those areas, the surge in late stage numbers that has been the essential storyline of endeavour venture in the course of recent years is easily seen.

Very dynamic government establishments and program, such as the European speculation asset have strengthened the journey of the funds, however as frequently been noted, noteworthy deterrents to reinforcing the Eurozone system of startup action remains. A standout amongst the most essential variables to manage at the top of the priority list is when taking a gander at mainland crossing number. Provincial movements are vital to speculation dynamic, for instance UK center business sector surpassed Germany in terms of income.

Taking a gander at how wander action has plunged in the course of the last a few quarters its simple to see why concern has emerged. From 1Q 2014 to 3Q 2015, the check of VC financing dropped by more than half, from the second quarter of 2015 of 3Q alone the decrease in the general number of European endeavor round surpassed 20% (Figure 3). Yet even as action has dive the past there quarter every hit 3 billion in VC contributed, putting the year as an opening at about € 9.5 billion contributed as of now, overshadowing even a year ago.



**Figure 3.** Number of Investment segregated by European Region  
Source: Pitchbook (2015).

The immense aggregate contributed for the current year has been skewed by Spotify monstrous \$526 million subsidizing. It makes sense that if there were an irregularity recently organize venture flooding a select gathering if built up new companies in the US, Europe would see a comparable overweighting. The issue

with the spread of VC financing is that numerous trepidation related to an absence of fundamental capital mixtures at prior stages of a startup.

### 3. MATERIAL AND METHODS

#### 3.1. HYPOTHESIS

Based on aforementioned explanation, we propose the hypothesis that countries with the high activities in research will give more beneficial environment to Startup business. Within this specific environment the probability of the successes in Initial Public Offering will be higher.

The model of entrepreneurship, economic growth, and innovation has been developed for many years (Aghion & Howitt, 1992; Brown *et al.*, 2009; Ptacek *et al.*, 2015). Within this research, author belief that the situation within each region in Europe has different factor in attracting PE. Therefore, there is a gap in number of private investment that is flowing among regions. Our hypothesis is the number of innovation within the region play a role and makes a difference in terms of number of venture capital or private investment.

To answer those hypotheses, first we would like to know whether the climate of entrepreneurship, which is represented by the number of government expense in technology sector, affect the deal. To control the model, we also put into a model about the condition of government expenditure within a year. We propose the idea that countries that have better innovation track record will get higher private investment and the number of deal after all. The money supply in research and development contributes to the number of Initial public offering of startup. These proxies of research and development activities within a countries give better information and reason why the number of IPO's in Europe are various.

#### 3.2. METHODOLOGY

##### *Data*

Type of data that is used in this research are secondary data. The data is taken from the database that is provided by private institution that count how many IPO in European countries from 2005 until 2014. The database of the data comes from European union statistic, Pitchbook Venture Capital, Merger and Acquisition database, and Dow Jones London Stock Exchange Database. The model is we have variable which is research expenses from government that will show us the impact R&D toward the number of IPO deal.

##### *Formulation of model*

In the previous research, the impact related to the impact of entrepreneurship, innovation and economic growth has been analyzed (Arora & Nandkumar, 2011; Galindo & Mendez, 2014; Örnek & Danyal, 2015). The model that propose the economic growth here will be replaced by the number of private deal as the proxies of private investment flow.

$$\ln(\Phi)_{it} = \beta_0 + \beta_1 \ln(rc)_{it-1} + \beta_2 \ln(\lambda)_{it-2} + \varepsilon_{it}$$

**Variable explanation**

The variable  $\Phi$  is the number of IPO deal, which is invested in one region of the country. Variable rc here is money supply in research and development. It shows the accumulation of how much money that government spends to create a good climate in research and innovation within a year. Variable lambda here is the percentage of government expenditure, showed the proportion of number of total expenditure that the government has in comparison with the GDP.

**4. RESULTS AND DISCUSSION**

**Presentation of Data**

We have collected the number of IPO of startup in each country in Europe, these countries are Czech, Denmark, Estonia, Finland, France, Germany, Hungary, Iceland, Italy, Lithuania, Luxemburg, Netherland, Norway, Poland, Rumania. Others country are not collected due to incomplete data in documentation. The data are consist of number of IPO deal in a year and classified by the number of money which is collected. One of the example from data that has been collected are Data from Czech and Denmark (Table 1).

**Table 1.** The example of data pool collection

	A	B	IPO	GovExpLn	IPOLn	LnRD							
1.	Czech	2005	0	3.7328963	0	4.8331023	11.	Denmark	2005	31	3.9357395	3.4339872	6.8472619
2.	Czech	2006	4	3.7086821	1.3862944	5.0059577	12.	Denmark	2006	36	3.908015	3.5835189	6.9062542
3.	Czech	2007	6	3.6888795	1.7917595	5.1682087	13.	Denmark	2007	55	3.9039908	4.0073332	6.9825844
4.	Czech	2008	5	3.693867	1.6094379	5.2642434	14.	Denmark	2008	32	3.9219733	3.4657359	7.1097161
5.	Czech	2009	5	3.7750572	1.6094379	5.2181913	15.	Denmark	2009	47	4.0395363	3.8501476	7.1561766
6.	Czech	2010	1	3.7612001	0	5.2998162	16.	Denmark	2010	65	4.0448041	4.1743873	7.1558646
7.	Czech	2011	13	3.7588718	2.5649494	5.4947062	17.	Denmark	2011	78	4.0395363	4.3567088	7.1798414
8.	Czech	2012	17	3.7954892	2.8332133	5.6127631	18.	Denmark	2012	86	4.0656021	4.4543473	7.21524
9.	Czech	2013	18	3.7518543	2.8903718	5.6524892	19.	Denmark	2013	111	4.0342406	4.7095302	7.2389996
10.	Czech	2014	16	3.7518543	2.7725887	5.6835798	20.	Denmark	2014	132	4.0253517	4.8828019	7.2534704

Source: Pitchbook (2015); The World Bank (2016).

The average descriptive information from the number of IPO are placed in Table 2.

**The Data Calculation**

The data then is calculated by data panel fixed model. The year of research is started from 2005 until 2014 (Table 3).

Based on the panel data calculation above we could see that the government expense affects significantly the success of IPO with the power of 7%. The confident of the independent variable is quite accurate with the  $\alpha$  less than 0.1. From this data we could take conclusion that countries with better research expense and more

**Table 2.** Average number of deal, capital invested, pre-money valuation, and post valuation median, divided per country for 10 years

Countries	Deal Count	Capital Invested Median	Pre-money Valuation Median	Post Valuation Median
Czech	9	9.598888889	2.91	259.6
Denmark	64	2.609166667	50.71125	54.881
Estonia	11	0.447272727	6.728	8.3
Finland	95	1.740909091	13.66142857	21.19818182
France	314	2.17	16.28333333	28.58166667
Germany	297	3.489	63.21090909	67.84818182
Hungary	12	1.354444444	1.6125	4.405
Iceland	7	0.674285714	3.28	113.3866667
Ireland	111	3.569166667	55.848	44.16545455
Israel	13	7.572727273	281.0685714	223.5311111
Italy	69	2.766666667	40.03625	33.14909091
Lithuania	9	2.857142857	9.12	29.84333333
Luxemburg	8	134.9944444	68.86	64.99666667
Netherland	106	4.244444444	181.55875	115.851
Norway	49	3.396363636	25.0425	50.90545455
Poland	33	1.919090909	6.075	59.806
Portugal	24	1.161818182	18.73	28.64
Rumania	5	1.80125	2	31.33

Source: Pitchbook (2015); The World Bank (2016).

**Table 3.** The Panel data calculation

Random-effects GLS regression	Number of obs	=	<b>170</b>
Group variable: <b>countrynum</b>	Number of groups	=	<b>17</b>
R-sq: within = <b>0.0314</b>	Obs per group: min	=	<b>10</b>
between = <b>0.3481</b>	avg	=	<b>10.0</b>
overall = <b>0.2568</b>	max	=	<b>10</b>
	Wald chi2(2)	=	<b>10.42</b>
corr(u_i, X) = <b>0</b> (assumed)	Prob > chi2	=	<b>0.0055</b>

IPOLn	Coef.	Std. Err.	z	P> z	[95% Conf. Interval]	
GovExpLn	<b>3.219029</b>	<b>1.050948</b>	<b>3.06</b>	<b>0.002</b>	<b>1.159209</b>	<b>5.27885</b>
LnRD	<b>.0775741</b>	<b>.089056</b>	<b>0.87</b>	<b>0.384</b>	<b>-.0969724</b>	<b>.2521205</b>
_cons	<b>-9.532897</b>	<b>4.018291</b>	<b>-2.37</b>	<b>0.018</b>	<b>-17.4086</b>	<b>-1.657192</b>
sigma_u	<b>1.1973381</b>					
sigma_e	<b>.84285128</b>					
rho	<b>.66866012</b>	(fraction of variance due to u_i)				

Significant codes: 0 '\*\*\*' 0.001 '\*\*' 0.01 '\*' 0.05 '.' 0.1 ' ' 1

Source: Pool regression of IPO activities as dependent variable, logarithmic of Government expenses in R &amp; D and ratio of R&amp;D expenses to GDP as independent variable, calculated by Statistica software.

favourable toward innovation get more benefit from the flow of foreign investment, especially in private sector.

## 5. CONCLUSIONS

The number of money supply in research and development robustly affects the number of IPO within a country. This proxy also able to explain why in some country they have better performance in IPO. The existence of startup in technology is believed as one of backbones for national economic growth. Intangible expense of European countries affects on their startup initial public offering successes. Technological expense has become a key function toward the success of Initial Public Offering. In venture capital market, due to 100/10/1, only one that will survive and probably going to IPO. Therefore, possibility of the firm will find an exit is very low and the support from external parties such as government is quite important. In microeconomic activities, Relationship of R&D and technology development are positive with market value added. We can assume that investor considers at countries that has more favourable climate with large R&D expenditures is a reliable place for their investment.

The number of research in the impact of research and development expense within a startup is relatively low. In the other hand, the development of economic growth relies on the accumulation of knowledge that represented by the existence of patent within a firm. This research will contribute in providing empirical research about the relationship between favourable research environment (represented by money supply in R&D) and firms IPO. The expectation is a government will promote and allocate more fiscal project in research and development.

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The contribution of co-authors is equal and can be expressed as 50% each of the authors: S. Rismani prepared the literature review, while D. Widiatoro prepared the statistical calculations.

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# Statement on the first research on digital startups in Poland

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## Abstract:

The objective of the paper is to present the results of the first study of Polish startups' ecosystem as the first stage of a larger study of digital economy landscape in Poland. The first estimate of the number of Polish startups amounts to 2400 entities. The publication presents the first survey Polish startups that marks the beginning of cyclical studies on enterprises belonging to the digital economy in Poland. The study was conducted among 423 entities using an in-house questionnaire prepared based on the author's own knowledge. Results are discussed. Startups most often consider themselves software producers who follow the SaaS model and operate in the following industries: mobile apps, e-commerce and Internet services. Nearly one in three startups achieve 50% annual revenue growth, while in one-fifth such growth exceeds 100%. Almost two thirds of Polish startups are financed exclusively from own funds. It is necessary to repeat and deepen the study in order to determine the significance of the digital industry in the economy of Poland and the CEE region. The originality of this work lies in taking this subject for the first time in Polish literature and in elaborating the proposition of a "startup" term's definition.

**Keywords:** digital economy; software industry; technology; innovation, survey

**JEL codes:** O33, O310, O330, L860

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## 1. INTRODUCTION

The development of digital economy is one of the highest priorities of the European Union (EU). In its publications and documents, the European Commission tries to assess the importance of this sector, for the economy of the EU (European Commission, 2014, 2015, 2016). The Commission also plans projects which should serve two purposes: on one hand, enhancing the use of new digital technologies by companies, especially industrial ones. On the other hand – encouraging the entrepreneurship of companies which create and commercialize solutions basing on the knowledge in terms of information and communication processing technologies with the use of the Internet. At the same time, there is a lack of publications in Europe which would characterize these companies. So far, no such publication,



which would in a comprehensive manner present the image of this sector in the EU or in the member states, has been created. The most important reason is the lack of a clear and well established definition of what a “startup” is. This issue is raised in the still few, but quickly growing, Polish scientific publications concerning the subject of startups (Korpysa, 2012; Cieřlik, 2014a; Łuczak, 2014; Burżacka & Gařiorowska, 2015).

The first study on Polish startups marks the beginning of cyclical studies on enterprises belonging to the digital economy in Poland. The research aimed to provide information which will make it possible to determine the significance of the digital industry in the economy and the direction and pace of its growth in Poland. Until now no research has been conducted which would make it possible to describe the industry’s most important features and support them with detailed figures. A database of 2 432 startups was created for this study, and 432 entities (17%) completed the survey between June 10 and September 15, 2015. The study was executed in a close cooperation with Startup Poland Foundation, that represents Polish startups in relation with decision-makers, politicians and local government officials. The foundation’s support has ensured the necessary range and significance to the study.

The objective of the paper is to present the results of the first study of Polish startups’ ecosystem as the first stage of a larger study of digital economy landscape in Poland. The Report of this research: “Polskie Startupy 2015” was published in October 2015 (Skala, Kruczkowska & Olczak, 2015).

## 2. MATERIALS AND METHODS

A challenging methodological issue in the study was a “startup” definition. The term has recently become as popular as inaccurate (Osterwalder & Pigneur, 2010; Blank, 2012; Ries, 2012; Blank & Dorf, 2013; Henrekson & Sanandaji, 2014; Cieřlik, 2014b). In this study, “startups” are understood as enterprises where information processing and derivative technologies constitute a key element of their business models. Such a definition complies with the academic and political understanding of the “new economy”, also known as “e-commerce” or “e-business.” A Polish startup is an entity which is registered in Poland or has at least one partner who is a Polish citizen and operates in part in Poland. A branch of a company whose headquarters are located abroad is not considered a Polish startup.

For the purpose of the study, a startup database was prepared by procuring startup names from the following sources: venture capital funds, accelerators, entrepreneurship incubators, training companies, organizers of startup competitions, subsidy lists, lists from industry media sites, as well as the private rankings and databases of “startup activists”. This represents the first attempt on such a scale to estimate the number of startups in Poland. The population of Polish startups was assessed in this manner at 2 432 entities. An e-mail message was sent twice to each of them with a request to complete the survey questionnaire; additionally, one or

two telephone calls were also made. Startup representatives could also find out about the questionnaire from the media and social networking sites.

The study was conducted using an in-house questionnaire prepared based on the author's own knowledge. A pilot study was conducted (38 completed questionnaires) between May 10 and 25, 2015, during which the questionnaire was evaluated by competent parties, i.e. experts specializing in startups. After analyzing the remarks, some of the suggested changes were incorporated into the questionnaire. The pilot study results were described and presented during the Digital Ecosystems conference organized by the Digital Economy Lab of Warsaw University (DELab) in June 2015 (Skala & Gieżyńska, 2015).

The questionnaire was completed by 423 entities (17% of the population reached). The sample is not representative. In the case of 21 questionnaires, doubts arose as to whether the company qualifies as a "startup". After analyzing this small group of projects, the decision was made to include them in the analyzed population. Therefore, the results discussed refer to all 423 entities. In over 80% of cases, the questionnaires were completed by the (co-)founders and/or management board presidents (CEOs) of the companies. Other persons most often included other board members, and less-often product managers, sales managers and board assistants. The questionnaire was made up of 36 questions. The majority were multiple-choice questions and included space for an additional answer. Startups were required to provide their company names, the role of the person completing the questionnaire and to label themselves as startups (or not) in line with the adopted definition. All other answers were voluntary. Various methods of data analysis were used in the study. Responses to closed-ended questions were analyzed mainly using analytical tools made available by the website [webankieta.pl](http://webankieta.pl). Responses to open-ended questions were studied via keyword coding analysis, indicating those statements that appeared most often. Potential correlations were checked using SPSS Statistics. The study has been divided into six sections:

1. Startup profiles: presentation of the location, period of operation and legal form of startups taking part in the survey;
2. Business models and growth: specification of the main categories of clients, most popular product types, stage and pace of growth, plans for the future and valuation of companies;
3. Resources: divided into two sub-chapters that discuss sources of capital in startups and their needs with respect to non-financial resources;
4. Employment: analysis of founder teams, employment volume and prospects in startups;
5. Exports: devoted to the presence of startups in foreign markets and description of their export activities;
6. Innovation: presentation of the sources of inspiration, and the means of applying innovation in startups.

In this paper the main findings from every six sections mentioned above will be presented.

### 3. RESULTS

Over half of respondents are registered startups (or are currently operating) in one of three cities: Warsaw, Krakow or Poznan. Popular locations also included Wroclaw and the Tri-City and, to a lesser extent, Lodz and Katowice. Dominant legal structures include limited liability companies (almost two-thirds); one in five are conducted as a sole proprietorship. Only 5% are joint stock companies.

30 types of products and industries were proposed, and startups were asked to choose those that best describe their primary business activities. Startups most often consider themselves to be software producers (half of all answers) selling in the SaaS model and operating most readily in the following industries: mobile applications, e-commerce and web services. Startups indicated B2B as their primary sales model almost twice as often as B2C. A relatively large number of startups produce corporate software in an agency model; Big Data, Research Tools and Business Intelligence also enjoy significant interest. Such industries as the power sector, artificial intelligence, logistics and telecommunications are the least popular fields for startups (Table 1).

Financing is one of the key elements determining startups' growth. Its availability has a significant impact on the scope of their operation, their tendency to invest in innovation and the number of jobs created. According to the answers regarding sources of capital in companies, almost 60% of Polish startups are financed exclusively from own funds. Other sources include EU funds in the form of subsidies (23%) or seed funds (7%). Almost every fifth examined startup reached for funds from Polish or foreign venture capital funds; the same number of companies received such funds from investment angels. One in twelve startups received bank loans (8%). Crowdfunding is still in its infancy with a result of 3%, representing only a small proportion of the examined population. It is worth emphasizing that none of the startups studied, including the New Connect market, indicated the stock market as a source of financing. It should be emphasized that foreign resources (both capital and others) are much less popular (or available) than domestic ones. Their level of use is several times lower than that of their Polish equivalents (funds, incubators, accelerators, etc.).

The startups were also asked whether they use other, non-financial forms of support. Only one in ten startups took advantage of an entrepreneurship incubator or a technology park; accelerators enjoy a similar (read: low) level of interest. On the other hand, less than 5% of startups operated or still operate as part of an academic incubator, i.e. they are located near a university. Polish startups rarely take advantage of the assistance of experienced entrepreneurs (Table 2).

As far as startup needs are concerned, at their present stage of development 60% of startups cite money as their greatest need. Half indicated new employees as another pressing need, and the same number also indicated a better contact network. Nearly one-fourth of startups need to increase specialist knowledge resources. Treating knowledge as a resource, startups were asked about their cooperation with

the research world. Such cooperation is understood as cooperation with universities, institutes, and laboratories, as well as regular, even informal, consultations. Exactly one in four startups confirmed that they cooperate with researchers. Compared to those of other startups, the clients of startups cooperating with researchers

**Table 1.** Characteristics of startups and its structure: locations, legal form, business models and products

	Characteristics	Structure (%)
Locations of startups	Warsaw	28
	Krakow	16
	Poznan	13
	Wroclaw	7
	Trojmiasto	7
	Other cities and abroad	29
Legal form	Limited liability company	65
	Sole proprietorship	19
	Joint-stock company	5
	Other	12
Business Models (multiple choice)	Business-to-business (B2B)	57
	Business-to-consumer (B2C)	28
	Business-to-business-to consumer (B2B2C)	21
	Software as a Service (SaaS)	39
	Hardware	11
	Software	49
Products (multiple choice)	e-commerce	22
	Web Service	21
	Mobile	24
	Corporate Software	18
	Big Data	17
	Agency	13
	Analytics	13
	Marketing Technology	12
	Games, entertainment	12
	Marketplace	10
	Utility designs	10
	Education	10
	Internet of Things	9
	Content / Social	9
	Programmers and Developers Tools	8
	Electronics/Robotics	7
	Financial services	6
	Virtual/Augmented Reality	5
	Life Science	5
	Telecommunication	5
Transport and logistics	4	
Semantic Web / Artificial Intelligence	3	
Energy Industry	2	

Source: own elaboration based on (Skala, Kruczkowska & Olczak, 2015).

more often tend to be corporations and institutions. They are most likely the recipients of products related to KETs (key enabling technologies) produced by one-third of startups in this population (one in twelve among the remaining group).

**Table 2.** Characteristics of startups and its structure: financial and non-financial resources

	Characteristics	Structure (%)
Sources of capital (multiple choice)	Only own funds	59
	EU subsidy	23
	Angel investment	20
	Venture Capital	18
	Bank (loan)	8
	Crowdfunding	3
Non-financial support (multiple choice)	Industry meetings	12
	Mentoring	12
	Participation in a startup competition	12
	Incubator or technology park	10
	Accelerator	10
	Academic incubator	5

Source: own elaboration based on (Skala, Kruczkowska & Olczak, 2015).

Startups cooperating with the research sector value their technologies and often claim that their products are innovations on a global scale. They hire three times the number of researchers as other startups, and they are twice as likely to patent their products (nearly half do so). It is not yet possible to indicate significant differences with respect to the rate of growth or valuation of such companies compared to the rest. Fifteen percent of startups were established by persons professionally involved in research (at least doctoral candidates). This group is quite small (64 companies) yet interesting, so it was decided to list its main features. First, “academic” startups most readily operate in such areas as hardware, biotechnology, analytical tools, as well as the power industry and education. They perceive their products as an innovation on a global scale more often than others (63%). Over half cooperate with research centers, yet they enter foreign markets at a level similar to other startups.

The most interesting differences lie in sources of financing – startups founded by researchers are more effective at procuring external financing, in particular VC funds and EU funds, and they use entrepreneurship incubators, technology parks and acceleration programs much more often. Such companies obviously indicate research grants as a source of financing. The researchers indicated access to properly trained personnel as a missing resource, and as such this may be taken as one of their barriers to growth. Such fears are not surprising in view of the fact that as many as half employ other researchers, and three-fourths plan to increase employment.

Employment is one of the most important aspects of a startup’s operation. From the point of view of the company, the competences of the founding team and proper selection of employees determine the success of the entire enterprise. On the

other hand, knowledge of employment volume and the rate at which startups create new jobs is necessary for macroeconomic analysis. The first part of the questions referred to the structure and number of members of the founding team. One in three startups are run by a single founder, while 60% are run by two- or three person teams. Startups managed by a single person are, as a whole, clearly at an earlier stage of development than the population average, and they are financed almost exclusively from EU funds and own funds. Women are partners in one-third of startups; in one in six, at least one founder is a person involved in academic work (doctoral candidate or higher). In 60% of cases, at least one of the founders is a person with experience in establishing and running a startup.

In the study, employees are understood as persons cooperating with the company on an ongoing basis, receiving payment for this activity and are not partners - without regard to the form of the agreement this relationship is based on (Table 3).

**Table 3.** Characteristics of startups and its structure: employment

	Characteristics	Structure (%)
Employment	No employees	17
	1 person	9
	2-4 people	34
	5-10 people	21
	11-20 people	8
	More than 20 people	11
Number of founders	1 founder	32
	2 founders	39
	3 founders	21
	More	8

Source: own elaboration based on (Skala, Kruczkowska & Olczak, 2015).

Among the examined startups, 54% are exporters; on the other hand, 40% claim that they do not sell outside of Poland. This is a high number, considering that in the entire Polish MSE sector only 7% of enterprises provide exports (Starczewska-Krzysztozek, 2012). Medium-sized companies in Poland, i.e. those with 50 or more employees, report an export level of 50%. It can thus be stated that, in reference to export activity, startups behave as if they had the potential of a medium-sized company at their disposal, evaluating their competitive advantage in a similar way. Among exporting startups, almost half complete over 50% of their total sales abroad (Table 4.). For 60% of exporters, the main destination countries are Great Britain or the United States. Germany is also an important export location. These are very demanding markets, testifying to the high level of Polish startups' offers. One fifth of startups have a foreign branch.

The final section of the study was devoted to the issue of innovation in startups and the nature of research & development and innovation (RDI) activities to be undertaken by such entities. The closed-ended questions – taking into account the fact that the study was being performed for the first time – were supplemented by four open questions, and startups were allowed to provide unlimited answers. Even

though analysis of the materials obtained in this manner was much more difficult, it allowed for observing general tendencies and procuring spontaneous opinions about innovations and their place in the everyday “life” of startups. To start, a question was asked about the level of product innovation; the respondents were asked to select the proposed scope of its “innovation”. Almost half of startups declared that their solution was “new on a global scale”. One-third of respondents believe that they are working on a solution that is new on a local scale, and one in four admit that their product is “more of an imitation, though it has specific advantages”.

**Table 4.** Characteristics of startups and its structure: exports

Characteristics		Structure (%)
Share of export in sales	None	40
	Up to 10%	18
	10-50%	10
	50-90%	10
	90-100%	16
	no answer	6

Source: own elaboration based on (Skala, Kruczkowska & Olczak, 2015).

Many startups indicated their product as the key innovation. This included breakthrough innovations (52% innovations) and innovations that improve upon an existing solution (40%). As mentioned previously, one in four startups cooperate with the research sector, which is perceived as a potential source of innovative solutions. A relatively large number, i.e. 59 companies (15%), declared that their activities are related to KET: Key Enabling Technologies. Almost one third of the examined startups declare that they own a patent or a reserved trademark, purchase or sell licenses for technologies – this group was called the “patent group”.

As mentioned previously, the respondents were asked four open questions in order to evaluate the sources of innovation in startups. In the first, they were asked to describe the manner in which innovations are created in the company; in the second, to list the sources of inspiration. The third question referred to RDI activity: how do startups understand this process, and how do they carry it out?

The first conclusion to be made based on analysis of the collected data is that clients form the basis for creating new solutions. For the majority of the examined companies, inspiration is provided primarily by: talks with their clients, the needs they voice, and feedback received. At the same time, it should be noted that, when creating new solutions, startups are guided more by the opinion of their present users, relatively rarely testing new solutions on potential recipients on their own initiative. The companies undertake work on innovation only sporadically, guided by classic market polling results. In creating new products, they try to respond to the specific problems voiced by clients, or they create solutions on the basis of their own market analysis (direct quote from the questionnaire): “searching for a problem concerning the protection of young children’s health, for which no ideal solution has been found so far”. When creating new solutions, previous experience is of great importance. Responses often featured the names of industries which the

owners came from (e.g. marketing, e-commerce). However, not only professional qualifications turn out to be useful; equally important – and sometimes even more valuable – sources of inspiration are conclusions drawn from real life experience: being a parent, a patient or a typical Internet user. As for methods of working on the idea, “brainstorming” is the clear favorite; “Lean Startup” also appeared several times. Many answers confirmed a lack of a clear manner of creating innovations by suggesting that they emerge “in the mind” or “in the shower,” or are simply an “inspiration”. Only a few startups mentioned collaboration with outside experts or advisors. The next question referred to sources and inspiration; here, the respondents most often put suggestions and needs voiced by clients. An analysis of these answers leads to the conclusion that sources of innovation in companies are quite pragmatic, e.g. modelling themselves on other startups, following trends, needs analyses for various groups of clients. A significant number of respondents simply draw ideas “from their surroundings” or “from the people they meet”. Only a few indicated “visions,” “ideas” or “drawing inspiration from travels and nature”. Inspiration is also provided by industry conferences and large successful companies, such as Apple or Amazon. Among Polish startups, a significant number of people are inspired by “the development of modern technologies”; thus, they readily follow the news on this topic and meet at conferences and other industry “rallies”.

The effects of these activities may be, for example, attempts to apply a given solution in a completely new area, or combining two ideas into one and searching for new applications for it. Success stories also tend to provide inspiration – both Polish and foreign startups as well as examples of companies and successful people from the world of business. A small group of respondents indicated that they look for ideas for new products in books or scientific studies. The idea of universities as sources of potential cooperation in innovation appeared only in a few spontaneous answers, which should be considered a low result. The topic of innovation also brought about answers regarding imitation. Some startups simply indicated the fact that their solution was copied from other markets (quote): “we are not outstanding innovators, we are intelligent observers”. The third question referred to how startups understand and implement RDI. The most frequent answer was: “improvement of existing product/process”. Less frequently, startups declared that they look for completely new solutions and ideas to implement. Other answers also included: “formulating solutions for specific clients” and (again) “analysis of data describing the behavior of our users”. Among the answers to this question, there were also several answers indicating that the creation of innovations takes place via intended copying of solutions from other markets. Once again, the issue of collaboration with the research sector appeared quite rarely, and more in the context of the insufficiency of such collaboration, its informal nature and sometimes even disappointment with its absence. The last open question referred to the existence of an RDI team in the company. Four times as many answers indicated the absence of a group of employees dedicated exclusively to work on innovations than those that indicated having such a group. Justification for the failure to form such a division in the company was varied. In some startups, the founders deal with creation of new



solutions, whereas employees focus on ongoing customer service. A significant number of respondents believe that if the entire company is innovative, “there is no need to set up a separate team to work on something new”. There is also the issue of the low number of people on teams: “There’s only the two of us, so we do everything on our own”. Several answers indicate that Polish startups do not work on innovations at all, e.g. “RDI is in our plans. At the present moment, we do not have funds for it [to set up a separate team]”. To summarize: the issue of creating innovations is important to startups, which described honestly and in detail the implementation of this key process in their companies. The answers often featured such phrases as: “passion” and “clients”, which jointly constitute the main “fuel” for innovation processes in startups. It is possible to see a small group of enterprises where such processes have already been professionalized, i.e. separated from other processes and given their own structure. The majority of startups still operate spontaneously, but knowledge about the market and awareness of its growing needs results in many answers featuring information about plans and attempts at a more serious approach to the subject. We hope to learn more about the specific nature of these intentions during subsequent editions of the study which is planned for 2016.

#### 4. CONCLUSIONS

This study deals with the problem of determining the significance of the digital industry in the economy of Poland and the region. The study constitutes the first stage of work on this issue and it is clear, that in its first edition it is not completely exhaustive. The main findings of the study are:

- The first estimate of the number of Polish startups amounts to 2,400 entities;
- Over half of the questionnaire respondents are startups operating in one of three cities: Warsaw, Krakow and Poznan;
- Startups most often consider themselves software producers who follow the SaaS model and operate in the following industries: mobile apps, e-commerce and Internet services;
- Nearly one in three startups achieve 50% annual revenue growth, while in one-fifth such growth exceeds 100%. Half of respondents expect at least a five-fold increase in enterprise valuation within the next two years;
- The results confirm the thesis that sales in foreign markets accelerates monetization of a business and increases its value;
- Almost 60% of Polish startups are financed exclusively from own funds;
- Other sources of capital include EU funds in the form of subsidies or seed funds. Almost one-fifth of startups examined made use of funds from Polish or foreign venture capital; the same number received such funds from angel investors;
- One in four startups cooperate with researchers. Startups established by researchers are more effective at procuring external co-financing, especially VC funds and EU funds, and more frequently use incubators, technology parks

- and acceleration programs. Barriers to their development include trouble finding properly qualified personnel;
- Almost half of all startups are exporters; half of these complete over 50% of sales abroad. Software production in the B2B and SaaS models dominates exporters' business profiles;
  - Exporters create more jobs than companies operating in the local market, and they start to bring in revenue and grow more quickly;
  - Startups that patent their products are twice as likely to apply for and receive money from venture capital funds or funds from investment angels; they also decide to expand globally more frequently than other companies;
  - The main source of startups' innovation is analysis of client behavior.

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# The systems approach perspective on leagility

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## Abstract:

A turbulent environment and very limited ability to make accurate forecasts triggers the need for building highly responsive organizations. What is more, there is much pressure exerted on the costs' reduction as one of the aftermaths of the crisis 2008+. The main goal of the article is to make a contribution to the stream of research devoted to creating capabilities needed for being lean and agile as response to contemporary challenges. The design of this research is based on in-depth literature review. The system approach was deployed to include lean and agile, both concepts and practices, under one consistent model. The detailed problem under discussion was meeting logistics requirements of customers. The Ashby Law suggests having differentiated responses to turbulent environment than only lean and agile. This also affects meeting requirements of customers in the supply chain. The originality of this work lies in showing the implications of identifying logistics requirements of customers for contributing to full flexibility within the system under discussion. The consequences of the Ashby Law for reactive and proactive behaviours of agents within the system should be further discussed in future research.

**Keywords:** agility; complexity; lean organization; system approach

**JEL codes:** M19, D23, L22

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*Reality is made up of circles but we see straight lines.*  
*Peter Senge*

## 1. INTRODUCTION

The strategies of combating the crisis 2008+ was based on the series of quantitative easing efforts as a result of which the global economy didn't suffer from a steep decline, however, the growth slowed down. Consequently, there is much pressure exerted on seeking efficiency through costs' reduction. We have also been witnessing the progress of the Industry 4.0 called even the fourth industrial revolution that consists of a bundle of technologies including internet of things, cloud computing, augmented reality, humanoid robots. Simultaneously, demographic changes with the growing number of both single and double incomes with no kids households in

line with the raising number of consumers benefiting from e-commerce convenience translate into new demand patterns. The consumers are increasingly sensitive and determined to obtaining a product meeting their individual needs. This, in turn, has been exerting pressure on extension of brand range and the choice on the retailers' stores shelves with new product developments. The latter is also combined with getting shorter shelf time of products. The trend towards products customization is reflected by growing a number of components and relations to cover within a supply chain.

The business environment is turbulent and it is sometimes called volatile, uncertain, complex, ambiguous. Growing complexity means the emergence of problem areas within which cause-effect relationships are subtle, and where the consequences of actions are not obvious within various timeframes. Taking this into consideration, forecasts cannot be more accurate and any predicted optimization point will be of a temporary status.

Having all above points in mind, we state that there is a need to be both lean and agile at the same time. Higher responsiveness is a driver of agile solutions, whereas pressure on costs reduction is a trigger of leanness. Agility is the key factor that gives an advantage for winners over losers in a complex, uncertain, ambiguous, volatile environment. Consequently, successful organizations should focus on building capabilities that support not only leanness but are also agile.

The demand-driven supply chain plays an increasing role in winning a competitive advantage by securing higher responsiveness. What is more, it should be also not cost intensive. As a result, the necessary capability of winning organizations is meeting customers' requirements within whole supply chain including customers' logistics requirements.

## 2. LITERATURE REVIEW

Agility is a business-wide capability that embraces organizational structures, information systems, logistics processes, and, in particular, mindsets. A key characteristic of an agile organization is flexibility. Indeed, the origins of agility as a business concept lies in flexible manufacturing systems (Christopher, 2000). However, agility should not be confused with leanness. Lean is about doing more with less. The term is often used in connection with lean manufacturing. Paradoxically, many companies that have adopted lean manufacturing as a business practice are anything but agile in their supply chain. (Christopher, 2000).

While leanness may be an element of agility in certain circumstances, by itself it will not enable the organization to meet the precise requirements of the customer more rapidly. Webster's Dictionary makes the distinction clearly when it defines lean as "containing little fat," whereas agile is defined as "nimble." One of the biggest barriers to agility is the way that complexity tends to increase as companies grow and extend their marketing and logistics reach. Often, this complexity comes

through product, brand proliferation, logistics including transportation, warehousing and customer service, but it also can come through the organizational structures and management processes that have grown up over time (Christopher, 2000).

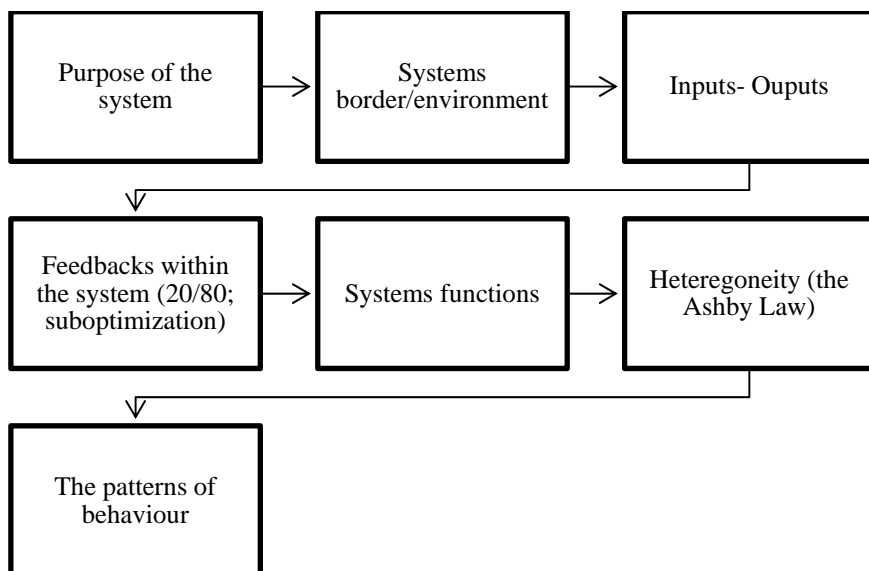
The simultaneous work of lean and agile principles can support the effective and efficient management (Olhager, 2003; Narasimhan, Swink & Kim, 2006) and relationships within a supply chain (Wikner & Tang, 2008), balancing efficiency and responsiveness (Olhager, Selldin & Wikner, 2006). Researchers have addressed differently the links between agility and leanness. Agility was defined as a 'post-lean paradigm' (Jain, Benyoucef & Deshmukh, 2008), which incorporates lean principles to cope with a turbulent environment. In some other studies, we can find an approach which highlights the difference between agility and leanness (Goldsby, Griffis & Roath, 2006) where leanness is a philosophy essentially focused on eliminating all waste including time, while agility is a way to use market knowledge to exploit profitable opportunities in a volatile marketplace. Agility could be seen as an effect of entrepreneurial orientation (Žur, 2013).

The existing literature allows us to assume that the co-existence of lean agile models is needed to adapt in the complex environment. The main goal of the article is to make a contribution to build capabilities needed for being lean and agile by including logistics requirements of customers.

### 3. METHODOLOGY

The co-existing of lean and agile practices and concepts triggers building models that could link both approaches with each other. Some authors suggest to deploy the segmentation approach. For example, the implications of segmentation concept for supply chain management are raised by Gattorna (2009, 2010). If customer groups exist with differing service requirements, then it makes sense to optimally match requirements through some form of differentiated supply chain strategy (Gattorna & Walters, 1996; Godsell & Harrison, 2002), so that the customers' requirements are triggers of supply chain segmentation. However, the segmentation idea is based on isolated approaching of the selected group of customers which could result in suboptimized solutions. In order to avoid suboptimizational pitfalls, we argue to deploy the system approach. General system theory, cybernetics, dynamic systems, non-linear dynamics theory, systems methodology are the components of the system approach (Schwaninger, 2006; François, 1999; Laszlo & Krippner, 1998). The history of system approach could be interpreted in terms of efforts towards solving complex problems (Wycisłak, 2013). Having all these assumptions in mind, we follow the methodology based on the system approach, which is presented on Figure 1.

The last of the distinguished stages reflects the link between microscopic and macroscopic levels. From the system approach point of view, this manifests itself by a topic of translating the change in behaviour of agents (eg. employees) into a patterns widespreading within a whole system (macroscopic level).



**Figure 1.** The methodology of the research

Source: own elaboration.

#### 4. ANALYSIS

Purpose of the complex logistics adaptive system is meeting logistics requirements of customers. Consequently, we assume a set of activities dedicated to meeting logistics requirements of customers as a complex system. The next stage of the procedure must be done to identify the boundaries of the system. Taking into consideration the cooperation within the supply chain the boundaries between system and its boundaries are ambiguous and inconclusive. Moreover, assuming that the objectives of the company should be oriented towards the outside, the scope of an external impact the company is extended. The constituting of boundaries means creating a difference in the sense that internal relations are less complicated than the external ones .

In terms of inputs, in regard to logistics system, we assume that a way of thinking of customers is based on the two main criteria: space and time. As a result, respectively, the ratio of  $\text{SKU}/\text{m}^2$  and shelf life trigger the logistics requirements of customers. The shelf time translates into logistics requirements of customers in terms of lead time, delivery frequency, on-time delivery, order placement, SKU preparation, logistics labelling, delivery quality (Christopher, 2011). The ratio of  $\text{SKU}/\text{m}^2$  affects order size, pallet heights, picking ratio, deploying of sandwich pallets (Christopher, 2011). In terms of outputs – meeting of logistics requirements of customers is measured by Customer Case Fill On Time (El Sayed, 2013).

The feedbacks within a system are reflected by suboptimization principle, and manifests itself by sales peaks. The latter is a result of certain patterns in behaviour of the sales staff due to the pressure on meeting monthly targets. As customers are aware of the latter, they wait for the months endings in order to get the highest possible discounts. As a result, customer service needs to secure resources for additional work on entry and validation of orders. Consequences are twofold: higher costs and increase in the number of errors. Logistics also need to secure additional transportation capacities from the spot market, which translates into higher costs. Transport Service Providers even run of capacities and are not able to ensure the proper service levels. What is more, the trucks are not fully loaded which means waste. The additional warehousing capacities should be secured, which translates into more resources to commit. As the additional temporary resources are primarily secured by employment agency, new employees are not skilled enough, and the training is time consuming. Consequently, productivity is on the downward spiral, and costs witnessing the growth.

The principle of 20/80 implies that we should focus on 20% of customers generating 80% of turnover. In this sense, it is reasonably to differentiate services towards customers. The latter is also strictly connected with the Ashby law which is reflected by the quotation:

$$V_r \geq V_d - V_o$$

$V_r$  – variety of potential responses;

$V_d$  – variety of problems;

$V_o$  – variety of outcomes tolerable by the essential variables.

Consequently the variety of logistics services both predicted and existing ones should be higher than variety of logistics requirement of customer. In other words, to predict logistics requirements of customers and to be prepared to what customers would want, and proactively manage over the customers' expectations.

The Ashby law called also the law of requisite variety reflects the conditions of ensuring business continuity through setting up full flexibility.

However, our own business practice observations of the implications of the Ashby law on the differentiation of the logistics services enables us to distinguish four options: lean, standard, agile, super agile solutions. For example, for lead time we can differentiate four options: lean – 48 hours, standard – 24 hours, agile – 12 hours, super agile – 6 hours; respectively for picking it is full pallet – lean; layer – standard; cartoon – agile; single item – super agile.

Qualitative and quantitative ranges of logistics requirements of customers – the scope of variety – are affected by the following factors:

- the negotiation power in the supply chain;
- stock management;
- geography.

The control over suppliers is a criterion behind the logistics requirements of customers. This is an effect of customers' position strength within the supply chain.



For example, if discounters cover the prevailing part of retail sales, they force suppliers to follow very short lead times, high delivery frequency (including delivery during weekends), high number of urgent orders, and very short delivery time slots or even delivery on –time.

The stock management strategy deployed by customers affects their logistic requirements. For example, some drugstore chains dispose about very advanced logistics solutions. Therefore, their orders are large and of high homogeneity. As the ratio of SKU/m<sup>2</sup> is high for drugstores (accounting for about 35-40), they repack products from pallets of high homogeneity to dedicated boxes (cages) in their own warehouses. This also means that drugstores chains tend to keep stocks in the warehouses for the period of several days. In adverse, discounters follow the strategy of minimizing inventory *days*. This means that the ratio of days on hand accounts for one, or two days.

Finally, geography and as a result travelled distances, terrain as well as climate conditions impact the exact numbers staying behind the logistics requirements of customers. The differentiated service offerings should include existing and a forward-looking catalogue of services. In these terms, it should be the response towards the growing variety of logistics customers' requirements. The first link between logistics requirements of customers and systems' response is the way how customers make orders, and how it translates into logistics complexity and logistics costs. In an ideal situation, it should be a perfect order. The latter is achieved when the customer's service requirements are met in full. Order fragmentation is the consequence of growing logistics requirements of customers, and is one of the indicators of logistics complexity within a supply chain. The order fragmentation is reflected by ratios as follow: orders invoiced per month, stock keeping units/order. The number of orders invoiced per month translates into a need for higher number of trucks and operational workloads including transport planning, consolidation of loads, handling in and handling out.

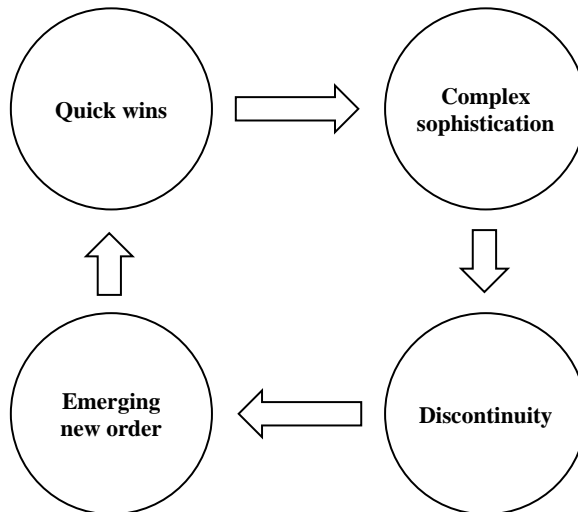
SKUs/order ratio mirrors orders' homogeneity. Various packaging sizes, material packaging types and temperatures result in higher logistics complexity levels. The modes of deliveries encompass central stock (distribution centre of customers), direct customers' shop deliveries, and customers' cross dock. Delivering directly to shops means higher complexity levels comparing to delivering to the distribution centre of customers. In business practice, the dedicated promotional actions are supported by direct delivery to customers' shops. Temperature levels also impact the model of delivery. The temperature regimes include ambient, chilled, and frozen modes. If deliveries follow various temperature regimes, it means high logistics complexity. This is because of different requirements for trucks, depots, and modes of deliveries.

The second link between logistics requirements of customers and system response is the level of customers' requirements fulfilment. Delivery time, order management, delivery quality are the crucial components of customers service required. Lead time, delivery frequency, on-time delivery translate into delivery time parameter within the logistics service level required. Whilst including pallet

heights, pallet weight, mixed pallets, sandwich pallets, logistics labelling, order placement, and SKU preparation stay behind the second parameter – order management, and delivery quality is measured by the ratio of claims/delivery notes.

There is a trade-off between logistics complexity and logistics trade terms. Logistics trade terms are a sum paid to customers for homogeneity of orders and order size. General rule is as follow: the higher logistics trade terms, the lower logistics complexity, and lower direct logistics costs. Logistics trade terms are a part of trade terms.

Taking into consideration – logistics complexity, logistics costs and logistics trade terms on the microscopic level, we can distinguish four patterns of behaviour on the macroscopic level. In the first step, we observe the quick wins that are results of high potential of costs savings. This reflects the lean approach. However, after exploiting low hanging fruits, the meeting of logistics of customers is achieved either by higher complexity or higher logistics trade terms. Complex sophistication should involve lean, agile, super agile and standard approaches. However, the pressure on costs reduction results in the discontinuity changes like setting up logistics centralized control tower. This new emerging order means new possibilities for quick wins, however (Figure 2).

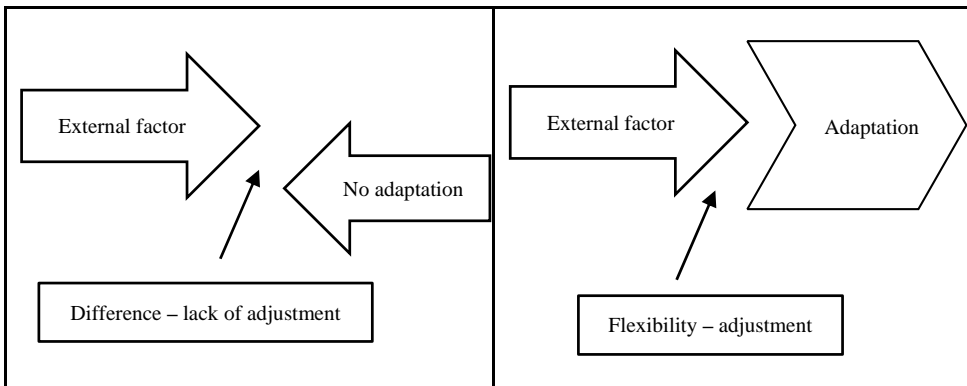


**Figure 2.** Patterns of behaviour in the complex adaptive logistics system  
Source: own elaboration.

### 5. DISCUSSION

Both Christopher (2011) and Gattorna (2015) don't deploy the system approach to resolve the problem of being lean and agile. What they suggest is the segmentation of customers based on selected criteria. What is more, Christopher and Gattorna don't include the logistics costs and logistics complexity versus logistics trade terms by covering lean and agile solutions.

Krupski (2008) suggests existing different levels of flexibility, and points out agility as one of the potential components of defining flexibility. Flexibility is also strictly and directly connected with customers driven supply chains. As customers gained influence, and the balance of power in the supply chain began to shift their way, suppliers struggled to provide the desired extra flexibility demanded by customers (Gattorna, 2015). The application of the system theory points out the importance of the Ashby Law. As a result, the difference between being both lean and agile versus flexible is a result of ignoring standard and super agile solutions (Figure 3).



**Figure 3.** Flexibility including lean, standard, agile, very agile options  
Source: own evaluation.

Flexibility could be perceived as reactive and proactive organization activities in terms of time, content, scope that are better tailored to the turbulent environment than existing ones. In this sense, the paper develops the approach to flexibility suggested by Krupski (2008).

## 6. CONCLUSIONS

The starting point of this paper suggested that co-existence of lean and agile models is needed to adapt in complex and hyper changing environments. However, in order to ensure the full flexibility for meeting logistics requirements of customers, we should have lean, standard, agile, and super agile solutions. The detailed factors affecting qualitative and quantitative ranges of logistics requirements of customers are as follow: the negotiation power in the supply chain, stock management, geography. There are two links between logistics requirements of customers and the system response, the first one – is the way how customers make orders, and how it translates into logistics complexity and logistics costs; and the second one is the level of customers' requirements fulfilment. Having in mind logistics complexity, logistics costs and logistics trade terms on the microscopic level, we can distinguish four patterns of behaviour on the macroscopic level.

Applying the system approach to solve problems of being lean and agile by including logistics requirements of customers we considered the implications of the Ashby law. This paves the way to develop the concept of full flexibility in meeting logistics requirements of customers by including logistics complexity, logistics costs, logistics trade terms on the microscopic level and four pattern of behaviour on the macroscopic level.

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# Captive offshoring services for SMEs in Poland: The role of mutual trust and cultural aspects

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## Abstract:

The study examines one of the governance models of offshoring and empirically tests relationships and differences in culture between employees within one company, from two different countries. The study outlines the current position of Poland as an example of destination for entrepreneurs deciding to offshore their services. This research joins case study method, together with surveys and personal observation. The qualitative method aims to investigate relations within the company and examine frequencies of employees' behaviours. Quantitative research method is used to identify the frequencies of qualitative results. The study proved that building common goals and positive relations facilitates working relations. Regular communication and maintaining trust between the countries is a crucial factor for the effective offshoring process. The originality of this work lies in focusing on cultural aspects of offshoring such as cultural distance and cross-culture communication. Further research into the issue of mutual trust in the context of offshoring processes is recommended.

**Keywords:** offshoring; communication; culture; Poland

**JEL codes:** M14, M51, D83, J21, L84

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## 1. INTRODUCTION

Outsourcing is acknowledged by many managers as the best solution for reduction of costs. This happens because some of the business activities are moved to a subsidiary or an independent service provider in a chosen destination. With the crucial development of the economy, the global market forces companies to focus on their own business. General outsourcing and offshore outsourcing help to improve production efficiency, lower operational costs and following all these operations, increase profits. According to Oshri, Kotlarsky and Willcocks (2009, p. 8), global sourcing might offer various advantages which are associated with the benefits of outsourcing in general. Any firm may obtain significant cost advantages through the creation of economies of scale, access to the unique expertise of a third party,

and the reduction or stabilization of additional costs. Furthermore, a company may gain benefits from outsourcing by concentrating on essential activities, on organizational specializations, or focusing on achieving key strategic objectives. No doubt, offshoring has become a valid business tool to be successful. How small and medium-sized enterprises (SMEs) should use offshore outsourcing effectively is a question that these companies need to consider and carefully establish necessary strategy.

The study outlines the current position of Poland as an effective destination for entrepreneurs deciding to offshore their services. The authors describe benefits of captive offshoring to Poland for small and medium-sized companies based on the example of one of British locum agencies<sup>1</sup>. The agency began offshoring operations to Poland in November 2010. Although lower costs in the beginning were key factors that attracted the company to offshore, other advantages such as skilled young workers and foreign government policy also played roles.

The aim of the study is to examine one of the governance models of offshoring and empirically test relationships between employees within one company, from two different countries presenting advantages and disadvantages of offshoring and investigate cultural differences and similarities. To be able to do that, authors provide an overview of development of offshore outsourcing activities within the medium-sized enterprise. By use of personal observation and surveys with the company's founders, its workers in the country and those who work offshore, the study discovers how to build relationship and succeed in captive offshoring.

The paper is divided into three main parts: theoretical study, research and discussion. The theoretical background gives sufficient frameworks of outsourcing, offshoring and describes the notions, explaining the importance of location choice and outlines the cultural specifics. The authors describe positive effects for the outsourcing in two different countries. The second part conducts research methods. The latter section reveals consequently the findings of the research. The paper ends with conclusions for practice and research alike.

## 2. LITERATURE REVIEW

### 2.1. CONCEPTS OF OUTSOURCING

Nowadays, almost any service can be outsourced. Types of outsourced processes differ between call centres, technical or IT support, third-party logistics, food services, distribution services, aircraft maintenance, back-office help etc. Outsourcing, mostly associated with activities outside companies, also creates its own sub-companies that work for the parent agency and carry out selected tasks to support its

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<sup>1</sup> 'Locum' is a medical professional that temporary holds a position at a hospital, clinic or private practice. The term locum tenens is a Latin word and is translated as 'stand-in' or 'substitute'. The NHS in United Kingdom has approximately 3,500 locum doctors working in trusts and hospitals every day. There is also about 15,500 locum general practitioners (National Association of Sessional GPs, 2008). Statistics differ on how many physicians are locum tenens. In most hospitals, there is approximately 50-80% doctors who work on a temporary agreements. Majority of locum doctors are contracted through locum agencies.

own company's actions. Definitions of outsourcing changed and evolved within time, technology progress and globalization. Various academics and practitioners claim that outsourcing is a form of external sourcing, or vertical disintegration. Some say there are two forms, outsourcing and purchasing, others that there are three forms, including outsourcing, purchasing, and subcontracting. Finally, it was commented that it is not very useful to treat various outsourced processes, including BPO, maintenance, IT, manufacturing, operations, repair, and R&D outsourcing as the same form (Mol, 2014, p. 7). Handfield (2006) explains the differences between the perceptions and understanding of the notion in the past and in recent times. He claims that until 1989 outsourcing has not been officially defined a business strategy. He also underlies that majority of companies were not completely self-sufficient as they outsourced activities that they were not competent of. In the 1990s managers started focusing more on cost-saving benefits. This caused that companies were outsourcing functions they needed, but they were not entirely related to the business. Entrepreneurs started to sign contracts with appearing companies which provide business services on the market. Through this process they wanted to deliver various services, ranging from data processing accounting, human resources, to security and maintenance. According to Handfield (2006) the current stage in the evolution of outsourcing is the development of strategic partnerships.

One of the most recent and commonly used forms of outsourcing is offshoring. Encyclopaedia Britannica defines the concept as offshoring as the practice of outsourcing operations overseas, usually by companies from industrialized countries to less-developed countries, with the intention of reducing the cost of doing business. Among the main reasons for locating services outside a corporation's home country are lower taxes, lower labour costs, less strict labour regulations, more lenient environmental regulations, and proximity to raw materials' (Encyclopaedia Britannica). Oshri *et al.* (2011) explains that offshore-outsourcing implies contracting with a third party (vendor) based at an offshore location (...) to accomplish some work for a specified length of time, cost, and level of service. Fariñas *et al.* (2014, p. 1815) agree with those definitions, claiming that the term 'offshoring' refers to firms that subcontract to suppliers that are located in a foreign market'. GAO Report to Congressional Committees from United States Government Accountability Office (2006) explains that offshoring intensive manufacturing operations began in the 1960s, followed in the 1970s and 1980s by increasingly complex operations, including design work and some research and development (R&D) and wafer fabrication. Offshoring became very important in international development in the middle of twentieth century. Companies focused their outsourcing activities at first on low-skilled or unskilled manufacturing jobs and simple assembly tasks. In the beginning of the twenty-first century, the exported jobs increasingly included skilled employees. The term offshoring splits into in-offshore house sourcing and offshore outsourcing (Table 1). First one is a production of goods or services sent to foreign countries within the same group of firms. The second one concerns specific transfer of the production of goods or services outside the home country not to the connected company.



It is important to pay attention to different ‘shores’ that might be involved in relocation of business services. Offshoring, on-shoring and nearshoring are derivatives from the word outsourcing. From a point of view of the location, companies can change place of activities from distant countries or only “nearshore” (Slepniow, Brazinskas & Wæhrens, 2013, p. 6). Nearshoring is outsourcing to foreign subsidiary but in a nearby country. On-shoring is the process of bringing home facilities currently located in foreign countries. It can minimize communication problems and improve the product development.

**Table 1.** Offshore outsourcing

Location	Internal production (in-house)	External production (outsourcing)
Within the country (domestic)	Production within the enterprise and the country (domestic in-house)	Production outside the enterprise but within the country (domestic outsourcing)
Abroad (offshoring or cross-border)	Production within the group to which the enterprise belongs but abroad (by its own affiliates) (offshore in-house sourcing in the sense of relocation abroad)	Production outside the enterprise (or the group) and outside the country by non-affiliated firms. This involves foreign subcontracting (offshore outsourcing or subcontracting)

Source: Hatzichronoglou (2007).

These models differ across involved effort, level of interaction, cultural differences and various time-zones. Some offshore outsourcing activities might be done entirely on the offshore location, but others on onsite location. In the offside offshoring, the company providing services will have its office close to its client’s location and offshore outsourcing facilities at some other geographical region. Offsite outsourcing organization is used to act as a middleman in communication between the client and the offshoring enterprise.

## 2.2. REASONS FOR OFFSHORING SERVICES AND THE CHOICE OF LOCATION

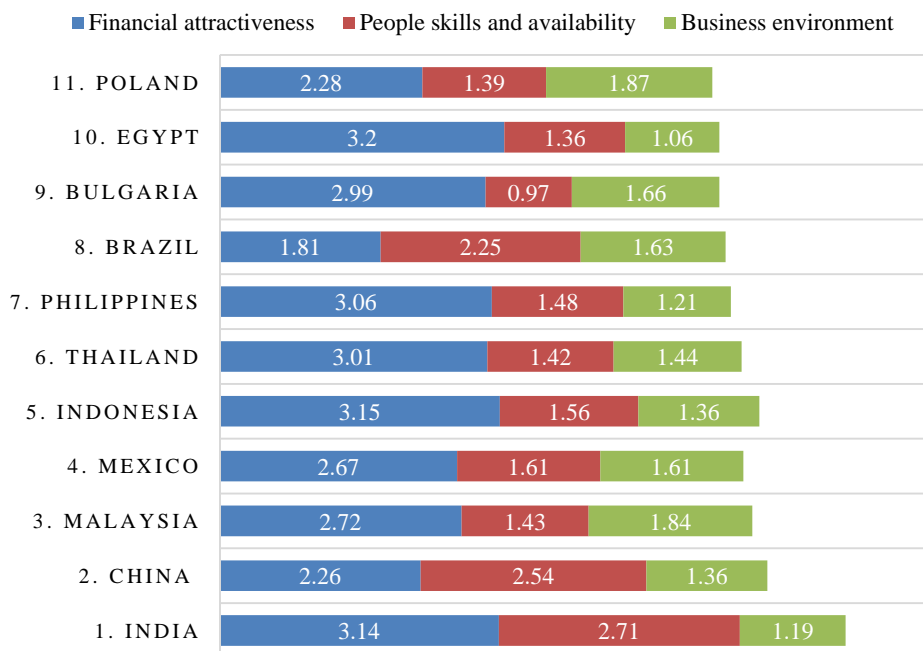
Offshoring becomes more and more popular thanks to the progress of technology and globalization. Multicultural political environment caused growth of international business operations. World exports grew from \$60 billion in 1950 to \$19.01 trillion in 2014 (World Bank, 2014). Lower labour cost is the initial key factor that attracts firms to offshore to other locations. Outsourcing activities abroad allows for exploitation of economies of scale. It also provides better and more flexible access to specific resources (Nielsen & Nielsen, 2008). Offshoring can also work other way round as not only residents of poorer countries may be happy for such solutions, it can also bring benefits for the inhabitants of the developed countries. Authors of *Applied Economics* (Fariñas *et. al.*, 2014) write about estimated effects of offshoring on productivity in US manufacturing industries. It was found that service offshoring has a valuable positive effect on productivity, accounting

for around 10% of labour productivity growth between 1992 and 2000. Offshore outsourcing inputs have a good influence on productivity but the range is smaller. On the basis of examination of establishment-level data for UK manufacturing industries, it was found that the establishment's outsourcing intensity is positively related to its productivity growth (Fariñas *et. al.*, 2014).

Outsourcing services is quite advanced in the United Kingdom when it comes to small and medium-sized enterprises (SMEs), in comparison to other European countries. Locum agencies are generally SMEs. Agencies decide to outsource projects with which they have some difficulties. It may be lack of specific skills or shortage of time. M. Edge, KPMG UK Head of Markets, said: "Our own research shows that UK businesses are increasingly optimistic about their prospects. In moving forward, businesses need the right people with the right skills. Increasingly, they are looking overseas to address this skills gap recruiting people to the UK or deciding to offshore both work and job" (KPMG, 2009). There is a lack of skilled workers across UK so the companies are forced to search for workers in European Union or further. The survey regarding labour market conducted by KPMG, shows that over 21% of 600 companies recruited migrant employees (Woods, 2010). When the problems are specified and a company is sure that it wants to use help from a foreign country, the other problem arises: to choose appropriate country with inhabitants that would help to develop the business (Outsource Magazine, 2010). According to the research conducted at the University of Nottingham, UK companies prefer to offshore to rather large countries which are relatively wealthy and close to the UK. Other important fact was the ability to speak English on a high level of fluency and understanding. The survey also reveals that UK firms value a relative abundance of human capital, good information technology and a market-friendly environment (Greenaway, 2007).

Offshoring gives agencies the possibility to use skills and experience of skilled workforce. Other than experience are also such important characteristics as willingness to work in international environment and interests in foreign culture which can result in friendly work environment and following this, greater will for work. Scholars from University of Institute of Economics of the Hungarian Academy of Sciences and University of Hertfordshire conducted a research among countries from Visegrád Four: Czech Republic, Hungary, Poland and Slovakia regarding offshoring and outsourcing business services. They carried out 30 interviews with senior managers in business service foreign investment and found out that cost of educated and skilled professionals and their flexibility was acknowledged by all of the questioned companies as one of the most influential factors in their decision to start investments in the Visegrád Four. Very important factors available in these countries for foreign investors are also qualified graduates with a wide range of language abilities and excellent communication and interpersonal skills. 50% of the respondents also valued such factors as location, quality of infrastructure and political and business environment which is viewed as favourable in these countries (Sass & Fifekova, 2011). All the above-mentioned factors have a significant influence on the costs for the companies deciding to offshore.

Poland, as one of the CEE countries is most gladly chosen offshore destination. The World Bank's *Doing Business* report placed Poland on 44th place out of 189 countries ranked for how easy it is to do business in 2014 and in 2015 Poland jumped up to 32nd place (*Doing Business 2015, 2014*). What is more, Poland is ranked 17th out of 28 EU member states. Poland has much to do if it wants to be compared with the best places to do business in (Dembiński, 2013). According to Polish Agency of Information and Foreign Investments (PAIIZ, 2015): "Among ca. 20 cities in the CEE Region internationally recognized as potential offshoring locations almost 50% are located in Poland with 3 leading cities of Warsaw, Kraków and Wrocław". Poland is the biggest territory in the Central and Eastern Europe Region with as much as 16 large cities where outsourcing industry is growing since 1995 (Doktor, 2013). Poland is a country in the centre of Europe and produces about 400 000 university graduates each year which gives opportunities for its development and foreign companies are really keen to invest to start business in such countries. Poland has an advanced management culture that has improved enormously over the last two decades. Annual survey published in a 'World Investment Report' shows that Poland has achieved sixth place in the world and was acknowledged as most attractive FDI host countries which are perceived by multinational corporations. According to the United Nations Conference on Trade and Development (2013), Poland has become the most attractive foreign direct investment coun-



**Figure 1.** Country ranking  
Source: A.T. Kearney (2014).

try in the European Union. According to survey conducted by A.T. Kearney (2014), Poland (Figure 1) is placed on the 11th place, straight after top ten which proves country's great potential, offering highly skilled players and mature industry.

Poland is considered to be on seventh place of the most hard working economies in the world, way ahead of the OECD average of 1,776 hours (Warsaw Business Journal Group, 2013). The country specializes in various fields, such as: software products, business analytics, human resources, finance/banking and accounting, multilingual contact centres and tele-information network management. Firms that used to outsource some of their business activities to Poland include Google, Shell, IBM, Heineken, HP, Motorola, Procter & Gamble, Citibank, and many others. The number rates to even more than 50 companies from the Fortune 500 list (Gera, 2013) and the number of companies investing in Poland workers is still rising. Additionally, the vacancy rate of office space in Poland in 2015 stood at 12.3% in Warsaw and maintains similar position in other cities in Poland (Młyniec & Polkowski, 2016). It gives opportunities to open new offices for foreign companies. What is more, Poland has not remained indifferent to the globalization and growing international market and helped to draw attention of foreign investors. Not only the economic development of the country attracted companies from abroad but also Polish Information and Foreign Investment Agency introduced varieties of programs to streamline the process.

### 2.3. CULTURE AND COMMUNICATION

Culture is about human preferences, values, attitudes and behaviours and is connected to human identity. Although learning from diverse cultures and markets that are stimulated differently or exploitation of economies of scale or better and more flexible access to resources from specific countries, it might not be easy for managers to conduct business abroad. The survey conducted by Vantage Partners shows that cultural differences can prevent both parties from achieving the full value of their deal: 64% of respondents say that the impact of cultural differences is greater than 10% of annual contract value, and 33% say the impact is more than 20% (Ertel *et al.*, 2010, p. 4).

Cultural distance reflects a difference in cultural values among countries that should be assessed at the cultural or country level. Psychic distance is based on the individual's perception and should be assessed at the individual level (Sousa & Bradley, 2006). Centre for International Business University of Leeds conducted a research concerning Poland and United Kingdom. The research found that British managers do not think much about Poland. One of the most striking features of the British vision of Poland was their attitude towards the influence of the communist system on the Polish psyche. British executives treated Poland as a very distant country with narrow thinking. The 'communist past' in Poland also affected the British idea about Polish authorities. For British managers Poles are reluctant to take decisions and do not question the decisions of their superiors. What is more,

Polish managers were considered to be very much Western European in terms of their jobs, careers, and a lifestyle.

Hofstede's differences in power distance (Table 2) between the two countries illustrate an influence of the history on culture. High power distance makes gap between superior and his/her subordinates. Ordinary workers that occupy lower positions are afraid of their supervisors. Managers have power which can also have a negative impact on the relations between other companies. High power distance in Poland is still an influence after long-lasting communist system that is why British managers still perceive Poland as a communist country. However, it is crucial for managers to overcome potential obstacles of starting a new business in foreign country. There are two levels of cultural impact on the company: macro and micro and only combination of those two may bring positive effects for the company. It means that not only the culture of the country matters but also own company's organizational culture. Before starting any business with foreign nation, a company has to study all cultural factors that influence inhabitants' behaviours but also implement its own organizational culture to maximally minimize cultural distance.

**Table 2.** Hofstede dimensions: Poland and UK

Cultural dimensions	Great Britain	Poland
Power distance	Low	Very high
Individualism/Collectivism	Very high individualism	High individualism
Masculinity/Femininity	Rather high masculinity	High Masculinity
Uncertainty avoidance	Rather high	Very high
Long-time orientation	Low	Low

Source: <http://geert-hofstede.com/dimensions.html> (10.01.2016).

Drogendijk and Zander (2010, p. 192) while studying cultural distance came into conclusion that when the foreign environment is 'further away' from our own, there are more cultural differences between them, and it is likely that we have more difficulty understanding the other. It means that the larger the distance, between the countries and the less they have in common, the harder it is to communicate and, following on from that, it is more difficult to conduct business in this country. It is not easy to interpret values and behaviours that shape the society when the two countries do not have much in common. Table 2 shows that except from power distance, other dimensions between UK and Poland are quite similar which gives opportunities for successful business between Poland and UK. Both countries represent masculinity which means that in these societies, gender roles are clearly distinct and there is recognition for a good job and high earnings, advancement and challenge to have personal accomplishments. In Britain it is slightly lower as the country attaches great significance to such aspects of life as good working relationships, cooperation, desirable living area for family, and employment security but Poland is still developing in this direction and tries to catch up with UK. What is more both cultures are highly individualistic, dynamic and future-oriented.

International Business scholars studied a concept of psychic distance, which is explained as the degree of uncertainty of a foreign market a firm considers entering. It covers not only the cultural differences between regions but also differences in languages, business practices and environment, political and legal systems, human capital, infrastructure, and economic development (Garcia-Prieto & Point, 2009, p. 3). However, the cultural barrier has been underlined as a main challenge for offshore services. According to Persson (2013), in development of globalisation, face-to-face meetings, temporal locations and frequent visits in the other countries are best practices with such benefits as for example trust and effective teamwork. However, when the distance is large between the two countries, the workers function relying on technology-mediated communication and this form of contact may fail.

Cross-culture communication is not only country cultural dimensions, influenced by the history and passing time but also all the other factors of human life, such as language, manners, religion or a world view. Thus, for example differences in languages can be a huge barrier in the cross-culture communication. Communication and translation of foreign languages requires more than the transfer of meaning from one context to another. Change of language may sometimes change our way of thinking as we have to adjust to the language conditions. Certain language is linked to specific culture and with specific associations which may be alien to our own mother language. This refers to the claim that foreign languages may be used differently by the foreigners which may lead to miscommunication and certain obstacles while conducting international business. Communication comes from Latin word “communicare” and means “to make common” so it is a process of transferring meanings (Halliyavar, 2013). According to authors of the book *Effective Internal Communication*, each organization has its own culture and when two of them try to merge, the importance of those cultures comes to the force. They define culture as the patterns of behaviour and attitudes exhibited by employees and management (Smith & Mounter, 2005, p. 3). In a 2010 Vantage Partners conducted a survey in which they revealed that the majority (57%) of respondents claimed that cultural differences influence their capability to manage relations. They also said that communication between people is somehow difficult between different nations. (Ertel, Enlow & Bubman, 2010). Communication can constitute huge problem when workers communicate only through technological devices. What is more, when employees are in different offices and come from different cultures, the process of communication becomes more complicated. According to Jakobson (1960), both addresser and the receiver can be Polish or British workers, depending who wants to address a message. There is always certain message, code, and context applied, however, the communication takes place between two cultures, so there are certain noises between sender and a receiver. First of all, the communication is carried on by the phone, so there are technical issues and noises that are not dependent on the sender, neither on the receiver. It is called physical noise and it is external to the speaker and listener. There is also a psychological noise occurring in communication which is mental interference that prevents from

listening. It can occur when a person has some problems or when there is too much work and it is difficult to focus. Additionally, there noises connected with the behaviour might occur, cultural background and language barrier of interlocutors and these are the most important factors in the business communication for the offshoring companies. It is called semantic noise as it occurs when there is no shared meaning in a communication. Semantic barriers are related to individual understanding of words and their meaning. They arise from differences of words or other symbols (Satyanarayan, 2008, p. 16).

In response to the view of differences as an obstacle, an alternative view has emerged where the differences are presented as a business opportunity for companies to develop a competitive advantage. The European Business Test Panel (EBTP) identifies some economic benefits of cultural differences. They mentioned ethical and legal reasons that lead companies to adopt diversity policies. 42% of respondents claimed that conducting business offshore helps resolving labour shortages, 38% of those polled considered enhancing company's image, and enhancing creativity and innovation was an advantage for 26% of the respondents (Garcia-Prieto & Point, 2009, p. 7).

As a solution for the problems connected with cross-cultural dangers can be the concept of cultural intelligence which explains features of each person, regardless of the nationality. Cross-cultural relationships have to be managed at individual level, depending on the country so managers have to learn how to deal with differences between cultures and teach their company's workers how to adapt to the new culture. Following this, cultural intelligence has emerged to explain and help to facilitate the cooperation between various cultures. The concept can be defined as a person's capacity to adapt effectively to new cultural settings or contexts based on multiple facets including cognitive, motivational, and behavioural features (Gregory, Prifling & Beck, 2008). A person with high cultural intelligence can find and describe universal or belonging to specific group or specific culture features shortly after observation. The concept divides into three main dimensions: cognitive, motivational, and behavioural. The first one is the self, a person's mental representation of his or her own personality, social identity, and social roles. Motivational means that a person is capable to attain a determined level of his/her performance. The last one is a range of specific skills that person has to possess while deciding to cooperate with other cultures. All of the above has to be accomplished due to the success at every stage of the cooperation.

### 3. MATERIALS AND METHODS

To explore the role of mutual trust and cultural similarities and differences in the captive offshoring process, the research has been conducted with Holt Doctors Ltd., medium-size company, one of the leading British suppliers of locum doctors to NHS clients. The company has its main office in Great Britain and all of its operations are being done within the country. Back office services are being outsourced to Poland and conducted by its captive centre. The division in Poland constitutes

a part of the company and provides support to recruiters and administration staff, assisting to complete the full registration process and to reach compliant status.

All of the agency's employees (both from UK and Poland) took part in the study. Invitations were sent to all company's workers. 68 (the total number of people working in the company – including the management board – 20 from Poland, 48 from UK) people received the invitation in total but 57 agreed to take part in the research. The majority of the respondents were women. The respondents occupy different positions within the company, from the lowest position to the directors. The age of the company workers differ from 20 to 60-years old. The average age of all the company workers is 36. The employees from Poland are younger than all the employees working in UK, thus the average age in Poland is 31 and the average age in UK is 37,5. Within the company, each of the workers corresponds to each other, each division is connected with the other one, including employees in Poland. Thus, the authors decided to send questions to all company's workers, to have a wide view on how the offshore outsourcing is perceived by each of the company member. Also, the response rate was taken into consideration, before deciding who should answer the questions.

This research joins single case study method, together with personal observation and surveys. The case study method could help investigate “contemporary phenomenon in its real-life context, especially, when the boundaries between phenomenon and context are not clearly evident” (Yin, 1981, p. 18). The method allows to conduct an in-depth understanding of cross-culture relations (Hurmerinta & Nummela, 2011). Observation of certain behaviours of the company workers allows to draw conclusions regarding their attitude towards the co-workers from the foreign country and allows the authors to confront the reactions with the answers. Thanks to the authors' close relations to the company workers, they are able to conduct deeper interviews if explanation of their answers is needed.

The survey data is collected via online questionnaire. It consisted of open-ended and multi-choice questions and was arranged in a five-point Likert scale. Quantitative research method is used to identify the frequencies of qualitative results. Some scholars claim that quantitative and qualitative approaches in combination provide better understanding of research problems than either approach alone. S. Lieberman said in his 1991 presidential address to the American Sociological Association: “The qualitative/quantitative distinction is itself somewhat arbitrary....What we really need is an effort to integrate both these methods, to take advantage of both procedures and combine their outcomes ... Thinking this through would be far more useful than method bashing. If we are truthseekers, then there should not be a qualitative truth and a quantitative truth” (Axinn & Pearce, 2009, p. 15).

The general purpose of the research is to identify the key factors of a successful captive offshore outsourcing and check if mutual trust influences the whole process. All of the questions are provided in English, both for British and Polish respondents. Open-ended questions allow the researchers to deeply analyse respond-



ents' attitudes. It allows the interviewers to be highly responsive to individual differences and situational changes. Open-ended questions also helped the interviewers to avoid accidentally imposing any of his or her own preconceptions and furthermore, the validity of data was protected. To facilitate the analysis of the interviews, the authors used standardized questions for all the respondents.

## **4. RESULTS AND DISCUSSION**

### **4.1. BRITISH AND POLISH VIEWPOINT**

Individual views on communication and managing relationship is presented below. The study shows how UK mother company and the subsidiary office in Poland manage relationships with each other, what they consider important in managing their outsourcing relationships, what cultural differences they noticed and how they influence their perception on the offshore outsourcing relations.

Maintaining constant communication with the workers from Poland is frequently identified in the relationship management by the British workers. The workers from the subsidiary have more difficult task as they are not only in different location but also are historically and culturally different. They do not see what happens in the main office, thus they have to be focused all the time and put more effort on caring about the good relations. The respondents answered that honesty is one of the main assets that helps in effective communication. What is more, those polled write that understanding of the requests and information given is a key to work effectively. Politeness is also acknowledged as important factor. Without it, employees could have misunderstood their intentions.

When it comes to the relationship management, British acknowledged that the most important factor is that both sides understand what the other side means when communicating. They answered that all of the employees need to know what is the goal of the company and they have to be informed constantly about everything that happens in the company in UK, thus the incessant communication is required. Feedbacking and mutual help occurred to be also valid factor in building the relationships for both countries' participants not only from the vendor's perspective but also from the mother's company point of view. Polish employees also pointed that travels and meetings in their country are valid in the whole communication process. They believe that management visits to their country give directors an opportunity to understand resources and processes at the subsidiary's site. Others pointed language as the critical factor in managing the relationship. Many of the British respondents also underlined that the differences in accents and use of phrasal verbs might be a problem for Polish co-workers.

Honesty is acknowledged as most valid in maintaining trust for both, mother and daughter company. Most of the British workers answered that being honest to each other, solving problems, asking for help and keeping in touch can help maintaining the trust to each other. Managing directors also reported that Polish workers' commitment helped them to keep trusting the employees abroad. The results

show that it is equally important both for the main office as well as for the subsidiary to instil a sense of trust between each other. According to the questionnaire, trust results from frequent and relevant information exchange and building positive relationships between all the company workers. More effective communication between the members results in higher level of trust and consequently, the work becomes more effective.

Almost no one from the British members noticed any cultural differences. One person mentioned that there are different ways of working which may indicate as it was acknowledged as a cultural difference. The respondent noticed difference in the way of being polite, saying: "In Poland it is not normal to flower the conversations, i.e. "thank you", etc., at the beginning/end of conversations". No other comment regarding cultural differences was mentioned by the British. However, there were a few comments about economic conditions of the country and local laws which according to the English respondents might occur as an obstacle in the effective relationship. The British culture is considered less formal than the Polish one. Study shows that there are certain differences in the behaviour that are constituted by history, customs and the laws governing the countries which occur as an obstacle. Majority of the respondents answered that only language may be a barrier but did not recognize any additional differences connected with the habits, behaviour and cultural background. Surprisingly, Polish employees noticed many differences in culture and in the work pattern. The respondents acknowledged British as those who do not care so much about the Polish workers. The subsidiary employees believe that making an effort to trying to understand the Polish employees and their situation, would help to build better relations. The reluctance to learn about the foreign country and Polish mentality was recognized as an obstacle in international business. Also, forgetting that English is Poles' second language, caused obstacles in effective communication. Polish think of themselves to be more flexible than their British colleagues. Many of the Polish respondents reported that British workers do not go behind their responsibilities, while the employees from Poland try to do as many tasks as possible. What is more, Polish workers think that all of the employees from UK, not only the managing board expect from them more flexibility than from themselves.

Regular contact, constant communication and good language skills are the most frequent answers in the survey for the British employees. The common aim of the company was also mentioned few times. The employees expected from its vendor more flexibility and work to learn the language better so the communication would be more efficient. The respondents from Poland answered that first of all, control from the management is crucial, especially at the beginning of cooperation. For those polled, it is also valid that both sides have to learn from each other how to behave, what to do and how to perform different tasks. Observing others and asking for help were acknowledged as key factors in achieving the effective communication between the countries.

There are similarities and differences in perceptions of mother-company and its daughter-company on their considerations of achieving and maintaining trust in

offshore outsourcing relationships. Both groups answered that constant communication between the countries is a key to maintain the relationship. Critical factors are also trust and language experience for both sides. What is more, both Polish and British members of the company identified the importance of personal visits, both in the home country as well as at the vendor country. Honesty was also mentioned as one of the critical factors in maintaining trusts for both parties. Majority of all respondents also answered that asking for help might be helpful for the company to manage the relationship. Both sides also considered that working together would facilitate their work and tighten the relations between them. It has been noticed that knowledge and experience exchanges occur only on informal basis and there are no formal meetings between the company workers. However, the company members that successfully implemented the cooperation with the offshore unit, do not feel any need of sharing their experiences. When it comes to the cultural differences, all of the company workers mentioned language and different accents as an obstacle in the effective communication.

The research showed that all of the company workers are satisfied with the cooperation between both countries. Home country employees value the skills of their colleagues abroad. Majority of the respondents claim that the quality of work is maintained on the higher level and reduces costs. Furthermore, the research shows that almost all of the respondents are satisfied with the communication between two countries and that their trust their co-workers. This leads to the conclusion that mutual trust influences firm's offshore in-house sourcing strategy.

## 4.2. EFFECTIVE COMMUNICATION

Most of the Holt Doctors respondents pointed that communication is the main issue in the offshore outsourcing process. One of those polled suggested: "Whenever you come across a problem or you don't understand something – speak up. The key is to clarify any misunderstanding as soon as possible". The process of communication is a complex process.

The process works not only from the side of the employees but also downwards. When an employee receives appropriate downward communication from management, he/she can better understand the message, thus his/her work is more efficient and the person is better motivated. The key point is not to send only orders and requests but also facts about organizational goals, procedures, viewpoints, management decisions, so the employees are involved for all of the company's undertakings and have a feeling that they constitute a part of the company. One of those polled in the survey writes: "the most important factor in managing relationships is keeping in touch, keeping all parties aware of everything that's happening". Furthermore, team members have to be able to identify problems together, analyse alternatives and recommend solutions for the company. Each of the company's members, no matter if a managing director or a worker on the lowest position have to be able to communicate his/her ideas persuasively to the others.

The environment in which we live or spend a lot of time, constitutes our way of thinking and imposes specific meanings on the words we communicate with. One of the Holt Doctors respondents wrote that the difficulties in communication is: “not being in the same office, it would be a lot easier to work together if we were, it would be better if we could see how each other works and what we do day to day”. It happens that one side does not understand the other, thus meaning of symbols articulated by sender have different meaning in the mind of encoder. What is more, all of the respondents noticed that language and use of different accents and phrases might be an obstacle in effective communication. One of the employees noticed that: “as all others clear communication and being as polite as possible especially via e-mail to avoid any misinterpretation of tone”. Again, the symbols are used differently and the meaning of words is constituted by the culture. Workers communicating to each other from two different countries have to pay special attention to what they say and how they express themselves as even single word used inappropriately can be misunderstood.

Communication is not only verbal. When it comes to the business, half of the communication process occurs through emails or texts. As there is no other form of day-to-day communication than phone calls and emails, employees have to also pay special attention to what they write. This form is even harder as the sender and a receiver cannot hear the tone of the addresser and it is more difficult to express feeling through writing. One of the respondents wrote: “clear communication and being as polite as possible especially via e-mail to avoid any misinterpretation of tone” are the most important factors in the communication. Business messages, both formal and informal are an integral part of all the communication process. All of the ideas in written communication have to be arranged logically and diplomatically, in order to satisfy the encoder motivational, practical and informational needs.

Next to the many positive aspects of the studied case, the research also showed dissatisfaction with certain issues. First of all, geographical distance was viewed as a boundary in the effective communication. More frequent visits would facilitate the relations between the offices. The ineffective communication due to the long distance and very rare face-to-face meetings result in dissatisfaction of work and generates time waste. Additionally, implementation of the offshoring process might have been done without planning and deep investigation into the country.

Differences in worldview, different cultures and environments impose the meaning on different words. Thus the viewpoint of the employees from the mother-company is slightly different from those of the foreign office subsidiary. Almost everything that is done during the offshore outsourcing process is prepared to achieve the best value. That is why paying attention to the relationship and culture is such important factor. Cultural differences can prevent both parties from achieving the full value of their deal. Holt Doctors respondents noticed this relation. Some of the views are very similar, however, there are slight differences in the understanding of the whole process of communication among the respondents.

The qualitative part of the survey indicates the frequencies of the presented quantitative data. The questionnaire answers give general view on other offshore outsourcing factors that constitute the effectiveness of the company cooperation. The results indicate the similarities between both methods, since again, majority of the respondents claim that the offshore outsourcing process works and it is effective, basing on their experience. The researchers asked if the offshore outsourcing process is cost effective and half of the respondents answered that they agree with the statement. 9% wrote that they totally agree but 3% of those polled disagreed with it. What is interesting, the majority of the respondents from the group that totally agreed that the process is cost effective, were Polish and those who did not express their opinion on the statement were British employees. All of the respondents agreed that qualified employees perform the tasks, thus the quality of the business process increases, and only 4% did not express their opinion. There were certain differences when it comes to the time, effectiveness and flexibility of the workers from the offshoring country. 9% of the British respondents answered that they strongly disagree that the offshored work is carried out more effectively and 8% of them claimed that it does not save time, when the Polish did not answer the question negatively. What is more, over 30% of British respondents wrote that their neither agree nor disagree with the statement that workers who outsource services are more flexible so the quality of work improves when almost all of the Polish respondents agreed with it.

Except from the slight differences between the answers of Polish and British employees, all agree that the offshore outsourcing is effective. Both countries are culturally similar, thus the management board does not have any bigger issues connected with the effective management. The results indicate that a combination of low cost and good quality is critical to motivate clients to outsource. However, the managers have to remember that cost saving cannot become the main motivator for outsourcing.

## 5. CONCLUSIONS

Offshore SMEs outsourcing is relatively new, and the number of studies looking at the outcome is very limited (Mohiuddin & Su, 2013). Since the business services are being developed, technology and globalisation progress, companies can take advantage of the offshoring processes, by focusing on core competencies and relying on its subsidiaries or external service providers. However, thorough market research of the targeted country is required. First of all, a comprehensive assessments of the offshore subordinates have to be prepared to guarantee fulfilment of company's assumptions. Each stage of company's operations, such as expertise, geographical location, local laws, financial stability, etc. have to be considered. Educated workforce, strategic location, and a strong domestic market are also reasons for choosing the service provider and the paper shows that these have positioned Polish economy as one of the best investment destinations in Europe. The studied case is a good example which confirms the recent researches regarding Poland

which show the country as a leader in back-office activities such as shared-service and contact centres that provided 9% of FDI projects and almost a quarter of jobs created (EY, 2015, p. 18).

According to Khan and Azeem (2014), “national culture”, “communication style” and “difference in mutual understanding”, intercultural challenges have statistically significant differences. With regards to Hofstede dimensions, Great Britain and Poland are culturally similar. Except for power distance, other dimensions between UK and Poland remain approximate which gives opportunities for successful business between Poland and UK. The study shows that slight differences in behaviour are driven by historical past, however, the differences remain at very low level and can be explained by constant and honest communication. Communication is a valid issue in the process of offshoring services. According to Rai and Rai (2008), communication involves ensuring that a message has received the target audience and that the receiver understands and responds as the sender expects. It also involves ensuring that the receiver takes care to receive, understand, interpret and respond to messages that are sent to him/her. Regular communication and maintaining trust between the countries is a crucial factor in the process. The study proves that building common goals and positive relations helps to understand the other side and facilitates working relations. Frequent visits and listening to both sides of the process help building trust and positive relations and this in a consequence influences the quality of services provided to the company’s clients.

The studied example shows that captive offshoring contributes to enhancing firms’ effectiveness, however, the research reveals that there are some obstacles and they should be taken into consideration in offshoring processes. The Holt Doctors agency started their services in 2010. Due to quite short time of conducting offshore operations and managing the office in Poland the proper evaluation of the operations is not entirely measurable. Offshoring is a long term strategy, thus the results are measured and assessed only in a short-term period. As this research does not take into account personal observation from the UK side, an extension to this study is proposed. Finally, similar studies in the sector would be useful, to compare the significant determinants. Further research into the issue of mutual trust in the context of offshoring processes is recommended.

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# Responsibility in the activities of transnational companies

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## Abstract:

The activities of transnational corporations bring many benefits, but also threats in the host countries and the world. The phenomenon of CSR, SRI and FT has been growing rapidly in recent years. The objectives of the article are: a description of the participation of transnational corporations in raising the level of stratification of society in the rich North and the poor South as well as an analysis of processes related to liability and justice – Corporate Social responsibility (CSR) and Socially responsible investing (SRI), including the concept of Fair Trade (FT) 3.0. Descriptive method was applied in respect to the first goal, in the case of second objective, the phenomena of CSR, responsible investing and Fair Trade 3.0. were examined and described. This study confirms prior voices that it is necessary to develop a new economy – the economy of social development – oriented to increase the standards of living and prosperity, and to stimulate economic growth and social development influencing positively the reduction of social inequalities. The originality of this work lays in proposal a new concept of Fair Trade 3.0 and indicates its theoretical assumptions. This is new concept of foreign trade is based on responsibility “towards others” and “for others”.

**Keywords:** transnational companies; CSR; Fair Trade; responsible investment

**JEL codes:** F23, M14, F14

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*“There is one and only one social responsibility of business – to use its resources and engage in activities designed to increase its profits so long as it stays within the rules of the game, which is to say, engages in open and free competition without deception or fraud”.*

– Milton Friedman

## 1. INTRODUCTION

In the era of globalisation and internationalization of enterprises, the liberalization of international trade and the removal of barriers to international flows of goods, services, capital and people growing division of the world into countries of the rich North and the poor South (Mbaruku, & Mutalemwa, 2015; Ulman, & Šoltés, 2015). North are economically developed countries with democratic traditions, characterized by a high standard of living, but with the demographic challenges of an aging population. South are economically undeveloped countries, often affected by poverty, low and often decreasing standard of living, threatened anarchy, wars or conflicts. The observed disparities in economic potentials, technological and civilization of these two parts of the world are the cause of imbalance and a huge disproportion relationship. Also growing criticism of the international financial institutions and transnational corporations (TNCs), which – especially since the outbreak of the financial crisis of 2008 – are regarded as organizations maintaining the current world order. In the face of these developments, tensions and threats in the activities of those entities are becoming more frequent ideas of responsibility and justice in business operations. The components of the described processes include, among others, corporate social responsibility (CSR), responsible investment (Socially Responsible Investment – SRI) and the movement of Fair Trade (FT).

The objectives of the article are: a description of the participation of transnational corporations in raising the level of stratification of society in the rich North and the poor South and an analysis of processes related to liability and justice – CSR and SRI, including the concept of Fair Trade 3.0. Descriptive method was applied in the first goal, in the case of second objective. Article provides an overview of selected literature, a description of the activities of TNCs and their impact on the processes of stratification of the population and the ideas of justice and accountability in the activities of those companies.

## 2. LITERATURE REVIEW

World literature presents numerous studies on the relationship between the transnational corporation's activities and an issue concerning CSR, SRI and FT. Table 1 shows examples of a synthetic summary of the selected studies results focused on this subject.

**Table 1.** Summary of research results focused on the relationship TCN's - CSR, SRI and FT

Reference	Subject	Conclusions
Garriga & Melé (2004)	Classifications the main CSR theories.	The findings suggest the necessity to develop a new theory on the business and society relationship, which should integrate 4 dimensions: instrumental, political, integrative and ethical theories.
Brammer, Jackson & Matten (2012)	Study the potential contributions of institutional theory to understanding CSR as a mode of governance.	Corporations may support a business case for a lot of activities resulting in what is commonly referred to as CSR. Business responds by reflecting and shaping institutions which govern the broader economic, social and political systems.
Jušcius & Snieška (2008)	Presentation the scheme of the formation of corporations' competitive advantages connected with CSR.	The role of CSR in the processes of competitive advantages formation on the academic ground, the following traditional models of competitive abilities analysis can be used: the model of five forces, the model of resource based approach and the model of network approach.
Jastrzębska (2012)	Connections between transnational corporations (TNC) and Fair Trade.	Bringing TNC into the Fair Trade system is a controversial issue, not always perceived positively. Concept of Fair Trade is aimed against the policies of giant TNC.
Forno & Graziانو (2014)	Social movements in the current economic crisis.	Description of analytical framework which will combine social movements and political consumerism theories by focusing on two basic dimensions: consumer culture and identity and organizational resources.
Dziawgo & Dziawgo (2015)	Selected aspects of CSR in the financial market.	After many years of CSR promotion on Polish financial services market – the level of knowledge and range expectations is low.
Capelle-Blancard & Monjon (2012)	Popularity of SRI in newspapers and academic journals.	The papers on SRI focus on financial performance, more research is needed on a conceptual and theoretical ground, in particular the aspirations of SRI investors and the relationship between regulations and SRI.
Child (2015)	Comparison of FT and SRI	Three hypotheses: the relation motivations hypothesis, the material interests hypothesis, and the organization of credibility hypothesis.
Zasępa (2013)	Effectiveness of investment in an index of socially responsible companies on the example of Polish Respect Index.	The analysis of rates of return and risk Respect Index compared to other Warsaw Stock Exchange main indexes indicates the achievement by companies applying CSR higher returns with lower risk.
Berry & Junkus (2013)	Study of importance of Socially Responsible Investing (SRI) for an investor.	Environmental and sustainability issues dominate as the major category associated with SR investing. Investors prefer to consider the SRI question in more holistic terms rather than using the exclusionary format favoured by most SRI funds.
Zysk (2015)	CSR, SRI and responsible tourism in Visegrad Group (V4).	Developing CSR, SRI and responsible tourism in Poland, the Czech Republic, Hungary and Slovakia can start a new era in fairer trade on the international level.
Rogowski & Ulianiuk (2012)	Analysis of the effectiveness of socially responsible investment.	Observed differences between the effectiveness of classic investment funds and SRI funds are small and / or statistically insignificant.
Bieler (2013)	The role of TNC in Free Trade and Fair Trade.	In the long-term the way production itself is organized, needs to be transformed. This will require completely different trade arrangements, challenging more fundamentally the capitalist social relations of production.
Rodriguez, Siegel, Hillman & Eden (2006)	Complex relationship between international business (MNEs) and society.	An agenda for additional theoretical and empirical research on politics, corruption and corporate social responsibility – three lenses on the MNEs.
Lund-Thomsen & Lindgreen (2013)	CSR in global value chains.	The drivers, main features, and conceptual underpinnings of CSR. Measures proposed in the new cooperation paradigm are unlikely to alter power relationships in global value chains.

Source: own study.

### 3. MATERIAL AND METHODS

In the face of – mentioned in the introduction – processes, tensions and threats in the global economy they are increasingly present the ideas of accountability and justice, also undertaken by transnational corporations. The objectives of the article are:

1. a description of the participation of transnational corporations in raising the level of stratification of society in the rich North and the poor South;
2. an analysis of processes related to liability and justice (CSR, SRI) – including the new concept of Fair Trade 3.0.

The author makes the following hypotheses: transnational corporates activity is an important factor affecting the deepening division of the world into rich and poor, companies will develop activities in the area of CSR (especially in Version 3.0) and SRI with a growing number of investors willing to trust companies that pursue a strategy based on a system of ESG factors (Environmental, Social, Governance) and indices that facilitate this type of choices. But in the area of FT (with growing turnover year after year) should be proposed new idea: foreign trade based on responsibility “towards others” and “for others” – Fair Trade 3.0.

In the article has been used statistical data available from annual reports of organizations dealing with the problems described here (EUROSIF, USSIF, Fairtrade International), data from UNCTAD and the report of The Fortune Global 500 Companies List in 2015.

### 4. RESULTS AND DISCUSSION

#### 4.1. TRANSNATIONAL CORPORATIONS, GLOBAL VALUE CHAINS AND SOCIAL INEQUALITIES

The today’s world economy is the interdependence of multiple systems and components. Globalisation in the economic sense is a global system of flows of goods, services, capital and people (Wach, 2014). We observe the growth of the phenomenon of internationalization processes of marketing, sales, production, logistics and distribution. Companies operating in this environment introduce and implement holistic strategies for global action on an international scale. Global value chains allow companies to specialize in the implementation of these processes where they are most competitive, which often means separation of the different stages of the production process geographically distant countries or regions. One of the elements described according to the relocation of actions taken by the company to produce and sell certain product or service (Porter & Kramer, 2006, pp. 78-92). Is distinguished by the following set of forms of relocation modules value chain enterprises (Oshri *et al.*, 2009, p. 15):

1. in-house sourcing – delocalisation of module value chain through internal ownership structure the company and the country in which it is located; it applies to greenfield investments, brownfield investments, joint ventures, strategic alliances, cooperation agreements;
2. outsourcing – delocalisation of the company's value chain module to an external provider located in the same country as an investor, the scope of analogous as in “1”;
3. offshoring – the delegation of the module value chain within the ownership structure of the company, but outside the country in which it is located; it applies to contracts for suppliers and cooperation;
4. offshore outsourcing – the transfer process and/or function of the value chain to an external provider located abroad, the scope of analogous as in “3”.

The activities of major market participants (transnational corporations and their foreign affiliates, banks, financial institutions and investment funds) brings many positive effects, such as reducing the distance of civilization, the impact on economic development, creating and liberalize international trade, increase competitiveness, the development of techniques and technologies, the creation of jobs, introduction of modern management methods and improving the quality of goods and services. On the other hand, the above-mentioned groups of companies are in a very special way responsible for your interactions with the countries of operation and for local communities, because they have a significant impact on the shape of the reality in which we live. Famous international scandals such as tax avoidance<sup>1</sup>, evasions, creative accounting practices (due to principle “greed is good” – guided by short-term benefits), overstating profits, manipulations of emissions in diesel engines (the latest Volkswagen’s scandal), giant billions in violation of tax laws in Luxembourg, environmental devastation and destruction of livelihoods of the population (last deforestation in Indonesia; it has had massive environmental and social impacts), human rights violations, deliberate bad risk assessment or creating fraudulent financial instruments. Often companies intentionally causing local conflicts (especially in the fight for access to natural resources), deprive wages, acquire land and crops (coffee, cocoa, bananas), they did not consult its activities with local communities, and in the case of litigation do not pay court-awarded damages – which in turn leads to a deepening social inequalities and deterioration in the standard of living societies. Transnational corporations and their affiliates generate approx. 70% of the turnover of world exports and imports (UNCTAD, 2015), often their revenues exceeds the average GDP of countries<sup>2</sup> – it is impossible not to notice the correlation between the activity and the reality of the entities described economic, political, social and ecological modern world.

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<sup>1</sup> Corporations avoiding paying corporate income tax in Poland might deprive even 46 billion PLN annually, according to a report for the European Commission (European Union, 2015).

<sup>2</sup> For example GDP in 2014 (billions USD): Norway – 499, Austria – 437, Iran – 416, Thailand – 405; revenues in 2014 (billions USD): Walmart – 485, Sinopec Group – 447, Royal Dutch Shell – 431, China National Petroleum – 428 (Fortune, 2015; UNCTAD, 2015).

As already mentioned the activities of these powerful – as demonstrated above – companies leads to social inequalities in the world and worsens the living standards of populations and living conditions. Rich corporations changing their business strategies, cost, wage (and pricing models) and with effective use in practice the idea of accountability and justice could affect even a small increase in real incomes the poorest sections of societies.

#### **4.2. JUSTICE AND ACCOUNTABILITY IN THE ACTIVITIES OF TRANSNATIONAL CORPORATIONS**

Because of the actions of corporations in the mortgage market, speculations financial institutions and excessive creation of money by the banks appeared the global financial crisis of 2008-2010. It changed the system of economic forces in many economies and infringed the balance of global economic relations. This situation calls to ask questions about the goals of further development of the economies and the roads leading to the realization of these tasks. Times of crisis and recession, most often tend to in-depth analyses about the role of companies operating globally. Part of transnational corporations realizes that the higher position in the global market also increases their responsibility for the environment and relations with stakeholders. In order to improve these relations and improve its image of a company involved in the promotion of such forms of action as corporate social responsibility (CSR), investment socially responsible (SRI) and in its doings take into account created by the International Community Fair Trade movement (Fair Trade). What is important – consumers (and stakeholders) have become more aware of the possibility of corporations and their impact on the environment. Consciously they began to require economic operators a fair, transparent and ethical code of conduct – instead prefer to purchasing goods, using the services and investing in the assets of those companies that take into account the proposals discussed in their business strategies. Hereby the customers have an impact on the development of the economy.

The latest form of corporate social responsibility is the idea of CSR 3.0, which further broadens the activities of companies. Version 3.0 has evolved from classic CSR activities (CSR 1.0) with idea “good behavior, because it is good” and from CSR 2.0 with the concept of responsibility for promoting joint relations with customers and suppliers (Garriga & Melé, 2004, p. 54; Brammer *et al.*, 2012, p. 4; Jušcius & Snieška, 2008, p. 36). In the concept of CSR 3.0 there are no longer local initiatives undertaken within the framework of good cooperation with local governments, but global cooperation corporations, governments and international organizations to create new commercial connections, as financial and social. Partnership "state – corporation – NGO" as a determinant CSR 3.0 gives synergies and aims solution described in this paper problems of inequality on a global scale. In case of a financial crisis in 2008-2010, the effects of which are felt to this day, governments reduced their involved in activities to improve the quality and standard of living in the poor countries of the South and allocated funds to stabilize their

economies. Corporations have decided to fill the gap in the activities of governments and non-governmental organizations, however, is not just a philanthropic activity, as part of the CSR strategy 3.0. Taking into account the rapidly changing market, corporations want to create links with insignificant today, customers who in the future may become an important business partner. An example of partnership between the state – corporates action in the US, where the project is implemented in the field of energy under the name "Power Africa" (USAID, 2015). Project includes the collective resources of the US Government, African governments, the World Bank, the African Development Bank, the Government of Sweden, the European Union, the African Union, the United Nation's Sustainable Energy for All, and more than 100 private companies, e.g. Citi, General Electric, Goldman Sachs, JCM Capital, Nedbank, Shell, Standard Bank, Symbion Power. Another example of cooperation between corporations, governments and NGOs is the activity of The Climate Group. The Climate Group (2015) is an award-winning, international non-profit with offices in Greater China, North America, India and Europe. This organisation helps leaders to pass to a prosperous low carbon economy, driven by the rapid scale-up of clean and renewable energy. In September 2015 CDP<sup>3</sup> and The Climate Group released a report showing that over 170 major companies (e.g. Bloomberg, Dell, HP, IKEA, HSBC, Nike, Phillips, Procter & Gamble, CECEP), states, regions and cities around the world have committed to reducing their greenhouse gas (GHG) emissions by 80-100%, or procuring 100% of their power from renewable sources.

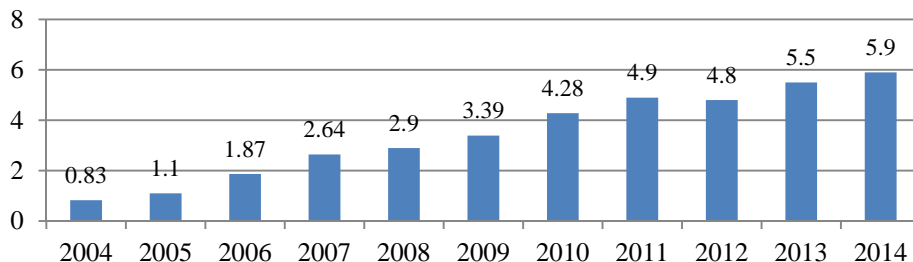
Since the nineties the twentieth century socially responsible investing is gaining popularity both in Europe and in the United States and other countries. According to data from European SRI Study 2014 (Eurosif, 2014), European Responsible Investing Fund Survey 2015 (KPMG, 2015) and Report on US Sustainable, Responsible and Impact Investing Trends 2014 (USSIF, 2015) in the years 2002-2014 SRI market size in Europe grew from 0.3 to 13.6 trillion EUR, and in the USA in the period 1995-2014 grew from 0.6 to 6.5 trillion USD (Zysk, 2015, p. 171). It is worth noting that investors who take into account the criteria of ESG factors (Environmental, Social, and Governance) in the structure of the investment portfolio, they need quality information about CSR strategy pursued by the company. An increasing number of socially responsible indexes is a result of growing interest in the topic of SRI (Capelle-Blancard & Monjon, 2012, p. 242; Berry & Junkus, 2013, p. 709). The purpose of such indices is to provide global standards for identifying the socially responsible, invest in them, and measuring their results in the area of economic, social and environmental. In addition, also they serve as part of facilitating investment decisions, and also allow minimizing the costs of acquiring information.

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<sup>3</sup> CDP (formerly the Carbon Disclosure Project) is a global not-for-profit organization, founded in 2000 and headquartered in London. It pioneered and provide the world's only global natural capital disclosure system where over 4,500 companies, representing over 50% of the market capitalization of the world's largest 30 stock exchanges, and 110 cities from 80 countries (CDP, 2015).



Companies aspire to qualify for social indices. This requires on their part undergo voluntary social audit, and what that entails making available a range of information, the involvement of significant resources, properly prepared staff and time. The company's membership to socially responsible index confirms its social orientation and the desire to build long-term value for shareholders, taking into account the social aspects. There is an increasing number of indexes in the world, which role is to promote and disseminate the essence of corporate social responsibility. Among socially responsible indexes we should mention the Dow Jones Sustainability Indexes (the world's first stock index listing of socially responsible companies, specifies 10% leading companies in the field of sustainable development of the 2500 world's largest corporations belonging to the Dow Jones Global Total Stock Market Index), The MSCI KLD 400 Social Index (the world's first American index based on ESG criteria, includes 400 companies<sup>4</sup>), the FTSE4Good Index (designed to measure the performance of companies demonstrating strong ESG practices), and The Ethibel Sustainability Index (contains a variable number of shares from companies that are included in the Russell Global Index and display the best performances in terms of CSR, the index collects companies from Europe, North America and Asia Pacific.). These indices are authoritative and consequently are the most commonly used in making an investment decision (Rogowski & Ulianiuk, 2012, pp. 64-81) and they are becoming more and more popular, as evidenced by the above-cited data.



**Figure 1.** Fair Trade turnover worldwide in 2004-2014 (in billion EUR)

Source: author's calculations based on Fairtrade International Annual Reports, years 2003/2004-2014/2015 (WFTO, 2016).

The Fair Trade movement promotes the idea of fair rules of the game in the area of international trade (Mohan, 2010, p. 19). The phenomenon of Fair Trade becomes the impetus to liberalization of access to markets in rich countries of North and covers more and more countries around the world (Moore, 2004, pp. 73-84; Dragusanu *et al.*, 2014, p. 220). The international Fairtrade system includes three producer networks, 25 Fairtrade organizations, Fairtrade International, and FLO-CERT, the independent certification body of the global Fairtrade system (Fairtrade,

<sup>4</sup> Founded as Domini 400 Social Index in 1990.

2015). According to a recent report “Global change, local leadership, Annual Report 2014-2015” prepared by the organization Fair Trade International in 2014 customers in more than 125 countries developed economically spent on Fair Trade products (32,000 types of goods) for 5.9 billion EUR. This is an increase compared to 2013 by 10%. Figure 1 shows the change in sales of goods FT in the world in 2004-2014.

Turnover of Fair Trade goods in the world from 2004 to the end of 2014 was almost seven times larger (from 0.83 billion to 5.9 billion EUR).

FT creates opportunities for economically disadvantaged producers, ensures no child labour, forced labour and good working conditions. One of the basic principles is respect for the environment (WFTO, 2015). The Fair Trade market has many documented benefits for a farmer, including a guaranteed floor price and access to credit. In the initial phase of development of the Fair Trade movement one could reach conclusions that besides the fight against unfair practices by corporations selling fair products was not associated with activities of these companies. However, it turned out that corporations have opted to join this rapidly growing movement instead of an active struggle against him. Preferred care about their positive image than entering into conflict. There are situations when companies use the Fair Trade mark only for marketing purposes, i.e. bring to market several products with the symbol of FT, thereby building their own ethical face of the brand, but the rest of the production run in a manner that contradicts the principles. Sometimes there is also the use of double standards – certification includes manufacturers, but does not include employees' rights in supermarkets and coffee networks that sell a product Fair Trade<sup>5</sup>.

FT growth shows the commercial viability of an approach to business based on transparency and respect. Purchasing Fair Trade goods gives consumers a direct way to help reduce poverty around the world. It's more than just trade. It's about relationships between buyers and sellers – let's call this model Fair Trade 1.0. However, the branding and mass production of the FT labels has made it difficult for the market to retain the solidarity connection between producers and consumers. It has been unable to create the kind of economic independence necessary for farmers to escape from periodical debt. Nowadays, fair trade labels are often employed simply to target ethical consumerism, and they seldom reflect a sincere relationship between producers and consumers. So – at West Virginia University (WVU) in the USA – appeared the idea to use the coffee industry as a tool for promoting international solidarity and cooperative development. It was decided to call this initiative WVU Fair Trade 2.0 (WVU Fair Trade, 2015). The project concept involves direct cooperation between with cooperatives from Central American countries that produce coffee, co called “First Hand Coffee”. The group is now selling the coffees under the label First Hand Coffee at multiple retail locations on the WVU campus, through a partnership with the university's dining services department. The concept

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<sup>5</sup> The outstanding challenge for Fair Trade is to harness the corporate conscientisation evident in initiatives like the Starbucks-backed Fairtrade Access Fund (Bowen, 2013).

of “First Hand Coffee” shows that producers not only receive a base price above that offered by fair trade labelling, but that the large percentage of profits normally allocated for marketing and branding (around 80%) is instead absorbed by volunteer labour and reinvested into coffee producing communities.

This is definitely a small – although lofty – local initiative, but has affected the author's idea for a new concept: Fair Trade 3.0. Assumption idea is to exclude intermediaries (which are often transnational corporations) and use in the development of responsible international trade in so-called “power of big cities”. According to the AT Kearney report “Global cities. The race accelerates” more than half of world’s population lives in cities, and by 2025 that number is projected to reach 60 % (ATKearney, 2015). According to the McKinsey Global Institute “Urban world: Mapping the economic power of cities” from 2011 only 600 urban centres generate about 60 % of global GDP (McKinsey & Company, 2011). While 600 cities will continue to account for the same share of global GDP in 2025, this group of 600 will have a very different membership. Over the next 15 years, the centre of gravity of the urban world will move south and, even more decisively, east.

Theoretical assumptions of the project Fair Trade 3.0 are as follows:

1. the greatest cities in the world use their strength (“power of big cities”) and begin to cooperate with manufacturers of the products Fair Trade;
2. there are created urban companies (for example companies dealing with energy, water, litter) and they trade FT goods delivering them directly to end users in schools, universities, local institutions and offices or ordinary customers (e.g. vending machines for coffee, cocoa, bananas, flowers, tea or juice);
3. it is used volunteer and student placement as a form of public education, as well as prison labor as a kind of re-education;
4. producers receive a good base price above that offered by fair trade labelling and transnational corporations;
5. in the further municipal companies would form joint ventures with producers in poor countries of the South, would be organized a system of certification and own logistics (TSL industry).

So organized process would exclude many traders (wholesalers, retailers) and as a result would be profitable for all parties of the transaction. This is new concept of foreign trade based on responsibility “towards others” and “for others”. Author of the concept realizes that the idea requires the creation of accurate pricing models and calculations; they will be the subject of further research.

## 5. CONCLUSIONS

The world economy at the present time is a system of connected vessels. The processes of globalization and internationalization of business activities resulted in rapid growth of transnational companies. Methodology of planning and organization of production, management methods and creating strategies has been changed, which gave effect to increase productivity and maximize profits. In addition to the

many positive effects of the phenomena there are also negative effects of these processes: opening of the income shears, impoverishment of a large part of the world's population, expansion of the disparities between the countries of the rich North and the poor South and the degradation and over-exploitation of the environment.

One of the many proposed solutions – which can be identified as a result of this article – aimed at eliminating these disparities are: the development of corporate social responsibility, responsible investment and promote Fair Trade movement (maybe the concept of FT 3.0) – especially in times of economic crisis. The crisis has deepened the unethical behaviour of transnational corporations, no sense of responsibility for their decisions, excessive desire to get rich at any cost, ordinary theft and fraud. It is worth to remember requirements of the new economy – the economy of social development – oriented in business practice on increasing the standard of living and prosperity, and which stimulates economic growth and social development influences the reduction of social inequalities. The author is fully aware that concept of Fair Trade 3.0 is not scientifically justified - this issue will be the subject of further research.

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# Regulatory framework as the primary reason for (no)internationalization of SMEs

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## Abstract:

The objective of this article is to identify the barriers in regulatory frameworks that affect SMEs and entrepreneurs' participation in the international markets. The idea was to analyse how regulatory framework affects an internationalization of Small and Medium Enterprises (SMEs). Member states differ significantly in the way in which they regulate the establishment of new businesses. The reduction of legal burden in European Union is a top-priority not only for the European Commission but also for national legislators. A competitive and dynamic economy requires an adequate regulatory framework so a business friendly environment for existing and potential small and medium-sized entrepreneurs must stay one of the European Union's main objectives. The contribution of this article is to analyse how regulatory frameworks affect the internationalization of Small and Medium Enterprises (SMEs) and suggest ways to overcome the barriers to SMEs and entrepreneurs' participation in the international markets.

**Keywords:** small and medium-sized enterprises (SMEs); regulatory framework; internationalization; legal form; freedom of establishment

**JEL codes:** K2, K20

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## 1. INTRODUCTION

European internal market and globalization process have erased the barriers of trade, developed competitive environment and made significant changes on entrepreneurial enterprises. Theory defines business enterprises in terms of small and medium enterprises (SMEs) on the one hand and large enterprises on the other. With their specifics, SMEs differ significantly from large enterprises.

According to the latest Annual report on European SMEs of European Commission, small and medium-sized enterprises (SMEs) represent more than 90% of all businesses in the EU, and form the backbone of a European Union's economy.<sup>1</sup>

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<sup>1</sup> Same Annual Report shows that in 2014 SMEs accounted for 99.8% of all enterprises in the non-financial business sector in the EU28. For every km<sup>2</sup> of land surface, the EU has an average of five SMEs. Moreover, in 2014 SMEs employed almost 90 million people – 67% of total employment, and generated 58% of the sector's value added.



The market for small and medium-sized enterprises (SMEs) worldwide plays a key role in shaping and developing the economy (Rozstek, 2015). Support for SMEs is one of the European Commission's priorities for economic growth, job creation and economic and social cohesion (McLaughlin, 2013, p. 29). On average about 13% of all SMEs in the European Union invest abroad but due to their size, SMEs realize additional challenges when doing business abroad (Eckard & Kerber, 2013, p. 3).

Considering Internationalization as an important means of enhancing SMEs' long-term growth and survival, the objective of this article is to identify the legal and administrative barriers in regulatory frameworks that affect SMEs and entrepreneurs' participation in the international markets. The reason for studying regulatory frameworks impact on the internationalization SMEs is the fact that the regulation of entry, as one part of the Economic regulations, is in the TOP 10 burdensome EU laws identified by SMEs (European Commission, 2013).

The structure of the article is as follows. After defining small and medium enterprises (SMEs), in section three, the article analyses the role of SMEs in national and international economy and detects administrative and legal burdens for internationalization process of SMEs. As earlier said European Union's regulatory framework for small and medium enterprises showed to be one of the burdens for internationalization of SMEs and many Member States already adapted their legislative frameworks to the requirements of entrepreneurs.

For the purpose of this article, author compares existing empirical studies on how the regulation of entry affects doing internationally business of SMEs and in addition, author does a descriptive overview of SMEs Exporting Landscape in selected countries.

The contribution of this article is to analyse how various European regulatory frameworks affect the internationalization of Small and Medium Enterprises (SMEs) and to suggest ways to overcome the barriers to SMEs and entrepreneurs' participation in the international markets. Conclusion brings analysis of the latest European Commission's regulation proposal for business friendly regulatory framework.

## **2. MATERIAL AND METHODS**

For the purpose of this article, it is made a descriptive overview of small and medium sized enterprises role in national and international economy through the number of employees in SMEs and their contribution in national and European Union's GDP. The EU Commission, Eurostat and data available in recent literature are used in the article. For the definition of small and medium sized enterprises qualitative and quantitative methods are used. Then, the author analyses and compares the theoretical literature to identify regulatory burdens for small and medium sized enterprises internationalization but also to answer the question does the legal form effects the internationalization of SMEs.

At the end, the article analyses the latest European Commission's regulation proposal for business friendly regulatory framework.

### 3. LITERATURE REVIEW AND THEORY DEVELOPMENT

There are two main strands of literature dealing with the problem addressed in this article: the literature on SME internationalization and the literature on corporate law. The literature on SME internationalization mostly deals with defining SMEs and reasons pro and contra internationalization of SMEs (Singer & Alpeza, 2015; McLaughlin, 2013, Calabro et al., 2009; Mohanty & Nandi, 2010; Molyneux, 2015) The literature on corporate law deals with legal forms of SMEs<sup>2</sup> and legal burdens for internationalization of SMEs (Becht et al., 2008; Djankov et al., 2002; Djankov, 2009; Eckardt, 2014, Purnhagen & Rott, 2014). The article is in the spirit by Becht et al. and Djankov et al. (2008) as well as by Eckardt (2014). Becht et al. (2008) studied how the decisions of entrepreneurs of where to incorporate affects deregulation of corporate law, while Djankov (2009) presents data on simplifying entry regulation of entry in 116 countries.

The main hypothesis thus states that friendly regulatory frameworks have a positive impact on internationalization of SMEs and that countries with low cost of business entry are more attractive for entrepreneurs. (H1) First, to define small and medium sized enterprises, it is necessary to make survey of the literature on SME internationalization and then the literature on corporate law.

**Table 1.** Classification criteria of micro, small and medium-sized enterprises

Enterprise category	Number of employees	Annual turnover (EUR million)	Annual balance sheet total
	EU/Croatia	EU/Croatia	EU/Croatia
Micro	< 10	≤ 2	≤ 2
Small	< 50	≤ 10	≤ 10
Medium-sized	< 250	≤ 50	≤ 43

Source: adapted from: Singer & Alpeza (2015); McLaughlin (2013); OECD (2005, p. 17).

There are similar definitions of the term SME. The European Union defines SMEs as micro, small and medium sized enterprises' (making it an odd abbreviation since the introduction of the 'micro' category) (European Union, 2003, p. 36). The three criteria used by the EU to assess whether an enterprise is micro, small or medium-sized are the number of employees (or headcount), the annual turnover (the sum received for goods and services in a year) and the annual balance sheet total (the total value of the assets or property of the enterprise, less the amount it owes), (McLaughlin, 2013, p. 29; Singer & Alpeza, 2015, p. 11). Table 1 shows classification criteria of small enterprises in European Union and Croatia<sup>3</sup> as the small and open economy and the youngest European state member.

<sup>2</sup> With special accent on Limited liability legal form.

<sup>3</sup> Criteria for classification of entities in the small and medium enterprise sector in Croatia are defined by the *Accounting Act* (Official Gazette, NN 109/07, 54/13) and the *Small Business Development Promotion Act* (Official Gazette, NN 29/02, 63/07, 53/12, 56/13).

According to above-mentioned criteria, a micro enterprise is defined as an enterprise that employs fewer than ten persons and whose annual turnover and/or annual balance sheet total, does not exceed two million EUR.

A small enterprise is defined as an enterprise that employs fewer than 50 persons and whose annual turnover and/or annual balance sheet total, does not exceed ten million EUR. A medium-sized enterprise is defined as an enterprise that employs fewer than 250 persons and whose annual turnover does not exceed 50 million EUR or whose annual balance-sheet total does not exceed 43 million EUR.

### **3.1. THE ROLE OF SMES IN NATIONAL AND INTERNATIONAL ECONOMY**

Small and medium sized enterprises play significant role in national and international economy. Despite last financial crises, employment in the SME sector remains positive and it can be said that in the twenty-first century to date, in the EU, new jobs have been created primarily by SMEs, not by large companies.<sup>4</sup>

In the European Union, SMEs account about 99% of all business enterprises and 67% of all employment. McLaughlin (2013, p. 29) represents data that this figures in the UK are 99.9% and 59%, although, pointing out that we must take care in interpreting the figures, as they are not directly comparable due to different underlying methodologies used to compile them. Similar data brings Buliga (2014, p. 5) saying that 99% of all German enterprises are small and medium-sized and they employ about 60.7% of the working population. According to the German Federal Ministry for Economic Affairs and Energy and „AG Mittelstand“, SME sector in Germany created a total of 250 000 new jobs in 2014 (Federal Ministry for Economic Affairs and Energy, 2016).

Table 2 is overview of SMEs in the private business sector, number of their employees and value added in selected European countries in context of SMEs role in national economies.

As seen from the statistics, Small and medium sized enterprises create most of all new jobs in Europe, and they contribute significantly to economic growth.

The good condition of SMEs affects the state of the overall economy both locally and globally (Rozstek, 2015) Globalization has faded the barriers of trade and development and made a competitive environment for SMEs (Mohanty & Nandi, 2010). Many SMEs have discovered that online sales present opportunities for exporting and are finding innovative logistical solutions to reach global customers (UPS, 2014, p. 7). Table 3 brings out an overview of SMEs Exporting Landscape in selected countries.

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<sup>4</sup> According to the Annual Report of European SMEs 2014/2015, the tentative green shoots of growth of 2013 gained in strength in 2014. Namely, in 2014 EU28 SME value added grew by 3.3% and employment by 1.2%, while in 2013 value added grew by 1.6% and employment declined by 0.5%. However, not all Member States shared the positive 2014 experience – SMEs in Cyprus, Sweden, Croatia, Greece, Italy and the Czech Republic showed a decline in value added, which in the case of Cyprus and Italy was also accompanied by a reduction in employment.

As it can be seen, small and medium sized enterprises in Belgium, the United Kingdom, and the Germany send the highest number of shipments outside the European Union. The United States is the most likely export country destination for

**Table 2.** SMEs and national economy in 2015

Country	Criteria	SMEs (in all businesses)	National employment	Value added
Austria		99.7	67.7	61.2
Belgium		99.8	69.3	61.4
Germany		99.5	62.7	54.4
Croatia		99.7	67.9	54.1
Italy		99.9	79.6	69.5
Poland		99.8	50.0	68.8
Slovenia		99.8	72.7	63.0
United Kingdom		97.7	51.0	53.0

Source: own study based on: Singer & Alpeza (2015); European Commission (2015).

SMEs shipping outside Europe. Among those exporting outside Europe, 53% are exporting to the United States, 49% to countries in Europe outside the EU and 47% to Asia. The United States is the top-ranking export country for SMEs in the UK (54%), Belgium (40%), and Italy (40%). (UPS, 2014, p. 11)

**Table 3.** The number of SMEs shipping

Country	Inside EU / %	Outside EU / %	Total / %
Belgium	96	75	171
Germany	81	14	95
Italy	16	4	20
Poland	18	1	19
United Kingdom	90	43	133

Source: adapted from: UPS (2014, p. 10).

### 3.2. INTERNATIONALIZATION OF SMES

Internationalization has been defined as “the process by which firms both increase their awareness of the direct and indirect influence of international transactions on their future, and establish and conduct transactions with firms in other countries” (Bearnish, 1990, p. 77, in: Calabro et al., 2009, p. 395). Traditionally, way of making individual companies present worldwide was export and import. Another ways of internationalization SMEs are alliance or subsidiaries and branches and joint ventures abroad (Mohanty & Nandi, 2010; European Business Development Group, 2016).

Thinking about the internationalization of SMEs, the question is what are the motives for internationalization of SMEs? Many SMEs view Europe as the new domestic market and are now looking for markets further afield. Therefore, we can say that access to new and larger markets is the main reason for internationalization

by SMEs that export or have establishments abroad. For SMEs that have only imports, this access is not a more frequent motive than access to know – how and technology, or high production costs on the domestic market. Still, not of all SMEs tend to be international and there are two main reasons for that. One of the reasons for no internationalization of SMEs is the fact that external barriers are too high.

Currently, there are 21 million SMEs in Europe, and even though 25% of European SMEs export to countries within the European Union, only 13% does business outside the European border. Speaking about burdens, they can be divided in internal and external. For the purpose of this article, the focus is on external burdens only.<sup>5</sup>

The regulation of entry, as one part of the Economic regulations, is in the top ten burdensome EU laws identified by SMEs.<sup>6</sup> Last global financial crisis has brought changes in Europe's financial regulatory framework that also led to financing problems for SMEs. Their situation further complicates the European economic crisis, which led to a fragmentation of financial markets in the euro area. Belke and Verheyen (in: Calciano et al., 2015) deal with the new tools for the financing of SMEs, which face problems such as information asymmetries, when trying to access funding.

### 3.3. REGULATORY FRAMEWORK AS BURDEN FOR INTERNATIONALIZATION OF SMES

Countries differ significantly in the way in which they regulate the entry of new businesses<sup>7</sup> (Djankov et al., 2002). Size, to some extent, determines the legal rules applicable to a company registered under the Companies Acts and to an LLP.<sup>8</sup> (McLaughlin, 2013)

As earlier said, registration (or cost of entry), as one part of the Economic regulations, is in the top ten burdensome EU laws identified by SMEs. When surveying the regulation of entry Djankov et al. (2002) came to the following conclusions: The number of procedures required to start up a firm varies from the low of two in Canada to the high of 21 in the Dominican Republic, with the world average

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<sup>5</sup> Available results show that more than 30% of the internationalized SMEs perceive no internal barriers for the internationalization process at all.

<sup>6</sup> The following EU laws have been identified by SMEs as the TOP 10 most burdensome EU laws: REACH (Registration, Evaluation, Authorisation and Restriction of Chemicals); VAT – Value added tax legislation; General Product Safety and market surveillance package; Recognition of professional qualifications; Shipments of waste – Waste framework legislation – List of waste and hazardous waste; Labour market-related legislation; Data protection; Working time; Recording equipment in road transport (for driving and rest periods); Procedures for the award of public contracts (public works, supply and service contracts); Modernised customs code.

<sup>7</sup> To meet government requirements for starting to operate a business (in 2002.) in Mozambique, an entrepreneur had to complete 19 procedures taking at least 149 business days; an entrepreneur in Italy needed to follow 16 different procedures, and wait at least 62 business days to acquire the necessary permits. In contrast, an entrepreneur in Canada could finish the process in two days and completing only two procedures.

<sup>8</sup> The Companies Act 2006, for example, applies less rigorous public disclosure and audit requirements to small and medium-sized companies, as those terms are defined in the Companies Act 2006 (as amended and supplemented by the Companies Act 2006 (Amendment) (Accounts and Reports) Regulations 2008 (SI 2008/393).

of around ten.<sup>9</sup> The minimum official time for such a start-up varied from the low of two business days in Australia and Canada to the high of 152 in Madagascar, assuming that there are no delays by either the applicant or the regulators, with the world average of 47 business days. A large academic literature has followed: 201 academic articles have used the data compiled by Djankov et al. (2002) and subsequently by the World Bank.

Simplifying entry regulation has been a popular reform since the publication of Djankov et al. (2002). In the context of burdens to the internationalization of SMEs, it should be noted that 193 reforms took place in 116 countries (Djankov, 2009, p. 183).

Limited liability legal form plays an important role in supporting entrepreneurial activities. Private limited enterprises account for nearly 60% of all SMEs in the EU-28. SMEs react to incentives resulting from differences in minimum capital requirements in different member states (Eckardt, 2014). Some of significant regulatory reforms of corporate law, made for that reason, were those in United Kingdom's Company Act 2006, Germans "Gesetz betreffend die Gesellschaften mit beschränkter Haftung (GmbHG)" in 2008, but also the other European countries such as Spain, Austria, France and Croatia. The reforms were in field of company law and regulation of the most used legal form SMEs – Private limited company (Ltd.).<sup>10</sup> Becht et al. (2008) as well as Eckardt and Kerber (2013) found empirical evidence that companies migrate to member states with lower costs of establishing a limited liability enterprise.

To this end, through the Small Business Act<sup>11</sup>, European Commission proposed a number of measures to support SMEs in general as well as concerning internationalization (Eckardt, 2014). Knowing that SMEs can thrive best in a business environment in which regulation respects the specific needs of SME, the European Commission has put the interests of SMEs into the core of its smart regulation agenda. The Commission follows the "Think Small First" principle, which requires that impacts on SMEs be taken into account when designing legislation and that the existing regulatory environment be simplified so that SMEs find it easier and cheaper to comply with regulatory requirements (MEMO/13/68). One of the latest documents for business friendly environment is Regulatory Fitness and Performance Programme (REFIT), which implement 164 initiatives for simplification and regulatory burden reduction identified by the European Commission.

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<sup>9</sup> The survey contained data on the regulation of entry of start-up firms in 75 countries including numbers of procedures, official time and official cost that a start-up must bear before it can operate legally.

<sup>10</sup> German: Gesellschaft mit beschränkter Haftung (GmbH), Croatian: društvo s ograničenom odgovornošću (d.o.o.).

<sup>11</sup> The Small Business Act (SBA) is an overarching framework for the EU policy on Small and Medium Enterprises (SMEs). It aims to improve the approach to entrepreneurship in Europe, simplify the regulatory and policy environment for SMEs, and remove the remaining barriers to their development.

#### 4. DISCUSSION

SMEs with international business show a significantly better performance in job creation, turnover growth and to innovation related activities. Statistics show that on average 44% of SMEs in the 28 European Union member states are engaged in international business activities in some form or another. Descriptive overview of SMEs exporting Landscape in selected countries showed that exports outside the European Union lead Belgium, the United Kingdom and the Germany. In all of these international SMEs, 90% are micro enterprises, 8% are small enterprises and 2% are medium-sized enterprises (Eckardt, 2014).

In doing business, entrepreneurs select countries with business friendly legal framework. The regulation of entry, as one part of the Economic regulations, is in the top ten burdensome EU laws identified by SMEs. Reducing the regulatory burden on smaller firms is the first step in making business friendly environment for SMEs. As Eckardt (2014) points out, SMEs react to incentives resulting from differences in minimum capital requirements in different member states. Becht et al. (2008) and Eckardt and Kerber (2013) found empirical evidence that companies migrate to member states with lower costs of establishing a limited liability enterprise.

Although many Member States already adapted their legislative frameworks to the requirements of entrepreneurs, simplifying the legislation and reducing the regulatory costs on the European level is necessary in order to achieve a clear, stable and predictable regulatory framework that will support economic growth and job creation.

In accordance with the REFIT, and to implement the SME initiatives and reforms, countries are reducing paperwork and bureaucracy, minimising administrative burdens and reducing compliance costs for SMEs. Still, all reforms should be made with great caution. Researches show that the best economies are not those with little regulation but those with good rules that allow efficient and transparent functioning of businesses and markets while protecting the public interest.

#### 5. CONCLUSIONS

Small and medium sized enterprises form the backbone of national and European economy. European internal market and globalization process have erased the barriers of trade, developed competitive environment and made significant changes on entrepreneurial enterprises. Due to their size, SMEs realize additional challenges when doing business abroad. Although they represent more than 90% of all businesses in the EU, only 2% of all SMEs in the European Union invest abroad.

Member states differ significantly in the way in which they regulate the establishment of new businesses so the reduction of legal burdens in European Union is a top-priority not only for the European Commission but also for national legislators. The regulation of entry is one of the biggest legal burdens for internationalization of SMEs. Available statistics show that friendly regulatory frameworks have

a positive impact on internationalization of SMEs. European Commission but the national legislators also, are very active in resolving legal burdens for internationalization of SMEs.

The latest document for making business friendly regulatory environment is Regulatory Fitness and Performance Programme (REFIT), which implement initiatives for simplification and regulatory burden reduction identified by the European Commission. A competitive and dynamic economy requires an adequate regulatory framework so a business friendly environment for existing and potential small and medium-sized entrepreneurs must stay one of the European Union's main objectives.

If we really want to take advantages of all the potentials of SMEs in the international market, we must create legal framework with clear aim of supporting SME, creating jobs and facilitating investment. The latest reforms in the field of company law in many European countries made significant step forward. Also, it is necessary to consider that the implemented reforms should serve the improvement of the regulatory framework and not only its simplification.

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# The most influential factors in venture capitals' exit decision: A qualitative study among Spanish venture capitalists

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## Abstract:

The objective of this research is to determine and draw the attention of venture capitals toward the most important factors that they should consider for making a proper exit decision. A list of suggested influential factors in venture capitals' exit decision was extracted from the literature. The list is refined and developed by the Delphi method through three rounds of Delphi with a Delphi group composed of 15 Spanish venture capitalists. A list of the 14 most influential factors in an exit decision is developed and is divided into four categories (venture capitals, investees, entrepreneurs and external environment). Some of the factors have been neglected in previous studies and some seldom have been studied. It is recommended that venture capitals consider a combination of the suggested factors to make an exit decision. Also when making the exit decision, venture capitals should not only pay attention to the factors regarding themselves and the investee, but also they should consider the factors regarding the entrepreneurs and external environment. The research brings together different factors in venture capitals' exit decision from different categories, refines and develops them, and produces a precise and actionable list of the most important ones.

**Keywords:** venture capital; divestment; exit decision; Delphi method; Spain

**JEL codes:** G24, G32, G33

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## 1. INTRODUCTION

The investment process of venture capitals is divided into three general steps, pre-investment, post-investment and exit (De Clercq et al., 2006). Getting out of an investment is the natural end to any venture capital deal and finally a day would come that the venture capital would decide to divest and exit the deal (Zider, 1998) by selling its shares in it, partially or fully (Cumming & MacIntosh, 2003a).

According to Wall and Smith (1997) more than 70% of venture capitals have difficulty in determining the proper time of their exit from a deal; and this problem still keeps on straining venture capitals (Hege et al., 2009; Oehler et al., 2007; Cumming & MacIntosh, 2003b).

The main question of this research is: 'What are the most important factors which influence a venture capital's exit decision?' The main objective of this research is to determine and draw the attention of venture capitals toward the most important factors that they should consider for making a proper exit decision.

This research is a qualitative and applied one. It is done based on literature review and by using the Delphi method with a panel consisting of 15 Spanish venture capitalists.

In this article, first, the literature on venture capitals' exit decision is reviewed. During the review the factors which are considered influential in venture capitals' exit decision are highlighted. After that, the research method (the Delphi method) is first introduced briefly and then how it is used for conducting this research is described. Later on, the results are reported and commented on and finally conclusions are drawn and future research opportunities are suggested.

## 2. LITERATURE REVIEW

First of all, there are two jargons which their difference needs to be clarified to prevent any misunderstanding and mix-up before moving forward. It is important to have in mind that an entrepreneur is a person who comes with a business idea. An 'investee' is a legal entity (usually in form of a company) which has been started by one or more entrepreneurs to convert a business idea into a business, and has been invested in by others such as venture capitals.

Venture capitals are one of the most important financial sources for micro-enterprises and SMEs. Venture capitals invest in those types of companies not in the hope of an instantaneous gain, but hoping that those companies would grow and consequently their investment value would grow. For this reason, venture capitals prefer to invest in companies with fast growth potential (Kaliski, 2006).

A venture capital enters a deal in hope of great return on its investment, usually 10 to 20 times of its investment; but the venture capital would be still satisfied with 3 to 5 times of it. Anything under that would be considered as a 'sideways deal' which means a low quality and an inferior deal (Berkery, 2007, p. 70). But in any case, whether the investee succeeds to achieve its promise or fails to do so; at some point, the venture capital have to divest and collect its profit or accept its loss. This process of divestment is called 'exit' (Félix et al., 2014; Nadeau, 2011; Bienz & Walz, 2010; Gladstone & Gladstone, 2004, p. 9; Zider, 1998).

Cumming (2008) says a venture capital faces many challenges while going through the exit step. For example, there usually would be disputes and confrontations between the entrepreneurs and the venture capital in evaluating the investee's value when the time of exit comes. Also, severe information asymmetry against the venture capital, would negatively affect its ability to exit a deal; it especially makes it hard to exit the deal by an IPO (Amit et al., 1998) – which is the preferred type of exit for a venture capital in terms of return on investment (Gompers, 1995).

Scholars have identified and studied different factors which affect venture capitals' exit decision. Berkery (2007, pp. 178–211) mentions five major factors which influence the exit decision of a venture capital:

- possibilities of different exit options such as IPO, stock buyback, merger and acquisition;
- the investee's life cycle stage such as seed stage, early stage, formative stage, later stage, balanced stage;
- other investment opportunities that the venture capital is facing, such as access to better deals or lack of that;
- dividends of the venture capital's current shares in the investee;
- the venture capital's strategic decision to reduce its shares in the investee.

Puri and Zarutskie (2012) show that an 'investee's life cycle stage' is a significant factor in the investee's value; hence, it plays a major role in a venture capital's exit decision. Also, when an innovative company is small and near its beginning; it is less valuable than when it matures and commercializes its innovative ideas (Chemmanur et al., 2014). As the investee grows, although it gets more valuable but also its capital needs grows too; hence, the venture capital faces several options; it could continue and invest more or invites other venture capitals for a syndicated investment or exits.

Hawkey (2002, pp. 3-52) provides eight factors which have an impact on a venture capital's exit decision, which are:

- The 'why': the reason that the venture capital is seeking to exit the deal. This factor in Hawkey's opinion is also the most important factor and would consequently determine when and how to exit the deal. For example, the venture capital could be facing another more lucrative deal and be in need of cash to invest in that, or the investee is not growing according to the expectations and the venture capital prefers to cash in on its investment as soon as possible or the venture capital could be in conflict with the entrepreneurs.
- Value: does the chosen exit option maximise the venture capital's return on investment?
- Control: how much control does the venture capital has over the chosen exit's transaction? And furthermore, does the venture capital still want to keep some degree of control over the investee after the exit?
- Risk: how risky is the chosen exit's transaction?
- Financial expectations: how much does the chosen exit option fulfil the venture capital's expected financial gain?
- Gratification and satisfaction: how much does the chosen exit option satisfy the venture capital's non-financial expectations such as reputational incentives?
- Payment certainty: The probability that the venture capital be fully paid based on what is agreed upon with the buyer(s).

- Deal flexibility: How much flexibility the chosen exit would provide for the venture capital such as suitable payment terms and possibility of future involvement in the investee.

Kuratko and Hornsby (2009, p. 220) consider ‘continuous assessment of an investee’s performance and financial status’ to be a key factor in a venture capital’s exit decision. They also suggest that venture capitals should prevent reaching an emergency situation by periodically calculating ‘Altman Z-Score’ (Altman, 1968) to monitor possibility of bankruptcy in near future; in order to take the proper exit measures before an exigency happens.

Fried and Ganor (2006) examine the relationship between use of ‘venture capitals’ preferred stock and control rights’ and their exit decision. They found out that venture capitals are practical and opt toward an exit option which maximises their financial gains; and that is not necessarily the option which has the best consequences for the entrepreneurs. On the other hand, the exit process and its consequences have more importance for entrepreneurs. Thus, in case venture capitals have preferred stock and control rights, they tend to use them for taking an exit decision which leans toward their preferred exit option.

Also, the role of ‘contractual control rights’ is important in venture capitals’ decision to exit. Those rights come from the contract between a venture capital and entrepreneurs which is the legal basis of the deal. The amount of control that a deal bestows to a venture capital over entrepreneurs eventually affects the venture capital’s exit decision (Cumming, 2008; Smith, 2005; Bascha & Walz, 2001; Hellmann, 1998).

Existence of a ‘call or put agreement’ in a deal between a venture capital and entrepreneurs is another factor in the venture capital’s exit decision (Gladstone & Gladstone, 2004, pp. 286–289; Black & Gilson, 1998). A ‘call agreement’ is an agreement which obliges the venture capital to offer a pre-determined quantity of its shares to the entrepreneurs based on a pre-agreed timetable and pricing formula. However, the entrepreneurs are not obligated to execute their option, which in this case, the venture capital could keep the shares or offer them to other parties.

On the other hand, a ‘put agreement’ is an agreement which obliges the entrepreneurs to buy a pre-determined quantity of the venture capital’s shares based on a pre-agreed timetable and pricing formula. However, the venture capital is not obligated to execute its option, which means the venture capital could keep the shares.

Wang and Zhou (2004) show an increase in the ‘number of stages that a venture capital invested in an investee’ reduces the risk of a bad exit. Besides, another factor in a venture capital’s exit decision and choosing a proper exit option is the ‘investee’s age’ (Giot & Schwienbacher, 2007).

‘Entrepreneur’s satisfaction’ is another factor which influences the performance of an investee and consequently affects the venture capital’s exit decision (Wijbenga et al., 2007; Zahra, 1996).

Other factors which affect a venture capital's exit decision are:

- NPV (Net Present Value) of the investee and its deviation from the venture capital's previous projections and current expectation (Neus & Walz, 2005; Cumming & MacIntosh, 2001; Gompers & Lerner, 2001; McGrath, 1999; Gompers, 1995);
- the ability of the buyer(s) to help the investee's growth and development in the future and by that maintaining a positive image of the venture capital and adding to its credibility (Bayar & Chemmanur, 2012);
- the venture capital's social capital, network ties and especially its relationship with financial markets' players (Lungeanu & Zajac, 2015; Ozmel, Robinson, & Stuart, 2013; Hallen & Eisenhardt, 2012; Hochberg et al., 2007);
- the buyback ability of the entrepreneurs (Cumming & Johan, 2008; Cumming et al., 2005);
- the venture capital's experience (Giot & Schwienbacher, 2007; Cumming et al., 2006).

As it is obvious different authors have focused on different factors that affect a venture capitals' exit decision. What is missing in the literature is a study which first of all gathers all those factors in one place, and secondly, specifies the most influential one so it could be of practical use for the industry. This study aims to fill this gap.

The influential factors on venture capitals' exit decision which are scattered through the literature and are identified above are used to form a raw list which this research aims to refine and develops it into a multi-dimensional and clear-cut list of the most influential factors on venture capitals' exit decision.

### 3. MATERIAL AND METHODS

To answer the main question of this research – which is: What are the most important factors which influence a venture capital's exit decision? – and also to probe how theoretical and practical influential factors on a venture capital's exit decision relate to each other, a qualitative method that is called "The Delphi Method" was employed.

The Delphi method is based on collecting and converging the views of a group of experts in the study's subject (The Delphi Group) which is led and handled by a coordinator. The aim is to reach a consensus among the experts over the subject.

Consensus is achieved by going through a systematic process. The process starts with defining the problem by the coordinator and guiding the Delphi group's discussion, and continues by receiving the comments and views of the Delphi group members. The discussion is summarized by the coordinator.

Afterwards, the synopsis of the discussion and the comments is fed back to the Delphi group by the coordinator. This procedure of discussion, summarizing

and feeding back is called a “Round of Delphi”. The rounds of Delphi usually continue until there is a consensus among at least two-thirds of the Delphi group members on the subject at hand.

It should be mentioned that the quality of the Delphi method directly depends on the quality of the assembled Delphi group. Also, it is recommended to have at least 15 members in the Delphi group and with larger groups it gives better results (Hsu & Sandford, 2007; Linstone & Turoff, 1975; Dalkey, 1969). There are several weaknesses associated with the Delphi method such as being time consuming and possibility of getting more general answers than specific ones (Hsu & Sandford, 2007).

For this study, primarily a group consisting of three high-ranking Spanish venture capitalists were formed (High-ranking means that they were head of a venture capital firm or a senior manager in one). Then, they each were asked to introduce four more expert venture capitalists; and by adding those experts, the Delphi group with 15 members was formed. The researcher took the role of the coordinator.

First, the coordinator – based on the literature – made a list of influential factors in a venture capital’s exit decision. The coordinator then briefed the Delphi group on the research’s objective and main question; and then, they were asked to comment on the factors list. By applying the comments and suggestions, a primary list of factors were formed to start the rounds of Delphi with.

During each round of Delphi, first, the experts discussed the factors list and then graded them by assigning a mark (0 to 100) to each one of the factors. Also, they could suggest corrections or new factors. Those suggestions would be put to vote and the chosen ones would be applied to the list for the next round.

#### 4. RESULTS AND DISCUSSION

The finishing criterion of the rounds of Delphi was set to reach to a minimum of two-third consensus among the Delphi group members and absence of new suggestions; which by the end of the third round both conditions were achieved. A final list of 14 factors was agreed upon with a 73.1% average mark and also valuable commentary on them was accumulated during the rounds of Delphi. Table 1 summarizes those three rounds of Delphi.

**Table 1.** Statistics of the rounds of Delphi on influential factors in a venture capital’s exit decision

Indicator	First Round	Second Round	Third Round
Number of suggested addition / correction to apply for the next round	5	2	0
Final number of factors	7	12	14
Average mark	41.3	62.6	73.1
Changes in the average mark	-	+21.3	+10.5

Source: own study.

The final list of the 14 most influential factors in a venture capital's exit decision has been further distributed in four key categories which demonstrate different dimensions of the exit decision (Table 2).

The first noticeable point in the results is that venture capitals have detailed factors when it comes to making an exit decision. It is in the contrast with major part of the factors that are mentioned in the literature which are mostly pointing toward general factors. The results are not contradictory with the factors offered by the literature, but they are finer, more detailed and practical while the factors mentioned in the literature are general, conceptual and in some cases vague.

**Table 2.** Final list of the 14 most influential factors in a venture capital's exit decision

Factors' Category	Factors List
Factors regarding investees	<ul style="list-style-type: none"> <li>- NPV (Net Present Value) of the investee and its deviation from the venture capital's previous projections and current expectation (mark: 87),</li> <li>- the investee's life cycle stage and if it is passed its fast-growth stage (mark: 84),</li> <li>- comparison of the investee's performance with its updated business plan (mark: 72),</li> <li>- comparison of the investee's performance with the venture capital's quantitative and qualitative performance criteria (mark: 69),</li> <li>- assessment of the investee's financial status and it's Altman Z-Score (mark: 68).</li> </ul>
Factors regarding venture capitals	<ul style="list-style-type: none"> <li>- attractiveness of the venture capital's alternative investment opportunities in comparison with keeping the current investment (mark: 79),</li> <li>- the venture capital's access to financial resources and its cache requirements (mark: 74),</li> <li>- the venture capital's contractual control rights and existence of a put agreement (mark: 70),</li> <li>- availability of buyers who are interested in the investee (mark: 68).</li> </ul>
Factors regarding entrepreneurs	<ul style="list-style-type: none"> <li>- the buyback ability of the entrepreneurs and existence of a call agreement (mark: 75),</li> <li>- the entrepreneurs' potential in attracting more funds and their previous records (mark: 71).</li> </ul>
Factors regarding external environment	<ul style="list-style-type: none"> <li>- priorities and preferences of the venture capital's fund providers and the capital markets (mark: 72),</li> <li>- financial legal system (mark: 68),</li> <li>- changes in the market of the investee's products/services (mark: 67).</li> </ul>

Source: own study.

As it is shown in table 2, there are five factors regarding investees. It is important to consider that those do not solely depend on the entrepreneurs or the venture capitals, but they are the result of the cooperation between the entrepreneurs and all the venture capitals and other stakeholders involved with the investee.

An interesting result – which is not discussed in any previous study – is that a venture capital updates the initial investee's business plan based on the current realities of the investee and external environment, and takes this updated version of the business plan into consideration for making an exit decision.



Also, it should be taken into account that a venture capital's quantitative and qualitative performance criteria depends on many elements especially the source of its funds. Venture capitals that have more access to governmental funds have different criteria than the ones who have limited or no access to such funds.

Venture capitals which have access to governmental funds consider the government's strategic plans and non-profit objectives into their decision making process. For example, if the government is funding an especial industry, then the profit is less important as a criterion to the government than knowledge creation.

A venture capital considers if an investee is passed the fast-growth stage in its life-cycle. In this situation if there is not much possibility of a lucrative exit in the future (such as an IPO) then the venture capital prefers to exit and invests the earning into another deal with fast-growth possibility.

In the factors regarding venture capitals, 'attractiveness of the venture capital's alternative investment opportunities in comparison with keeping the current investment' means that in the same situation depending on what alternatives a venture capital has, it may or may not keep its shares in an investee. So, if there are not any better alternatives, a venture capital prefers to keep its shares in a weak investee.

Also, in case there is not any suitable buyer, a venture capital may prefer to hold on to its shares in a weak investee. In the factors regarding entrepreneurs, an entrepreneur's potential in attracting new funds and previous record is important to a venture capital. For example, venture capitals are more tolerant and patient with serial entrepreneurs than new entrepreneurs. Also, as another example, they are more tolerant with famous entrepreneurs who could attract new funds from other sources.

In the factors regarding external environment, changes in the market of an investee's products/services is influential in a venture capitals exit decision, which has been neglected in the previous studies. Some of the Delphi group members mentioned that they had had experiences of investing in investees with attractive products which later on, foreign cheaper products took their market and they had been forced to exit the deals.

## 5. CONCLUSIONS

Choosing the timing of an exit is one of the major concerns of venture capitals (Hege *et al.*, 2009; Oehler *et al.*, 2007; Cumming & MacIntosh, 2003b; Wall & Smith, 1997). They are hopeful to do it on the right time in the right manner to maximize their profit or minimize their loss. A review of literature shows that many factors could influence a venture capital's exit decision. Additionally, most of the literature has its focus on successful exits and unsuccessful exits and early exits have been studies less.

This research composed a comprehensive list of factors extracted from the literature and discussed them with a Delphi group of Spanish venture capitalists and finally arrived to a list of the 14 most influential factors, which some of them

were neglected by the literature or have been studied rarely. The factors regarding external environment which could affect a venture capital's exit decision seldom have been studied. And the same goes for studies of call or put agreements. Also, the results show that Altman Z-Score is an important factor that could help a venture capital to make an early exit decision. Based on the results, venture capitals are advised to consider a mixture of important factors regarding four different dimensions – themselves, the investees, the entrepreneurs and external environment – to make a proper exit decision. Also, they are strongly advised to pay more attention to external environment factors.

It should be considered that although the results does not seem to be location bound and country specific but, anyhow, the Delphi group was consisted of homogeneous members in the sense that all were Spanish venture capitalists, and that may have influenced the results although there is no clear indication of that. Also, it should be taken into account that the results not only are based on the thoughts and ideas of a group of Spanish venture capitalists but they are also affected by the reality of current economic situation of the country and the continent. Thus, further researches are required to show the degree of extendibility of the results to different places, times and situations. Moreover, based on this research and for the future studies, it is suggested that scholars consider prioritizing and weighing up those 14 factors. Additionally, designing a general model based on them could be helpful and valuable.

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# Health resorts as a social enterprise in Ukraine's economic development

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## Abstract:

Modern economic development is highly dependent on sustainable community development. In Ukraine, the tourism sector is one of the driving forces of economic development. The main aim of the paper is to study health recovery tourism in Ukraine, on the case of creating social enterprises in a health resort network. The paper is oriented on the managerial and value creation issues. The aim is to describe the business idea of a health resort (Lviv region of Ukraine) as an innovative economic agent with social goals and value added to the local community in general and on the example of three existing spas. Taking into consideration the amount of tourists in Lviv region and the key indicators of small businesses in the sector, the social enterprise is an alternative to the for-profit entities. The study findings suggest that starting the social enterprise in health resort services may become a good practice for the local development strategies. The health resort social enterprise may add value to the Lviv region by supporting the employment of local population and social value provision to groups of the society. The main contribution of the paper is in applying the social entrepreneurship model in the sector of health resort services. As the current political and social issues and problems in Ukraine are concerned, the non-profit entity project has potential for implementation.

**Keywords:** tourism sector; social enterprise; local development; health resort services; non-profit entities; value creation; modelling

**JEL codes:** Z32, I19, O18

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## 1. INTRODUCTION

Economic development in Ukraine is currently dependent on the regional policy. The national state authorities consider effective regional and local development policies as an instrument for the short and the long-run welfare promotion. The regional differences among the administrative entities called oblast in Ukraine have proven to affect the economic and social well-being. New development strategies need to be integrated with local assets, competitive advantages and opportunities.

Regional investment promotion and entrepreneurship development efforts must result from and help achieve national and regional economic and social development goals.

Strong regional disparities and resulting economic and social implications can hamper or delay the implementation of reforms and sector policies. Rapid restructuring can exacerbate traditional regional gaps (e.g. between urban and rural regions) and create new disparities. A design of a regional development policy should even out the regional unbalances in the transition, define policies and tools that tackle the different structural problems. There is high probability that interventions at a city or regional level can enhance the beneficial impacts of the macro changes and the higher tier policies. The capacity of cities and regions to develop and implement effective development strategies become vital to harnessing indigenous strengths, contributing to national growth and levelling regional disparities.

The tourism sector in Ukraine can become one of the significant drivers of regional development and social value creation in industrial and post-industrial countries in the 21st century. The potential challenges of this sector is the negative impact on the local environment of local identity. Thus, the tourism sector policy in terms of regional development has to be coordinated with the long-run regional development strategies. Pursuing sustainable regional development in the tourism sector will mean the search of an effective competitive advantages of the location and appropriate quality of the applied solutions.

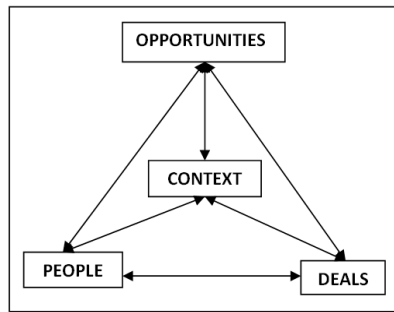
Nowadays there is a high demand on the social issues of the communities. Often the members of society are expressing their need to balance commercial and social values. Private sector agents are expected to act more socially responsible towards society and the environment. Communities can now develop business ideas that answer local needs, help provide vital services and support vulnerable groups. This is a new way for communities themselves to provide goods and services in response to people's needs and to improve the quality of life for others (Angove, 2007). Innovative entities such as social enterprises not only provide employment, but also engage motivated workforce invaluable work to tackle real needs in the community. A Survey of Social Enterprises undertaken by the Small Business Service in 2005 reported that in 17 % of social enterprises' primary aim was to help the environment; 34% aimed to help both the environment and people by providing employment, goods or services and 49% aimed to specifically help people (Survey of Social Enterprise across the UK, 2005).

The main aim of the paper is to study health resorts activities in Ukraine and their role in the tourism sector. Three existing spas are described along with identification of existing opportunities for further growth. It positions social enterprises in the health resort network as a tool of the tourism product provision and as means of additional value creation for the local community. It aims to promote the business idea of a health resort in Lviv region of Ukraine as an innovative economic agent with social goals and value added to the local community.

## 2. SOCIAL ENTERPRISE AS AN INNOVATIVE BUSINESS MODEL

There are several models describing the social enterprise from different points of view. Current paper aim was to study the managerial and value creation issues. In the paper, the idea was to develop more the possibilities of the social entrepreneurship on the regional level. The model PCDO is a central to describe the model of the health resort social enterprise.

The PCDO (people, context, deal and opportunity) is a management-focused model of the entrepreneurship presented by Sahlman (Teo & Tan, 2013). The model developed in 1996 explains the four interdependent components and their role for the management according to different situations (Figure 1).



**Figure 1.** People, context, deal and opportunity (PCDO) framework  
Source: Austin et al. (2006).

A group of authors (Austin *et al.*, 2006) has elaborated the application of PCDO framework for the social enterprises. The elaboration of the Sahlman’s PCDO model was for the purpose to study the interdependency of the people, context, deal, and opportunity, which the entrepreneur must recognize and manage accordingly in different situations. In the PCDO model, the managerial ability of the entrepreneur is critical and is the key determining factor of success and progress of the entrepreneurial venture.

The opportunity and the context (Figure 1) together form the scope of the opportunities for the social entrepreneur. Opportunity is a desired future state that is different from the present and the belief that the achievement of that state is possible. Opportunities in the social sectors require the investment of scarce resources with the hope of future returns (Austin *et al.*, 2006).

The authors of the PCDO model consider as well the external context. They define it as factors affecting the nature and outcome of the opportunity, but are outside the control of management. There are several components of the external context which are the macroeconomic, the tax and regulatory, and the socio-political environment(Austin *et al.*, 2006).



One should understand the role and goal of the human resources in the social enterprise building. The key suppliers, customers, competitors, and talent are required to create the organization. Others should also recognise the social entrepreneur for the reputation and capabilities to gain the trust from others who will be willing to work with and invest in them. Social entrepreneurs are seeking to attract resources for the social good, rather than for financial returns. Thus, they rely on a robust network of contacts that will provide them with access to funding, board members, and management and staff, among other resources. A social entrepreneur must be skilled at managing a wider diversity of relationships with funders, managers, and staff from a range of backgrounds, volunteers, board members, and other partners.

Deals are mutually beneficial contractual relationships between the entrepreneurial venture and all resource providers (Austin *et al.*, 2006). Social entrepreneurs are seeking investors to provide financial resources, as well as skills and talent to help them generate a return on their investments, whether financial or social. The sources of talent, contacts, capital, and amounts raised are of primary concern for both types of entrepreneurs.

Other models attempt to explain more in details the social enterprise and its features. Among such models, authors name the model of Guclu, Dees, and Anderson from the Centre for the Advancement of Social Entrepreneurship and the Social Entrepreneurship Framework of the three authors Austin, Stevenson and Wei-Skillern of Harvard University (the modification of the discussed model) (Kickull & Lyons, 2012).

Value chain creation is a model that helps to analyse specific activities through the firm's activities in creating value and the competitive advantages. The model may be a tool to identify or distinguish the traditional businesses and social enterprises, and with the framework, it can help in creating the value of social enterprise. It enables the identification of different values collected with the value chain creation model in contrasting these two business models.

The term 'social enterprise' came into use in the 1980s, as an attempt to differentiate traditional, purely non-profit, charitable organizations from socially-oriented organizations that venture into revenue-generating activities (Defourny & Nyssens, 2010). While scholars have advanced many definitions of social enterprise, social enterprises essentially refer to the range of organizations that operate for a social purpose. The difference between a social enterprise and a purely for-profit business enterprise, and in some cases, from a charity is often not obvious. There are social enterprises that behave like for-profit business enterprises, while others enclose qualities more of charities than business enterprises. Although the agreeable and widely accepted view that, there is a conceptual gap in establishing clear distinctions among the three organizational forms (Teo & Tan, 2013). Social entrepreneurs may share similar characteristics to the for-profit ones such as efficiency, dynamism, innovativeness, high performance and economic sustainability (Austin *et al.*, 2006).

Social entrepreneurs are innovators who use their ideas and different resources for troubleshooting in the social sector. The differences between the social enterprises charity organizations and traditional business are in the table 1.

**Table 1.** The key features differentiating social enterprise from charity organisations and traditional business

Social enterprises	Charity organisation	Traditional business
Social oriented structure	Social oriented structure	Commercial oriented structure
No dependence on the external financing; initial capital is needed only	Dependence on the external financing, donors, grants	No dependence on the external financing; initial capital is needed only
Revenue is gained from its activities, which are aimed at troubleshooting of some specific social problems	Receives grants, donations, which are aimed at troubleshooting of some specific social problems	Revenue is gained from its activities, which are aimed at maximising the profit
Profit is reinvested	No profit	Profit is distributed among the shareholders

Source: own elaboration.

Social enterprises are entities that solve social problems based on self-finance, innovations and sustainability. There are some main characteristics of this type of firms. They are the following:

1. Social influence as means solving or softening some specific social problem or need;
2. Innovation as new ways of solving old problems or new ones, new views on things;
3. Self-financing as a financial sustainability and independence from external financing or grants;
4. Replicability as the ability to apply the same model and approaches in different location and in other social environment.

The main principles of a social enterprise are:

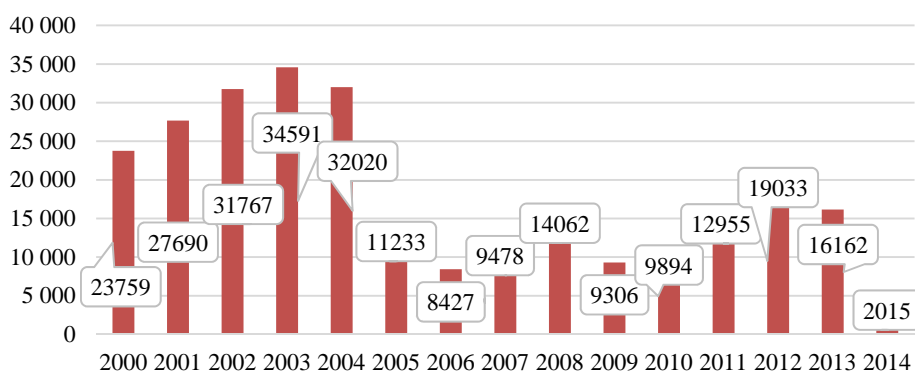
1. Mutual ownership of the members and distribution of the shares with the enterprise;
2. Membership is according to the charter;
3. Democratic decision-making;
4. Revenues invested within the entity or in external social or ecological projects;
5. The entity is receiving both the revenues and the grants;
6. The commercial, social and ecological outcomes assessed by the financial and social audit;
7. The goal is the social welfare, not the private one.

According to the surveys, the share of the social enterprises in Europe is around 10%, representing nine million full-time jobs. The European policy towards this type of economic agents is loyal and the European Commission has established

a Social Economy Unit in the Directorate General for Industry (IFF Research, 2005).

### 3. POTENTIAL OF LVIV REGION

The tourism sector of Ukraine is one of the sectors that possess potential for further economic development, employment and regional development (Figure 2). The number of foreign tourists in Lviv region was fluctuating considerably from 34591 in year 2003 to 19033 in year 2012 and to 15 in year 2014. Thus, the region has prospects for becoming a tourist destination. The lack of appropriate promotion of tourism services results both in the low trends during last 10 years (Figure 2) and negative impact on local areas and communities' activities.



**Figure 2.** Number of Foreign Tourists in Lviv Region during last 14 years  
Source: adapted from Regional Statistics Lviv.

There is a small amount of businesses in tourism sector in Lviv region (Table 2). During the last 4 years the number of business decreases from 1038 in 2010 to 794 in 2014. The share of the payroll expenses is around one third to the total sales.

**Table 2.** The key information about the small enterprises in sector of tourism in Lviv region

Year	Number of enterprises	Number of employed persons	Number of hired persons	Payroll expenses (mln UAH)	Total sales (mln UAH)
2010	1038	6574	6325	82.6	243.3
2011	854	6501	6267	102.3	268.1
2012	789	5390	5213	107.3	322.3
2013	825	4878	4577	99.5	288.2
2014	794	4500	4161	95.2	315.6

Source: adapted from Regional Statistics Lviv

Recently, development of small scale entrepreneurship in the regions of Ukraine helps to revive business. It is an opportunity to encourage people to work and implement changes, to increase social resources of the region with the help of

development of a small scale entrepreneurship, farming, cooperatives and different forms of self-organization.

According to data, there were 96 enterprises in tourism of Lviv region as self-employed forms (Table 3). There was a substantial increase in the number of the provided service to foreigners from 73 in 2011 to 1256 in 2013 and that is around 17 times more. The private businesses that may be in form of social enterprises are the entities that possess the opportunities for the employment in the region and the attraction of foreigners. For instance, the tourism services provided for the foreigners in 2013 is 10% or 7 million UAH.

**Table 3.** The key features of individual enterprises in Ukrainian tourism sector

Indicators	2011	2012	2013	2014
Total number	96	131	129	92
Average amount of employed persons	46	64	89	53
Revenue (mln UAH)	4.41	17.57	9.7	7.84
Number of provided tourism services:	5067	7051	12032	7980
including foreigners	73	537	1256	307
including foreigners (%)	1.44	7.62	10.44	3.85
Amount of provided tourism services (mln UAH):	29.39	42.99	79.71	75.96
including foreigners	0.69	2.84	7.44	1.13
including foreigners (%)	2.35	6.61	9.33	1.49

Source: adapted from State Statistics.

The total number of legal entities in Lviv tourism sector is higher respectively to the self-employed (Table 4). Such tourism entities provide the majority of the services and raise higher revenues. During the 2011-2014 years, the tourism business has faced a trend of decline. The number of foreign customers decreased significantly from 6500 persons in 2012 to 864 in 2014 or by 87%. Taking into consideration the previous years, there are available opportunities for the tourism services delivery including those aimed at foreign customers.

**Table 4.** The key features of legal entities (enterprises) in Ukrainian tourism sector

Indicators	2011	2012	2013	2014
Total number	134	148	143	143
Average amount of employed persons	627	679	757	654
Revenue (mln UAH)	109.65	159.15	219.00	166.91
Number of provided tourism services:	49170	58889	75060	52947
including foreigners	6332	6500	4334	864
including foreigners (%)	12.88	11.04	5.77	1.63
Amount of provided tourism services (mln UAH):	128.89	162.77	227.46	330.73
including foreigners	16.58	18.76	25.82	4.73
including foreigners (%)	12.86	11.53	11.35	1.43

Source: adapted from State Statistics.

The involvement of the tourism industry such as hotel accommodations, leisure services and health resorts, can also be a target for entrepreneur to create social enterprise cooperation while establishing and growing their businesses. Such innovative model in Lviv region of Ukraine may generate a new level of social economy adapting to the consumers' expectations and gaining social benefits for the local society.

The potential for tourism services is based on the location and efficient branding of Lviv as a cultural and European centre in Ukraine. Thus, health care services such as health resorts that provide rehabilitation and spa, in combination with the social goals may be a profitable business model. According to the current information, the available resources in the health resort entities are applied only per 50% (Table 5).

**Table 5.** The key information about the health resorts in Lviv region and Ukraine

Indicators	2011		2014	
	Lviv region	Ukraine	Lviv region	Ukraine
Applied health resorts potential (%)	0.53	0.25	0.49	0.46
Employed persons (thousands)	9.06	94.62	7.37	51.12
Employed doctors (thousands)	0.52	4.82	0.33	2.05
Customers (thousands)	231.03	2639.11	170.83	1463.84
Foreign customers (thousands)	37.77	355.90	9.00	22.77
Revenue from provided services (mln UAH)	749.04	6869.94	690.91	3084.87
Revenue from rooms (mln UAH)	15.42	981.70	15.57	168.48
Revenue from total tour (mln UAH)	697.37	5547.93	648.30	2739.84
Revenue from additional services (mln UAH)	36.25	340.30	27.05	176.55
Operational costs (mln UAH)	632.46	9298.05	541.36	2868.98
Costs of materials (mln UAH)	278.03	3469.18	240.20	1303.64
Payroll costs (mln UAH)	159.44	3145.81	151.77	742.81
Depreciation (mln UAH)	59.05	603.25	32.10	161.89
Total costs (mln UAH)	1128.98	16516.29	965.43	5077.32

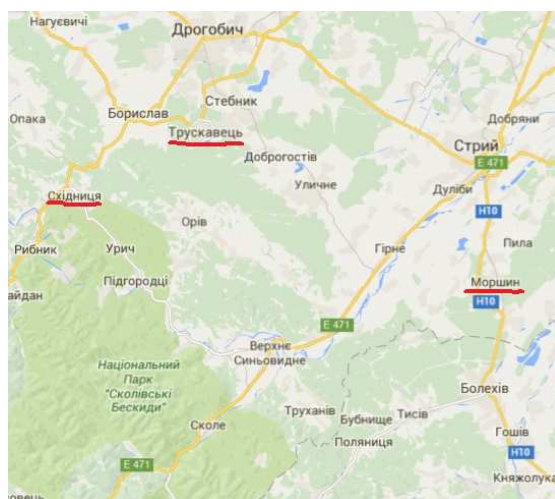
Source: adapted from State Statistics.

#### 4. HEALTH RESORTS AS SOCIAL ENTERPRISE: STUDY OF THREE SPAS

There is a growing demand for medical services tourism. The experts are assuming that around 50-70% of the health services are delivered to the foreign patients. There are a few Ukrainian health spas worth considering for tourists. The two most popular Ukraine health spas are Morshyn and Truskavets. Shidnytsia health resort is more local customers oriented. The infrastructure is not sufficient for the foreigners to arrive to Shidnytsia. Truskavets is the largest and the most international one. The three Ukrainian spas offer mud baths, natural springs, specialized diets, physical exercise, massages, Jacuzzis, etc. The visitors usually find that Ukraine's spas are high quality and affordable.

Health resort may become the entities that run a responsible business. Creating the social enterprise in sector of health resorts for a social purpose will generate social value while operating with the financial discipline, innovation and determination of a private sector business in the region. The motivation for health resort social entrepreneurs is the high demand in the sector of health tourism nowadays in Europe due to the ageing population and the need for medical treatment. There are several health resort areas in Western Ukraine, which may provide good price/quality recovery medical services.

The model of creation social enterprises in health resorts sector may be a part of the cooperation programs within the Carpathian Euro region. The approach was to model three different health resort social enterprises in main recovery health services regions- Truskavets, Morshyn and Shidnytsia (Figure 3).



**Figure 3.** The location of the three towns Truskavets, Morshyn and Shidnytsia  
Source: Google maps.

Truskavets is among the most advanced health resorts in the country. Most of the services provided by the commercial hotels are pools, saunas, steam baths, massages and salt caves. The main advantage of this area are large reserves of underground mineral waters that are rich in hydrocarbons, magnesium, and calcium and petroleum carbons. Such a combination of the location and natural resources holds potential to attract a major hotel and medical development to the region where businesses enjoy special tax breaks. The region and town of Truskavets have been developing considerably during the Euro 2012 championship preparation period. The resort is located 100 km south from Lviv and 90 km from the western border.

Another popular spa resort, Morshyn is famous for its healing waters, which contain such minerals as iron, iodine, dissolved oxygen, bromine, and magnesium. However, Morshyn offers many of other treatments as well, including simple massages and mud baths to exercise routines and specialized diets.

Following the PODO model, the market failures in the Ukrainian regions are the external context of the social enterprises creation in Ukraine. There are several prerequisites for a social entrepreneurship as the following: 1) the state authorities are unable to solve all the social problems; 2) traditional business entities are not receiving good spurs to join the social programs; 3) traditional business and state representatives are searching for commercial and political benefits respectively. As the grant programs are decreasing, social entrepreneurship is a good option for the third sector of the economy. The social entrepreneur may be as a person able to compete with traditional businesses. Thus, there is a significant room for the social enterprises development in Ukraine.

Nowadays there is a tendency of the charitable funds to appear in many locations in Ukraine as reaction to the military conflict needs. There were 10 thousand of charitable funds in the end of October 2014 and 15 thousand in the February 2015.

The problem of creating social enterprises in Ukraine is that the founders overestimate the role of grants as a form of funding compared to other resources. The fact of raising financing in other forms requires business profit-oriented approach that consequently will lead to efficient activities of social entrepreneur. The grant technique of investments results in a low level of motivation among the staff to implement the goals and social ideas of the entity.

The social entrepreneurship in tourism industry is a new phenomenon in Ukraine. The perception of tourism as a sector for receiving profit poses obstacles for the probability of creation of non-profit entities. In case of Ukraine, the innovative approach that is guaranteed by the social enterprise creates both monetary, well-being and social value. The latter one is discussed often in the context of regional policy.

Applying the PODO model for the case of health resorts in Lviv region requires understanding the market forces. The opportunities and the context elements of the model in case of Ukraine and Lviv region may be a good source of financing for the social enterprise and the demand for the social value from the society. Such source is the sector of the IT services. There is already voluntary project that is designed to provide free courses for the ex-military persons who are not able to find employment. The project is not yet formed as a social enterprise.

The social enterprises in Truskavets and in Morshyn are modelled as health resorts, rehabilitation and training centres for the participants of ATO (antiterrorist operation). The health services are designed for physical rehabilitation. The training services are the additional and voluntary activities for the new competencies of the soldiers for their future employment. The idea of the project is to run already proved type of business with some extra options like training courses.

The social enterprise in Shidnytsia is a model of the entities that makes profit for the infrastructure objects building in the area of the small town. The idea of the project is to run already proved type of business with extra option in terms of the profit allocation. The social enterprise uses the strategy of buying only local food

for consumption in the health resorts, e.g. the distance has to be not more than 35 kilometres.

The data of the clients of the modelled social enterprises is taken based on the previous information about the amount of the persons who have travelled to the three locations in the years. Such information is provided in the table 3.

**Table 6.** The amount of customers at the spa resorts Truskavets, Morshyn and Shidnytsia

Years	Amount of clients of the spa resorts (in thousand)								
	2005	2006	2007	2008	2009	2010	2011	2016*	2017*
Boryslav (Shidnytsia area)	1.8	2.0	2.2	2.3	2.2	2.2	2.4	3.2	4.3
Morshyn	39.9	44.5	47.9	50.5	49.9	42.5	46.3	68.9	91.9
Truskavets	159.2	164.7	158.6	171.1	159.8	150.0	135.1	235.4	313.8
Total market force	2205.9	2217.2	2215.7	2231.8	2220.9	2204.7	2194.8	3319.5	4426.0

Source: adapted from Regional Statistics Lviv; \* - estimated by author.

The findings show that the trend in the service consumption is relatively low. The stable small amount of tourists in the area of Shidnytsia health resorts is the result of the lower standards of both accommodation and staff. But the region has an attractive location near the mountains.

Following the PODO model the people is the main asset of the social enterprise. Any business is divided into three different spheres. It firstly exists for the product/service that it offers, then for the people who use the product/service, and finally for the employees. For the business to thrive, the three spheres must be coherent. Those three spheres then make a concept/entity that helps the product/service differentiate from other products. The combination of the coherence and the differentiation are the foundations of the business model (Lafeuille, 2009).

The motives in the case of health resorts must be mixed: it must appeal to both goodwill (preservation of the land) and self-interest (empowerment of the community). As for the key stakeholders, the enterprise will have to benefit the community as well as the visitors. The members of the community will represent 100% of the workforce, who will get a market-rate salary.

The common issues in the business model of social health resorts in the three towns is the marketing program which aims to promote the understanding among the customers the social idea and the benefit of their personal consumption of the services for the local community.

The application of the value creation approach is built on the customer side. There are benefits for the consumer while the product or service is delivered. The additional bonus is the awareness of the consumer that a share of the revenue supports social needs or ecological issues. The social entity is planned to be a profitable project and ecologically friendly with the aim of the social welfare. The effectiveness of the social enterprise is considered on the basis of the three results. The three results are the financial viability, the creation of public wealth and environmental responsibility. The details of the triple approach are the following (Spreckley, 2014):



1. Financial viability is the commercial success and independence in the decision-making and in control. Attaining it means the organization and management are efficient.
2. Creation of public wealth is the ability of the group of people mutually to reach their goals.
3. Environmental responsibility is the responsibility for the green gas emissions, the biodiversity, the balance between the commercial benefits and the ecology.

The analysis was conducted to show the new value which can be created in social enterprise, namely social benefit. The social benefits of the new tourism entities in towns of Truskavets, Morshyn and Shidnytsia are the following: (i) clients – IT employees and the persons participating in the antiterrorist operation in Ukraine, internally moved persons within Ukraine. The clients are both shareholders and main clients; (ii) products or services – health services, spa services, rehabilitation services, spa services for IT employees.

The interested parties in the social enterprise are local government (authorities), local citizens, local other business (transportation, restaurants, shops, malls, theatres, etc). The approach is to divide the interested sides in three categories: main ones, the secondary ones and the third ones. The main interested side is the target group of people or main clients. They are employees, the consumers, business partners, volunteers. The secondary interested sides are the suppliers, banks, other partners, private and non-governmental organisations, the competitors. The third interested side is the amount of people who communicate rarely with social entrepreneur, e.g. financial institutions, consultants, etc.

## 5. CONCLUSIONS

Ukraine's social problems are very crucial nowadays. Social benefits were in demand during the independence period of Ukrainian state. The modelling a social enterprise now in Ukraine means benefiting from local resources.

The tourism sector in Ukraine can become one of the significant drivers of regional development and social value creation. The opposite side of this sector functioning is the negative impact on the local environment and objects of local identity. Thus, the tourism sector policy in terms of regional development has to be coordinated with the long-run regional development strategies. Pursuing a sustainable regional development in the tourism sector will mean the search for an effective competitive advantages of the location studied and appropriate quality of the applied measures.

The steps for the establishment of a social enterprise in health resort regions are the following. The first step is the education issue. There should be a special program for the local owners and managers of tourism social enterprises. That program would include the tourism management training, the apprenticeships for the business skills. The regional tourism associations are an efficient tool for better understanding the industry (Fruchtman, 2013), for personal communications, the market information sharing, the problems discussions and decision-making. Such

associations must develop and implement a market research program for social tourism entities, so that potential entrepreneurs can base themselves on reliable sources. A regional association, with a Board of Directors formed with experienced social tourism operators, could then provide a social tourism voice in the tourism industry strategic planning and policy development.

The realization of the modelled social enterprises is crucial for the Lviv region and the three towns analysed in the paper. There are several prerequisites which should be mentioned as follows: building a strong linkage between business and research by modifying the academic curriculum at the appropriate universities and institutes according to the changing needs of the tourism sector of economy; further development of tourism cluster functioning in Lviv region such as active membership of all institutions involved in the sector of tourism services.

Preliminary conclusions of the study show the expected positive effects on the employment of the regional citizen labour market. The employments possibilities may lead to improved living standards, as they have resulted in each of the three studied cases. Thus, the innovative model of running business improved the managerial skills, decreased the level of governmental instruments of financing, increased the responsibility for the environmental issues of the region's community.

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