

FORMS OF ENTREPRENEUR'S CAPITAL AND EARLY PERFORMANCE OF NEW VENTURES IN TRANSITION ECONOMIES

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PROBLEM OUTLINE

New venture creation is a central issue in transition from a centrally planned economy to a free market economy in the post-communist countries (Lyles, Saxton & Watson 2004; Mueller & Srecko 2002; Smallbone & Welter 2001). Young firms stimulate the economic growth of emerging markets¹ and provide a counterbalance to the loss of workplaces in state-owned enterprises that have dominated in the former socio-economic system and are now privatizing, restructuring, or closing (PEAD 2003; World Bank 2000; Grudzewski & Hejduk 1998). In addition, new ventures in transition economies provide individuals with human capital related benefits such as knowledge of management practices in a free market economy, thus, increasing their adaptability to the new conditions (Aidis & Sauka 2005).²

However, young enterprises are exposed to a higher risk of failure (Cooper, Gimeno-Gascon & Woo 1994). In fact, survival of new ventures within the first year of operation is a significant challenge they have to face particularly in transition economies. For example, in Poland, about 40-45% enterprises fail within the first year of their existence (PEAD 2003). From an academic and public policy perspective, there is a need to determine **what factors and to what extent they contribute to early performance of new ventures in emerging market economies.**

Factors influencing new venture performance have been extensively analyzed since the beginning of the 1980s (e.g., Schwarz, Ehrmann & Breitenecker 2005; Bosma, Van Praag, Thurik & De Wit 2004; Brüderl, Preisendörfer & Ziegler 1998; Cooper, Gimeno-Gascon & Woo 1994; Gartner 1985). Previous studies have applied primarily approaches that focus on personal factors (e.g., entrepreneur's personality, management experience, or level of education), on firm factors (e.g., initial finance capital, initial size of the venture, or strategic planning), and on environment factors (e.g., competitive intensity in the industry or support infrastructure for new ventures). It should be also noted that the field of entrepreneurship has been dominated by research on the United States and West Europe. Therefore, existing models of new venture performance are particularly applicable for mature economies with abundant resources, entrepreneurial role models and a stable institutional environment.

Countries that are in transition from communism, however, "do not have the same levels of resource slack, the same founding mechanism or the same flows of capital that exist in the relatively resource rich Western economies" (Muzyka 1992, p. 33). Likewise, accepted legitimacy of entrepreneurship has been shown to be different in emerging economies than in mature economies (Lyles, Saxton & Watson 2004). In addition, the extensive changes in transition countries regarding long-standing social, political, and economic institutions create considerable uncertainty about the future and make the environment of the entrepreneur relatively unstable (Schwarz & Wdowiak 2006; Danis, 2003). Consequently, the existing models of firm survival and growth developed in mature economies do not fully capture the entrepreneurial process in economies with a different institutional environment, scarce resources and a lack of entrepreneurship tradition. Furthermore, research concerning enterprise performance in transition economies is relatively rare (see overview of Hisrich & Drnovsek 2002), has

¹ Emerging markets encompass a wide range of countries including but not limited to these that are in transition from communism such as Central and Eastern European countries, former Soviet countries and China.

² Transition of the economic system in post-communist countries runs parallel with social changes that are connected with democratization of society. Entrepreneurship becomes one of the most effective instruments in the reorientation of social awareness and reciprocally: "without liberating social awareness, the emergence of the private sector and a market economy are impossible" (Piasecki 1995 cited in Smallbone & Welter 2001, p. 250).

mostly a one-dimensional character (e.g., Wasilczuk 2001), and addresses often large state-owned enterprises (e.g., Tan 2003). In summary, there is a lack of theoretical grounded and methodological rigorous studies that analyze factors crucial to new venture performance in different environments in a systematic way.

OBJECTIVES OF THE RESEARCH

The aim of the paper is to determine influence factors of new venture early performance in transition economies (see Fig. 1). We will develop a model of new venture performance, which considers the influences of uncertain and resources constrained environment in transition economies on the level of entrepreneur's initial endowment in terms of Bourdieu's forms of capital, i.e. cultural, social, and economic capital (Bourdieu 1986). We will test the model by examining founding conditions and early performance of a new firm close to the start-up moment, i.e., three months after the business opening.

It has to be assumed that initial resources of a new enterprise are crucial for their survival and early growth (Cooper, Gimeno-Gascon & Woo 1994). Initial resources are defined as attributes of the founder (e.g., education, experience, and personality), his/her social and political environment (e.g., networks, political and legal conditions) as well as venture characteristic (e.g., financial capital, industry). A crucial issue of the study is the entrepreneur who creates the venture under conditions of high uncertainty due to the liabilities of newness and smallness, in general, and in weak institutional and resource constrained environment in transition economies, specifically. The necessity to concentrate on a founder person results also from the fact that the majority of new ventures is created only by one person who mostly does not engage any employees at the beginning of a business venture. Therefore, "the entrepreneurs' experience, personality, perceptions and resources are formative" for new venture survival and growth (Garnsey 1998, p. 530). Based primarily on the human capital theory, the signaling theory, and the network approach, we will demonstrate the relevance of person-related initial resources, specifically founder's cultural and social capital, for early performance of new ventures.

We assume also that survival and growth of new ventures depend on the country's stage of economic development, its cultural features, and societal democratization (Wasilczuk 2000; Köllermeier 1992). Recent findings in the entrepreneurship research implicate that context matters as it shapes considerably structure and performance of new ventures (Aidis & Sauka 2005). Therefore, we will pay attention to context-related aspects of the entrepreneurial process in transition economies. Specifically, we will analyze the impact of different environmental conditions in these emerging markets on entrepreneur's cultural and social capital.

Culture capital comprises an individual's institutionalized capital such as occupational certificates and education diplomas, and an individual's incorporated capital such as competences and skills gained through experience and habits consisting of behavior, work norms, and values (Bourdieu 1986, p. 243-248). Cultural capital of entrepreneurs in transition economies is affected by the individuals' investments in education, competences and skills developed both under the communism and in the emerging market economies as well as by the values and practices reflecting their historically constrained environment. We hypothesize that entrepreneur's investment in business education done under communism, work experience in state-owned enterprises, and individual's habits reflecting communism legacy have a negative influence on new venture performance in a transition economy. For example, the realization of production targets was a crucial issue in the state-owned enterprises in the former socio-economic system (Danis 2003). Therefore, a lasting legacy of the centrally planned economy may be the production-first mentality of entrepreneur that can be not supportive for new venture performance in the market economy, where the profit orientation is predominantly required (Suutari & Riusala 2001). By contrast, previous work experience of the founder gained abroad as well as in Western enterprises acting on markets in transition countries has a positive influence on new venture performance in a transition context.

Social capital of entrepreneurs in post-communist countries plays also a very important role for new venture creation and performance (Lyles, Saxton & Watson 2004; Smallbone & Welter 2001). It relates to components of social structures in society as well as resources placed in social networks (Coleman 1991; Bourdieu 1986). We hypothesize that there will be a positive correlation between

entrepreneur's weak and strong ties and new venture performance; however, in contrast to mature markets, the influence of strong ties will be stronger than weak ones due to the fact that the institutional environment of transition economies is still unstable and non-transparent. Because state-owned enterprises are still key power brokers in transition economies (Lyles, Saxton & Watson 2004), we assume that previous management experience of the founders in state-owned enterprises contributes to new venture performance positively by the use of "old" networks and connections. Likewise, entrepreneur's close ties to government and state-owned enterprises have a positive impact on new venture performance in a transition economy.

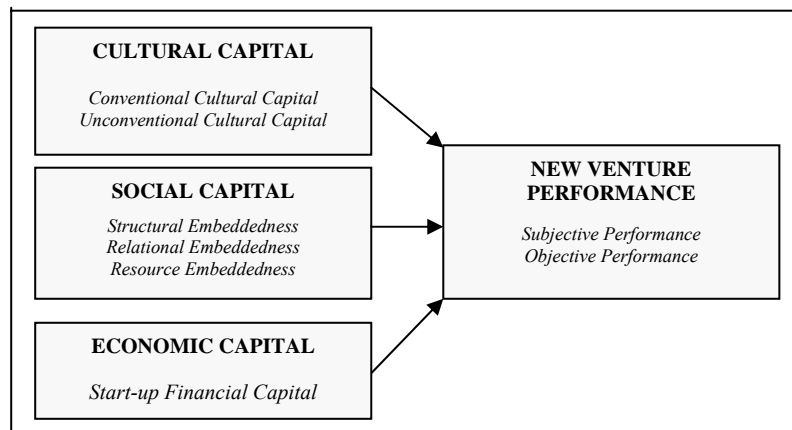


Fig. 1: Proposed model of new venture performance in a transition economy.

Due to a short period of economic (financial) capital accumulation in private households in transition economies and a limited availability of capital on emerging markets, the lack of financial capital is still one of the main barriers to new venture creation and performance in post-communist countries (Pissarides 1999). In traditional economies, financial constraints at the start-up moment have proven to have also a negative impact on survival time of ventures and their profitability (Bosma, Van Praag, Thurik & De Wit 2004). Our model encompasses therefore also financial capital at the start-up moment.

METHODOLOGY

We will test the model in two transition economies, namely, in Poland and Slovenia. We will also compare results in both emerging markets, thus, taking into consideration the heterogeneity between transition economies. Questionnaires covering diverse aspects related to the entrepreneur's profile, founding conditions, and early performance will be sent to 2.000 newly created ventures in Poland and Slovenia in November 2006 (a random cross-industry sample). The database consists of new enterprises that have been opened three months before the survey data and are not derivative business foundation. Investigating the entrepreneur's profile and entrepreneurial process close to the business opening enables us to avoid the information bias. The expected response rate is ten percent. Therefore, about 200 cases will be analysed. We explore the relationship between cultural, social, and economic capital of the entrepreneur and new venture performance using factor analysis and regression analysis.

In order to reflect environmental start-up conditions in transition economies, multidimensional performance measurement is necessary. We examine both subjective and objective performance of new ventures. We define *subjective performance* as founder's satisfaction of being an entrepreneur³ and as fulfilment of founder's expectations with regard to sales development and creating the customers' basis. Survival and improvement of organizational resource basis are *objective measures of performance* used in the study.

³ This subjective measure is included in the model particularly because of the high level of unemployment in the majority of transition economies. In Poland, for example, the rate of unemployment has not been less than 17.5 % since 2001 (Central Statistical Office, 2006). We assume therefore that entrepreneurs creating their ventures under conditions of high unemployment may be initially content with their decision to be self-employed, even if other measures of performances are low yet.

Taking into account a transition context, we distinguish between conventional and unconventional cultural capital. *Conventional cultural capital* comprises variables that have been included in previous models of new venture performance in mature economies, i.e., educational level, field of education, entrepreneurship training, entrepreneurial experience, management experience, and industry experience. *Unconventional cultural capital* consists of variables related to an economy in transition, i.e., state-owned experience, work experience gained abroad, work experience in foreign enterprises acting on emerging market economies, business education under communism, social skills, and individual's work values and practices reflecting communism legacy.

The model includes structural, relational and resource embeddedness as social capital dimensions. *Structural embeddedness* relates to the structure of network relations and comprises network size, network density, and network diversity. *Relational embeddedness* refers to the extent to which economic actions are affected by the quality of individuals' social relations and consists of weak and strong ties of the entrepreneur. In a transition context, it is necessary to incorporate resource embeddedness into the model, i.e., the degree to which network ties contain valuable instrumental resources. *Resource embeddedness* covers close ties of the entrepreneur to key institutions such as state-owned enterprises and government.

EXPECTED RESULTS / CONTRIBUTION

The systematic analysis of entrepreneurial process in transition economies allows us particularly to achieve the following research objectives: (a) to explore the impact of initial resources – including transition-related factors – on early venture's performance in economies with difficult environment conditions, and (b) to explore the impact of communism legacy on the level of founding factors and the entrepreneurial process in transition economies.

The project results are of relevance for several interest groups:

- a) *Researchers*: The proposed project is based on the idea that survival and growth of new ventures are dependent on the country's stage of economic development and its cultural features. We argue that existing models of new venture performance developed in mature economies are applicable to economies in transition only to a certain degree and have to be extended along economic and cultural dimensions. Thus, by integration of transition-related aspects within founder's cultural and social capital into the model, we conceptually extend prior research on new venture performance in a developed context to a transition one. Furthermore, we examine founding conditions close to the start-up moment, thus, avoiding the information bias and providing a better insight into the entrepreneurial process.
- b) *Policy maker/financiers*: While public actions usually aim at improving founding conditions in order to encourage individuals to start a business (e.g., an entrepreneur-friendly fiscal system), it is also reasonable to undertake actions to support the early venture development in order to increase enterprise's chances for its sustained performance, thus, benefiting from such performance also on the macroeconomic level. Consideration of transition-related aspects of business creation and development enables the bankers/investors in transition economies to review their evaluation criteria, which are usually based on assessment instruments developed previously in mature economies. For example, they regard business education as a success factor and do not take into account the quality of that investment. But does business education made under communism or at the beginning of the system transition really provide the entrepreneur with valuable knowledge how to manage an organization in a free-market economy?
- c) *Entrepreneurs*: The major contribution of the project is determination of *initial* success factors that allows the entrepreneur to assess his/her potential in a new venture context. Because the majority of investigated aspects can be modified, the entrepreneur may early enough undertake actions to reduce expected negative effects of the identified shortcomings, for example, by taking part in entrepreneurship/business management courses. Entrepreneurs will also become more aware of the role of their social contacts, including how they can maintain such important assets.

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