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# Entrepreneurship

## A Psychological Approach

Edited by  
Martin Lukes & Mariola Laguna

# PREFACE

Societies have recognized the important impact of entrepreneurship on economic growth, the reduction of unemployment, regional development, and innovation. Governments world-wide are calling for an increase in entrepreneurial activities. Acknowledging the significance of entrepreneurial activity, researchers from many disciplines aim to recognize the economic, social, and political factors, which create the overall climate for new entrepreneurial initiatives. Although all those environmental factors play an important role in the development of entrepreneurship, the emergence of a new firm depends, in the end, on the decision of the person who intends to undertake the task. At the same time, comparatively few individuals make such a decision. These issues have inspired the dynamic development of psychological research on entrepreneurship.

During the past twenty-three years we can observe the dynamic progress of this new field of investigation. There are more and more publications on the psychology of entrepreneurship, presenting a high level of academic knowledge. One of the recent, and most important, is “The psychology of entrepreneurship” edited by J. Robert Baum, Michael Frese and Robert A. Baron, published by Lawrence Erlbaum & Associates in 2007. However, in our opinion, there is still the need for a good handbook, presenting case studies and examples, recommendations and ideas for the practical side of entrepreneurship. Our aim was to prepare such a handbook detailing the psychology of entrepreneurship that would appeal to students in the areas of entrepreneurship, management, as well as work and organizational psychology. It would also be of interest to nascent, and experienced, entrepreneurs.

Therefore, this book consists of twelve chapters which present the main theoretical concepts developed in that field, the research findings and it also contains practical recommendations for readers. Aiming to make the book easy to read and attractive, there are different kinds of short illustrative elements included in every chapter. They help one to understand better the issues presented in the chapters. These elements are distinguished from the text as the separate frames. They include definitions of the most important constructs, examples of the measures used in the research, figures and tables that may be an aid to understanding the topics discussed. The authors of the chapters also present their own research.

In addition, we would like to introduce the key representatives; researchers important in the field of the psychology of entrepreneurship, and related disciplines, and also professionals from the field – entrepreneurs, investors and managers. Therefore, we have invited some of those experts to

prepare short notes presenting their ideas and research. It is to our great pleasure that they agreed to take part in this project.

With the aim of being as close to real life as possible, we also include short practical examples, cases, interviews with entrepreneurs etc. There are also exercises and questions which may help to develop and increase the competence of the readers. It may help to establish a bridge between theory and practice, between academic research and real entrepreneurial activity. We hope that it may also inspire the readers to undertake this kind of activity and promote entrepreneurship.

The book starts with an introduction to the psychology of entrepreneurship; presenting the definitions of that phenomenon (chapter 1), and the differences between social and commercial entrepreneurship (chapter 2). Next, three chapters concentrate on the entrepreneur as a person - on the personality characteristics (chapter 3), motivation (chapter 4) and positive dispositions of entrepreneurs (chapter 5). Focusing on entrepreneurial success, chapter 6 proposes its definitions and measures. Chapter 7 discusses the importance of planning for the achievement of success. The subsequent chapters concentrate on the process of starting, and expanding, the business - the role of opportunity recognition and development (chapter 8) and the possible use of internet marketing for new ventures (chapter 9). While a firm gets bigger, the important issues turn out to be leadership (chapter 10), management of the growing firm (chapter 11), and supporting entrepreneurial activities inside the organization, i.e. corporate entrepreneurship (chapter 12).

Most of the authors of the chapters are members of the International Network for Psychology of Entrepreneurship Research and Education (INPERE, [www.inpere.org](http://www.inpere.org)). INPERE is a network created in 2005 by researchers who shared a mutual interest in promoting entrepreneurship and developing international research projects that will have global implications.

The edition of this book was possible thanks to the support of the European Commission; in the form of a grant; and the support of the Faculty of Business Administration, the University of Economics, Prague. We would like to express our appreciation of all the people who have helped us to bring this project to fruition. We are grateful for the eager and helpful comments of the reviewers Professor Zbigniew Zaleski and Professor Jiri Hnilica. We would also like to thank Ian Martin Quigley and Milan Randl for their assistance in the editorial work on the manuscript. Last, but not least, we would like to thank our invited experts and the authors of the individual chapters for their professional contributions.

*Martin Lukes and Mariola Laguna*

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We would like to thank all the guest contributors who accepted our invitation to prepare short expertise. The list of authors (others than chapter authors) of these "Expert's view", "From practice" and "My Research" frames, putted in an alphabetical order, help the reader to find them in the book.

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# Chapter 1

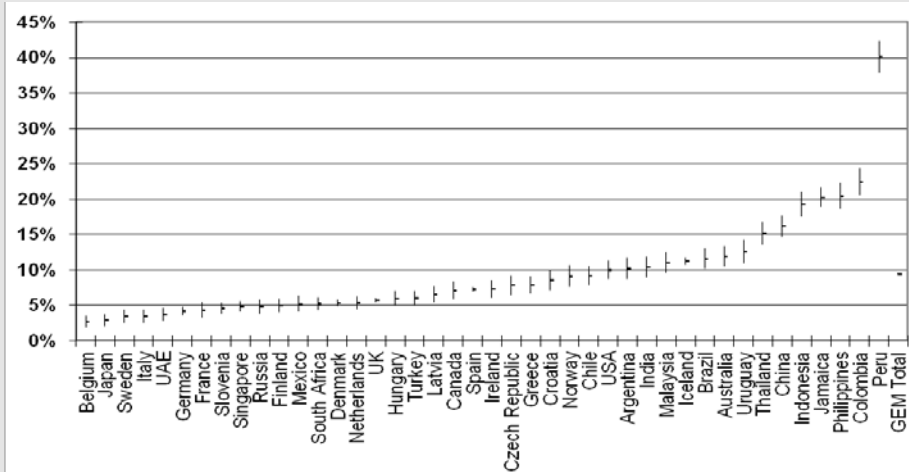
## THE ENTREPRENEURIAL PROCESS: AN INTRODUCTION TO THE PSYCHOLOGY OF ENTREPRENEURSHIP

Lorraine Uhlaner and Martin Lukes

### 1.1 Why entrepreneurship is an important area of study in social science

Entrepreneurship is a topic of growing interest worldwide. The vibrant economy of countries like the United States are often contributed to the fact that relative to other advanced economies, a higher proportion of Americans consider starting their own businesses.

**Figure 1.1: Early stage entrepreneurial activity across the world**



Notice: Population in age 18-64 years, participating in early-stage entrepreneurial activity (%)

Source: Bosma and Harding (2006)

Figure 1.1 shows the rate of early stage entrepreneurial activity across 42 countries which participated in the Global Entrepreneurship Monitor (Bosma and Harding, 2006). Although a number of the countries with the highest rates of entrepreneurial activity are those with developing economies (e.g. Peru, Columbia and the Philippines), certain highly developed economies such as the United States and Australia also have higher rates than many European countries.

A growing body of evidence comparing different regions and/or countries (referred to as the macro level of analysis) supports this link between entrepreneurship and economic growth, especially at the national level. In such studies, it is common to define *entrepreneurship* as the occupational choice to work for one's own account and risk (i.e., the self-employed and other business-owners) (Hébert & Link, 1982; Wennekers, 2006). A recent review of 57 studies by van Praag and Versloot (2007) supports previous views that entrepreneurship contributes to employment creation, productivity and economic growth, thus corroborating the relevance of entrepreneurship for the world's economies (Audretsch & Thurik, 2001). Moreover, entrepreneurship satisfies unfulfilled needs of people, supports regional development and builds human and intellectual capital of individuals involved in entrepreneurial activities.

At the individual level, (referred to as the micro-level of analysis), researchers have examined a variety of questions such as:

- Who is more likely to become an entrepreneur? (Are there particular personality traits, childhood, adolescent or adult experiences of the person, or specific motives that are associated with entrepreneurship)
- Why are some entrepreneurs more successful than others?
- Are entrepreneurs different than other people? Do they have different *personalities*? Do they *act* differently?

Researchers have taken many approaches to answering these questions, but research in psychology used to examine other types of workers (such as managers for instance), can be used to examine similar types of questions with respect to entrepreneurs. Later chapters in this book explore many of these questions in greater detail. For instance, Chapter 3 examines the topic of the entrepreneurial personality; Chapter 4, that of entrepreneurial motivation; Chapter 5, that of positive psychology, and Chapter 7, that of planning and self-management strategies. However, before examining any of these questions, it is important to clarify what we mean by the term, *entrepreneur*, as well as the term *entrepreneurship*. We examine these terms in the next section.

## 1.2 Who or what is an entrepreneur?

Although the field of entrepreneurship itself is a rather young field, the word “entrepreneur” can be traced back to the thirteenth century, from the French word, “entreprendre,” meaning to do something or to undertake something. Richard Cantillon (1680-1734), an economist, is credited with the first academic use of the term, Cantillon identified three categories of economic agents, including *landowners*, who were financially independent, *hirelings*, who give up the right to make active business decisions in exchange for a fixed wage contract (i.e. salaried employees), and *entrepreneurs*, defined as someone willing to buy at a certain price and to sell at an uncertain price, (with the hope of making a profit but taking the risk also of making a loss). Thus, Cantillon can be credited as the first academic to define entrepreneurs with respect to the activity of venture creation, the personality trait of risk-taking, and the profit motive (Cantillon, 1755).

### **Exercise 1.1: Discussing the meaning of entrepreneurship**

What do the word, “entrepreneur” and entrepreneurship mean to you? Would you describe yourself (and/or another member of your family) as an entrepreneur? Why or why not?

Schumpeter is also a very influential economist in the history of entrepreneurship, often linked to the Austrian tradition. He is credited with the view that economic growth comes from innovations or new combinations, not capital accumulation per se. The role of the entrepreneur is to disturb the status quo (the general equilibrium) through innovation. Furthermore, the individual entrepreneur is characterized by the desire to found a private kingdom, the will to conquer and the job of creating. These are very different motives than making money, per se. Schumpeter describes the effect of entrepreneurship on society as that of “creative destruction.” Old firms die and new ones take their place, redistributing wealth but also transforming entire industries and society at large. A common and easily visualized example is that of the computer industry. It not only created an opportunity for certain entrepreneurs (Steven Jobs, Bill Gates, Michael Dell) to amass private wealth, but redefined the way people do business and even communicate socially and personally in their daily lives. At the same time, obsolete technologies and related employment (typewriter machines, adding machines, etc.) disappeared. Thus Schumpeter is credited with suggesting activities of entrepreneurship include innovation, motives relate to creativity and power.

### **Key representative 1.1: Joseph Alois Schumpeter (1883 – 1950)**

Born in Třešť, Moravia, graduated from the University of Vienna, became a professor of economics and government at the University of Czernowitz. Then changed several jobs in Austria (e.g. Austrian Minister of Finance) until moving due to the rise of Nazism to the United States where he taught at Harvard.



Source: [http://en.wikipedia.org/wiki/Joseph\\_Schumpeter](http://en.wikipedia.org/wiki/Joseph_Schumpeter)

A third major influence on our modern day views of entrepreneurship can be traced to Israel Kirzner (1930--), also an economist. Kirzner equates entrepreneurship with entrepreneurial alertness to new opportunities<sup>1</sup>. This alertness is seen as a special kind of knowledge, though not necessarily a special talent. Entrepreneurial activities are creative acts of discovery and entrepreneurship involves opportunity recognition. The role of opportunity recognition is an integral aspect of modern day entrepreneurship research and is distinct from business ideas. In 1889, after the death of the famous American philosopher, Ralph Waldo Emerson, he was misquoted as coining the following saying (Leinhard, 2005):

*“If a man can make a better mousetrap than his neighbor, though he builds his house in the woods the world will make a beaten path to his door.”*

Emerson could not have said this because the mousetrap was invented after his death. According to more recent historical accounts, the original quote is as follows:

*If a man has good corn or wood, or boards, or pigs, to sell, or can make better chairs or knives, crucibles or church organs, than anybody else, you will find a broad hard-beaten road to his house, though it be in the woods* (from Leinhard, 2005, p. 204).

However the metaphor communicated by both expressions is the same: Invent something new and people will buy it. Unfortunately many a failed entrepreneur has discovered the hard way that this is just not so. The modern field of marketing was probably born from analyzing the fallacy of this metaphor. It also underscores the difference between the inventor and the entrepreneur. In particular, to be successful, in addition to coming up with something novel:

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<sup>1</sup> Though the original view focused on profitable opportunities, recent research also includes alertness to opportunities with social value, referred to as social entrepreneurship, further described in chapter 2.

- Customers need to know about your new idea.
- Customers must want your new idea.
- Customers must be willing to pay for your new idea. And most importantly
- Customers must be willing to pay more than it costs you to make or offer your product or service.

Thus, an idea is something one can do for a business, whereas an opportunity is something the marketplace wants enough that the founder can make a successful business out of it. (See chapter 8 for detailed information on opportunities). This difference is often a matter of *timing*. According to Kirzner, entrepreneurs have the knack or ability to know/sense the difference. This alertness is the focus of a new research field called entrepreneurial cognition, which borrows heavily from the field of cognitive psychology (Mitchell, et al. 2007).

Timing is an essential aspect of introducing either new products or services. If one introduces the product too soon, he or she often runs out of resources before enough customers can learn about it or are interested in buying it. A good example of this was the early mainframe computer industry. Eckert and Mockley was actually the first firm to attempt to develop and market mainframe computers. Few people have heard of the company because it went bankrupt. Another firm, International Business Machines (IBM), which had already become well known for its mechanical adding machines, actually adapted some of the technology originally developed by Eckert and Mockley into the first successful mainframe computer firm.

One can also be too late with introducing a product, especially if there are already too many competitors in the same field, and/or customer interest is at a peak but starting to decline. Companies dependent on existing technologies are always vulnerable for the following “disruptive” technologies which follow in the next “wave” (Christensen, 1997). A related concept to timing is that of the *window of opportunity*. According to one definition, window of opportunity refers to (an often short) period of time during which the entrepreneur must act on an opportunity in order to achieve a profit, or else it will be missed (Timmons and Spinelli, 2009). Typically, it is seen as somewhere between the early invention phase and maturity. Jumping into a market at the right moment may be a combination of luck or entrepreneurial skill. Looking backwards in time, it is often relatively easy to spot the moments of birth, growth, maturity and decline of a particular industry. But of course, the entrepreneur has to sense when to enter without the benefit of hindsight. This process is still not well understood but is indeed essential to the success of many if not most firms.

Video rental stores are a good example of the importance of timing and the related concept of window of opportunity. Though by the late 1990's such stores became much less profitable, and with changing technology, increasingly obsolete, in the early to mid 1980's, video rental services (whether as freestanding stores or as side products) had a relatively low barrier to entry for many small firms. Even the supermarket and local convenience store would offer videos for rental, quickly recouping the original purchase price. Relatively small but specialized video rental stores could also make a good profit. Then, in the mid 1980's, Blockbuster entered the market, initially in the United States and later in the United Kingdom and elsewhere. Blockbuster would locate in the market of smaller competitors, often directly across the street, putting thousands of these smaller stores out of business. Thus, at one point competition within the video rental industry was fierce, but then, newer disruptive technologies (such as downloading videos by internet) began to threaten the video rental industry altogether. By 2009, Blockbuster itself was struggling to survive; by 2010, it too was facing bankruptcy (Newman, 2009). In sum, in any industry, the challenge in the early phase is to be able to recognize a new product or service with growth potential (i.e. when the window of opportunity is about to open). But as an increasing number of competitors enter the market, it is also important to be able to spot when an industry approaches maturity, (i.e. when the window of opportunity is about to shut), either because the market is glutted with competitors or the entire industry is threatened by a new replacement technology. But it also requires a special ability to notice when it is time to introduce a new product (and/or to abandon an old one). Thus the flip side of alertness to opportunities also requires alertness to changes which may threaten one's core business and require an entirely new approach or set of products. To summarize, with respect to Kirznerian approaches to entrepreneurship, much attention is paid to the entrepreneur's ability to recognize opportunities. Activities of the entrepreneur involve decisions to enter (or leave) certain markets.

To illustrate the current understanding of entrepreneurship, we have selected from many existing definitions three that nicely describe what entrepreneurship is. All three definitions describe entrepreneurship as a process (see subchapter 1.4). The first definition, developed at Harvard, captures the core of entrepreneurship – the activity of an entrepreneur and his/her courage to pursue opportunities even without having his or her own resources at hand. According to this definition, a person with entrepreneurial spirit can find enough resources for turning his or her idea into reality. It also emphasizes the fact that entrepreneurship can take the form of independent or corporate entrepreneurship (see Chapter 12).

By starting with the word "mindset", the second definition suggests that an individual must be "mentally prepared" to engage in an entrepreneurial activity that also has positive economic outcomes. This definition also emphasizes creativity, innovation and the managerial skills required to develop the initial idea in later stages.

**Definition 1.1: Entrepreneurship**

- „is a process by which individuals – either on their own or inside organizations – pursue opportunities without regard to the resources they currently control”

Source: Stevenson and Jarillo (1990, p. 23)

- „is the mindset and process to create and develop economic activity by blending risk-taking, creativity and/or innovation with sound management, within a new or an existing organisation.“

Source: Green Paper on Entrepreneurship, European Commission (2003, p. 6)

- „is the process of creating something different with value by devoting the necessary time and effort, assuming the accompanying financial, psychic, and social risks, and receiving the resulting rewards of monetary and personal satisfaction.“

Source: Hisrich (1990, p. 209)

Finally, Hisrich’s definition (Hisrich, 1990) adds that there must be some new value for the customer, that entrepreneurship usually takes a lot of time and effort and involves both risks and positive outcomes.

In contrast with Schumpeter and Kirzner, motives of entrepreneurs are addressed by David McClelland (see Key representative 3.1 frame), a psychologist who specifically identified characteristics and motives of entrepreneurs (McClelland, 1961). In his research, he was especially interested in studying the Need for Achievement (nACH), with respect to entrepreneurs. Someone with a high nACH seeks to excel, and because of this avoids both low-risk and high-risk situations. The low-risk situation is too easy, and thus will not provide a sense of accomplishment whereas the high-risk situation is a matter of luck. The high nACH person also needs regular feedback to monitor his or her progress. Although McClelland does not define entrepreneurship per se, he does identify then, what he feels is a central motive differentiating entrepreneurs from other individuals. For more details about McClelland’s research as well as current findings on differences between entrepreneurs and other individuals see Chapter 3 for specific traits and chapter 4 for motivation.

### **Exercise 1.2: Application of the psychological theory or concept to entrepreneurship**

Consider a theory or concept you have learned in another course in psychology to explain human behaviour. How might you use this theory or concept to answer one of the three “micro-level” questions introduced at the beginning of this chapter (i.e. who is more likely to become an entrepreneur? Why are some entrepreneurs more successful than others? Are entrepreneurs different than other people?)

In the next section, we introduce some of the most recent trends in efforts to explain why some people and not others are able to discover and exploit particular entrepreneurial opportunities.

### **1.3 Cognitive psychology and research on entrepreneurial cognition**

Researchers who describe their work as that of *entrepreneurial cognition* borrow from cognitive psychology to examine the question, ‘How do entrepreneurs think?’ Four perspectives have been identified within the general umbrella of the entrepreneurial cognition approach, including the heuristics-based logic, perceived connections and alertness, entrepreneurial expertise and effectuation models (Mitchell, et al. 2007). Because these models are particularly of interest to psychologists who study entrepreneurs, we will briefly describe them in the remainder of this section.

#### **Heuristics-based logic**

“Heuristics” refers to simplifying strategies used by individuals to make decisions (Mitchell, et al, 2007). Apparently entrepreneurs and nonentrepreneurs can be found to differ in the heuristics they use. For instance, entrepreneurs often make significant leaps in their thinking, leading to innovative ideas that are not always very factually based (Mitchell, et al, 2007). A nonentrepreneur may feel that the entrepreneur is “jumping to conclusions” but it is exactly this jump that can lead to insights about new possibilities. Interestingly, entrepreneurs are also less susceptible to “sunk costs.” They are quicker to drop a strategy if they see it is not working out. This heuristic based logic also helps entrepreneurs to make sense of uncertain and complex situations, what others might call thinking “outside the box” or shifting paradigms to seeing facts in a new way.

#### **Perceived connections and alertness**

A second stream of research is directly linked to the notion of alertness proposed by Kirzner (1979). In extending Kirzner’s work in the social cognitive framework, Gaglio and Katz (2001) measure and test alertness differences. Other research suggests that the cognitive frameworks of some individuals may help them to connect the dots between environmental



changes, market trends, and customer demands, and which helps them in turn to see new business opportunities.

### **Entrepreneurial expertise**

Another research trend uses expert information processing theory to examine differences between entrepreneurs and nonentrepreneurs in their decision making. In brief, successful entrepreneurs may be far better able to use information than nonexperts, geared to business related decisions (Mitchell et al., 2000; Mitchell et al., 2007). Combinations of knowledge and applications are referred to as expert scripts.

#### **Exercise 1.3: Assessing your personal skills, abilities and interests**

Do a self-inventory of your own skills and accomplishments. Successful businesses often originate from past work, hobbies, or even experiences you may have had as a satisfied (or dissatisfied) customer.

**Part I:** Think about (and briefly jot down for yourself only) answers to the following questions:

- a) What kind of work have you done (or do you do now?)
- b) What kind of work do you enjoy?
- c) What are your hobbies?
- d) What really excites you? Or alternatively, which activities/events (work or nonwork) have given you the most satisfaction (i.e. job well done?)
- e) What are some of your greatest accomplishments?
- f) What are your long term goals?
- g) What do you dislike doing or don't do well?
- h) Which experiences could help you in launching a new firm?
- i) Who do you know who could help you get started in business?
- j) If you were to ask three people who know you well to list your three major skills what would they be?
- k) Circle the action verbs in your lists. Make a list of your top five skills. While you're at it, list five skills that you do not possess.

**Part II:** Prepare the following in writing:

- a) Prepare a short (1-2 page) biography of yourself which you can present to others. Provide a description and evaluation of yourself that will tell others what is most important in your self assessment. Consider your key strengths, weaknesses, key accomplishments, where you're headed, and what you could contribute to a business start up. How would you rate your motivation and aptitude as an entrepreneur?
- b) How much interest have you shown to date to become an entrepreneur?
- c) Try to list 10 business ideas which fit your background. (Don't worry at this point whether they are feasible or not).

## **Effectuation**

Finally, perhaps one of the most fully developed entrepreneurship cognition research trends is that of *effectuation* (Sarasvathy, 2001). The effectuation approach contrasts with the causal approach. In the causal approach, it is assumed that an entrepreneur recognizes an opportunity, and then considers alternative means to achieve outcomes leading to success (causation). In the effectuation approach, the entrepreneur begins with the means available to them and then sets out to use those means to create opportunities. According to this research, successful entrepreneurs, then are effectuators: They not only identify opportunities; they create opportunities. More important, they see possibilities others don't see. In the simplest example, in explaining the theory, Sarasvathy contrasts the chef in the kitchen who follows a recipe to make a dessert (causation model) and the chef who looks on the pantry shelf, finds three or four ingredients and creates a dessert from the available ingredients. In a more detailed example, she describes the case of the U-Haul company, a very successful US firm (see From practice 1.1).

### **From practice 1.1: U-Haul company**

In post World War II, the US population was becoming more mobile, with a combination of increased wealth and affordability of the automobile. Seeing this, L.S. Shoen and his wife, Anna Mary Carty Shoen, started the U-Haul company with the help of \$5,000 from the Carty family. By 1949, Shoen had already built a coast-to-coast moving service. The U-Haul company was built with a limited amount of resources:

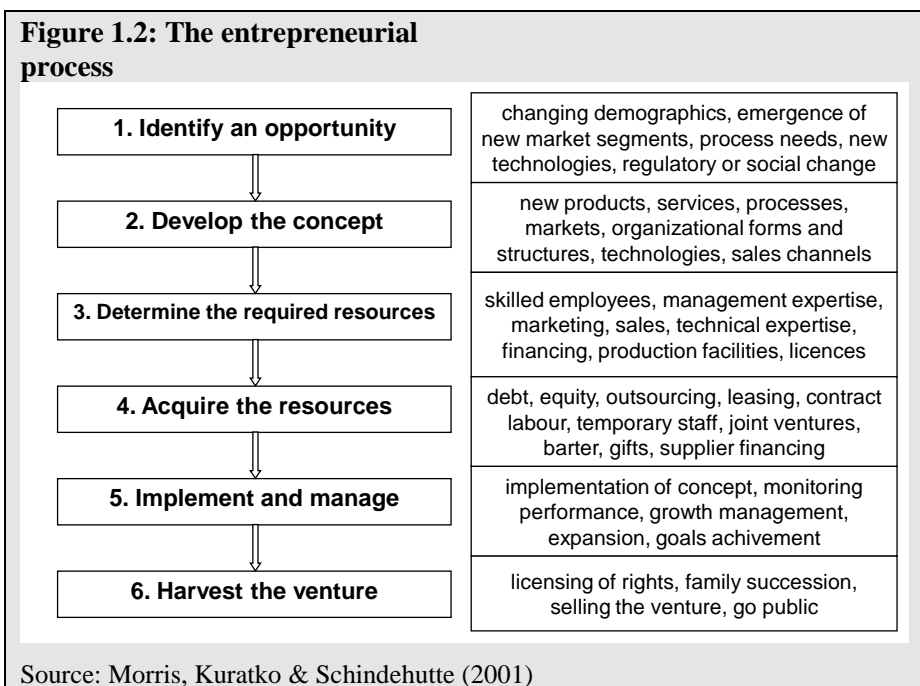
- There was no personal movers market in 1946. Shoen had to see a market that did not yet exist.
- Shoen worked with limited resources for advertising, so he painted his trucks bright orange with advertising on the truck: "U-Haul Rental Trailers, \$2.00/day."
- Again, having little money for trucks, Shoen convinced friends, family, and customers to make down payments and then lend him money to buy his first trucks.
- Finally, he contracted with service station outlets to help sell the rentals and offered early customers a discount if they established a U-Haul rental agent at their destination!

Source: Sarasvathy (2001)

## 1.4 A framework for understanding the entrepreneurial process

Modern day researchers in entrepreneurship tend to view entrepreneurship as a process, that is, a series of activities, steps or stages, rather than as a single event. Figure 1.2 presents six stages of the entrepreneurial process, according to Morris, Kuratko and Schindehutte (2001). To the right of each stage, key decision variables or alternatives which come into play at each stage are also listed. According to Morris, et al. (2001), the entrepreneurial process can be applied to any organizational context, from the start-up venture to the established corporation or social enterprise.

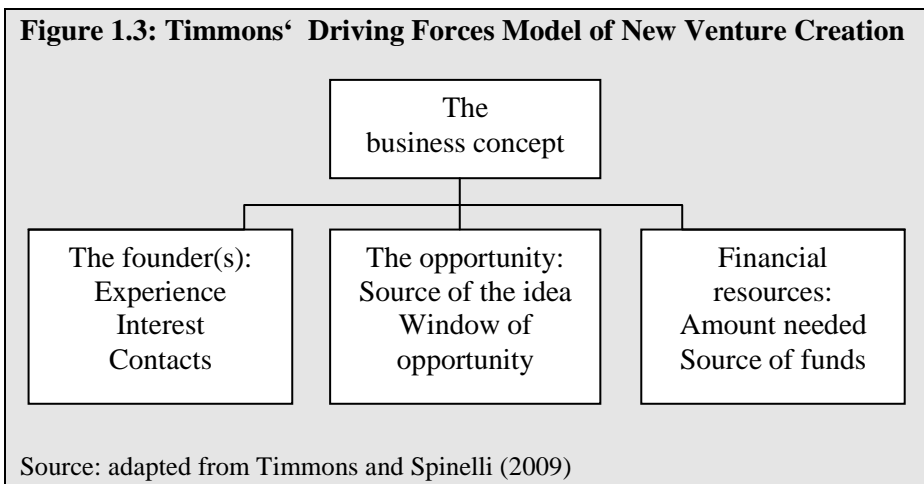
Note that this model is consistent with what Sarasvathy refers to as a “causal” approach - that is, the entrepreneur begins with identifying the opportunity, then determining and acquiring resources. In reality, different entrepreneurs may approach the problem in different order (first assessing available resources, then opportunities which can fit, etc.). However, in the process, eventually all six stages or steps must be executed in the start-up or in the ongoing firm.



Some of these stages will be addressed in more detail in subsequent chapters. Thus, opportunity recognition and development will be discussed in chapter 8, on opportunities. Chapter 10 will discuss aspects of entrepreneurial

leadership and Chapter 11, Managing the growing firm will address certain aspects of implementation and management of the firm.

Timmons and Spinelli (2009) identify three elements that are the driving forces behind new venture creation, including the founder(s), the opportunity, and (financial) resources. (See Figure 1.3). All three must balance with one another to assure success of the venture. Many experts consider the founder(s) as the most important element in start-up success. The entrepreneurial team is a key ingredient for what they refer to as a higher-potential venture. A commonly accepted view now amongst venture capitalists, is that a Grade A Team and a grade B idea is better than a Grade B team and a Grade A idea (Timmons and Spinelli, 2009). In other words, the quality of the team is more important than the quality of the opportunity.



Opportunities can be adapted or changed over time, additional resources can be sought, but if the founding team is wrong from the start, it is unlikely that a firm will survive. In later chapters we will come back to more detailed discussion of these three elements. However, a useful starting point in developing a business concept is a thorough self-assessment of one's own skills, interests, and contacts (see Exercise 1.3). We have already introduced the second key aspect, the opportunity. Sources of ideas may come in many places but again, timing and the appropriate window of opportunity as well as many other aspects must be considered to distinguish an opportunity from an idea. Surprising to many students is that financial resources are least important of the three. Although financial resources are important, a really great team and opportunity can often attract external capital, or the entrepreneur can find ways to bootstrap the company (controlling without owning resources) to launch the firm.

### **From practice 1.2: The start-up of RIM-Tech**

Mr. Jaromir Vaja received his degree from Prague University of Chemistry and Technology and his PhD. from the Czech Academy of Science in the late 1980's. In his first employment after receiving his PhD, he went to work for the Research Institute for Rubber and Plastics (RIRP). There, he worked on a project using reaction injection moulding (RIM) technology in cooperation with DSM, a Dutch-based multinational company focused on the material and life sciences. But in 1989, after the Velvet Revolution, the communist regime collapsed, after which the government simply stopped to pay researchers. Out of necessity, thus he decided this would be a good time to start his own business, which he named RIM-Tech. When it was founded, RIM-Tech was the only firm in the East-European market using RIM technology. The goal of the new firm was to produce big plastic parts in medium-sized series, mainly for bus and truck producers such as Karosa, Tatra or Avia.

When Mr. Vaja, launched his firm, he had very little personal savings and only some of the needed technical know-how. But he formed a start-up team with five other former (Czech) colleagues of the research institute, who contributed not only know-how but additional financial capital. In addition, a Dutch company provided expert advice regarding the production process and also helped contact customers. Start-up capital only came from the partners and their families. Note that at this early stage, banks were unwilling to finance the firm and venture capital funds were not yet on the Czech market.

At the start, the partners appointed Mr. Vaja as chief executive officer (CEO). This decision was partly due to his initiative in launching the firm, and also partly due to his expertise in speaking English, essential for working with his Dutch partners and with customers. To compensate for Mr. Vaja's lack of business background, RIM-Tech hired Mr. Zatloukal as the firm's economist. From the bankrupted research institute, RIM-Tech bought some devices from the now defunct research institute, RIRP, enabling it to start production using RIM technology but only in small volumes. At this start-up stage, due to the limited capital and lack of funds to build a larger production plant, however, growth was relatively slow-paced.

In the early years the owners paid themselves almost no salaries. Rather than pay themselves, the owners reinvested earnings to buy and improve machines and technologies. After one year, Mr. Zatloukal proved himself to be very capable, therefore he became a co-owner. Even when they started to pay themselves, they paid their manual workers twice as much so that they could retain good people. In the beginning, Mr. Vaja controlled most activities himself. However, when he saw that some of his co-owners

would be better able to perform certain tasks, he was happy to give them responsibility for those tasks.

Source: interview with Mr. Vaja led by Helena Rezacova

#### **Exercise 1.4: Applying the Driving Forces Model to RIM-Tech case**

Consider the Timmons Driving Forces Model of new Venture Creation. Evaluate each of the factors: the founding team, the opportunity and resources in the above-described case of RIM-Tech (see From Practice 1.2).

## **1.5 To conclude**

Reviewing the different theories in this chapter, we see many different interpretations of who or what is an entrepreneur: someone who takes risks financially (according to Cantillon), innovates with new products, markets or applications (Schumpeter), recognizes and is alert to opportunities (Kirzner) and can create opportunities that others don't readily see (an effectuator according to Sarasvathy).

The more recent research in entrepreneurial cognition is promising, because it tries to use cognitive psychology to better understand how entrepreneurs think, and whether they use different decision-making approaches than either less successful or nonentrepreneurs. However, this research is in its early stages. More work will be needed before we can draw clear conclusions.

The final section of this chapter introduces the stages in the entrepreneurial process and the driving forces model of new venture creation.

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## Chapter 2

# SOCIAL ENTREPRENEURSHIP

Ute Stephan

### **2.1 Introduction**

This chapter aims to provide a practitioner-oriented introduction into social entrepreneurship (SE) with a special focus on how psychological theories and research can enrich our understanding of SE. I will discuss how common social entrepreneurship is, dominant theoretical approaches to social entrepreneurship, the joint creation of economic value and social change along with illustrative examples and exercises suitable to use in the classroom. But let us start with an attempt to clarify what social entrepreneurship is, i.e. with a specific example and its definition.

In September 2007 Northern Rock, a UK bank experienced a bank run and was finally nationalized in February 2008. While many other smaller banks failed, the US government sponsored enterprises Fannie Mae and Freddie Mac, the major capital and guarantee provider to the US mortgage market, were nationalized on September 7<sup>th</sup>, 2008. In short sequence major US retail and investment banks were nationalized or sold at panic prices, while Lehman Brothers was allowed to fail. Losses of large US and European banks due to the credit crisis between 2007 and 2010 are estimated to exceed 2.8 trillion US Dollars (Reuters, 5.11.2009). The banking crisis subsequently developed into an economic recession that destabilised entire economies. The International Monetary Fund provided rescue packages to 15 countries – loans totalling 165 billion US Dollars in September 2009.

In 2008, the year in which the crisis unfolded, the press releases of Triodos Bank Group, a European banking group active in the Netherlands, Belgium, Spain, the United Kingdom and Germany, convey a different, optimistic picture. For instance, in February 2008 Triodos announced the launch of a new investment fund to provide financing to organic and Fair Trade producers in developing countries and emerging markets – some of which were hit hard by the financial crisis. Triodos Group grew its balance sheet by 23% in 2007, by 25% in 2008 and by 30% in 2009, each year earning profits of about 10 Million Euros. In autumn 2008, when the UK government announced that it would engage in quantitative easing to rescue the economy and banks around the world were met with deep mistrust, Triodos Bank had to



close its share issue early, because too many people were interested in investing in it. The secret of Triodos Bank? It lends exclusively to the real economy, i.e. money that people and institutions deposit with the bank is exclusively lent out to and invested in sustainable businesses and projects such as renewable energy companies, new developments in biomass, socio-ethical and cultural projects and over 100 microfinance institutions in 40 developing countries. In short, Triodos Bank is a social enterprise and a major financier of social enterprises.

A defining feature of social businesses is that they are cause- or mission-driven. The cause or mission they pursue is to create social value. Their second defining feature is that they are businesses or enterprises, i.e. they engage in revenue generating activities through which they earn at least part of their income, and – depending on the definition of entrepreneurship one adopts (see Chapter 1) – they act ‘entrepreneurial’ as businesses, i.e. adopt innovative business models, products, services or processes. Consequently, social enterprises are also characterized as ‘hybrid’ organizations, i.e. a combination of pure philanthropic, non-profit organizations and pure commercial, for-profit organizations (Alter, 2007).

**Definition 2.1: Social entrepreneurship**

“Common across all definitions of social entrepreneurship is the fact that the underlying drive for social entrepreneurship is to create social value, rather than personal and shareholder wealth ..., and that the activity is characterized by innovation, or the creation of something new rather than simply the replication of existing enterprises or practices.”

Source: Austin, Stevenson & Wei-Skillern, 2006, p.2

Note that, although some narrowly define social entrepreneurship as the application of business know-how in the nonprofit sector, i.e. nonprofits developing earned income strategies, in fact social entrepreneurship does not have to be bound to a certain legal organizational form (Austin et al., 2006, see also Figure 2.1). While, a non-profit organization that derives 100% of its funding from government and provides an established service to the local community such as running a kindergarten would not be regarded as a social enterprise. A for-profit business such as a company limited by liability may be considered to be a social enterprise, for example when it focuses on providing consulting services to businesses on how to green their operations and become more sustainable. Lastly, creating shareholder value is clearly not the main focus of social enterprises. Surpluses are typically reinvested in the enterprise, however some social enterprises may also pay out a dividend to shareholders. The spectrum of social entrepreneurial organizations can be roughly characterized as depicted in Figure 2.1. Note that the distinction between mission-driven for-profit social enterprises and traditional for-profit firms

engaging in some added social activities is sometimes hard to draw as indicated by the dotted line.

**Figure 2.1: Social enterprise spectrum**

NGO	Social Enterprise			For-Profit	
Traditional Non-governmental/non-profit organization	Not-for-profit Social Enterprise	Hybrid Social Enterprise	For-Profit Social Enterprise	Traditional For-Profit engaging in social activity	Traditional For-Profit
focus on social/environmental goals, not-for-profit status	focus on social/environmental goals, not-for-profit status, innovation	focus on social/environmental goals; earned income strategy integrated or complementary to the mission	high but not exclusively social/environmental goals; earned income strategy	e.g. Corporate Social Responsibility initiatives	exclusively economic goals, maximizing shareholder value/economic return to owners

Source: adapted from Justo, Lepoutre and Terjesen (2010, p.48)

## 2.2 The spread of social entrepreneurial activity

How common is social entrepreneurship? In 2009 the Global Entrepreneurship Monitor (GEM) Project for the first time collected data (via population representative surveys) on the prevalence of social entrepreneurship across 49 countries. GEM used a broad definition of social entrepreneurship and included both social entrepreneurial organizations and projects that are in the founding process as well as those that are established<sup>1</sup>. Approximately 1.8% of the population across countries are engaged in social entrepreneurial activity (Justo et al., 2010). This ranges from as low as 0.1-0.2% in Guatemala, Malaysia and Saudi Arabia to over 4% in Argentina and United Arab Emirates. Within Europe rates were, for example, 0.9% in The Netherlands, 0.7% in Germany, 0.5% in Spain, with higher rates in the United Kingdom (2.1%), Belgium (1.7%) and the post-communist countries such as Hungary (2.7%), Slovenia (2.0%) and Latvia (1.9%). GEM found that across countries males are more likely than females to start social enterprises, although the gender gap is smaller than that for entrepreneurial activity in general. In a similar way to

<sup>1</sup> The question respondents answered was „Are you, alone or with others, currently trying to start or owning and managing any kind of activity, organization or initiative that has a particularly social, environmental or community objective? This might include providing services or training to socially deprived or disabled persons, using profits for socially oriented purposes, organizing self-help groups for community action, etc." (Justo et al., 2009, p.44)

entrepreneurship, education is positively linked to social entrepreneurial activity. Taken together, only a small minority of a country's population engages in social entrepreneurship.

**From practice 2.1: LATE! - Juan Pablo Larenas, co-founder**

*Could you briefly summarize what LATE is about?*

LATE is a Social Enterprise that trades different mass-consumption products in the Chilean market. 100% of our profits fund social initiatives/projects in Chile. Each product is related to a social cause for children at social risk in Chile. Currently, our main product is bottled water, but we are planning to launch new products very soon (that generate much fewer negative externalities than bottled water). LATE was founded in late 2008.

*How did you get involved in starting it?*

I will answer the Why instead of the How. All Late owners (5 people) were unsatisfied with the current market economy and the little commitment from both firms and consumers in creating a more sustainable and friendly society. Thus, we are trying to implement in a more massive way the idea of Social Enterprise, with common products. Also, with Late products we are encouraging consumers to think about the consequences of their daily acts of consumption. Thus, to think more social, more ethical. So, our vision is to positively impact both the supply and demand side.

*What is distinct about social enterprise and social entrepreneurs, in other words how do social enterprises/entrepreneurs differ from NGOs and for-profit businesses?*

The triple bottom line. Social Enterprises should do ALL in one, which basically means achieving Economic, Social and Environmental positive impact, and minimizing negative externalities. In the case of Late, our BIG challenge is to be MUCH MORE environmentally friendly. Also, and personally speaking, the main motivation is that Social Enterprises are becoming an alternative to the traditional type of enterprise. They include new values and concepts, that certainly generate growth, reduce poverty and inequality, and contribute to a more friendly environment.

*Having lived in both Chile and the UK, would you say that social entrepreneurship differs in more developed countries compared to less developed countries?*

I believe that in both countries you can see great ideas and great people behind them. I have had the opportunity to meet very inspiring people in both parts, with similar personality (traits and values). Currently, I see three main advantages from a developed country, in regards to Social Entrepreneurship:

1. Amount of research: gigantic differences in the amount of research in these topics, which are transformed into public policies or support platforms.
2. Support platforms from third sector organizations, government bodies, etc.: to become a successful social entrepreneur, it is necessary but not a sufficient condition to be innovative, proactive and hard working. Networks and support platforms (tailor made financing, training, etc.) probably play a key role for social ventures (e.g., Ashoka, Social Enterprise London, Social Enterprise Coalition, Fair Trade Department, Social Enterprise HUB in the Olympics and so on).
3. Role of the consumer: Last, but not least, in developed countries the idea of consumption and citizenship are merged. In Chile and the rest of Latin America not yet. Thus in the UK you can observe consumers that use the “act of consumption” as a political weapon, punishing the companies that do not behave ethically, and rewarding those that do behave ethically. Thus, the massification of the ethical (social, environmental) market can be explained in part by the role of the consumer. This is still a big challenge in Chile. Ethical product consumption increased exponentially because of the demand side pressures.

Source: interview of the autor with Juan Pablo Larenas, [www.late.cl](http://www.late.cl)

## **2.3 The (lack of) psychological theory in social entrepreneurship**

To date no single unifying theory of social entrepreneurship exists. In a similar way to entrepreneurship, many disciplines including economics, management, and sociology make valuable contributions to our understanding of social entrepreneurship - largely based on theoretical approaches grounded in their respective discipline. Furthermore, research into social entrepreneurship has been predominantly theoretical or case based with a lack of studies conducted on larger samples testing formal hypotheses (Short, Moss & Lumpkin, 2009 for a review). Moreover as measured by publications in psychology journals, social entrepreneurship has essentially been ignored by psychologists (Short et al., 2009). However, I will next discuss one of the most developed theoretical perspectives on social entrepreneurship – institutional theory and outline how psychological approaches complement this theoretical perspective. I will then follow this by highlighting opportunity recognition, values and motivation, organization building as well as cross-cultural issues as areas where psychological approaches can deliver valuable insights.

Institutions are constraints that structure political, economic and social interaction (North, 1991) and as such they can be informal (e.g. culture,

traditions, and codes of conduct) and formal (e.g., property rights, laws etc.). Institutional theory analyses these institutions and the processes by which they become established. The literature on institutional entrepreneurship (Battilana, Leca & Boxenbaum, 2009) makes an important contribution to understanding specifically how social entrepreneurs emerge and change institutions, such as successfully implementing commonly accepted norms and standards, like the Fair Trade label, or laws. For example, Mair and Marti (2009) provide an insightful analysis that highlights the role of so-called institutional voids, i.e. the absence of political, legal and economic institutions that enable equal market participation of all segments of society, as an important opportunity structure to which social entrepreneurs respond.

**My research 2.1: Non-profit leaders and for-profit entrepreneurs – similar people with different motivation**

*Martin Lukes & Ute Stephan*

Today's market conditions require non-profit leaders to act in an increasingly business-like fashion. Our study asked whether NPO leaders have a similar disposition to act entrepreneurially as for-profit entrepreneurs, but hold different underlying motives. For this purpose, we contrasted a sample of 78 leaders of non-profit organizations with 117 entrepreneurs on their personality traits and motives using standard personality tests and interviews. Both groups were located in Prague, the Czech Republic.

Motives were captured by an open-ended question "What motivates you to be an entrepreneur / non-profit leader?" General traits were measured with the short Big Five inventory MRS-20 (Schallberger & Venetz, 1999). Furthermore, we collected information on specific traits, i.e. general self-efficacy (Schwarzer & Jerusalem, 1999), personal initiative (Frese et al., 1997), locus of control (Burger, 1986) as well as risk and responsibility taking (Koch, 2000).

Non-profit leaders and entrepreneurs exhibit similar (and entrepreneurial) personality traits, but differ significantly regarding their motivation. While non-profit leaders' motivation stems primarily from the meaningfulness of their work, for-profit entrepreneurs are mainly motivated by the independence as well as by the income and profit provided by their work.

The results show that non-profit leaders form a unique group – the group of people who are entrepreneurial and yet have primarily social good in mind motivating their behaviour. In this regard, NPO leaders may be called social entrepreneurs: 'social' because of their motivation and 'entrepreneurs' because of their personality traits.

A psychological approach complements an institutional analysis, for example, by highlighting which individuals are most likely to respond to such situational opportunities. This approach builds on an interactionist understanding of individual action, integrating situational and personal characteristics. Important *personal characteristics* to consider are personality traits (Chapter 3) as well as individual motivation (Chapter 4). In our own research (see My research 2.1), we found no difference in non-profit social entrepreneurs compared with commercial entrepreneurs regarding personality traits. We could, however, identify clear differences in motivation between the two groups. Building on this research, the psychological concept of values seems particularly relevant in social entrepreneurship research.

Values are general goals that people strive for in life and are a driver of their motivation (Schwartz, 1992). Values guide attention and information processing processes (e.g., Schwartz, 2009) and as such may also guide *opportunity recognition and discovery* processes. More specifically, a combination of prosocial and openness values are most likely to underlie the opportunity recognition of social entrepreneurs. Individuals with such values would be particularly perceptive to social needs (prosocial value orientation) and would see potential to create new things and innovate (openness to change value orientation, Schwartz, 1992). Moreover, past research suggests that opportunities are not merely discovered but are actively shaped by entrepreneurs in collaboration with committed others – especially in highly uncertain situations (Sarasvathy, 2008). Social enterprises arguably act under conditions of high, if not extreme, uncertainty as the very notion of social enterprise and their business models are often unfamiliar to potential customers, regulators and market incumbents. Prosocial values have been found to be associated with a higher propensity to collaborate and consensus seeking behaviour (e.g. Bersma & De Dreu, 1999), and as such would seem to facilitate the exploitation of opportunities in collaboration with partners.

Theories of human motivation, particular those based on values and dealing with prosocial motivation (e.g. Bierhoff, 2007; Kasser, Cohn, Kanner & Ryan, 2007; Schwartz, 2009, also Chapter 4) can also help to build a more fine grained *understanding of the ‘social’ component* in social entrepreneurship and potentially explain variation within the population of social enterprises. Prosocial behaviour refers to actions that are taken in order to improve the situation of another person (Bierhoff, 2002) or benefiting another person (Piliavin & Cherg, 1990). The motivation to engage in prosocial behaviour seems to have (at least) two components, pure concern for the other person and egoistic motives (such as alleviating ones own discomfort arising from seeing another person suffer or gaining benefits such as increased status or reputation). Research could relate such motivational characteristics to the type of organizations that social entrepreneurs set up, the indicators they use to evaluate organizational success and ultimately the

societal change and economic success that these organizations achieve. First research on commercial entrepreneurs indeed supports the notion that variation in entrepreneurs' values helps explain variation in the way they define organizational performance (Gorgievski, Ascalon & Stephan, 2010).

### **Exercise 2.1: What are your values?**

Shalom H. Schwartz has developed arguably the most theoretically stringent and comprehensive theory of human values to date (e.g., Schwartz, 1992). You can self-assess your values by filling in the Schwartz Values Survey as available in Schwartz (1992). Alternatively, refer to a short version of this value survey using a different presentation format, the Value Portrait Questionnaire. You can find that questionnaire at:

[http://www.europeansocialsurvey.org/index.php?option=com\\_docman&task=doc\\_view&gid=477&tmpl=component&format=raw&Itemid=80](http://www.europeansocialsurvey.org/index.php?option=com_docman&task=doc_view&gid=477&tmpl=component&format=raw&Itemid=80)

Pages 2/3 or 4/5 depending on your gender. To compute your values scores follow the instructions here:

[http://ess.nsd.uib.no/ess/doc/ess1\\_human\\_values\\_scale.pdf](http://ess.nsd.uib.no/ess/doc/ess1_human_values_scale.pdf)

When evaluating your personal value profile, you may want to consider the values that have been suggested to be typical for social entrepreneurs. These are self-direction, stimulation, universalism, benevolence, and achievement.

Moreover, work and organizational psychology can help to understand the unique features of social entrepreneurial *organizations*. For instance, person-organization fit theory and the Attraction-Selection-Attrition framework (Hoffman & Woehr, 2006, Schneider 1987) suggest that social enterprises should particularly attract prosocially motivated employees. At the same time our understanding of how to lead and manage prosocially motivated employees is limited. How should HRM and reward systems be designed and which leadership style is optimally suited to lead prosocially motivated employees? Furthermore, there seems to be a tension inherent in social enterprises, which are typically highly resource constrained and thus have to rely on employee creativity and proactivity to be successful. In other words, social enterprises would seem an ideal research field to test, integrate and further develop novel approaches in work and organizational psychology focusing on prosociality and proactivity (Grant & Parker, 2009).

At the same time, if social enterprises successfully manage these tensions they could be organizations that uniquely *empower their employees* and thereby contribute to positive societal change (Spreitzer, 2007). Core dimensions of employee empowerment are the provision of meaningful work and the freedom to develop personal competences enabled through workplace autonomy and participatory leadership. All these features might be particularly prevalent in social enterprises. For instance, through their mission- and cause-orientation social enterprises provide employees with

meaningful work. While equality concerns inherent in prosocial motivation as well as resource constraints suggest that workplace autonomy and proactive behaviour will be widespread in social enterprises (e.g., Fay & Sonnentag, 2002).

Lastly, cross-cultural theories of culturally shared values but also culturally shared practices (descriptive norms) can help us to understand which societal context, i.e. which informal institutions, particularly facilitate or hinder social entrepreneurship. For instance, socially supportive cultures, which have been found to predict various types of national entrepreneurship rates (Stephan & Uhlander, 2010) might also be conducive to social entrepreneurship.

## 2.4 The creation of social and economic value

Understanding how an enterprise generates profits and sustains this profit generation in the long-term, i.e. understanding an enterprises business model, is arguably key for successful entrepreneurship (Chapter 8).

### **Definition 2.2: Business model**

At the most rudimentary level, the business model is defined solely in terms of the firm's economic model. The concern is with the logic of profit generation. Relevant decision variables include revenue sources, pricing methodologies, cost structures, margins, and expected volumes.

Source: Morris, Schindhutte and Allen (2005, pp. 276-277)

However, since profit is not the main goal of social enterprises, understanding social enterprises' business models is only half the story. Key to understanding social enterprise is both the logic of how economic return is generated and the logic of how social value is created. The latter is captured in the Theory of Change, which reflects the social entrepreneur's mental model of how social change is achieved. Finally, social enterprises differ in how well profit-generation and the generation of social impact are aligned. This is discussed at the end of this chapter (see operational models).

A social enterprise's subjective theory of change is invaluable not only in steering its actions but also to legitimize itself in the eyes of important stakeholders including its employees, customers, and financiers. At the same time, disciplines such as social psychology (e.g., Bierhoff, 2002; Hogg & Vaughan, 2008 for reviews) and social movement theory (e.g., Chetkovic & Kunreuther, 2006) provide research insights into how societal change can be achieved. I first discuss bottom-up strategies that outline how change on the individual/micro-level leads to change on the macro-level and then discuss those that directly target the macro-level. The underlying psychological approaches could be characterized as approaches building on individual



empowerment and those drawing on minority influence models as well as on persuasion and attitude change theories.

**Definition 2.3: Theory of change (TOC)**

A TOC is a tool for developing solutions to complex social problems. A basic TOC explains how a group of early and intermediate accomplishments sets the stage for producing long-range results. A more complete TOC articulates the assumptions about the process through which change will occur and specifies how all of the required early and intermediate outcomes related to achieving the desired long-term change will be brought about and documented as they occur.

Source: adapted from Anderson (2005)

*Bottom-up, or micro-to-macro strategies* concentrate on engaging a specific target or client group. That is, social change is seen as a participatory process in which the social enterprise works with the client, rather than on behalf of the client. As early as the 1940s Kurt Lewin pioneered action-research that, in order to instil social change, would directly involve those people whose behaviours should be changed. He empowered his clients by providing them with the necessary skills for behaviour change. Similarly, social enterprises, aim to promote clients' self-determination through involvement and skill-building – i.e., they provide 'help for self-help'. While some enterprises stress individual empowerment as social change per se, others link this with collective action, i.e. educate, motivate, inspire individuals beyond the immediate self-help and even facilitate collective action. For instance, microfinance institutions such as Muhammad Yunus' Grameen Bank (the recipients of the 2006 Nobel Peace Prize), lend small amounts of money predominantly to poor women so that they can set up micro-enterprises (e.g., buy materials to weave fabric at home, which they then can sell on local markets). Microfinance has not only helped to reduce poverty by enabling women to earn income and actively participate in market exchange, it also empowers women, supporting their self-organization and helping to positively change perceptions of women in society.

*Macro-level strategies* to bring about societal change focus on political advocacy aiming to change legislation. The means to achieve changes in legislation are lobbying, networking, and building partnerships as well as creating public opinion pressure through information and campaigns. This social change strategy is arguably mostly employed by pure nonprofits and NGOs (non-governmental organizations). Research in social psychology on minority group influence (e.g., Bierhoff, 2002; Hogg & Vaughan, 2008 for reviews) especially helps to explain how NGOs bring about macro-level societal change. First, research finds that when faced with a strong majority that is perceived to be unanimous, as often exists in close-knit cultures or

totalitarian states, any kind of dissent (independent of its content) helps to enhance the social influence of minority groups as it gives minority actors *per se* more legitimacy.

Second, in order for a certain message to take hold, NGOs/social enterprises often do many things that research found to be characteristic for minority groups that successfully influence majorities. The single most important point is that a minority group needs to argue and behave consistently with regard to its message. That is, it must practice what it preaches. For instance, Triodos Bank advocates the use of fully transparent banking practices<sup>2</sup>. Consequently, Triodos regularly publishes a list of all projects, enterprises and institutions it finances, how it votes in annual meetings of companies in which it invests etc. This consistency draws attention, conveys an alternative point of view as well as certainty in and strong commitment to this view. Moreover, it provides a solution that contrasts with the dominant majority solution. An example of the confusion and detrimental effects of inconsistency is the recent debate about errors and misleading evidence published on climate change and the forecasts of its effects.

Furthermore, minority groups in general and social movements and individual NGOs in particular are especially successful when they are seen to be acting out of other-concern and not self-concern (indicators are significant investments or material sacrifices); when they are seen as autonomous rather than being influenced by some other entity; and when they are not acting inflexibly but appear open-minded while simultaneously keeping to their message.

Building partnerships and networks are important, because the influence of a minority group (or opinion) increases with the size of the group (or people that endorse it). At the same time, a variety of interpersonal influence techniques (see Cialdini, 2001) come into play when NGOs lobby political institutions.

When it comes to persuading not only representatives of political institutions but also the public in order to create public opinion pressure, research on how to achieve attitude and behaviour change and particularly towards adopting prosocial and environmental behaviours (e.g., helping others or recycling) can help NGOs to devise appropriate strategies. One crucial condition in this regard is to instil responsibility and commitment, and to outline clearly what each specific person can do and how to help. Approaches focussing on motivating behaviour by instilling guilt (e.g. not helping organization will kill more trees) result in short-term, but not long-lasting change.

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<sup>2</sup> The opacity of financial markets was one of the prime factors that allowed the banking crisis to occur.

Finally, change is associated with uncertainty. The benefit of the status quo is that everyone is familiar with it and accepts it. Once a minority group, say an NGO, proposes a different course of action, it introduces uncertainty and often people use ridicule as a defence mechanism. The influence mechanism outlined above is useful to minorities in countering this. In addition, it can be helpful that the minority group bears some similarity with the majority. When somebody or a group is perceived as similar to oneself or (at least partly) as part of one's own group, it is harder to ridicule or reject and easier to accept him/her and the group. In the case of Triodos Bank, this is the adoption of a for-profit model and incorporating as a company with limited liability. In other words, Triodos works within the same constraints as other banks and demonstrates that it can deliver profits with 100% sustainable lending and investment activities. Another important mechanism to reduce uncertainty and inspire change is visionary leadership such as discussed in the concept of transformational leadership (Greenberg & Baron, 2008).

### **Exercise 2.2: Brainstorming theory of change**

Identify the theory of change for the two examples below, along with strengths and potential weaknesses. Try to generalize from these examples and other examples of social enterprises and answer the following questions.

- **What are ways to create sustainable social change and impact?**
- **Who needs to be involved to bring about social change and how?**

E.g., what kind of stakeholder groups, which partners etc. What are the incentives for the various groups and partners to be involved?

- **What kind of challenges is one likely to be faced with?**

#### **Example 1: The Big Issue**

The Big Issue is a UK-based social business founded in 1991 by Gordon Roddick and A. John Bird. It offers homeless and vulnerably housed people the opportunity to earn a legitimate income. The Big Issue consists of a limited company which produces and distributes a magazine to a network of street vendors, and a registered charity which exists to help those vendors gain control of their lives by addressing the issues which have contributed to their homelessness. **The Big Issue Company** publishes a weekly entertainment and current affairs magazine, which Big Issue vendors buy for 85p and sell for £1.70, thereby earning 85p per copy. Any profit generated through the sale of the magazine or the sale of advertising is passed on to the registered charity, **The Big Issue Foundation**. The Foundation also relies on donations from the public to fund its work with vendors.

In December 2008, The Big Issue supported over 2900 homeless and vulnerably housed people across the country. The magazine is read by over 670,000 people every week throughout the UK. The Big Issue is also an

international entity with versions of the magazine being published in Australia, Japan, South Africa, Kenya, Ethiopia, Malawi & Namibia. The Big Issue is a founding member of The International Network of Streetpapers which represents the interests of over 80 similar social businesses in 37 countries.

The founders of the Big Issue believed that the key to solving the problem of homelessness lay in helping people to help themselves, and to offer a legitimate alternative to begging. The Big Issue Foundation charity was created in 1995 with the aim of tackling the underlying issues which cause homelessness, and supporting vendors in their journey away from the streets. The foundation provides services and referrals to address issues around housing, health, finances, education and employment – and supports vendors in fulfilling their personal aspirations.

The Big Issue is a business solution to a social problem, demonstrating that an organisation can succeed whilst being simultaneously driven by commercial aims and social objectives. It has helped thousands of individuals to regain control of their lives and has simultaneously altered public perceptions of homeless people. And through its editorial content the magazine has informed, challenged and entertained millions of people.

**Source:** [www.bigissue.co.uk](http://www.bigissue.co.uk)

#### **Example 2: Ashoka – Innovators for the public**

Bill Drayton founded Ashoka in 1980. The first early stage social entrepreneurs were elected Ashoka Fellows in India in 1981, Ashoka has grown to an association of over 2,000 Fellows in over 60 countries on the world's five main continents. Ashoka today works on three levels: 1) Identifying and supporting individual social entrepreneurs—financially and professionally—throughout their life cycle. 2) Bringing communities of social entrepreneurs together to help leverage their impact, scale their ideas, and capture and disseminate their best practices. 3) Helping build the infrastructure and financial systems needed to support the growth of the citizen sector and facilitate the spread of social innovation globally. Ashoka sees their work on these three levels as mutually reinforcing in pursuing their vision (Everyone a Changemaker™): “Ashoka's job is to make Everyone a Changemaker™. To help create a world where everyone has the freedom, confidence, and skills to turn challenges into solutions. This allows each person the fullest, richest life. And a society so constituted will evolve and adapt faster and more surely than any other.”

Important for bringing about societal change is an understanding of history and the citizen sector: “... the citizen sector, led by its entrepreneurial cutting edge, "tipped" irreversibly onto its new competitive path and entered a period of rapid catch-up productivity acceleration and growth... Ashoka now has a rich pipeline of proven, high leverage

interventions ready to spread globally and an institution that spots needs and then builds and adapts quickly.... Ashoka is no longer alone. It has a growing number of partners and potential partners.”

**Source:** www.ashoka.org, Bornstein, 2007

### **Exercise 2.3: Steps to create a theory of change**

1. Identify a long-term goal.
2. Conduct “backwards mapping” to identify the preconditions necessary to achieve that goal.
3. Identify the interventions that your initiative will perform to create these preconditions.
4. Develop indicators for each precondition that will be used to assess the performance of the interventions.
5. Write a narrative that can be used to summarize the various moving parts in your theory.

Sources: adapted from www.theoryofchange.org and the Harvard Family Research Project, <http://www.hfrp.org/evaluation/the-evaluation-exchange/issue-archive/evaluation-methodology/an-introduction-to-theory-of-change>

Social enterprises differ in the way they combine financial self-sustainability, i.e. income-generation, with the creation of social change. Alder (2007) provides a descriptive overview of operational models, which are summarized in From practice 2.2 Operational models a) through f) integrate the business and the social function. In the service subsidisation and organizational support model (g), the two functions are largely separate.

### **From practice 2.2: Social enterprise operational models**

- a) **Entrepreneur-support model:** SE selling business support and financial services to its target population or "clients," which are other self-employed individuals or firms. Social enterprise clients then sell their products and services in the open market. Income generated through sales of its services to clients, and used to cover costs associated with delivering the support services and the business' operating expenses. Example: Microfinance Institutions, e.g. Grameen Bank [www.grameen-info.org](http://www.grameen-info.org)
- b) **Market-intermediary model:** Similar to a), i.e. SE providing services to its target population/clients, small producers (individuals, firms or cooperatives), to help them access markets. SE services add value to client-made products, typically these services include: product development; production and marketing assistance; and credit. Unlike a) the market intermediary SE purchases the client made products or takes them on

consignment, and then sells the products in high margin markets at a mark-up. Example: marketing organizations such as Fair Trade organizations.

In a version of the market-intermediary model, the **market linkage model**, the SE facilitates trade relationships between the target population/clients (such as small producers, local firms and cooperatives) and the external market. The SE functions as a broker or sells market information connecting buyers to producers and vice versa, and charging fees for this service.

- c) **Employment model:** SE provides employment opportunities and job training to its target populations or people with high barriers to employment such as disabled, homeless, at-risk youth, and ex-offenders. SE operates as an enterprise employing its clients and sells products in the open market. Example: Big Issue, Dialogue-in-the-Dark [www.dialogue-in-the-dark.com](http://www.dialogue-in-the-dark.com)
- d) **Fee-for-service model:** SE commercializes its social services, and then sells directly to the target populations or "clients," individuals, firms, communities, or to a third party payer. Income generated through fees charged for services. Example: typical model among nonprofits, membership organizations, trade organizations, museums. SE-example: [bookshare.org](http://bookshare.org).
- e) **Low-income-client as market model:** Similar to d), i.e. target-population or client is the market for goods or services to be sold. Specific target-/client population are poor and low income clients (,base-of-the-pyramid' clients) that cannot typically access the products and services in question. Examples: Health insurance for the poor, self-adjustable glasses ([www.vdw.ox.ac.uk](http://www.vdw.ox.ac.uk)), telemedicine ([www.uniteforsight.org/global-health-university/technology](http://www.uniteforsight.org/global-health-university/technology)).
- f) **Cooperative model:** SE provides direct benefit to its target population/clients, cooperative members, through member services: market information, technical assistance/extension services, collective bargaining power, economies of bulk purchase, access to products and services, access to external markets for member-produced products and services, etc. Example: Mondragon Cooperative in Spain's Basque country ([www.mondragon-corporation.com](http://www.mondragon-corporation.com))
- g) **Service-subsidization model:** business and social function are separate. The SE sells products or services to an external market and uses the income it generates to fund its social programs. Example: LATE! See box From practice 2.1.

In a version of the service-subsidization model, the **organizational support model**, a nonprofit creates a vehicle social enterprise that sells

products/services in the market to generate income for the nonprofit organization itself. In some cases, the vehicle SE may sell products and services to the target population/client, thus integrating the business and social function. Typically, however, the vehicle SE generates revenues that the nonprofit is employing to achieve its social objectives.

Source: Alter (2007)

#### **Exercise 2.4: Innovative earned income strategies for NGOs**

Instructor note: This exercise ideally takes the form of a discussion and joint work in small groups which then present their solutions in a forum.

1. Select on NGO that you are familiar with, ideally one that to date has little self-generated revenue and relies on state or private funds. Examples could be a cultural facility such as a theatre or museum, a sports facility, an NGO that raises public awareness for a certain social or environmental issue (Greenpeace, Worldvision etc.).
2. Present it to your group and brainstorm together about income generating activities that this NGO could develop.
3. Discuss income generating activities with regard to their
  - a) profitability including the level of competition which is likely to be faced, investments and costs to be incurred etc.(see Chapter 8), and
  - b) alignment with the NGOs mission and social impact generated, and
  - c) the operational model that you would adopt (see From practice 2.2).

## **2.5 To conclude**

This chapter provided a brief, practitioner-oriented introduction into the nascent field of social entrepreneurship. While the practical significance of social entrepreneurship for development of inclusive, sustainable societies is largely recognized both by politicians and researchers, rigorous research beyond theoretical analyses and case studies is rare to non-existent. Particularly, psychological approaches to social entrepreneurship are underdeveloped. Yet existing insights from past psychological research as well as future research drawing on psychological concepts have the potential to deliver a unique contribution to the field of social entrepreneurship.

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All information on Triodos Bank is taken from publicly available sources available at [www.triodos.com](http://www.triodos.com) and the respective websites of Triodos Bank in

The Netherlands, Belgium, the United Kingdom, Germany and Spain. More in-depth information on Triodos Bank will become available in Stephan, U., Huysentruyt, M. and Van Looy, B. (in preparation).

My research 2.1 is based on Lukes, M. & Stephan, U. (2008, August). *Entrepreneurs and leaders of non-profit organizations: Similar people with different motivations*. Paper presented at the Academy of Management Annual Meeting, Anaheim, USA.

## Chapter 3

# DISPOSITIONS OF ENTREPRENEURS: EXPLORING ENTREPRENEURS' PERSONALITY CHARACTERISTICS

Andreas Rauch

### 3.1 Introduction

The personality approach is one of the most controversial approaches to entrepreneurship. Dispositions of successful entrepreneurs have already been addressed in classical theories of economic growth and received a considerable amount of attention in the literature on entrepreneurship in the eighties. However, critics of this approach increased at the end of the 90's, causing a number of researchers to stop looking at the personality traits of entrepreneurs. Fortunately, most of the recent theoretical and empirical evidence has resulted in a renaissance of the personality approach to entrepreneurship. This chapter highlights the recent theoretical developments of the personality approach as well as the practical consequences. More specifically, I address the stylized facts with regard to the decision to start an enterprise, and to maintain it successfully, as well as the practical implications, such as a self-assessment of one's entrepreneurial potential, personality management and training intervention.

#### **Definition 3.1: Personality traits**

Personality traits are enduring dispositions to exhibit a certain kind of response across various situations.

Source: Caprana & Cervone (2000)

Personality traits are enduring dispositions to exhibit a certain kind of response across various situations (Caprana & Cervone, 2000). Thus, personality traits are relatively stable, and moreover, about 50% of the variance in personality is inherited (Loehlin, Willerman, & Horn 1988). Additionally, personality traits are not specific to a certain task (Kanfer, 1992), and therefore, only indirectly related to entrepreneurial activity. As a natural consequence, entrepreneurship practitioners, as well as our entrepreneurship students, usually show two dominant responses to the

personality approach: Firstly, personality traits are not specific to entrepreneurship, and so, their influence can be neglected in entrepreneurship education and research (Gartner, 1988)<sup>1</sup>. Secondly, since personality is partially inherited, and relatively stable, one cannot change his personality traits easily; thus, why should one care?

In this chapter I will address why one should care. Personality characteristics explain general behavior in a number of domains, such as career choice, or job performance, and they should, therefore, also predict outcomes in the domain of entrepreneurship. Applying the personality theory to entrepreneurship requires the use of a theoretically sound conceptualization of personality. In the first place, one should distinguish between broad personality traits and those which are specifically related to the context of entrepreneurship. I will argue that specific traits are more important than broad personality traits. Secondly, while personality affects both, the decision to start an enterprise and its subsequent success, the underlying mechanisms are fundamentally different. Thirdly, personality affects action characteristics and decision processes that facilitate entrepreneurial behavior, and moreover, that are dependent on situational influences. Finally, I address personality management and change. As a consequence, the personality approach provides important evidence based best practice recommendations.

### **3.2 Broad Big Five traits of entrepreneurs**

Personality traits have been described at different levels of specificity. The Big Five Personality Traits (Costa & McCrae, 1988) describe personality at its broadest and most general level along five dimensions: Neuroticism versus emotional stability, extraversion versus introversion, openness to experience, agreeableness and conscientiousness (Table 3.1). This trait taxonomy has been applied to a number of outcomes such as leadership (Lord, De Vader, & Alliger, 1986) and job performance (Barrick & Mount, 1991). This research indicated that conscientiousness is one of the most important predictors of job performance. Moreover, both conscientiousness and openness to experience are positively related to the decision to start a business venture, as well as to the venture's subsequent performance (Zhao, Seibert, & Lumpkin, 2010; Zhao & Seibert, 2006).

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<sup>1</sup> I will not address the criticism, and the response to the criticism of the personality approach here, because there are published reviews covering this debate e.g., in Rauch & Frese, 2007a; Gartner, 1988)

### **Table 3.1: Broad Big Five personality traits**

Neuroticism represents individual differences in adjustment and emotional stability.

Extraversion describes the extent to which people are assertive, dominant, energetic, active, talkative, and enthusiastic.

Openness to experience is a personality dimension that characterizes someone who is intellectually curious and tends to seek new experiences and explore novel ideas.

Agreeableness assesses one's interpersonal orientation. Individuals high on agreeableness can be characterized as trusting, forgiving, caring, altruistic, and gullible.

Conscientiousness indicates an individual's degree of organization, persistence, hard work, and motivation in the pursuit of goal accomplishment.

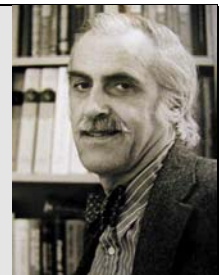
Sources: Barrick & Mount (1991); Costa & McCrae (1988)

## **3.3 Specific personality traits**

Since the broad Big Five Traits are not directly related to the domain of entrepreneurship, entrepreneurship research has more often examined more specific traits. Often these specific traits are sub-factors of the Big Five Traits. Specific traits are related to the tasks of opportunity recognition and exploitation. Traits that have been specifically related to entrepreneurship are displayed in Table 3.2.

### **Key representative 3.1: David C. McClelland**

David Clarence McClelland (1917-1998) was psychologist and professor at Harvard University. His book “The achieving society” (1961) is one of the most frequently cited books, and has stimulated research on achievement motivation. McClelland proposed a psychological theory of economic growth, arguing that achievement motivation affects the wealth of countries. Moreover, achievement motivation predicts the performance of entrepreneurs.



Specific traits that are particularly important for entrepreneurs are the need for achievement, innovativeness, and generalized self-efficacy. The *need for achievement* is related to a preference for difficult and attainable tasks, active search for new and better ways to improve task performance, feedback

seeking and taking responsibility for both goal achievements and failure (McClelland, 1961). The need for achievement seems to be

<b>Table 3.2: Specific personality traits</b>		
<i>Trait</i>	<i>Definition</i>	<i>Effect size (predicting choice of entrepreneurship and success)</i>
Need for achievement	Choosing tasks of moderate difficulty, accepting responsibility for results, and seeking feedback on action outcomes (McClelland, 1961)	High
Locus of control	Belief that one's own actions determine the rewards (business outcomes) rather than chance events or powerful others (Levenson, 1974)	Moderate
Risk taking	Pursuing goals even when the probability of succeeding is low (Stewart & Roth, 2004)	Low
Need for autonomy	Avoiding restrictive environments, preference for being in control (Cromie, 2000)	Moderate
Innovativeness	Willingness and interest to look for novel ways of action (Patchen, 1965)	High
Generalized self-efficacy	Confidence in one's own capabilities to perform various tasks in uncertain situations (Bandura, 1997)	High
Stress tolerance	Not getting strained in situations characterized by high pressure and uncertainty (Rauch & Frese, 2007b)	Moderate
Proactiveness	Taking the initiative, attempting to influence the environment (Crant, 1996)	Moderate

particularly relevant for entrepreneurship, given that entrepreneurs recognize and exploit challenging opportunities. Accordingly, empirical evidence indicates that the need for achievement is positively related to the decision to become an entrepreneur, and to business performance (Collins, Hanges, & Locke, 2004; Rauch & Frese, 2007b).

*Innovativeness* addresses individual's interest in innovation (Patchen, 1965). Conceptualizing innovation as a trait of entrepreneurs does not imply the introduction of innovative products, rather, more a preference to engage in creativity and experimentation. Innovativeness helps entrepreneurs to recognize valuable opportunities and to search for new ways of completing tasks (Ward, 2004). Innovativeness is positively related to the decision to start an enterprise, and the venture's success (Rauch & Frese, 2007b). Interestingly, entrepreneurs' innovativeness produces higher relationships with business success as compared to the relationship between firm level innovations (introduction of new products, services, processes and markets) and success (Rosenbusch, Brinckmann, & Bausch, 2010). It would be interesting to discover whether or not firm level innovativeness is dependent on the owners' innovativeness.

*Self-efficacy* addresses peoples' confidence in their capabilities to perform various (and often unanticipated) tasks in uncertain situations (Bandura, 1997). Self-efficacy is related to entrepreneurship because it is associated with the active search for information, persistence in the face of problems, the search for opportunities, and the long term perspective. According to the results of our own studies, self-efficacy is the trait most closely related to the decision to start an enterprise and success (Rauch & Frese, 2007b). A number of additional traits have been related to entrepreneurship (Table 3.2). It is interesting to see that the *risk-taking* propensity has a relatively small relationship with business creation and success, although risk-taking has been related to entrepreneurship in classical economic theory (Knight, 1921), and has received a considerable amount of attention in entrepreneurship research. Therefore, a number of authors have suggested that entrepreneurs are moderate risk takers, and that they try to reduce high risks (Timmons, Smollen, & Dingee, 1985). This is a position that needs to be supported by future studies.

**My research 3.1: Let's put the person back into entrepreneurship research: A meta-analysis of the relationship between business owners' personality traits, business creation, and success**

The personality approach to entrepreneurship was heavily criticized in narrative reviews at the end of the eighties. These critics were so influential that such studies were not published anymore in entrepreneurship journals.

Therefore, we decided not to do another primary study, but to reanalyze the results of prior studies quantitatively. Meta-analysis has certain advantages as compared to narrative reviews. Firstly, a narrative review suffers from certain biases that reduce the likelihood of finding the positive effects of personality characteristics. Secondly, meta-analyses share their decision rules and, therefore, are open to replication and criticism. Thirdly, meta-analysis can control for methodological weaknesses inherent in individual studies, such as, e.g., different sample sizes. Finally, meta-analysis allows an assessment of the magnitude, as well as of the generalizability of the effects.

Our final meta-analytic database consisted of 116 independent samples from 104 different articles, which met the criteria for inclusion, and provided the necessary information for computing the statistics (with an overall No. of 26,700). Of these, 62 studies dealt with business creation and 54 studies tested the relationships between owners' traits and business success.

Our results indicated that:

1. Personality traits of entrepreneurs predict both the decision to start an enterprise as well as business success.
2. The best predictors of entrepreneurial behavior are traits specifically matched to the task of entrepreneurship.
3. Effect sizes of matched traits ranged between .103 (risk taking) and .313 (self-efficacy).

	K	N	Corrected r	% Variance due to sampling error	95% Confidence interval
All personality traits with business creation	62	18835	.190	13,51	.123 to .199
All personality traits with success	54	7865	.195	24,45	.105 to .193
Traits matched to task	89	18887	.249	18,48	.178 to .273
Traits not matched to task	33	6752	.076	34,38	.006 to .125
Need for achievement	60	12611	.262	22,73	.155 to .265
Innovativeness	22	5420	.254	86,84	.138 to .262
Proactive personality	5	679	.270	110,09	.124 to .278
Generalized self- efficacy	19	3581	.313	41,45	.174 to .368
Stress tolerance	17	2607	.151	75,59	.077 to .169
Need for autonomy	19	5099	.238	22,33	.086 to .291
Locus of control	47	9607	.161	40,86	.080 to .176
Risk taking	31	10607	.103	30,62	.023 to .143

Note. K = No. of studies. N = No. of participants. Corrected r = effect size. % variance due to sampling error = heterogeneity test. 95% confidence interval = significance test.



### **3.4 The effects of personality traits: Business creation and business success**

When evaluating the effectiveness of personality traits, we need to address three issues. Firstly, we need to distinguish between the prediction for starting a business, and business success. Secondly, we need to look at the effectiveness of broad versus specific traits. Finally, we need to understand the processes and the contexts that facilitate the effects of personality traits.

Theoretically, there is a huge difference between the decision to start a business venture and business success. The decision to start an enterprise is usually explained through a career choice perspective (e.g., Zhao & Seibert, 2006), which assumes that people choose work environments that match their personality characteristics. For example, entrepreneurs have to find and exploit valuable opportunities, they have to make rapid decisions under conditions of uncertainty, and in a resource constraint environment; they have to work harder than most employees, and they have to possess a wide variety of skills, knowledge, and abilities (Rauch & Frese, 2007a). Consequently, people choose to become an entrepreneur if they think that there is a close match between their own traits and the tasks involved in starting and running a new business venture. Performance theory explains why some traits are linked with positive venture outcomes (Barrick & Mount, 1991). In general, persons that score higher on traits related to entrepreneurship show more behavior that is associated with entrepreneurship which then, in turn, allows for successful opportunity exploitation (Zhao et al., 2010). In other words, entrepreneurs high in achievement motivation select strategies that are more successful than entrepreneurs low in achievement orientation (Rauch, Frese, & Sonnentag, 2000). It is important to note that the distinction between business creation and success is important because both are related to different underlying mechanisms. However, empirically, personality traits predict both the decision to start an enterprise, and the venture's success.

#### **Expert's view 3.1: How to survive in entrepreneurship**

*Ivan Pilny, private investor and ex-CEO of Microsoft Czech Rep.*

When we step on the thin ice of entrepreneurship, it is good to know what traits and skills we should have in order to belong among the successful. The first is the courage to take risks. Czechs, and Europeans in general, tend to avoid risks and prefer security. The risk must be calculated, not reckless. We cannot burn the candle at both ends. Often, the ones who succeed are those who mercilessly cut off the umbilical cord with their school, academic career or employer. We cannot run a business on a third throttle. The second premise is to move towards our goal. Going

consistently towards our own goals does not mean to plough through other people, but to go hard and without compromise. We must be willing to work hard and long. Workoholism is not worth following, but neither is "going to work". There are gold-diggers, who think, in their thirties, that they have worked enough and it's time to retire. But investors do not put money into a company that has great ideas, but lacks the enthusiasm and drive.

Another prerequisite is the ability to respond to changes. Perfect, constant and comforting harmony can be achieved only in a Tibetan monastery, or in a coffin. We must perceive change as a fact of life and a welcome diversion from our daily routine. It is good to do things voluntarily before we are forced to do so by a crisis, to which we often respond hastily, and under pressure. To find our way is not always easy, and we must persevere through the unpleasant and unexpected obstacles. Sometimes, even, we are the first, and we cannot rely on the experience of our predecessors. Perseverance is rewarded by the fact that we reach the finish line first. If the goal is properly chosen, the others will be staring at the taillights of the rapidly disappearing train. There is no need to worry about forcing one's way. Someone said that when someone kicks our backside, it means that we are ahead.

There is a need to develop the ability to decide. In life, we often fight internal battles for what becomes the basis for our personal or managerial decisions. On the one hand, as a famous American manager put it: "In God we trust, the others bring the data". On the other hand, this can be against our intuitive feelings towards the idea, or intention, presented to us: "This is a great idea!" or "Go to ...". The fact that most decisions are made in a hurry, and under stress, as well as the fact that we are not equipped with complete data, does nothing to ease the situation. As a good manager, you know that decisions need to be made on time and you should not put it off with the excuse that you do not have all the information. The truth of the claim that it is better to make a wrong decision than no decision has been proven many times.

“Learn, Learn, Learn ...” this saying has something in it, although its author is not Jack Welch, but the Bolshevik revolutionary, V.I.Lenin. Firstly, the fact that learning is as normal as moving should be accepted. Just as people who are accustomed to the daily physical activity miss movement during forced inactivity, we must also miss appropriate mental activity. Of course, we should have the opportunity to put the acquired theory into practice, as soon as possible. Otherwise, the drawers in our head will start to empty and fill with something else. It helps a lot to look around, think about why someone, or something, works or does not work. Perhaps I should finish by saying that it is good to take education as an

investment, and it is our thing, not the thing of the state, company, or our parents’.

Feedback is important. It is not enough just to look around, we have to see. It is not enough to hear, we have to listen and understand. This applies to our customers, our colleagues and employees, competition, and the whole environment in which we operate.

Let's stop with the non-linear processes of intuition, creativity and imagination. It seems that the breakthrough shift in our thinking from the left to right hemispheres is needed. The left hemisphere controls the cognitive processes, strategy, science and math. Right hemisphere affects the imagination, spatiality, perspective and harmony. The domination of left hemisphere was the basis of economic growth in the last three hundred years. However, for the necessary change to the right (oh, how it corresponds with the political spectrum!) our population is not at all prepared. Schools teach hard skills, math, applications, and technologies. They develop creativity, problem thinking, imagination, and work with people to a much lesser extent.

What to say in conclusion? Stick to common sense. Do not look at how hands on the clock move; move with them. Look ahead, not in the rearview mirror. Only then will your business be sustainable. Warren Buffet says: "Only when the tide goes out do you discover who's been swimming naked." Do not be afraid to be entrepreneurs; be the architects of your own future.

The prediction of business creation and success seems to depend strongly on the specificity of the trait assessment. The broad versus specific debate is not new to organizational behavior, and has started in the domain of entrepreneurship as well. Broad personality traits are relatively easy to measure and they have a high validity in various situations (e.g., job performance, personnel selection, leadership, entrepreneurship). And this is true for entrepreneurship as well; in particular, conscientiousness is related to both the decision to start a business, and the venture’s performance (Zhao et al., 2010; Zhao & Seibert, 2006). However, broad traits are stable and predictive for many situations, not just for the specific decisions of individuals. Specific traits rely on a situation in time and, therefore, are more proximal to a certain decision. Since specific traits are related to the domain of entrepreneurship they have high criterion related variance. Accordingly, specific traits, such as the need for achievement, self-efficacy, and innovativeness are more strongly related to entrepreneurship activity than the broad Big Five Traits (Rauch & Frese, 2007b).

In order to understand how personality traits affect entrepreneurial behavior, one has to address two final issues: the mediation processes and

moderators affecting the impact of personality traits. The mediating processes refer to the mechanisms through which personality affects venture performance. Such mediators include entrepreneurs' motivation, cognition, and self-regulatory processes (Kanfer, 1992). For example, high achievement oriented entrepreneurs develop higher growth motivation and demand more performance feedback. This feedback allows achievement oriented entrepreneurs to adjust their decisions quickly to changing environmental conditions. Thereby, the need for achievement affects venture success. Moreover, entrepreneurs' traits affect the strategic choices of the entrepreneur. For example, achievement oriented entrepreneurs develop more effective business plans (Rauch et al., 2000), and innovative strategies (Baum, Locke, & Smith, 2001), which in turn affect venture success. This evidence indicates that personality variables are a precondition for developing strategies that allow entrepreneurs to successfully exploit business opportunities.

The variance of effect sizes reported in the literature indicates that the effects of personality traits on entrepreneurial behaviors depend on moderating conditions. Notably, attempts to develop a typology of relevant situations are scarce. An exception is Mischel (1968), who argued that the effects of traits should be strong, particularly in situations that allow for interpretation and expression in contrast to situations that determine individual behavior. Thus, personality traits should predict entrepreneurial behavior well in situations that are characterized by a low structure, high autonomy, and little ambiguity (Hattrup & Jackson, 1996). In consequence, an entrepreneur has to select and create an environment that allows him to unfold his strength and to keep control over decisions and venture outcomes. For example, entrepreneurs high in extraversion should perform better on tasks involving high customer contact, such as sales jobs (Vinchur, Schippmann, Switzer, & Roth 1998), while introverted entrepreneurs may perform better on tasks involving less customer contact, such as administrative tasks.

### **3.5 Personality self assessment and self management**

The previous sections indicated whether, and how, traits explain the decision to become an entrepreneur, and how personality affects venture success. The effects are moderately strong and appear in combination with other predictors of venture success. At the same time, the effects of personality traits are high enough to allow the drawing of a number of practical implications.

### **From practice 3.1: Inspiring Czech entrepreneurs**

*Marek Slama, Business Development Manager, Ernst & Young*

Since 2000, hundreds of entrepreneurs participated in the Entrepreneur of the Year programme in the Czech Republic. We have had the chance to meet all of them, listen to their stories and also to ask many questions. Although they all are unique personalities, there are common features that these successful people share, despite their different business areas.

Firstly, a true and successful entrepreneur must have his/her own vision and be passionate to pursue his or her dreams. Tomáš Březina, the 2007 winner, said that vision and ideas, perseverance and determination, along with an understanding of the environment and market, allows an individual to become a successful entrepreneur. The other ingredients would be, definitely, courage, intuition, unflagging will, diligence and hard-work. Vladimír Kovář, the 2008 winner, established Unicorn when he recognized a growing demand for programming services. Even though at that time the information technology sector did not really exist in Czechoslovakia, he was able to create a team of programmers, and with them, successfully complete their first major project for the Austrian radio broadcasting company; ORF. The mission to bring high added value for customers through excellent software services was created.

Many entrepreneurs who have been building their business for more than 10 or 15 years, have invested a lot of time and effort to sustain and develop their companies. It would not come as a surprise to say that the successful entrepreneur must be a strong personality to be able to cope with the different challenges facing him, and to work to overcome all obstacles, while all the time looking forward. Mr. Březina said that a true entrepreneur should be an incurable optimist, regardless of all the worries mirrored in his or her face, or gnawing at his soul.

Given the small size of the Czech market, the more niche products the company offers the more crucial it is to expand and succeed abroad. Pavel Baudiš and Eduard Kučera, the 2009 winner, founded Alwil Software to develop and distribute anti-virus program. A major turning point came after the entry of global competitors. The loss of the domestic market forced them to reinvent a new business model. Thanks to their innovative approach, the company succeeded in creating a massive worldwide community of users.

Despite their international presence, true entrepreneurs are rooted in their local communities. Many entrepreneurs would confirm that they feel, and bear, the responsibility for their employees along with their families. Such a person must be able to lead and motivate and come up

with inspiring new ideas. The successful company owner recognizes that his firm's success is team work, not just a one-man show.

Innovation and creativity is another imperative to keep competitive advantage. Eduard Kučera from Alwil Software strives to have machines free his employees' time for creativity and innovation, thus making his company more effective and productive. Vladimír Kovář from Unicorn implemented a factory like approach to software development and other key principles, such as the focus on young people, having an innovative mindset and continuous training.

Last, but not least is putting always quality and customer first. Radim Jančura, the 2005 winner, and another successful self-made entrepreneur, attributes his success, besides the instant re-investing of the profits into the firm's expansion, to the customer-oriented corporate ethics. Mr. Březina's company's strong point remains its attitude towards quality. He is focused on world-class production technology of his new plants, and constantly modernizes his current facilities to the latest technological standards.

### **Exercise 3.1: Self-assessment**

1. Inspect the IPIP webpage for instruments assessing personality traits: <http://ipip.ori.org/>
2. Fill in the on-line personality questionnaire and save your results.  
<http://www.personal.psu.edu/~j5j/IPIP/> (use the short version for Big Five Traits and the long version for the underlying dimensions)
3. Compare the scores of your own personality assessment with the one of a friend or fellow student. Are these results in line or in contrast to the impression you had before seeing this assessment? What is surprising?
4. Evaluate your personality assessment with regard to the Rauch and Frese (2007b) and Zhao et al., (2006/1010) studies. Do you have an "entrepreneurial" personality structure?

Firstly, it would be valuable for a potential entrepreneur to have an assessment of his own personality characteristics. This would allow him or her to reflect on whether one is high in achievement motivation and, therefore, will enjoy working extremely hard in the start-up years, including foregoing leisure time and holidays. High emotional stability would allow potential entrepreneurs to sleep well in the face of the difficulties associated with a business start-up. Knowing one's characteristics allows one to not only identify areas of strength and weaknesses, but also to identify opportunities inherent in ones character. A personality assessment would therefore help in

the decision to become an entrepreneur, to develop strategies that match the environment to one's characteristics, and to compensate for one's weaknesses. For example, a potential entrepreneur realizing that his introversion would help him to run the administrative tasks successfully, but hinder him in maintaining customer contact, may consider teaming up with an extraverted cofounder.

Secondly, a personality assessment can help practitioners, such as career counselors, and investors selecting the right entrepreneurs. In this context it is important to weight the effects of traits correctly and to compare the persons' personality traits with other indicators of entrepreneurial activity, such as human capital and the business plan. The effect sizes reported in published meta-analyses provide estimates for weighting the effects of individual personality traits (Rauch & Frese, 2007b; Zhao et al., 2010; Zhao & Seibert, 2006). For example, one needs to put less emphasis on risk-taking propensity and more emphasis on achievement motivation.

Thirdly, it is a myth that personality traits are stable over time. For example, people in general tend to become more emotionally stable over their life times (McCrae et al., 2000). This does imply, at the end, that traits can be changed. Therefore, training intervention can increase the entrepreneurial potential of people. This is all the more true for more specific traits, such as self-efficacy, and need for achievement; both traits can be changed by training intervention (Bandura, 1997; Eden & Aviram, 1993). A typical self-efficacy training is most effective if it is related to a specific task. The most efficient drivers of self-efficacy are mastery experience and performance feedback. Therefore, self-efficacy training usually includes exercises and feedback on performance. Depending on the goals of the training, the training includes showing a model of an entrepreneur succeeding, for example, in attracting an important customer. The training participants would discuss the behavior seen and practice the behaviour successfully in role play. The feedback is provided by trainers and trainees. While specific self-efficacy can be enhanced relatively easily by specific training intervention, a need for achievement training is more complex and the training may last for several days (Miron & McClelland, 1979). Such training includes understanding one's own characteristics and goals, practicing achievement related cases, role play and business games, relating achievement behaviour to one's own goals and behavior, developing a plan and action steps for personal and business improvements, and feedback on the progress made towards goal achievement. Thereby, the training creates a belief that it is possible, and desirable, to increase achievement motivation, to change behavior and to commit oneself to achieving specific goals and the means to achieve these goals. Goals should be difficult to attain because difficult goals motivate one

to work harder. Moreover, goals should be specific (quantifiable) because specific goals allow the collection of performance feedback.

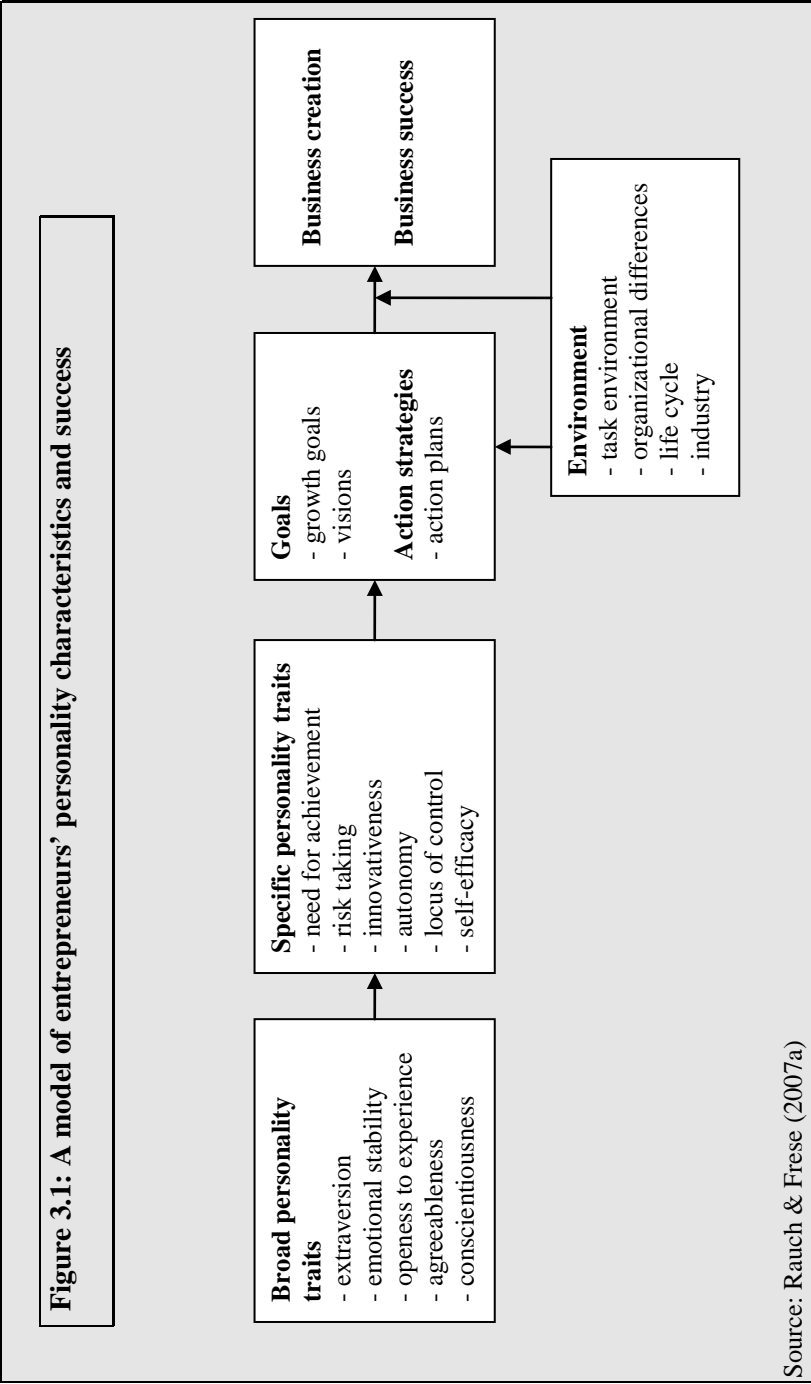
### **Exercise 3.2: Achievement orientation exercise**

1. Identify your own goals with regard to the accomplishment you want to achieve (for example with regard to the course you are attending, with regard to entrepreneurship).
  - Goal setting is very critical for achievement motivation.
  - Good goals are difficult and specific.
2. Relate achievement related behavior to these goals
  - What do I have to do to attain the goal?
  - When do I have to do these activities?
  - Where/ in which contexts do I want to perform the behaviour?
3. Develop a personal plan how to improve performance regarding these goals.
4. Identify opportunities and milestones that allow the collection of feedback on the progress made towards achieving the goals.

## **3.6 To conclude**

The present chapter indicated that the relationship between personality traits and entrepreneurial behavior is relatively consistent if the approach is applied correctly. This implies that broad personality traits do not affect entrepreneurship behavior directly, but they affect specific traits that are more proximal to behavior. Specific traits, such as the need for achievement, in turn, affect goals and strategies that facilitate business performance. Moreover, the effects of goals and strategies are dependent on the business environment. Obviously, entrepreneurship activity is a result of multiple influences (Figure 3.1).





Source: Rauch & Frese (2007a)

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## Chapter 4

# ENTREPRENEURIAL MOTIVATION: INDEPENDENCE, MONEY, SELF- REALIZATION AND PASSION FOR WORK

Marjan Gorgievski

### **4.1 Introduction**

This chapter on entrepreneurial motivation deals with the question of what motivates people to pursue an entrepreneurial opportunity, and become entrepreneurs (venture creators). In addition, it will deal with the more general topic of human motivation and performance during the later stages of entrepreneurship. In doing so, it will focus especially on the passion for work. Recently, entrepreneurship scholars have emphasized the importance of motivational concepts labeled “a passionate, selfish love of work” as key to understanding entrepreneurial behavior, and a key characteristic of entrepreneurs (Shane, Locke & Collins, 2003).

### **4.2 Entrepreneurial motivation and venture creation**

A great deal of research on entrepreneurial motivation has focused on the question of what motivates people to create a venture and start an entrepreneurial career. This issue has been approached from different points of view, the most important of which are the macro-economic and the individual perspective.

#### **The macro-economic perspective**

From a macro economic perspective, different factors have been identified that relate to differences in the start-up rates for different countries and geographic regions. An important discriminating element in this respect is the economic development of a country or region, which has been related to different start-up motives. The Global Entrepreneurship Monitor identifies three phases of economic development, ranging from factor driven economies, which are basically extractive in nature; to efficiency driven, in

which scale intensity is a major development, and finally, the innovation driven economies (Bosma, Acs, Autio, Coduras, Levie, 2009).

Concerning start-up motives in different economies, scholars have put forward the so called “U-curved” hypothesis. This hypothesis is based on the idea that entrepreneurship can be triggered by either “push” or “pull” factors. “Push” factors are expected to motivate people to get out of their current, unpleasant situation, leading to so-called necessity driven entrepreneurship. “Pull” factors stimulate striving for valued, future gains, in other words “opportunity driven” entrepreneurship.

Typical “push” motives are avoiding, or ending, unemployment, especially if benefits are low. Another push factor might be dissatisfaction with the current job, because of poor working conditions, low pay, on the job conflicts, etc. Concerning “pull” motives, the driving force is not dissatisfaction with the current situation, but the attractiveness of the positive outcomes of entrepreneurship. The future entrepreneur may be convinced of a great opportunity to start a successful business. In addition, business starters who are pulled towards entrepreneurship, see opportunities to fulfil one or more of the following usual personal motives: 1) gain autonomy, freedom and independence, 2) achievement motives, 3) extrinsic motives (gain money, status and social recognition), 4) intrinsic motives (personal development, creative expression, liking for doing entrepreneurial tasks); 5) personal and family security, or better work life-balance (Birley & Westhead, 1994; Kuratko, Hornsby & Naffziger, 1997; Shane et al, 2003)

It may come as no surprise that necessity driven business start-ups occur more often in countries with low levels of economic development. When the economy develops, the rates of necessity driven entrepreneurship decline, whereas the rates of opportunity driven entrepreneurship rise. Hence, opportunity driven business start-ups are more prevalent in high-income countries (Bosma et al., 2009).

**Expert's view 4.1: The role of autonomy in business start-up**

*Marco van Gelderen, Business psychologist, VU University Amsterdam*

*Paul Jansen, Professor of Industrial Psychology, VU University Amsterdam*

A solid body of research shows that entrepreneurship is making various positive contributions to the economy, such as employment creation, innovation, and growth. And the beautiful thing is that entrepreneurs do not start their businesses because they intend to make these macro-economic contributions. They have their own reasons to start venturing.

The question of what motivates people to set up their own business has been studied extensively. A central theme to emerge in these studies is that the business starter wants autonomy (also labeled as independence, or freedom). People start businesses (*inter alia*) in order to be autonomous, and

in many cases the success of their firm is instrumental to achieving that goal. It is no wonder therefore, that autonomy has been found to be one of the main drivers of business owners' satisfaction. Although differences in opinion exist on the details, the broad consensus is that autonomy means that individuals make their own choices independent of others. People who value autonomy strive for a state of independent self determination.

However, there is an element of circularity in the explanation that people want to have an autonomous (independent) business because they want autonomy (independence). It is more fruitful to investigate why small business starters want autonomy. While most small business starters begin a business because they want autonomy, they vary in the reasons why they want autonomy. All autonomy driven business starters like the decisional freedom it brings. They like to be responsible, to decide on strategy, on working methods, and to regulate their own time. But in addition, autonomy is also valued because it is instrumental to the achievement of still other motives. Some are motivated by negative freedom, in the sense that they generally dislike, or are currently experiencing, a difficult boss or unpleasant rules. Others emphasize the fact that self-employment offers the opportunity to work in accordance with one's goals, values, and attitudes. Still others emphasize the opportunities that self-employment offer for being in charge, for directing, and for leading, instead of being led. Our empirical work shows that these are the main underlying sources of the autonomy motive.

The research also shows that for many just one underlying motive dominates, while the others are virtually absent. Thus, small business starters differ in their respective emphasis on independence ('others do not determine what I will do'), self-congruence ('I want to do my own things in my own way'), and power to decide ('I want to be the one who is in charge'). At the same time, these viewpoints present their own paradoxes and pitfalls. Persons, who resist bosses and rules, must now become a boss and set rules themselves. Their resistance of constraints and restraints might make it difficult for them to deal with the pressures of customers, suppliers, and other stakeholders. People who want to express their personality and creativity in their work might be so busy and occupied that there will be little space left for the expression of personality and creativity. Moreover, their focus on self endorsement and congruence might make it difficult for them to deal with controlling forces and circumstances that small businesses are often confronted with. People who want autonomy because of the power and control it brings them may find that, as a small business owner, they often have very little control, if only because they have to deal with several types of uncertainty. A focus on power and control might also make it difficult to empower employees and to retain a relaxed attitude.

Starting, or running, a business means that a line is drawn - within bounds it is now the small business owner who is autonomous. However, drawing a boundary will not make the outside world go away; quite the contrary. Autonomous small business starters and owners have to deal with customers, suppliers, competitors, etc., on a continuous basis, and in doing so need to balance their wish for autonomy with the demands imposed on them by the business environment. Freedom and constraints on freedom are at the heart of the entrepreneurial motivation and practice.

In addition to the overall economic development of a country, several framework conditions have been identified that play an additional role in stimulating business start-up. Framework conditions are created through active political initiatives. Examples are local and national policies, the existence of trade agreements, the administrative complexity of the society (which can again be related to tax policies and specific governmental rules and regulations), intellectual property rights, and labour market regulation (Verheul, Wennekers, Audretsch & Thurik, 2002). What framework conditions are important depends on the economic development phase.

In factor driven economies, framework conditions are about providing basic requirements, such as infrastructure, macro-economic stability and health and primary education. In efficiency driven economies, efficiency enhancers become more important. These are, for example, goods and labour market efficiency, financial market sophistication and higher education. Finally, in innovation driven economies, levers of economic development gain relevance, such as governmental entrepreneurship programs, Research and Development transfer and a more specific entrepreneurship education.

Thirdly, in each phase of economic development, prevalent rates of early stage entrepreneurship differ across groups. Most importantly, start-up rates are generally higher in the group of 25-34 years of age, as compared to younger and older age groups. This reflects the interaction of desire to start a business, which decreases with age, and feelings of being efficacious, which increases with age. In innovation driven countries, men are generally twice as likely as women to start up a business. In factor and efficiency driven economies, overall, start up rates among women are much more similar to those of men, although large differences may exist between countries. For example in Angola, there are actually many more women than men who start a business (Bosma, et al., 2009). Other relevant characteristics of the population are: the urbanisation rate, unemployment rates, income level, and industrial structure.

Finally, cultural values have been identified as predictors of business start-up rates (Hayton, George and Zahra, 2002). Values are concepts or beliefs about desirable end-states, or behaviors that transcend specific



situations, and guide the selection or evaluation of behaviors and events (Schwartz and Bilsky, 1990; p. 551). Cultural values are values shared by a group of people, such as an organisation, a family or a whole country.

Cultures have been hypothesized to promote entrepreneurship if they value and reward typically entrepreneurial behaviours and propensities, such as risk taking and independent thinking. On the other hand, cultures that value stability, conformity, and control over the future are not expected to stimulate entrepreneurship. In empirical research, especially values such as high individualism, low uncertainty avoidance, and high power distance have been related to national rates of new firm formation rates and innovation (Hayton et al., 2002).

#### **4.1 Exercise: Identification of macro-economic stimulating and hindrance factors in your environment**

Take about 10 minutes to answer the following questions:

##### Stage of development

- What is the stage of economic development in your country?

##### Framework conditions

- What do you know about the framework conditions in your country?

- What do you know about the framework conditions in your region?

##### Values<sup>1)</sup>

Think about the people who live in your region. Do you think:

- ... most people seek new challenges?

- ... most people fear changes?

- ... most people value independence and autonomy?

- ... most people place a high value on personal initiative?

- ... most people tend to avoid uncertain situations?

- ... most people believe in their capabilities?

- ... most people are used to taking responsibility to do high quality work?

##### Search for information

You can start searching for information to fill in the blanks. Find information in the chapters of this book, on the internet and the GEM reports.

<sup>1)</sup> Source: (Stephan, 2008)

Several mechanisms have been put forward explaining the relationship between cultural values and entrepreneurship (Hayton et al., 2002). Firstly, values are expected to influence new venture creation and self-employment through its influence on the institutional context. In other words, on the social,

regulatory and legal systems of a country. The institutional context of a country both reflects and influences its culture. Next, cultural values may moderate the extent to which the institutional and economic context predicts start-up rates. Some cultures can be expected to produce more people who can recognize and use the opportunities provided by the environment. Cultural values have been found to shape individuals' needs and motives (e.g., need for achievement), cognition (knowledge, heuristics, decision preferences), and beliefs that are predictive of entrepreneurial ambitions and activity. This brings us to the individual perspective.

### **The individual perspective**

From a psychological perspective, scholars have studied the question of why, given the same national and institutional framework conditions, and given the same opportunities for business creation, some people chose to become entrepreneurs, whereas others do not. On this individual level, scholars have emphasized the importance of motivation

#### **Definition 4.1: Motivation**

An important driving force that directs one's actions towards related goals, and thus focuses one's attention and sustains taken actions.

Source: Locke & Baum (2007, p. 93)

Motivation is based on peoples' personality, needs, values, desires and intentions (Locke & Baum, 2007). Many psychological studies have focused on whether people may be attracted to entrepreneurship because they have certain personality traits (see Chapter 3). Personality traits are expected to underlie the motives driving peoples' career choice.

#### **Key representative 4.1: Edwin Locke**

Dean's Professor (Emeritus) of Leadership and Motivation at the R.H. Smith School of Business at the University of Maryland, College Park. American psychologist and pioneer in goal-setting theory. Prof. Locke has published over 285 chapters, notes and articles in professional journals, and is also the author or editor of 10 books. A recent survey found that Locke's goal setting theory (developed with G. Latham) was ranked #1 in importance among 73 management theories. His work has been supported by numerous research grants, and he has served as consultant to research firms and private businesses.



Source: <http://www.edwinlocke.com/>

Other scholars have focused on dynamic aspects rather than stable personality constructs underlying peoples' motives. According to them, motivation results from a process of creating visions and setting specific business directed goals. Vision is expected to generate motivation, because it shapes the anticipation of desired results. This would be the first step in taking deliberate action. After vision creation, people are expected to start more specific planning, which would set in motion a motivating spiralling process, also referred to as "the high performance cycle" (Locke & Latham, 1990). The role of planning in business success was described in more detail in Chapter 6 of this volume.

### **4.3 Entrepreneurial motivation and entrepreneurial performance**

The motives for venture creation can be expected to influence subsequent venture performance, as well as the individual performance of the entrepreneur. For example, motives largely influence entrepreneurs' ambitions, and permeate business strategies and related planning. For instance, a strong financial motivation, but not the need for independence, may relate to business growth. In addition, necessity-driven entrepreneurship, which is more prevalent in low-income countries with demanding business environments, along with low transparency concerning business entry regulations, has been related to lower estimations of entrepreneurs' resources, such as starting capital (Bosma et al, 2009). Lack of sufficient resources during the venture creation stage, in turn, has been related to lower levels of early stage entrepreneurial activity. This in turn leads to lower expectations concerning, for example, company growth. Many of the motivational personality characteristics which have been investigated in the context of venture creation, such as personal initiative, self-efficacy and internal locus of control, can also be expected to play an important role in achieving success and performing well after the launch phase. That topic has been dealt with in chapter 3 of this volume. Here, we will focus in more detail on the role of one motivational construct that has recently started to arouse interest; and that is the passion towards activities.

#### **Definition 4.2: Passion towards activities**

A strong inclination towards an activity that people like, find important and on which they spend time and energy on a regular basis.

Source: Vallerand (2008, p.1)

Two forms of passion for activities have been identified: “harmonious passion” and “obsessive passion” (Vallerand et al., 2003). In the case of harmonious passion, the person controls the activity, and the activity occupies a significant, but not overpowering space in the person’s life. Contrast this with the case of “obsessive” passion, where the activity controls the person, eventually taking up disproportionate space in the person’s identity and causing conflict with the other areas of his or her life. Research has shown that a large percentage of people have a passion for a variety of activities. Research in a wide range of life domains has shown that Harmonious passion typically leads to adaptive outcomes and Obsessive passion to less adaptive and even maladaptive outcomes (Vallerand et al., 2003).

**Key representative 4.2: Robert J. Vallerand**



Full professor of Social Psychology in the Department of Psychology at Université du Québec at Montreal (UQAM). Most of his research has focused on intrinsic and extrinsic motivation. More recently, he has proposed a Dualistic Model of Passion for activities. Professor Vallerand has written more than 200 articles and book chapters, as well as 4 books. Professor Vallerand has secured more than \$3 millions in research grants. He has received several honors, including being elected *Fellow* of the American Psychological Association, the Association for Psychological Science, the Canadian Psychological Association, and the Society for Personality and Social Psychology, and receiving the Sport Scientific Award from the International Olympic Committee and the Adrien-Pinard career award from the Société Québécoise pour la Recherche en Psychologie.

Source: [http://www.er.uqam.ca/nobel/r26710/LRCS/rjvaller\\_en.htm](http://www.er.uqam.ca/nobel/r26710/LRCS/rjvaller_en.htm)

In the context of working, two concepts have recently been formulated, which bear strong similarities to the concepts of harmonious versus obsessive passion. The first is the concept of work engagement, which is comprised of vigor, absorption and dedication (Schaufeli, Taris & Bakker, 2006). Vigor is characterized by high levels of energy and mental resilience while working, the willingness to invest effort in one’s work, and persistence in the face of difficulties. Dedication refers to being strongly involved in one’s work, and experiencing a sense of significance, enthusiasm, inspiration, pride and challenge. Finally, absorption is characterized by being fully concentrated on, and happily engrossed in, one’s work, whereby time passes quickly and one has difficulty in detaching oneself from one’s work. In short, engaged individuals work

hard (vigor), are involved (dedicated) and feel happily engrossed (absorbed) in their work (Schaufeli, et al., 2006).

**Definition 4.3: Work engagement**

A positive, fulfilling, work-related state of mind that is characterized by vigor, dedication, and absorption.

Source: Schaufeli, et al. (2006, p. 195)

The second concept is workaholism. Different conceptualizations of workaholism exist. For example, some authors define workaholism as a behavioral and cognitive tendency alone, such as “an individual’s steady and considerable allocation of time to work related activities and thoughts, which does not derive from external necessities” (Snir & Harpaz, 2004, pp. 522). However, in order to understand the “sting” in workaholism, it is important to add to this definition the affective components and attitudes towards work that explain the tendency to work excessively hard. Workaholics follow an inner drive, a compulsion, because of which their behavior is quite consistent across a range of situations (Scott, Moore & Miceli, 1997). Workaholics find it difficult to disengage from work, and persistently and frequently think about work when they are not at work. This inability to disengage from work leads to risks to health and well-being, if it relates to insufficient time for recovery.

**Definition 4.4: Workaholism**

The compulsion or the uncontrollable need to work incessantly.

Source: Oates (1971, p. 11)

In sum, both work engagement and workaholism may relate to an innate tendency to excessively allocate time and thoughts to work and get fully immersed. However, the crucial difference between workaholism and work engagement is that workaholism lacks the positive affective (fun) component of work engagement. In contrast, work engagement does not include the compulsive drive of workaholism. Differences also exist concerning their predictors. Research has shown that the main drivers of work engagement lie in the work environment, such as job resources, sometimes in combination with challenging demands. Drivers of workaholism, in contrast, are primarily stable personality constructs, such as perfectionism. Some scholars have argued that workaholism can be induced by characteristics of the working environment, such as a cultural norm of overworking. However, in the long run, non-workaholics are expected to leave such environments (Scott et al., 1997).

### **From practice 4.1: Work induced workaholism?**

For Mike, a 44 year old business owner, a six or even seven day workweek is quite common. He also admits he does not get much sleep. He is often up until hours after midnight, answering emails, talking on the phone, and doing his administrative tasks in the quiet hours after a long and hectic workday, and after his family members have gone to sleep.

Mike owns a small labour office. Until three years ago, he had always worked for other labour offices as a truck driver on short local routes. As a father of two little children he had liked the freedom related to temporary contract work, which allowed him to work part-time and take time off on short notice, for example when one of his children was ill. After his children had reached adolescence, he wanted to develop himself more. He decided to capitalize on his prior experience as a truck driver and on the contacts he had gained as a temporary worker, and started his own business.

From the day he had made this decision, his whole life changed. He finds he is unable to switch into "off" mode. It is the mentality shared by many entrepreneurs eager to grow and build their small businesses. He feels responsible for providing his workers a stable income and reasonable amount of welfare, which means he is in constant search for temporary job openings. Moreover, he is faced with many novel tasks that he has to learn on the job. Those include tasks related to personnel selection, training and leadership. It is understandable entrepreneurs like Mike give of themselves more than 100% during the start-up stage of the business, but at some point it can start to consume them. When that happens, a reliable, hard worker can slowly morph into a burnt-out workaholic who has slowly bled out all of his or her personal and social resources, and who is surviving rather than thriving.

Mobile technology makes it that much more difficult for workaholics to unplug. Mike can attest to this. He responds to client communications day and night. "I sleep with my cell phone close by. Sometimes they wake me up at four in the morning, for example, when a company suddenly needs a replacement for a truck driver on sick leave. They always know Mike is stand-by."

For entrepreneurs like Mike, relinquishing control of duties is hard. For many business starters, the idea of leaving the business for even one week sends chills down their spines. Many entrepreneurs resist delegating to others, making it that much more difficult to take time off from work. This may relate to their personality, such as in the case of perfectionists. However, sometimes the financial situation of the start-up firm does not allow for hiring extra people to perform managerial tasks, or renting office space to relocate the business out of home.

Overall, Mike feels he has found his passion, and he is perfectly happy with his choice to start a business. Nevertheless, now after three years, he too often feels he does not enjoy himself at all. He is starting to get into conflict with his sons who resent he works too much. He says: "It's important to find balance again in life. I'm not willing to become a workaholic at the expense of losing contact with my children." He has set new rules for himself, such as engaging in sports several times a week, getting away from the business during the weekends, and paying more attention to family and friends. He tries to stick to his rules.

Source: Personal communications

Research among employees has unequivocally shown that work engagement predicts outstanding work performance. Theoretically, there are several reasons why work engagement would stimulate good individual job performance (Bakker, 2009). First of all, work engagement is accompanied by positive emotions. Positive emotions have been related to a broader scope of attention and ability to build up one's resources (Frederickson, 2001; see chapter 5). Thus, engaged workers and business owners may be more open to new opportunities, be more helpful towards other people, and may be better able to build social networks, job resources and personal resources, such as self-confidence and optimism than less engaged individuals. Secondly, work engagement has been found predictive of good health, because of which more engaged people may be better able to perform well.

#### **My research 4.1: Entrepreneurs' passion for work, findings for The Netherlands and Spain**

We summarize the results of two of our recent studies that investigated both work engagement and workaholism and their link to work performance in an integrated manner. The studies compared self-employed workers to salaried employees.

##### Design and methodology

Study 1. The first study compared the results of 1900 Dutch employees and 262 Dutch self-employed individuals. This study used the short 9-item version of the Utrecht Work Engagement Scale (UWES) to measure work engagement (Schaufeli, Bakker & Salanova, 2006). Example items are: 'At my job I feel strong and vigorous', and 'I am immersed in my work'. Workaholism was measured with two subscales based on Flowers and Robinson (2002), and Spence and Robbins (1992), respectively. Seven

items measured Working Excessively ( $\alpha = .84$ ); for example 'I find myself continuing to work after my co-workers have called it quits'. Ten items measured Working Compulsively, such as 'I feel obliged to work hard, even when it's not enjoyable' ( $\alpha = .86$ ). Job performance was assessed with three sub scales. Task performance and contextual performance were each measured with three items from Goodman and Svyantek (1999). Participants were asked to indicate the extent to which they found statements characteristic of themselves, e.g. for task performance: 'Achieves the objectives of the job' ( $\alpha = .86$ ) and contextual performance: 'Willingly attends functions that are not part the job, but help in the overall image of the organization' ( $\alpha = .74$ ). Finally, the employee's level of innovativeness at work was measured by six items developed by Janssen (2003). For example, 'I invent new solutions for problems at work' ( $\alpha = .90$ ).

Study 2. Study two is a replication of study 1, and applied the same measures in an internet survey among a Spanish sample of 295 salaried employees and 196 self-employed individuals.

### Results

In line with expectations based on the entrepreneurship literature, both studies showed that self-employed individuals indeed scored higher on 'passion for work' than employees. In addition, both studies convincingly showed that work engagement relates positively to self-reported work performance. In study 1, multi-group structural equation modeling was used. Results showed positive associations of work engagement with all three performance indicators for Dutch salaried employees, and with task performance and innovativeness for the Dutch self-employed sub-sample. Study 2 used hierarchical regression analyses to predict work performance indicators based on work engagement, working excessively and working compulsively, controlling for demographic variables. Results showed that work engagement predicted all three indicators - task performance, contextual performance and innovativeness - for salaried employees and self-employed individuals.

Results concerning workaholism were more equivocal, showing non-significant, positive, and also negative relationships. For Dutch salaried employees, workaholism significantly predicted innovativeness. A strong positive association was found with working excessively ( $\beta = .39, p < .05$ ). However, a negative (suppressor) effect of working compulsively was found at the same time ( $\beta = -.13, p < .05$ ). The implication is that the net effect of workaholism, which is characterized by excessive and compulsive working, was undone. For the Dutch self-employed, similar counteracting patterns of



working excessively and working compulsively were found concerning contextual performance ( $\beta = .63$  versus  $\beta = -.47$ ,  $p < .05$ ) and innovativeness ( $\beta = .53$  versus  $\beta = -.40$ ,  $p < .05$ ). No associations were found between workaholism and task performance.

For Spanish salaried employees, hierarchical regression analyses showed only one association. Excessive working positively related to contextual performance ( $\beta = .25$ ,  $p < .001$ ), with no counteracting effect of compulsive working. For Spanish self-employed workers, two associations between workaholism and work performance were found. This time, a positive relationship of working compulsively ( $\beta = .25$ ,  $p < .05$ ) was nullified by the negative effect of working excessively ( $\beta = -.23$ ,  $p < .05$ ), so that, overall, the association between workaholism and task performance was not significant. In addition, working excessively had a moderate positive association with innovativeness ( $\beta = .17$ ,  $p < .05$ ).

Source: Gorgievski, Bakker & Schaufeli (2010); and work in progress

Scientific research shows that both workaholism, and work engagement, have an overall positive relationship with performance. However, when controlled for the excessive amount of time worked by workaholics, working compulsively was shown to curb the increase in creative and contextual performance for workaholics. Scholars suggest that workaholics may work hard, but not smartly. They suffer from perfectionism, are rigid and inflexible, do not delegate; and create difficulties for their co-workers (Gorgievski, Bakker & Schaufeli, 2010). This may be the sting of workaholism, and the reason why excessive working may pay off less for workaholics than for engaged workers, who may also be working hard.

## 4.4 Practical recommendations

To conclude, taking entrepreneurs' motivation as a starting point, different types of entrepreneurs have been discerned. One important distinction was between push and pull motivated entrepreneurs. Another distinction could be made based on more personal motivational differences, such as money and achievement related motives versus personal motives (autonomy and work-life balance). In a society, the number of entrepreneurs sharing particular motives differs depending on, for example, the economic development of a country. On the other hand, entrepreneurs' motivation relates to the type of businesses they start, and entrepreneurial success.

What are the practical implications for the individual? Firstly, it would be helpful to increase entrepreneurs' awareness of their own motives, and the relationship between entrepreneurs' motives, business type and performance. High goal-self concordance leads to intrinsic motivation, which

in the long run is essential for success and well-being. The more entrepreneurs are aware of their own deeper motives, and the more they know about the relationship between entrepreneurial motives and different types of businesses and business strategies, the more likely it is that they can set goals for themselves and their business that are in concordance with their selves. This helps them persist in the face of adversity, and increases the chance of business survival in the long run.

This chapter had a special focus on passion for work. A compulsive and harmonious form were identified; i.e., workaholism and work engagement. Both forms of passion for work appeared to have an overall positive relationship with performance. However, working compulsively nullified the effect of excessive working on creative and contextual performance for workaholics. This may be the sting of workaholism, and the reason why excessive working may pay off less for workaholics than for engaged workers, who may also be working hard. For this reason, entrepreneurs should avoid compulsive working, and regularly assess whether they are still working out of positive motivation.

Next, the extent to which the *drivers* of workaholism and work engagement are present need to be assessed. The most important drivers of work engagement relate to resources at work. Hence, entrepreneurs can build work engagement, through improving the way their own jobs are designed. In order to increase work engagement, and prevent workaholism, interventions can also focus on the individual level. Workaholics are not normally inclined to step back when they find themselves in an environment which demands excessive working, and does not provide invigorating rewards, because it makes them feel guilty. In order to prevent negative feelings when not working, predictability and controllability may be increased through the planning of activities. Workaholics, especially, may benefit from actively planning recovery activities, such as engaging in sports after work hours. Increasing skills, such as time management and conflict management skills, may also be helpful in decreasing the need to work excessively hard. In addition, a culture glorifying working excessively long hours may need to be counteracted, and replaced by a culture emphasizing working cleverly over working hard.

#### **Exercise 4.2: Creating balance and setting boundaries**

For many working people, the number one priority is creating a balance between work and personal life. People whose life is balanced focus on opportunities rather than problems and pitfalls. Especially for (starting) entrepreneurs, a focus on opportunities is key to success.

In order to create balance, you first need to assess the status quo. Where might you be out of balance? Assess the importance and quality of 7 areas of

your life. Rate quality on a 7-point scale ranging from 1 'very poor' to 7 'very good'. Rate importance on a 7-point scale ranging from 1 'totally unimportant' to 7 'very important'.

- *Career / work*: Consider passion for work. Are you happy with your work lifestyle and the people, places, things you interact with; the environment you work in, income and benefits, does it drain or invigorate you?
- *Relationships / romance*: Are you happy with the quality of your relationship? Are you not in a relationship, but are you happy with that? Do you spend enough time with your loved one? Is there playfulness, safety, intimacy, respect, etc. to the level you would like? Are there any sexual or reproductive issues that need to be addressed?
- *Money*: Consider your income, your expenses, debt, debt elimination program, credit history, retirement plan, insurance, savings, how you manage your money. How is your relationship with professionals who help you with your money matters?
- *Health and wellness*: How is your posture, weight, level of vitality, strength, muscle mass, skin, teeth, feet, eating, sleeping habits? Aches and pains absent?
- *Family and friends*: How are your relationships with your friends? Are they supportive, honest and communicative? Is there enough closeness? Do you spend enough time with them? Do you have enough relationships?
- *Physical environment*: Are you happy with your home, car, office, personal appearance (hair and wardrobe). Are you up to date on maintenance?
- *Recreation / rejuvenation*: Do you have enough time to play, go on vacation, do nothing, activities outside work? Do you have some kind of fun every day?
- *Spiritual*: Do you feel the kind of connection you would like with a higher power or spiritual community?
- *Personal growth*: Consider your level of satisfaction with skills, love, communication, risk taking, etc. Are you satisfied with who you are becoming?

After your assessment of the current situation, set priorities for improvement. Next, set smart goals for attaining improvement. For example, if your goal is to start your own business you may decide:

- Long-term: Get an MBA in entrepreneurship in 4 years from now.
- Middle-term: I want to start the MBA this September.
- Short-term: find information on different programs within the next 6 weeks.

Source: Haddock (2001)

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## Chapter 5

# POSITIVE PSYCHOLOGY INSPIRATIONS FOR ENTREPRENEURSHIP RESEARCH

Mariola Laguna

### **5.1 Introduction**

Entrepreneurs pursue their dreams of developing successful new ventures regardless of all the obstacles and barriers to be faced. One of the interesting questions raised in research carried out on entrepreneurship is, what helps people to undertake entrepreneurial activity, and to continue on with it to achieve its successful outcome, even if it is such a demanding task? Recent analyses suggest that the personality of the entrepreneur is important for successful business start-up and growth (see chapter 3).

It is also worth noting that research to date has focused on a limited number of personality traits. Many other personal variables, that may be relevant from the viewpoint of entrepreneurial activity, could not be included in the meta-analyses on account of there being too few appropriate studies. Therefore, the need to include new variables in further research on entrepreneurship is recognized (Baron, 2007; Rauch & Frese, 2007). The positive psychology movement, dynamically developing in recent years, opens up an interesting area for further research (Seligman & Csikszentmihalyi, 2000), including a closer examination of entrepreneurship. It directs the researcher's attention towards variables that were rarely studied in the past; e.g., the entrepreneur's well-being and positive emotions.

This chapter reviews the inspiration for the research carried out on entrepreneurship, which was provided by the positive psychology movement. Firstly, the main ideas of this movement are presented. Although they are new, they go hand in hand with earlier entrepreneurship research. Afterwards, new research findings inspired by positive psychology are discussed.

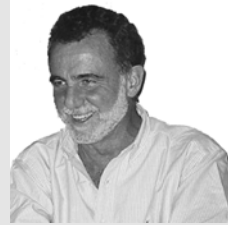
### **5.2 The positive psychology and its applications**

A few years ago, a new movement called 'positive psychology' emerged as a field of inquiry. This approach aimed at providing a scientific foundation for the study of human happiness and optimal functioning (Seligman &

Csikszentmihalyi, 2000). It is founded on the belief that people want to lead meaningful and fulfilling lives, to cultivate what is best within themselves, and to enhance their positive experiences. The leaders of this movement call for the commitment of scholars and practitioners to the identification of factors which may contribute to well-being, to the design of interventions for the development of human strengths and potential, as well as the orientation of public policies towards promoting the well-being of society as a whole (Seligman & Csikszentmihalyi, 2000). As a consequence, the importance of studying optimal human functioning, and the positive side of life experience has gained the growing attention of researchers (Caprara et al., 2009).

**Key representative 5.1: Gian Vittorio Caprara**

Professor of Psychology at Sapienza University, Rome. Author and coauthor of more than 400 scientific publications, including several volumes. He is a member of several scientific associations, and has been President of the European Association of Personality. He is the leading expert in the field of research on positive personality characteristics.



**Expert's view 5.1: Agency, self-efficacy, and positive orientation**

*Gian Vittorio Caprara, Professor of Psychology, Sapienza University, Rome*

The main subject of my study is personality - the complexity of psychological systems that contribute to the unity and continuity of an individual's conduct and experience as they are expressed by the individual and perceived by others.

Over the years the importance of personality research has been largely acknowledged among scientists, and in various applied settings, due to the influence that individual characteristics associated with leadership, motivation and innovation exert on the functioning and development of successful organizations. The notions of agency, and potentials in particular, are crucial for orienting psychological investigations and interventions. Promoting personal welfare and achievement requires a focus on what individuals can become beyond what they tend to be like, and societies and organizations must learn how to capitalize on their members' mental potential if they are to flourish in a rapidly changing world.

Whereas, the notion of agency points to the fact that people may actively contribute to the full expression of their natural and social endowments, the notion of potentials highlights the fact that many human strengths derive from people discovering and nurturing their capacities while acknowledging environmental opportunities. Capacities for self-

regulation through self-reflection, self-evaluative reactions, and forethought are unique endowments of the human species that allow people to adjust their cognitive, affective, and behavioural responses in order to attain personal goals, and thus to exert a considerable influence over their experience and course of life.

People select, interpret, and transform the environments they encounter, and are, to a great extent, responsible for the full expression of their talents, as these develop in interactions with the social context. Environments contain resources, opportunities, and challenges whose influence is not invariant across people and remains latent in the absence of active choice. Even assets and strengths do not impose themselves on individuals, but must be actively pursued. Thus, a basic goal of agentic and potentialist views is to shed light on the psychological systems that enable people to regulate their experiences and actions, and thus to contribute to the development of their potentials. This view is particularly relevant to the promotion of entrepreneurship, as well as to the development of organizations.

A vast body of research, including my own, suggests that both self- and collective efficacy beliefs are the central features of human agency that play a key role in the full realization of individuals' potentials no less than in the best functioning of groups and society. Unless people believe they can produce desired results by their actions, they have little incentive to undertake activities and seek opportunities that they perceive to be beyond their reach. Likewise, people's shared confidence beliefs in the joint capacities of the groups and organizations they belong to are crucial to produce the synergies that are needed in order to achieve challenging and ambitious common goals.

Recently I have focused on positive orientation, namely the latent dimension at the core of life satisfaction, self-esteem, and optimism. Findings attest to the large genetic component of this dimension, as well as to its stability, generality, and pervasive influence across the domains of functioning.

Scholars in diverse disciplines put their efforts into studying human potential and strengths. Positive beliefs proved to be important to functioning in many areas such as health, sport, and educational achievements (overviews of research in Bandura, 2001; Snyder, 2002). Positive experiences and positive personal characteristics manifest themselves also in the workplace (Linley & Joseph, 2004). Scholars focus on identifying and developing such organizational characteristics that lead to high individual and organizational performance. We may expect that these positive characteristics play, as well, an important role in entrepreneurial activity (see Exercise 5.1). Expert's view



5.2 presents the strengths profiles of enterprising psychologists prepared by leading positive psychologists from the Centre of Applied Positive Psychology.

**Key representative 5.2: Alex Linley**

Professor of Psychology, Founding Director of the Centre of Applied Positive Psychology (CAPP), the author of over 120 academic publications and seven books, the latest being *The Strengths Book: Be Confident, Be Successful, and Enjoy Better Relationships by Realising the Best of You* (CAPP Press, 2010). One of the leaders of positive psychology movement in Europe.



**Expert's view 5.2: Positive psychology of entrepreneurship**

*Alex Linley, Nicky Garcea, Jonathan Hill, Centre of Applied Positive Psychology*

Dr. Jonathan Hill was interested in exploring how the strengths profiles of enterprising psychologists compared to broader entrepreneurial strengths profiles. He interviewed three psychologists who had successfully established business psychology consulting practices with turnovers in excess of GBP £1m (approx. US \$1.6m). Content analysis of the three interviews revealed seven core themes:

- *Sales Achievement*: gaining a “high” from selling and deals;
- *Client Service Values*: helping clients to feel pride in their own effectiveness;
- *Expertise Appreciation*: admiration of the accomplishments of technical specialists;
- *Business Sense*: objectivity about client’s business model and striving to improve performance of client’s business;
- *Intellectual Curiosity*: taking an open-minded pleasure from continual learning, being widely read and widely travelled;
- *Mentorship*: developing colleagues and clients, and taking a sense of delight from seeing their growth;
- *Altruistic Values Commitment*: focus on, and interest in, topics including international development, education, family values and conservation.

Relative to other entrepreneurial profiles, the “values commitment” of enterprising psychologists is a notable addition that is not usually found elsewhere.

Our experience suggests that this “values commitment” may be found even more strongly in the work of applied positive psychologists in particular. There is much inherent interest about the applications of positive

psychology that is concerned with “making a difference in the world”, since positive psychology has something of an intrinsically positive value base. For example, Linley set out the three pillars of responsibility of the strengths approach, all focused on achieving the wider good: (1) a personal responsibility to use and develop our strengths; (2) a collective responsibility to create the conditions that enable the development of the strengths of others; and (3) a social responsibility to harness strengths for the benefit of the wider society.

As entrepreneurs and applied positive psychologists ourselves at the UK’s Centre of Applied Positive Psychology ([www.capepu.com](http://www.capepu.com)), we hold our altruistic values at the core of our corporate mission of *Strengthening the World*, as well as in practice, through the efforts of our charitable arm, *The Strengths Project*. Entrepreneurs likely have a particular strengths profile that enables them to be successful. For positive enterprising psychologists, however, we believe that this entrepreneurial strengths profile is often wrapped around a deep core of positive, altruistic values that may ultimately come to define and distinguish those who work in this field.

### **5.3 Positive roots of the psychology of entrepreneurship**

Searching for that which gives strength to act and contribute to the development of personality, appears to be close to what has always inspired research on entrepreneurship. McClelland’s (1961) early research on the need for achievement also referred to those dynamisms of personality that favor development, in the individual, as well as in society. Research on self-efficacy, already having a well-established tradition in the psychology of entrepreneurship (e.g. Markman, Balkin & Baron, 2002; Rauch & Frese, 2007), also refers to the positive aspect of the personality.

David C. McClelland (1961) undertook to explain the phenomenon of economic growth. Assuming that entrepreneurship constitutes one of the key forces behind economic development, he attempted to explain why some people focus on, and succeed in, economic activity. Asking the rhetorical question: “What could be more obvious than that great achievements are motivated by strong desires to achieve, on the part of at least some people in the culture?” (1961, p. 36), he pointed to the connections between the need for achievement and the economic development of societies. In this way, he initiated the psychological analysis of economic phenomena.

Another positive personal characteristic, often addressed in entrepreneurship research to date, is self-efficacy (Bandura, 2001). A meta-analysis shows that generalized self-efficacy is one of the most important psychological factors in entrepreneurship (Rauch & Frese, 2007). Other research has shown that individuals who have started their own businesses

feel more capable of dealing with entrepreneurial tasks than those who have not decided to do so (Markman, Balkin & Baron, 2002). The conviction that one has a firm sense of personal efficacy, is one of the positive resources important in entrepreneurial success, which is definitely confirmed by research findings (see chapter 3).

### **Exercise 5.1: Strengths and virtues**

Positive psychology proposes a systematic classification of universal character strengths and virtues (CSV). It describes six classes of "core virtues", made up of 24 character strengths.

1. Wisdom and Knowledge: creativity, curiosity, open-mindedness, love of learning, perspective.
2. Courage: bravery, persistence, integrity, vitality.
3. Humanity: love, kindness, social intelligence.
4. Justice: citizenship, fairness, leadership.
5. Temperance: forgiveness and mercy, humility and modesty, prudence, self-regulation.
6. Transcendence: appreciation of beauty and excellence, gratitude, hope, humour, spirituality.

Firstly, try to identify your own personal strengths. Take one of the strengths you have identified, and for the following week, use the strength in a new way every day.

Secondly, thinking about entrepreneurial activity, try to evaluate which of the character strengths seems to be most important for entrepreneurs.

Source: Peterson & Seligman (2004)

There are also studies investigating the relationships between creativity, innovativeness and entrepreneurship (e.g. Strzalecki, 2007). These are also positive personality characteristics stressed for many years in entrepreneurship theories. As can be seen, studies on entrepreneurship – earlier than the beginnings of the positive psychology movement – have focused on the positive aspects of the entrepreneur's personality.

The positive side of the phenomenon, namely the search for the determinants of entrepreneurial success, is also the focus of theories explaining the firm's creation and development process (Baron, 2007). They search for what supports the entire process, paying less attention to "the darker side of the coin," meaning, the causes of possible failures. It is therefore possible to say that, while making no direct references to the positive psychology movement, they are 'positively biased.'

## 5.4 Recent research on positive psychological capital and entrepreneurship

Even if previous research on entrepreneurship took into account many personal characteristics which can be considered as positive aspects of the personality, or strengths, of the person; the emergence of the positive psychology movement introduced new insights into this field of study. There are not many research findings yet, but we can observe the rise of new study topics and ideas inspired by this movement.

### Positive psychological capital

Traditionally, in management as well as in entrepreneurship, three types of resources have been isolated: financial resources, physical or technological resources, and human resources such as knowledge, competence, or social capital (Honig, 1998). The new proposal put forward by Luthans and his research team (Jensen & Luthans, 2006; Luthans & Youssef, 2004) also takes into consideration positive psychological capital. That is, the strengths of the organization's employees. As regards the key components of positive psychological capital, the following were proposed as important positive resources of the organization; i.e., ones that may increase its competitiveness in the marketplace: confidence (identified with self-efficacy), hope, optimism, and resiliency (the ability to recover successfully from problems and adversities). They can contribute to the market advantage of those firms which know how to use and develop them. The recognition of these new forms of capital does not negate the role of traditional capital, but offers new ways of understanding and managing human behaviour and motivation in the work context.

#### Key representative 5.3: Fred Luthans

Professor in the Department of Management, at the University of Nebraska, specializing in organizational behaviour and leadership. He has proposed a theory, and conducted research, on positive organizational behaviour. His research has shown that developing psychological capital increases the organization's competitiveness.



Source: <http://cba.unl.edu/profiles/996>

Jensen and Luthans (2006) point to the connections between positive psychological capital and leadership in the context of management. In the model proposed, they treat positive psychological capital (confidence – identified with self-efficacy; hope, optimism, and resiliency) as variables that have an impact on entrepreneurial leadership. The findings of their

research, conducted on a group of business founders, confirm this model. While more research is needed to draw definite conclusions, these initial findings suggest that it may be important to identify the positive psychological capital of entrepreneurs which helps them to run their emerging organizations.

**Definition 5.1: Dispositional optimism**

Belief that good rather than bad things will happen; general expectancy of positive events in the future.

Source: Scheier & Carver (1985)

**Self-referent beliefs**

What seems interesting from the positive psychological perspective is the question of whether, and to what extent, positive beliefs may help entrepreneurs to deal successfully with the firm's creation and development. My own research concentrates on four positive self-referent beliefs: self-efficacy, self-esteem, hope, and dispositional optimism (see My research 5.1). Do these psychological factors matter in entrepreneurship defined as a goal realization process?

**Definition 5.2: Hope**

Interconnected self-beliefs concerning a sense of successful goal-directed determination (agency); and the perceived capability to generate workable routes to desired goals (pathways); beliefs supporting people in attaining their goals.

Source: Snyder (2002)

The results of the two studies confirmed that positive self-referent beliefs can affect the stages of the entrepreneurial process, although this influence is not always positive (Laguna, 2010). The self-referent beliefs that help potential entrepreneurs to deal successfully with the creation of the new firm are entrepreneurial self-efficacy and hope. The higher the level of entrepreneurial self-efficacy, the higher, also, is the level of entrepreneurial intention and planning; how, where, and when to establish a new firm (for the importance of planning see chapter 7). Hope also turns out to be a significant predictor of the positive assessment of this goal. However, self-esteem and dispositional optimism show mixed effects. They increase the assessment of the chance of success in the creation of the new firm, but negatively affect other stages of the entrepreneurial process. Self-esteem turns out to decrease the assessment of the value of new firm's creation: people with higher level of self-esteem perceive it as not so important for them, even if they are unemployed. We can interpret

it as a way of protecting a high self-esteem level in a situation when they may experience failure. It will enable them to say: I didn't establish my own firm, but it was not so important for me. A higher level of optimism decreases the level of planning; - expecting that the future will be positive, people tend not to prepare carefully for it. Further studies replicated the positive effects of self-efficacy and hope, and the negative effects of self-esteem in other domains related to work (Laguna, 2010).

### **My research 5.1: Self-referent beliefs and the process of new firm's creation**

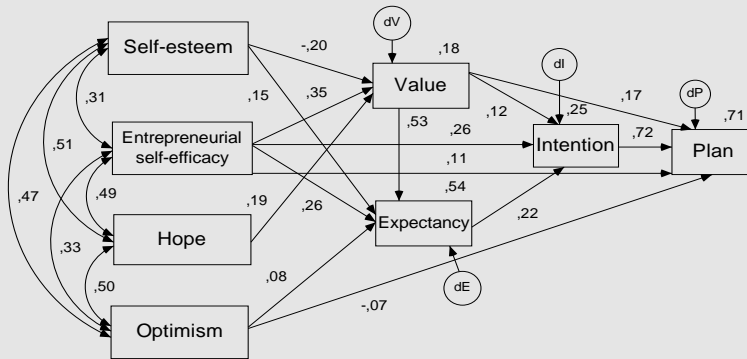
What is interesting for me is the question of whether positive self-referent beliefs help potential entrepreneurs to deal successfully with the new firm's creation. I decided to treat the entrepreneurial process as a process of goal realization, comprising three stages: 1) goal assessment (how valuable the firm's creation is, and how likely one is to succeed in this endeavour); 2) entrepreneurial intention, and 3) implementation of intention (a plan how, when, and where to establish the new firm). This allows us to put the analysis into the broader context of goal-directed behaviour theories.

Using Rosenberg's Self-Esteem Scale, Laguna's Entrepreneurial Self-Efficacy Scale, Snyder's Adult Dispositional Hope Scale, Scheier, Carver, and Bridges's Life Orientation Test, Zaleski's Goal Questionnaire, as well as Laguna's Entrepreneurial Intention and Entrepreneurial Implementation Intention Scales, data from 606 subjects was collected (328 women and 278 men). To explain the relationships between variables, Structural Equation Modeling was used.

Figure 5.1 shows the relationships between positive self-referent beliefs and the three stages of the entrepreneurial process (all statistically significant). Entrepreneurial self-efficacy is an important direct predictor of entrepreneurial intention, as well as of planning. It has also indirect effect, through goal assessment. A higher level of hope increases the assessment of the goal's value. A higher level of optimism favors a higher assessment of success chances in starting one's own business, but at the same time it decreases the level of planning. Self-esteem, as it turns out, influences the assessment of the value of firm creation negatively, but it positively affects the expectancy of goal attainment. The expectation that the creation of a firm is an attainable goal increases the level of entrepreneurial intention. Putting greater value on this goal increases not only the level of intention but also the level of planning.

**Figure 5.1: A model of the relationships between study variables**

( $\chi^2 = 3,734$ ;  $df = 8$ ;  $p = .880$  ;  $RMSEA = .001$ ;  $GFI = .998$ )



Source: Laguna (2010)

These findings are in congruence with previous studies which show that beliefs regarding oneself are important behaviour regulators (Bandura, 2001). However, we should not expect that every personal belief that seems to be positive will be helpful. Such exclusive concentration on the positive aspects seems to be a too rosy and one-sided view of human functioning (Held, 2005). There is evidence that high self-esteem does not always bring positive effects (Baumeister, Campbell, Krueger & Vohs, 2003). The findings of other recent studies also demonstrate a negative relationship between entrepreneurs' dispositional optimism on the one hand, and the revenue and employment growth of their new businesses on the other (Hmieleski & Baron, 2009). Moreover, past experience in creating firms and industry dynamic changes moderate these effects, even strengthening the negative relationship between entrepreneurs' optimism and business performance. As all these studies show, attempts to boost the self-esteem and optimism of potential entrepreneurs may even give counterproductive results.

### Emotions

The role of positive emotions is an important area of interest to positive psychology (Fredrickson & Branigan, 2005). However, so far there have been very few studies dealing with this issue in connection with work and organization psychology, and still fewer exploring it with reference to entrepreneurship (see Exercise 5.2).

One of the scarce studies on the role of emotions in entrepreneurial actions, implemented a 24-day experience sampling methodology (Maw-Der, Uy & Baron, 2009). It found that entrepreneurs' negative affect directly predicts their effort toward tasks that are required immediately, and positive

affect predicts the venture's effort beyond what is immediately required. Another longitudinal study on business founders' decision making processes showed a positive relationship between a positive mood and motivation for entrepreneurial goal attainment; – and a negative relationship between a negative mood and motivation (Van Delden, 2008). However, there was no direct relationship between mood and the entrepreneur's decision effectiveness. My own research shows that in cases of women planning to create new firms, the higher their curiosity level is, the higher is also the assessment of value of the new firm's creation (Laguna, 2008). At the same time, a high level of fear decreases their expectancy of success in entrepreneurial activity.

### **Exercise 5.2: The broaden-and-build theory of positive emotions**

This theory, developed by Barbara Fredrickson, suggests that positive emotions broaden awareness, cognition and increase the number of potential behavioural options. This way they encourage novel, varied, and exploratory thoughts and actions. Over time, this broadened behavioural repertoire builds skills and resources.

Listen to Barbara Frederickson's lecture on "The broaden-and-build theory of positive emotions" (4'59") at

<http://www.centreforconfidence.co.uk/pp/audio.php?p=c2lkPTE=>  
(retrieved April 27<sup>th</sup> 2010).

How can this theory be applied to explaining the process of new firm creation and development?

### **Well-being**

The well-being and health of entrepreneurs and their role in entrepreneurial success is another new field of research. Establishing and running a firm is a demanding task, and some entrepreneurs dedicate all their time and energy to the venture. This has been observed to have negative consequences for the entrepreneurs' private life, work-life balance, well-being, and health (see chapter 4). However, entrepreneurs' job characteristics can at the same time be motivating and lead to work engagement, job satisfaction, and well-being (Gorgievski & Laguna, 2008). There are also first studies which point to a positive relation between entrepreneurs' health and well-being, and entrepreneurial success (see Stephan & Roesler, 2009). These two sides of the coin have not been adequately addressed by entrepreneurship research, so far.

Entrepreneurs, as organization builders play a key role in ensuring a good quality of life not only for themselves but also for their employees. Developing the firm, they shape the characteristics of the organization and job characteristics of their employees. They can influence their employees' quality of work and life by implementing an organizational design, its



structure and culture. A high-quality of life, repeated experience of positive emotions, and engagement at work in turn constitute the important mechanism through which organizational design influences innovative employee behaviour (Amabile, Basarde, Mueller, & Staw, 2004). In this way, creating organizations that increase the quality of life may result in greater innovativeness and market competitiveness of the firm. It is also possible to introduce positive organizational practices proposed by the positive psychology movement (see From practice 5.1).

### **From practice 5.1: Strengths-based recruitment of new employees**

Facing the new firms' creation and development challenges, most entrepreneurs have to look for employees. Doing so, it is possible to use strengths-based recruitment strategy, developed as one of the positive organizational practices. This strategy tries to match the organizational role to the person rather than change the person to fit the role.

The strengths-based approach recommends to the entrepreneur, as employer, to start out by identifying all the personal strengths that are necessary from the viewpoint of expected, and desired, outcomes. What are the results, valuable for the firm, which an employee should deliver through effective role performance?

Knowing what strengths are needed to achieve the firm's anticipated outcomes, it is possible to recruit people for their natural strengths. Personal strengths are the capacities for performance that give people energy and enable their optimal functioning and development. During the recruitment process, the entrepreneur may ask candidates to demonstrate their strengths and provide recent examples of the key capabilities necessary for the role they are applying for.

Source: Linley & Page (2007)

## **5.5 Summary and practical recommendations**

Even if, taking into account new research findings, we change the exact list of positive psychological capital components proposed by Luthans and colleagues (Luthans & Youssef, 2004), it is important to consider the role played by this kind of capital. Positive personality characteristics may be identified as resources that help entrepreneurs employ the right strategies to deal with the challenges and demands of business. In doing so, they help to increase, rather than reduce, total resource reservoirs. Having a high level of these positive psychological resources, the entrepreneur may be more able to persist in the face of adversities, move on successfully through the phases of the entrepreneurial process, and focus on gains rather than losses. Taking this into account helps us understand the gain and loss cycles of resources and

better explain the process of new firm creation and growth (Gorgievski & Laguna, 2008). High demands typical for entrepreneurial work do not need to lead to resource loss, if a person is rich in positive psychological capital.

Positive psychological characteristics are not as constant as, for instance, the personality traits described in the Big Five model. This means that they can change, either in the long run as a consequence of life experiences, or as a consequence of specially developed trainings (Luthans & Youssef, 2004). Such trainings may aim, for example, at increasing the level of positive capital (Snyder et al., 2000), at developing self-regulatory mechanisms helping to achieve a balance between optimism and realism (Hmieleski & Baron, 2009), or at managing emotions (Shepherd, 2004).

For example, in order to develop hope, goal setting is vital. Ingredients of a training program aimed at increasing people's hope usually include (1) helping people to set specific, realistic but also challenging goals, (2) breaking long-term goals down into smaller sub-steps (stepping) and planning several routes to reach those goals, (3) strengthening the motivation to use those routes (Snyder et al., 2000). Based on these suggestions, it is possible to propose exercises for trainings aiming at increasing the level of hope (see Exercise 5.2).

### **Exercise 5.2: Hope recipe**

Firstly, try to use the suggestions presented below to increase your level of hope for goal achievement.

#### 1. Set clear goals:

- consider a few attractive goals before setting on one,
- set goals that you really want to achieve, that are realistic, but also challenging,
- establish markers that can be used to see progress in the goal's realization.

#### 2. Think about how you can reach those goals:

- break the goals down into smaller sub-steps,
- plan several routes in case one route gets blocked.

#### 3. Call forth the motivation to use those routes:

- accentuate your strengths and positive movement toward a goal,
- consider barriers as challenges, and a normal part of life, rather than failures,
- recall how overcame previous barriers.

Secondly, based on the above description, propose ways to develop hope in the context of entrepreneurship. Try to develop exercises that could be included in a training program for potential, or actual, entrepreneurs which use all three ways of increasing hope.

Source: Snyder et al. (2000)

This chapter has presented certain inspiration that positive psychology introduces to entrepreneurship research. Although, from the beginning, analyses of the phenomenon of entrepreneurship have focused on what gives people the dynamism and strength to engage in various kinds of entrepreneurial activities, the positive psychology movement has moved the attention of researchers in a new direction. The issue of the role of variables such as well-being, hope, and optimism has been taken up. New research findings show that having a high level of positive psychological capital, such as self-efficacy and hope, the entrepreneur may be more able to focus on gains, persist in the face of adversity, and successfully move on through the phases of the entrepreneurial process of the new firm's creation and growth (Laguna, 2010).

At the same time, entrepreneurship psychology has managed to avoid a one-sided focus on the positive role of these variables only, present at the first stage of the development of positive psychology (Held, 2005). For instance, while recognizing the advantages of optimism, it points to the problems that excessive optimism may cause (Hmieleski & Baron, 2009).

To conclude, it appears that the inspirations provided by positive psychology will significantly influence the direction of further research on entrepreneurship.

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## Chapter 6

# DEFINING AND MEASURING ENTREPRENEURIAL SUCCESS

Dominika Dej

### **6.1 Introduction**

This chapter provides evidence that entrepreneurial success has many faces and can be measured using various methods. Firstly, it briefly introduces the economic and psychological approaches to entrepreneurship, and shows how entrepreneurs themselves view success. Secondly, it proposes the classification of entrepreneurial performance into aspects of an organizational and personal character, and summarizes the benefits and shortcomings arising from their subsequent measurement. Furthermore, the chapter presents the selection criteria used to identify the most successful entrepreneurs by practitioners to identify the most successful entrepreneurs. A psychological definition of success that focuses on the fulfilment of valued success criteria, and work satisfaction, are provided.

Lastly, I introduce the recent research findings on entrepreneurial success and introduce a novel instrument for evaluating entrepreneurial performance.

### **6.2 Entrepreneurs' views on success**

Entrepreneurship is typically associated with innovation (e.g., Schumpeter, 1993), market expansion (e.g., Littunen, 2000), economic growth (e.g., Carree & Thurik, 2003) and advancement of a country's welfare (Lumpkin & Dess, 1996; Porter, 1990). Within this economic approach to entrepreneurship, the measurement of success is based predominantly on organizational performance indicators such as company survival, sales, profits, employee growth, market share or return on investment (e.g., Chandler & Hanks, 1998). Does, however, the economic perspective encompass the whole spectrum of possible criteria that shape success? Exercise 6.1 fosters reflection on the possible palette of aspects that entrepreneurial success might include.

### **Exercise 6.1: Example of a successful entrepreneur**

Please think of an entrepreneur you know personally (friend, relative, colleague, etc.), or whom you know from the media who according to your opinion, is very successful. Please justify your choice of this entrepreneur by means of at least 5 arguments.

Unlike the economic disciplines, a psychological approach to entrepreneurial success recognizes the importance of entrepreneurs' personal motives, goals and aspirations. Research in this field emphasizes the crucial role of intangible success criteria when defining and measuring entrepreneurial success. For instance, entrepreneurs were found to value personal initiative, autonomy, independence, work-enjoyment, self-directed work and high achievement (e.g., McClelland 1968; Schwartz & Bardi, 1997). Beyond profit generation and maximization (e.g., Bird 1989; Kuratko, Ireland, & Hornsby, 2001), entrepreneurs strive to maintain positive relationships with their employees and customers, for social recognition, to contribute back to society or for firm continuity (e.g., Gorgievski, Ascalon & Stephan, 2010; Kuratko et al., 1997).

### **From practice 6.1: Interview with Marta Novakova**

When I promised to do an interview for this book with a successful entrepreneur, I felt a little embarrassed. I did not want to do an interview with "icons" of business. Some have become "successful" because they quickly understood the function of the newly established capital market in the Czech Republic; others were operating on the fringes of the law. I was looking for someone more "normal", who stands with both feet on the ground. Finally, I asked for a brief interview Marta Novakova, my colleague from the "Day D" (the Czech version of TV show Dragon's Den).

*Marta, could you give us a brief introduction to your firm: U&Sluno?*

This company was founded by my husband and his colleague, but I was present as a "back office" from scratch. At the beginning, it was meant to be only temporarily in the fields of accounting, business and employee management; and now it is almost 20 years. Our company specializes in process consulting and the implementation of information systems in retail, wholesale and distribution companies. I rely primarily on the ability of my colleagues, their specific knowledge of technology, and our customers' business, in order to be able to offer high quality services with the greatest possible flexibility.

*How important is success for you and what does it actually mean to you?*

Success is an important part of my life. For me it is not money, but rather to achieve in time the set objectives.

*There are still less women entrepreneurs; is it harder for them in business?*  
I think gender is not crucial. More important is ambition, achievement and motivation. Women, perhaps, give up too quickly.

*How important is the work-life balance for you?*

The body definitely needs some compensation and the brain needs to clean itself out. I do not avoid the adrenaline experiences, adequately.

*When looking back to the past, would you have done anything differently?*

Sure. I would have relied more on myself.

*How do you react to changes, are they for you, rather, opportunities or threats?*

Change is a part of life, so I do not fight against it, and I always watch what is happening.

*What would you do, if you were not an entrepreneur?*

I really do not know. My husband claims that if I stayed for a week in a sheepfold, I would begin to organize even the sheep.

*Is there any book, quote or someone who inspired you? I like one quote from you, "... is on holidays". We often say what should be done, but there are not many people willing and able to do it.*

Years ago I read a book about the life of Tomas Bata. It inspired me a lot and I come back to it occasionally, even now. Only a few people are ingenious, but his example shows that success can be achieved by honest work, perseverance, and consistency. Maybe it sounds pathetic, but integrity also belongs among these qualities.

Source: interview with Marta Novakova was led by Ivan Pilny

A recent qualitative study, exploring the definitions of success which were provided directly by entrepreneurs, found that many of them value personal fulfilment and work-enjoyment, as well as interpersonal relations (Dej, Stephan & Gorgievski, in preparation). My research 6.1 presents the quotations of entrepreneurs who were asked to define success during face to face interviews.

### **Definition 6.1: Entrepreneurial success**

Entrepreneurial success is a complex phenomenon and it includes multiple criteria of a financial and non-financial character (e.g., Gorgievski et al. 2010; Orser & Dyke, 2009; Schenk, 1998).

The diversity of aspects that entrepreneurs value and seek to achieve, implies that there is a need for an extension of the traditional economic success definitions into a more comprehensive one that include multiple, pecuniary and non-pecuniary criteria.



### **My research 6.1: Entrepreneurs' point of view**

Almost 54% of entrepreneurs defined success by personal fulfilment and work-enjoyment, for example:

*Success is when I am independent in defining my goals for the future.*

*I am successful when I continuously set higher and higher goals.*

*Success is, for me, to have fun at work.*

*Success is to be completely absorbed in the job; to feel full of energy.*

*Entrepreneurial success means to be happy with what I do, and the way I do it.*

Over 70% of participants defined success by relationships with employees and customers, for instance:

*Success is to have a positive working climate and a "We" feeling.*

*Harmonious cooperation within the company is crucial for success.*

*Success is if your clients are happy.*

Source: Dej, Stephan & Gorgievski, in preparation; Dej, Sztuba & Stephan (2010).

### **6.3. Organizational and personal success indicators**

Given the fact, that an extended definition of success includes diverse criteria reflecting the complexity of entrepreneurs' realities, the evaluation of success should take these into account as well. The classification of success into criteria of an organizational and personal character provides a comprehensive framework against which to measure entrepreneurial success. Organizational performance criteria include business related aspects such as: firm survival, cash flow, company sales and profits, and number of employees, as well as company growth (e.g., Schenk, 1998), which can be collected in the following three ways (Richard, Devinney, Yip and Johnson, 2009). Firstly, researchers may gather objective accounting and financial market information. Secondly, they may ask entrepreneurs to report on these economic parameters (e.g., company growth, sales or profits). Thirdly, entrepreneurs might be asked to evaluate their company's performance, e.g., its financial situation and market share, or alternatively, compare it with that of the rival.

Although organizational success indicators collected in the three ways presented here are potentially very useful, their actual benefit in entrepreneurial settings is greatly limited. In particular objective data is scarce for researchers, since it is often not public. In addition, entrepreneurs avoid divulging financial numbers and often manipulate them for tax reasons (Schenk, 1998). Also, general evaluations of business performance are not free of error. Cognitive biases such as the halo effect or the tendency to positively judgement of one's own situation (e.g., Taylor & Brown, 1988), may lead to under- or overestimations of

company success. Finally, the majority of economic criteria (except for some, e.g., employee’ growth) are susceptible to seasonal fluctuations; consequently, performance evaluations that are based on them display short rather than long term success (Schenk, 1998).

Personal success criteria refer to entrepreneurs’ non-organizational goals, and therefore include predominantly intangible indicators such as personal fulfilment, self-realization, and work-related social relationships, as well as contributions to society and social recognition. In addition to these non-financial aspects, personal pecuniary rewards or financial security also fall into this category. Collecting data on the achievement of personal success criteria is less problematic compared to organizational data; researchers obtain them by employing questionnaires, or open ended questions. With the exception of personal income, this kind of information is mostly freely disclosed by entrepreneurs. It is notable, that the achievement of personal success criteria depends strongly on entrepreneurs’ aspirations and can be distorted by cognitive bias as well. Table 6.1 presents most important personal and organizational success criteria.

<b>Table 6.1: Taxonomy of entrepreneurial success criteria</b>	
<i><b>Personal success criteria</b></i>	<i><b>Organizational success criteria</b></i>
Self-enhancement / Self-realization	Company survival
Autonomy / Independence	Employee numbers and growth
Financial Security / Personal Income	Return on investment
Interesting Tasks	Cash flow
Being one’s own boss / Influence	Sales and their growth
Reputation / Prestige	Market share and expansion
Social interactions with employees and customers	General company performance and growth
Providing needed products and services	Being better than rivals
Source: Based on Richard et al., (2009); Schenk (1998).	

Whereas the scholars aim to describe, explain and measure entrepreneurial success, practitioners try to identify and acknowledge successful entrepreneurs. From practice 6.2 “Entrepreneur of the Year” presents the criteria used to nominate the most successful entrepreneur.

**From practice 6.2: Entrepreneur of the Year**  
*Marek Slama, Business Development Manager, Ernst & Young*

In 2010, Ernst & Young announced the 10<sup>th</sup> Entrepreneur of the Year winner in the Czech Republic. The Entrepreneur of the Year competition, which selects the most successful business pioneers and innovators, was

established in the United States in 1986. It aims to present outstanding individuals in the field of business to the public, and to provide role-models for young entrepreneurs.

An independent jury selects the winner based on a thorough assessment of all applications. The jury decides in strict accordance with the award's international rules to ensure comparable results worldwide. The jurors carefully review the following six key areas and aspects of the entrepreneur's personality, and his or her entrepreneurial story.

**Entrepreneurial spirit:**

- Setting high standards and demonstrating a desire to be successful
- Taking risks and overcoming obstacles
- Demonstrating perseverance and learning from experience

**Innovation:**

- Pioneering new approaches or technologies
- Ability to adapt and develop products/services ahead of the market
- Building a culture of innovation and investing in research and development

**Personal integrity/influence:**

- Personal values and approach to relationships with staff, clients, suppliers, and colleagues
- Experience as a role model, mentor and/or advisor to others
- Personal involvement in the wider community

**Financial performance:**

- Strength of financial performance and track record in raising equity and debt finance
- Strategies for managing cash flow and ensuring long-term sustainability
- Growth in financial results and reinvestment of profit

**Strategic direction:**

- Developing a vision and setting goals for future growth and expansion
- Building an effective team (e.g., staff, directors, advisors)
- Measuring and benchmarking progress against goals

**National (or community)/global impact:**

- Achieving a substantial market share
- Extent of expansion into national and international markets
- Plans to enable international growth and increase impact

## 6.4. Psychological definition of success

In the heart of the psychological definition of entrepreneurial success lies the assumption that a high achievement of valued outcomes is indicative of success (see Lang von Wins, 2004). Therefore, neither the attainment of personal, nor of organizational, success criteria matters per se, because only the individual evaluation of one's own performance, that is, the realization of important goals, is synonymous with success.

### **From practice 6.3: What has entrepreneurial success to do with love?**

*I cannot work on things I don't fully love, deeply and passionately. For me it has to be there, the feeling has to be there, otherwise you will always be distracted and you will want to do something else...*

Jack Dorsey, the founder of Twitter, <http://www.venturetv.de/>

*I love everything about being self-employed. It is wonderful to be an entrepreneur.*

Valerie Bönström, the founder of Mrs. Sporty Franchise AG  
<http://www.degut.de/Repraesentanten-2010.html>

*I didn't get here for my acting... but I love show business.*

Ted Turner, the founder of CNN Network  
<http://www.tedturner.com/enterprises/home.asp>

However, what kind of role does individual assessment of one's own accomplishment play in entrepreneurship research? The relevance of the definition of psychological success is twofold. First of all, success criteria that entrepreneurs value and strive for reflect their individual goals, values and aspirations, which in turn are meaningful for entrepreneurial outcomes. More specifically, according to the literature, human decisions, behaviours and outcomes are substantially influenced by goals, especially their specificity and difficulty (Locke & Latham, 1990). The link between goals and subsequent accomplishments suggests that success criteria can determine the future of the company, and its actual objective performance. For example, entrepreneurs who strive for financial reward are likely to put more effort into gaining new customers and market expansion, whereas those interested mainly in the work-life balance will invest less time and energy in activities providing these kinds of growth related outcomes.

Regardless of which success criteria they seek, successful entrepreneurs are extremely engaged with their businesses. This suggests an unexpected link between entrepreneurial success and love. In the From practice 6.3, entrepreneurs who achieved considerable success will provide hints about what entrepreneurial success has in common with love.

### **Exercise 6.2: Individual psychological success**

The following exercise comprises four steps. This exercise aims to support you to discover and prioritize personally important success criteria. It stimulates your reflection on entrepreneurial success and forces you to determine the yardsticks for the measurement of the achievement of success.

1. Reflect on what entrepreneurial success means to you and what your individual success criteria are.
2. Prepare a mind map indicating and visualizing the 5 most important and the 5 least important success criteria. Which of them are crucial for your work satisfaction?
3. Try to determine how you would measure the achievement of your success criteria. For instance, the achievement of work-life balance can be measured by the number of holidays and free weekends.
4. Reflect on which success criteria may be difficult to combine or even which are mutually exclusive. For example striving for a high growth venture and for minimal level of financial risks at the same time hardly appears to be mutually compatible.

Furthermore, the psychological definition of success is associated with work satisfaction, which arises from the discrepancy experienced between the initially formulated goals and their subsequent achievement (Cooper & Arz, 1995). Work satisfaction represents a crucial psychological indicator of entrepreneurial success, and is important for subsequent entrepreneurial decisions and behaviour. For instance, entrepreneurs who are dissatisfied with their businesses are more destined to give up (Schenk, 1998).

More specifically, work satisfaction emerges as a result of the comparison between individual aspirations, goals, and wishes and their actual attainment. If the gap between what is valued and what has actually been achieved increases, entrepreneurs are likely to experience the negative state of work dissatisfaction. Indeed, previous research found that entrepreneurs who are motivated by personal goals, e.g., self-realization during the start-up phase, report higher satisfaction and are inclined to continue even in marginally performing businesses, whereas their counterparts who strive predominantly for financial rewards tend to give up earlier (Cooper & Artz, 1995). This suggests that initial entrepreneurial goals are essential for subsequent satisfaction, and the future of the company. Exercise 6.2 leads to a better understanding of the personal palette of success criteria and their measurement.

Research that includes psychological success and acknowledges the role of intangible success criteria (e.g., autonomy, self-realization, personal satisfaction) is being carried out by, among others, by Barbara Orser and Donald F. Kuratko.

**Key representative 6.1: Barbara Orser**

Deloitte Professor Telfer School of Management. She explored how occupation and gender influences entrepreneurial success criteria. She investigated differences in how men and women view success and compared small- and medium-sized business owners and corporate managers to find out which criteria do they use to define success.



Source: <http://www.research.uottawa.ca>

Finally, the definition of psychological success challenges the traditional economic approaches to entrepreneurship. It relies first and foremost on the organizational performance indicators when measuring success, and puts the person back into the entrepreneurial process. Acknowledgement of the entrepreneurs' role is justified since behind every successful company stands a successful entrepreneur.

**Key representative 6.2: Donald F. Kuratko**

The Jack M. Gill Chair of Entrepreneurship, Indiana University, Bloomington. He is a leader in the field of new venture development, and corporate entrepreneurship research. He investigated entrepreneurial goals in sustaining entrepreneurship. In 2003 he was named the Entrepreneur of the Year for the state of Indiana by Ernst & Young.



Source: <http://newsinfo.iu.edu/pub/libs/>

Recent research on success definition and its measurement is presented in My research 6.2 frame.

**My research 6.2: How do entrepreneurs view success, and what criteria do they achieve?**

My main research questions concern entrepreneurial success as perceived and experienced by the entrepreneurs themselves. Therefore, I looked at business owners-managers in small and medium sized companies and asked them how they view success and what is important for them, and how do they evaluate their entrepreneurial performance. I am especially interested in exploring female and male perspectives of success. Furthermore, I examined job demands and job resources in small and medium sized companies and their influences on entrepreneurs' and employees' well-being, job engagement and satisfaction.

Basically, I relied on self-reported data, collected via interviews and standardized questionnaires. My research benefits from using both, quantitative and qualitative data analysis strategies.

<b><i>Importance of success criteria</i></b>	<b><i>Achievement of success criteria</i></b>
<b><i>1) company performance</i></b> company survival, stability and growth, market expansion <b><i>2) workplace relations</i></b> positive customer and employee relations and loyalty, employee security <b><i>3) community impact</i></b> providing environmentally friendly services and products, contributing to the society <b><i>4) personal financial rewards</i></b> income growth, affording a good living <b><i>5) personal fulfilment</i></b> goal setting and challenge, work-enjoyment, satisfaction, free time and health	<b><i>1) financial outcomes</i></b> company and personal financial rewards <b><i>2) workplace relations</i></b> positive employee' relations, their satisfaction and loyalty <b><i>3) community impact</i></b> providing environmentally friendly services and products, supporting society <b><i>4) dynamism / growth</i></b> expanding new markets, winning new customers, self-enhancement <b><i>5) personal balance</i></b> maintaining contacts, work-life balance, flexibility
Source: Dej, Gorgievski, Augustin, & Wegge (2009)	

My research findings provide evidence that entrepreneurs value and achieve various success criteria. Based on confirmatory factors analyses, the importance and achievement of success consists of 5 main factors.

Presented below is the instrument for measuring psychological entrepreneurial success, which may be used by both researchers and practitioners. The measure is called *Subjective Entrepreneurial Success Scale* (SESS).

## 6.5 To conclude

This chapter emphasized the central shortcomings of the traditional economic approaches to entrepreneurial success. In particular, it provided evidence that entrepreneurs' themselves define success using various success criteria, whereas economists rely predominantly on organizational performance indicators, which are difficult to obtain in entrepreneurial settings. To counterbalance these limitations, this chapter introduced a psychological approach to success and underlined its benefits. It especially showed entrepreneurs' own views of success, achievement of valued success criteria and work satisfaction as being an inherent part of the definition of success and its measurement. However, since there are always two sides of the same coin, psychological success and its measurement suffer from several limitations as well.

## Measure 6.1: Subjective Entrepreneurial Success Scale

Entrepreneurial success criteria						
1	Company profitability (e.g. high returns)	1	2	3	4	5
2	Turnover/sales	1	2	3	4	5
3	Profit growth	1	2	3	4	5
4	Personal income growth	1	2	3	4	5
5	Personal financial security	1	2	3	4	5
6	The ability to afford a lot materially	1	2	3	4	5
7	Social responsibility for your employees	1	2	3	4	5
8	Good relationships with your employees	1	2	3	4	5
9	Employee satisfaction	1	2	3	4	5
10	Loyalty of your employees	1	2	3	4	5
11	Supportive company culture (e.g., company values and positive attitudes)	1	2	3	4	5
12	Employee growth	1	2	3	4	5
13	Social contribution of your company	1	2	3	4	5
14	Environment friendly company (e.g., recycling)	1	2	3	4	5
15	Social recognition (e.g., good reputation)	1	2	3	4	5
16	Increase of market share (e.g., company expansion)	1	2	3	4	5
17	Innovation (e.g., of new products, services, or production methods)	1	2	3	4	5
18	Being better than direct rivals in the same industry sector	1	2	3	4	5
19	Good relationships with customers (e.g., positive company image, positive attitude of your clients towards your business)	1	2	3	4	5
20	Own decision-making	1	2	3	4	5
21	Personal development	1	2	3	4	5
22	Work-life balance (e.g., time for yourself)	1	2	3	4	5
23	Maintenance of private contacts (e.g., friends, memberships in associations)	1	2	3	4	5
24	Personal work flexibility	1	2	3	4	5

Using this scale it is possible to evaluate 1) the importance of entrepreneurial success criteria, 2) their level of achievement and 3) the mismatch between importance and achievement of success criteria.

Source: Dej, Gorgievski, Augustin, & Wegge (2009)

Most importantly, entrepreneurs vary in dispositional propensity to be satisfied and optimistic, and therefore, their evaluations of success might be distorted according to these predispositions (e.g., Staw, 1981). Furthermore,



entrepreneurs' judgments are not free of the influences of cognitive biases, which lead to over- or under-rating of performance (Taylor & Brown, 1988).

**Measure 6.2: Recommendation for the measurement of entrepreneurial success**

Entrepreneurial success is multidimensional and should be measured by multiple success indicators of an organizational and psychological character (e.g., Schenk, 1998)

In order to provide the most comprehensive measurement of success, which benefits from both psychological and economic approaches, they should be combined. As presented in the "Recommendation for the measurement of entrepreneurial success", both psychological and organizational success criteria should be integrated.

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## Chapter 7

# PLANNING AND ENTREPRENEURIAL SUCCESS

Ute Stephan and Marjan Gorgievski

### 7.1 Introduction

Management scholars and research teach us that among other things strategic planning is key to business success (Miller & Cardinal, 1994; Schwenk & Schrader, 1993); although recently, an intense debate has emerged on the value of planning for new firms, as well as for established small firms (Brinckman, Grichnik & Kapsa, 2010; Sarasvathy, 2008). This chapter deals with the question of whether planning in general is beneficial for business success, and it addresses possible contextual factors that may increase, or decrease, the effectiveness of planning.

#### **Definition 7.1: Strategic planning**

“... an explicit process for determining the firm's long-range objectives, procedures for generating and evaluating alternative strategies, and a system for monitoring the results of the plan when implemented.”

Source: Armstrong (1982, p. 198)

Strategic planning, a kind of *firm-level planning*, is typically required of business founders in the form of business plans in order to receive loans, investments or state subsidies. Business plans are actually business planning outcomes; that is, complete descriptions of the business idea, the mission statement, business activities, external factors, etc., that can be expected to influence the business' performance. A business plan creates a written outline that can be used to evaluate all aspects of the economic viability of the venture, including a description and analysis of business prospects. The business plan will become a roadmap to chart the course of the business. Many web sites exist that provide nascent entrepreneurs with guidelines for writing business plans (e.g. [www.garage.com](http://www.garage.com)), as well as giving sample business plans.

Particularly for small, entrepreneurial businesses, the individual planning habits of the entrepreneur are likely to be of great importance, as well. These *individual planning habits of the entrepreneur* are referred to as

self-management strategies. Self-management, in general, is taken to mean how one goes about structuring and planning one's life. This chapter will specifically focus on self-management within the context of work.

### **Expert's view 7.1: The Investor's perspective on business planning**

*Ondrej Bartos, Founder and Partner, Credo Ventures*

[www.credoventures.com](http://www.credoventures.com)

One of the first things you get asked when you address investors with your project is „Do you have a business plan?“. I cannot count how many times I've heard one of the following answers: „I don't have it on paper“, „Sure, I have a detailed business plan – in my head“ or a bit more aggressive „Why the heck would I need it?“.

Entrepreneurs sometimes just don't understand the importance of good business planning, partly because they do not know how to write it, and they think it is too complicated and hard to put together; partly because they are strong individuals who want to do things differently from how others do them (which by, the way, is generally great for business). But in this case my recommendations are:

Please be creative, different and unique in everything else, but stick to the one conservative pre-requisite for a successful business venture; write a business plan. It doesn't need to be in a standard template, length or format if you really want to be creative. But it needs to answer all the important questions: WHAT, WHY, for WHOM, and HOW.

Investors sometimes loudly claim they do not understand why entrepreneurs do not grasp the importance of a business plan, and they even sometimes get angry and yell at the blunt wannabe entrepreneur – believe me, I have seen it. And I understand the yelling.

I myself started as an entrepreneur back in 1996. Without a business plan. I didn't understand why I should waste time with putting together a complicated document, finding templates and samples, just to put on paper what I knew very well already. The company is still up and running. Does it prove that a business plan is a useless piece of paper that start-up entrepreneurs should avoid even thinking of?

My third company which I started had huge ambitions (who doesn't want to change the world, aye?). And as we were all experienced entrepreneurs (I had 3 partners; co-founders), some with consulting backgrounds, we started by putting together a solid business plan, we did market research, we did calculations and financial modelling, we did detailed SWOT analysis ... we did everything right, and the business plan was brilliant. The company was rescue sold 15 months after its inception, and it no longer exists. Does that prove that business plans are crap and nobody should bother with them?

The answer to both questions is big bold NO. Of course, a business plan does not give any guarantee of success. By the same token, its absence does not condemn a company to failure. What it does is that it significantly increases a company's chance of success, as well as eliminates the risk of total failure. And you can bet that this goes double for start-ups rather than later stage companies.

When an entrepreneur puts his business ideas on paper, with the intention of writing a business plan, it is a great opportunity for him to test whether, or not, everything that works in his head also works on paper; the human brain has the ability to make invisible connections between thoughts (I call them blind bridges), which appear to be dysfunctional when put on the paper. Also, whenever an entrepreneur who is as lazy as I was, (and you might be) writes a business plan (no matter who the intended recipient is), he or she realizes that more information is necessary, more data is to be collected, and spends at least another couple of hours on the Internet. Sometimes key data is collected and analyzed (occasionally, even correctly) during business plan writing.

For investors, the business plan is also the key tool that helps them understand better the ability of the entrepreneur to put together a complete, informative, convincing and logical plan how to execute their business vision and goals. Not that we know whether or not we should invest after the first reading of the business plan. But it gives us a solid picture of the entrepreneurial team and their ability to perform. Do not underestimate the value of the business plan. And good luck.

While firm-level planning is usually more formal, and in large firms institutionalized in separate departments for strategic business development; the entrepreneurs' self-management strategies refer to the personal, informal, everyday planning approach. For both firm-level and individual-level planning, content and process can be differentiated (Frese et al., 2007). The *content* of what is being planned is not the focus of this chapter; we will look into *how* the planning is done, i.e. the *process* of planning.

**Definition 7.2: Self management strategies at work**

Self-management at work is a person's habitual approach to the structuring and planning of their work.

## 7.2 Self-Management strategies

A large body of research exists covering the relationship between business success and the entrepreneurs' personality constructs (see Chapter 3).

However, according to the action theory (e.g. Frese, 2007; Hacker, 1986), a direct relationship between the personality traits of entrepreneurs and business success is expected to be relatively small. Our personality characteristics are but only one influence on our actions; these, in turn, affect business success. Moreover, their effect is indirect.

### **Key representative 7.1: Winfried Hacker**

Professor emeritus at the Dresden University of Technology where he is currently head of the research centre for “Knowledge-Thinking-Action”. He has been Professor for Work and Organizational Psychology, as well as for General Psychology: Cognition and Motivation at the TU Dresden. He temporarily chaired the Institute for Psychology at the Munich University of Technology, as well as the Chair for Work and Organizational Psychology at the University of Giessen. In 2003 Winfried Hacker received the Outstanding Contribution Prize of the European Association of Work and Organizational Psychology for his work on action psychology, the foundations of which he laid in the 1970’s. He has widely published on action psychology. Arguably, his most influential work is the „General Work Psychology“ which among other things specifies the theory of psychological action regulation as the basis for the analysis, evaluation and design of work.



Source: [http://tu-dresden.de/die\\_tu\\_dresden/fakultaeten/fakultaet\\_mathematik\\_und\\_naturwissenschaften/fachrichtung\\_psychologie/i1/ag\\_wdh/mitarbeiter/hacker](http://tu-dresden.de/die_tu_dresden/fakultaeten/fakultaet_mathematik_und_naturwissenschaften/fachrichtung_psychologie/i1/ag_wdh/mitarbeiter/hacker)  
<http://de.wikipedia.org/wiki/Arbeitspsychologie>

According to Frese (2007), the effects of personality traits on business success are mediated by actions; more specifically, individual action planning. Similar to how people differ in their personalities, people also differ in their usual approaches to action planning. By their very nature, of being closer to behaviour, action styles are easier to change through appropriate interventions.

Indeed, several studies have found individual planning to be substantially related to business success in the Netherlands, Africa, Germany, Poland, and the Czech Republic (Frese et al., 2007; Frese, 2007; Frese, van Gelderen, & Ombach, 2000; Stephan, Spychala & Lukes, 2006; van Gelderen, Frese & Thurik, 2000). Different kinds of planning approaches (or ‘styles’) can be discerned. And not all of them have equally strong associations with business success. It should come as no surprise that entrepreneurs who do not engage in any planning (the so-called ‘*reactive strategy*’), often see negative consequences for their business’ success. Typically, entrepreneurs who do not engage in planning are driven by the situation and are busy reacting to its

demands (e.g., an entrepreneur, characterized by reactive planning strategies, would start his workday mainly by reacting to what tasks he finds on his desk, and incoming calls, requests, emails etc., rather than following through on a certain task, such as a customer order). He will not get back to working on the order until it becomes urgent, either because the customer reminds him or because the deadline approaches. In other words, he or she suffers poor time management.

**Key representative 7.2: Michael Frese**

Professor at the Business School of the National University of Singapore, and Professor of Psychology, Entrepreneurship and Innovation at Leuphana University, Germany. Prior appointments were, amongst others, with the London Business School, the University of Giessen, and the University of Amsterdam. He is the past President elect of the International Association for Applied Psychology; the author of over 200 journal articles and the author, or editor, of over 20 books. His research is published in top international journals (for many of which he serves as a (co-)editor). He is one of the most highly cited European authors in work and organizational psychology. His research interests include psychological approaches to entrepreneurship and innovation, personal initiative, stress and unemployment, and the error management culture.



Source: [http://www.bschool.nus.edu.sg/staff\\_profile/cv.asp?ID=2366](http://www.bschool.nus.edu.sg/staff_profile/cv.asp?ID=2366)  
<http://www.leuphana.de/michael-frese.html>

Furthermore, studies show that elaborate; also called *complete planning*; to be positively associated with business success. Complete planning is characterized by a very thorough and structured planning approach with a long-term focus, along with the development of fallback plans. Another, slightly less structured form of planning that is also typically positively associated with business success is *critical point planning*. Here the entrepreneur concentrates on the most difficult, unclear and most important point first, i.e. he or she sets a priority which goal is the most important to achieve.

Accordingly, plans are made as to how to achieve this ‘critical point’, while other things are left unplanned. The fourth approach is the *opportunistic* one. This is similar to the reactive strategy in that the entrepreneur is mostly driven by the situation. Although the entrepreneur would start with rudimentary planning, he or she deviates easily from doing so when the situation presents distractions; e.g., a phone call. The entrepreneur displays, however, more proactive behaviour; i.e., he or she grabs opportunities, but rarely follows them through.



### **Group exercise 7.1: Putting self-management into practice**

Divide the class into four groups. Each group will be a 'mini-enterprise'. All the enterprises compete in the same local market. Students will be handed out goods, which they need to sell in the streets within the next hour. Before they leave the classroom they will receive instructions on how to go about selling 'their products'. These relate to the four different types of planning: complete planning, critical point planning, opportunistic planning and reactive planning. Students are asked to keep to the instructions as closely as possible. The aim of the exercise is to experience how effective different kinds of self-management are.

After the students have returned to the class room, they will compare how long it took them to sell the goods using the different self-management approaches and how much money each mini-enterprise earned. More importantly, they will reflect on the advantages and disadvantages of the various self-management approaches by comparing their experiences.

Zempel (2003) developed a questionnaire with which one can self-assess one's planning style. An authorized English translation is published in Stephan (2008).

## **7.3 Research Findings: Effectiveness of planning across a range of different situations**

The question of whether planning is always useful; i.e., under all circumstances; refers to whether there are variables moderating the planning – success relationship. Research has identified several important factors that may influence the effectiveness of planning in some situations as compared to others.

First among them are *environmental conditions and firm age*. Van Gelderen et al. (2000) study suggests that different kinds of individual planning approaches are differently effective depending on the firm's environment. Complete planning, for instance, would be particularly useful in complex and stable, rather than fast changing, environments. While less planned approaches were more successful in more stable and non-complex environments; e.g., characterized by low product and service diversity as well as a low number of competitors.

More generally, Sarasvathy (2008) presents evidence for the central role of uncertainty with regard to the effectiveness of planning. In support of her theory of effectuation, she finds that when entrepreneurs are faced with high amounts of uncertainty, for example, stemming from the start-up process itself, or the market environment; they may be best advised to refrain from elaborate planning and market analyses that aim to predict, inter alia, future demand. Researching expert entrepreneurs she found that these do not follow

predetermined plans; rather, they respond to the situation in that they leverage contingencies (i.e., 'luck'), and rely on committed partnerships. Moreover, they concentrate on the means and information currently available to them, and make the best of it, so to speak. They carefully test, or experiment, with next steps, such as developing a new product; but withdraw effort if a predetermined and personally affordable loss is reached. Sarasvathy acknowledges that once uncertainty is reduced, which is typically the case when entrepreneurs have established themselves in the market, more elaborate planning can be successful. This is supported in Brinckmann et al.'s meta-analysis (2010), which finds planning particularly predictive of success for established vs. young small businesses.

**Exercise 7.2: Deriving hypotheses about the adequate self-management style in different European cultures**

Below you find the cultural practices scores for uncertainty avoidance and future orientation for different countries (according to the GLOBE study, House et al., 2004). Based on the information presented in the text above, which self-management style (complete planning vs. flexible critical-point planning) would you expect to be most effective in these cultures? Why? What could the potential problems be?

Country	Uncertainty Avoidance Score	Future Orientation Score
Switzerland	5.4	4.8
Germany – West	5.2	4.0
Germany – East	5.2	4.3
Netherlands	4.7	4.6
UK	4.7	4.3
USA	4.2	4.1
Spain	4.0	3.5
Italy	3.8	3.3
Poland	3.6	3.1
Russia	3.1	3.1

Another environmental variable are cultural characteristics. Two studies found evidence that complete planning is especially effective in high uncertainty avoidant and future oriented cultures (Rauch, Frese & Sonnentag, 2000, Stephan et al., 2006). In these cultures, planning is an effective means to reduce uncertainty and plan for the future, i.e. effectively reach future goals. Thus, planning fits these cultural contexts in that the firms' customers, banks and suppliers expect the firm's owner to plan. The more flexible, critical-point planning approach, however, is more effective in the more

uncertainty tolerant and present oriented societies (Stephan et al., 2006). Brinckmann et al. (2010) report, across different kinds of strategic and personal planning, a moderating effect for uncertainty avoidance such that planning is particularly important for business success in low uncertainty avoidant cultures. However, even for entrepreneurs in high uncertainty avoidant cultures there is still a positive, albeit smaller, effect of planning on performance.

Secondly, there are *conditions within the firm*. Frese, Brantjes and Horn (2002) found that business owners with a complete planning approach were particularly successful, when their firm displayed a particular strategic orientation: an entrepreneurial orientation (which consists of a firm's striving for autonomy, innovativeness, competitive aggressiveness, and risk taking).

Thirdly, and finally, the *characteristics of the individual entrepreneur* matter too. Escher, Grabarkiewicz, Frese, van Steekelenburg, Lauw and Friedrich (2002) found a moderating effect for cognitive ability on the relationship between individual planning and business success. More specifically, they found a compensating effect, i.e., business owners with low cognitive ability could compensate their lower cognitive ability with detailed planning and consequently were as successful as entrepreneurs with a high degree of cognitive ability. For the latter, it did not matter so much whether they planned in a very detailed way or not; their large cognitive capacity, seemingly, allowed them to process all relevant information without the help of a plan.

## **7.4 Practical recommendations**

Research findings show evidence for a positive effect of business planning on business performance, both for strategic planning and for individual level self-management strategies (Brinckmann et al., 2010). One practical implication of these findings is that entrepreneurs should be taught effective self-management skills in addition to being encouraged to engage in strategic planning.

Furthermore, the findings that the effectiveness of different planning strategies depends on the business environment, and the stage of business development imply that it is crucial for entrepreneurs to combine business planning with an open mind to changing their plans. For starting entrepreneurs, business planning was found to be somewhat less effective than for managers of more established small firms (Brinckmann et al., 2010). Hence, they need to carefully search for feedback that tells them whether their plans are working or not. In such cases, entrepreneurs need to feel

comfortable deviating from their original plans, and combine planning with a learning approach.

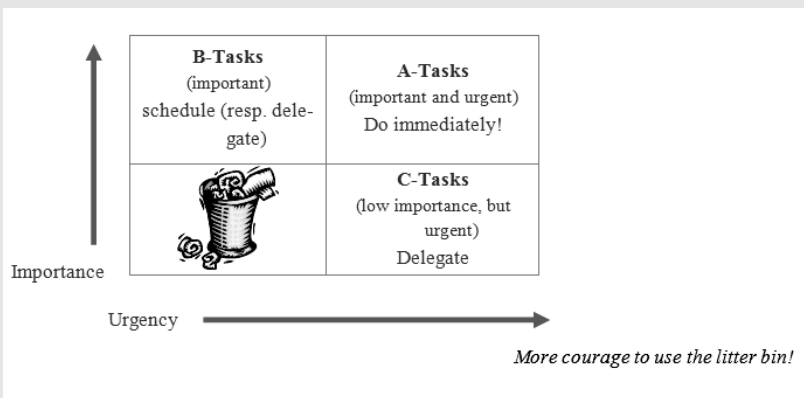
### **Expert's view 7.2: About time management**

*Ivan Pilny, private investor, ex-CEO of Microsoft Czech Rep.*

If you, like me, belong among the ordinary people who look with envy at those few individuals who are able, without any stress, and with grace, complete all tasks, you sometimes look for ways how you can do it, too. I have, as usual, two pieces of news; one good, the other bad. I will start with the bad news. If you are not lucky enough to be one of the few 'elect' who are able, not only to learn, but also to really use the methods of time management of the fifth generation, i.e., getting things done, mind maps etc.; do not throw away money on courses or books explaining these "guaranteed success" methods. Your initial attempts to apply what you have learned gradually come to resemble your attempts to diet; an amazing start, but after a few weeks you are back to square one. Now, for the good news. A few things I learned from manuals "for dummies" or "for complete idiots", which focus on the target group, which I, unlike many fellow citizens, undoubtedly fall into. I am always throwing out emails, journals, and materials which I felt that I will look at sometime later. Later becomes never and just multiplies a pile of useless junk in which you cannot find anything. I try to deal with those issues first, which I hate the most. If I postpone them, they tend to reappear at the least suitable time. Sometimes I try to imagine living in a time without mobile phones (oh, what bliss), and I could not text just before the meeting that I am late. Then a few other small things that probably everyone will find himself / herself. Not to manage time is common, but not a necessity. If you are religious, you also sometimes sin, but your faith makes you do something with it.

### **From practice 7.1: Ten rules to gain time**

1. **Goal-orientation "Aiming"**: Use time like you would use a bow and arrow: aim first! Orient your daily work and activities towards fulfilling your goals.
2. **Prepare**: Plan your next day the evening before – in writing. Allow enough time for routine tasks (e.g., checking email), but also for the unexpected (60:40 rule).
3. **Set Priorities**: Tackle important things first and leave unimportant stuff. Beware of the tyranny of urgency!
4. **Summarize**: Allocate similar tasks (such as phone calls, mail correspondence, short meetings) to the same time slot, so you won't be constantly interrupted by them when working on A and B tasks.



5. **Simplify:** Divide difficult tasks into small steps. Schedule the order you will work on these steps and set deadlines for each step.
6. **Let others do it:** Don't forget to delegate: What? Who? Why? Till when? Don't be afraid to say NO and fight off time thieves!
7. **Shield:** You don't have to always be available for everybody. Make appointments - also with yourself and use them!
8. **Be considerate & respectful:** Being late, overrunning meetings, and rescheduling appointments are taboos. Determine goals and endpoints of meetings beforehand.
9. **Telephoning:** Ask for an adequate time instead of interrupting. Arrange binding appointments for phone calls and call-backs.
10. **Enjoy success:** Perceive settled tasks and things as success! Reward yourself and others.

Source: adapted from Seiwert, 2004 (translation by first author)

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## Chapter 8

# **OPPORTUNITY RECOGNITION, EVALUATION AND DEVELOPMENT**

Martin Lukes

*„When one door closes another door opens; but we often look so long and so regretfully upon the closed door, that we do not see the ones which open for us.“ Alexander Graham Bell*

### **8.1 Introduction**

The recognition of opportunities, the selection of the right ones and their development into products and services successful on the market belong among the key areas of competence of a successful entrepreneur. They relate to a difficult task. The entrepreneur needs to be alert, sensitive to market needs and inefficiently used resources, and have the courage to make the decision to seize the opportunity he has just noticed. Opportunity recognition, selection and development mark the start of the entrepreneurial process, but are also recurring, as entrepreneurial opportunities need to be developed, evaluated, further developed and modified, and again, evaluated repeatedly in a cyclic manner. The efforts may result in the creation of a new venture (Ardichvili, Cardozo & Ray, 2003), but also in the creation of new value within an existing organization, such as new products and new production methods (e.g., Shane, Locke & Collins, 2003; see chapter 12).

### **8.2 Entrepreneurial opportunity**

In general, an entrepreneurial opportunity can be defined as the possibility to satisfy market needs through a new combination of resources that will offer added value (Kirzner, 1973). Alternatively, Shane and Venkataraman (2000) define opportunity as a „situation in which new goods, services, raw materials, and organizing methods can be introduced and sold at greater price than their cost of production“ (p. 220). Baron (2004) summarized that opportunities have three central characteristics:



- potential economic value (i.e. the potential to generate profit),
- novelty (i.e. something what did not exist previously), and
- perceived desirability (of the new product or service in society).

### **Key representative 8.1: Robert A. Baron**

Professor of Entrepreneurship at Spears School of Business, Oklahoma State University. He holds three U.S. patents and was for eight years also President and CEO of Innovative Environmental Products, Inc. Professor Baron has published more than one hundred articles in professional journals, including, for instance, Academy of Management Journal, the Journal of Applied Psychology and the Journal of Business Venturing. The topics focused on opportunity recognition and factors influencing it, positive affect, optimism, creativity and innovations in new ventures, entrepreneurial decision making, entrepreneurs' social competence, entrepreneurial self-efficacy, personal values, and venture performance, to name but a few. He is also a co-author of the books "Social Psychology, 12th Ed.", "Entrepreneurship: A Process Perspective, 2nd Ed." and "The Psychology of Entrepreneurship".



Source: <http://spears.okstate.edu/directory/168-eee/826-rbaron>

Opportunities start as vague initial ideas and simple concepts that are further developed by entrepreneurs. Opportunities emerge from the complex of changing technological, economic, legal, social and demographic conditions (Baron, 2004). The question is, whether opportunities exist independently and just need to be recognized by an alert entrepreneur (Kirzner, 1973; see chapter 1 for details on entrepreneurial alertness), or whether it is necessary for an entrepreneur to create them actively. Sarasvathy, Venkataraman, Dew and Velamuri (2002) differentiate between opportunity recognition, opportunity discovery and opportunity creation. Opportunity recognition involves bringing together rather obvious supply and demand (e.g., franchising). In the case of opportunity discovery, only one side (either demand or supply) exists. In this case, the nonexistent side has to be "discovered" before the match-up can be implemented (e.g., cures for diseases, the use of farm animals for agro-tourism). Finally, opportunity creation is the most difficult situation when neither supply nor demand exists in any apparent manner. Both have to be "created", and several inventions in marketing, financing etc. have to be made before the opportunity can come into existence (e.g., Google).

Generally, opportunities always involve either *unfulfilled market needs* (e.g., poor customer service offered by existing companies, products overpriced or unavailable on the local market) or *unused or inefficiently used resources* (e.g., new possibilities for advertisement, unused waste, free time on pensioners' hands) or both. See Expert's views 8.1 and 8.2 with recommendations from experienced investors on how to recognize and develop opportunities. Opportunities are also situational. The window of opportunity must be open long enough to enter, but narrow enough to keep others out (see chapter 1).

### **Expert's view 8.1: Opportunity recognition and development**

*Ondřej Bartoš, Founder and Partner, Credo Ventures*

Opportunity is one of the key words for entrepreneurs, and the ability to recognize the opportunity can significantly increase the chances for entrepreneurial success. The best way to find out how to recognize the right opportunity for business is, in my opinion, to actually look at case studies of the entrepreneurs who have done it before, or are in the process of proving that they did it. No textbooks, not even such a practise-oriented text like this one, can guide you in a better way than studying the stories of successful entrepreneurs and business leaders, their books, blogs, columns. Look for inspiration from real life. Just remember that you will most probably not build another Microsoft or Virgin, so get inspired, don't copy.

On a very general level, I believe that the best description of the opportunity recognition process is that we should look for any unserved needs of customers in the market. The bigger the need is, the bigger the opportunity that should lie ahead of us. And the ideal situation, in terms of business opportunity, is when a NEED turns into a PROBLEM.

The best way to illustrate this is probably a situation we can all imagine easily; what if there was no grocery shop at the place where you live. You and all your neighbours would have to carefully plan your grocery shopping, you all would need to use a car to get butter, milk or fresh bread. And let's assume that your neighbourhood in this case is as large as a small town. That surely is a clear opportunity for a new grocery shop, as there is a significant group of potential customers which recognize the NEED for the chance to shop for groceries in the neighbourhood. Some of them could even perceive it as a PROBLEM.

One of the most common mistakes made by entrepreneurs is that they recognize a problem, and create a product to solve this problem, without noticing that they are only solving a problem of their own. In our case it could be the absence of a grocery shop in your neighbourhood

which is inhabited by yourself and your dog Freddy. That is how the so called hobby projects are born; when entrepreneurs come up with solutions for a small group of similar hobbyists, which are on target and solving needs, but the target markets are too small to build businesses, so you have to beware of being obsessed with the product itself, and you always have to think whether you really have found a market; or you are only solving your own problems and serving your own needs.

Of course, when the right opportunity, of significant size, is recognized, that is not the end of the job. The opportunity has to be addressed with a solid and well thought out product, as well as a plan to get it onto the market. And the best way to get the most out of the opportunity is to build the solution to the need or problem on the market in such a way as provides us with a sustainable advantage and prevents potential competitors from entering the same market with as many barriers to entry as possible. In other words, our goal is, when the opportunity is recognized, to build a TEMPORARY MONOPOLY.

In a free market economy it is impossible to create a monopoly situation which would be long-term, that's why we talk about temporary monopoly. But with no further detailed description needed, every entrepreneur should always look to build a temporary monopolistic position, for as long as possible, with as much strength as possible. The most successful ones can last as long as a couple of decades. Remember Microsoft.

### 8.3 Factors influencing opportunity recognition

The process of opportunity development starts with the recognition of an opportunity, i.e., when entrepreneurial alertness exceeds some threshold level, and the entrepreneur realizes that the idea might be a good one. *Entrepreneurial alertness* can be defined as the propensity to notice, and be sensitive to, information about objects, incidents, and patterns of behaviour in the environment, with a special sensitivity to supplier and user problems, unmet needs and interests, as well as novel combinations (Ardichvili, Cardozo and Ray, 2003). Not only alertness, but also other personality characteristics play a significant role in influencing opportunity recognition; e.g., optimism (see chapter 5), self-efficacy and innovativeness (see chapter 3).

Another crucial factor is *information asymmetry and prior knowledge*. People have the tendency to notice information that is related to something they already know. Prior knowledge creates a „knowledge

corridor“ and triggers recognition of the value of new information. Key areas are: prior entrepreneurial activity, prior knowledge of markets, customer problems and ways to serve markets (Ardichvili, Cardozo and Ray, 2003). Information asymmetry also leads to the making of mistakes by other market participants, and creates the space for the better exploitation of an opportunity.

Hills, Lumpkin and Singh (1997) found that entrepreneurs with extended networks of different types of social contacts were able to identify more opportunities. Four types of *social networks* may be discerned:

1. The inner circle, also called strong ties, which consists of long-term, stable relationships with people close to one, such as friends and relatives,
2. The “action set”, including employees,
3. Partnerships, which includes the start-up team members,
4. Weak ties, referring to acquaintances, distant friends and people one meets only intermittently.

Strong ties, including close relatives and friends, serve as a perfect social support, and source of financing and/ or cheap labour. In contrast, weak ties often play the role of bridges to key information, and are often the best sparks for new ideas (Pirolo and Presutti, 2010). However, to use his or her social networks, the entrepreneur cannot just be passive. De Koning (1999) identified three cognitive activities (information gathering, thinking when talking, and resource assessment) that entrepreneurs use when interacting with their social networks in order to recognize an opportunity.

It is also worth noting, that opportunity recognition differs from country to country, both due to framework conditions for utilizing them (e.g., the legal framework, availability of an educated labour force); as well as to the *specifics of national cultures*. In the Global Entrepreneurship Monitor (GEM) project, the representative samples of the adult populations in 42 countries were asked whether they perceive any good business opportunities for starting a business in their place of residence within the next six months (Lukes & Jakl, 2007). Japan, Belgium or Germany were the countries with very low opportunity recognition (twenty percent of adults or less). On the other hand, in Denmark, Norway and in most developing countries, more than half of interviewees perceived good opportunities. In the Czech Republic, opportunities were more frequently perceived by men and by younger people, along with those who had a university education, living in bigger cities, and people with higher household incomes.

## 8.4 How to find new ideas

Despite the fact that most of my students live in a large city, are young and have almost completed their university education, "I do not have a good idea" is one of the most common answers when I ask them why they are not entrepreneurs. So what might be some recommendations for finding such a good idea?

### **Exercise 8.1: Generating business ideas**

Step 1: Generate a list of as many new venture ideas as possible. Think about your own unfulfilled needs as a customer, about interesting products and services you experienced while you were abroad, about interesting ideas you read about on the internet, or in newspapers, etc.

Step 2: Discuss your ideas with entrepreneurs whom you know, your friends or colleagues. Jot down their comments and improve your initial ideas which received the most positive evaluation. Think about what should be offered, how and for whom it should be offered, and how this is unique compared to what already exists on the market. Write it down.

1. Reflect on your own experiences. Try to identify which of your needs are not satisfied, and talk to other people and ask them whether they feel the same needs.
2. Engage in communication with "weak ties". Listen to other people; they are customers of many companies and have their own experiences and ideas that might provide inspiration for you.
3. Travel. A lot of businesses start as a geographical transfer. You may start up in your own hometown, or country, the same service with which you were satisfied when you were abroad, or you may start to import products that are not sold on your local market yet.
4. Internet and media. Read the economic news on the internet, or in the printed media. Get inspired by other successful businesses, identified market trends, think about what opportunities are born in the changing technological, economic, legal, social and demographic conditions. You may also watch Dragon's Den on TV, or to look at specialized servers introducing potential ideas, e.g., [www.mysmallbiz.com](http://www.mysmallbiz.com) or [www.entrepreneur.com/businessideas](http://www.entrepreneur.com/businessideas).
5. Monitor the distribution channels and production processes for problems. Different players in the distribution channel may have unmet needs, e.g., wholesalers can have problems with the quality of products, or retailers with wholesale logistics. Do not be afraid to ask.

6. Engage, either at work or with your friends, in different creative techniques, such as brainstorming, which may unexpectedly spark the idea.
7. If you have a high risk aversion, get some experience first. Most new ventures are launched based on the entrepreneur's experience from his/her previous job/s.

## 8.5 Opportunity development and evaluation

Between the initial business idea and the firm's foundation there is usually a long and iterative process of idea development and evaluation. When the idea is first developed, its potential advantages and value for specific users start to emerge, and also resources needed to develop the plan begin to be better defined (see Exercise 8.1). At first, the idea is evaluated rather informally and generally (see My research 8.1).

### **My research 8.1: Cognitive evaluation of entrepreneurial opportunities**

*Tomas Laboutka, Martin Lukes*

As the phenomenon of entrepreneurial opportunities is increasingly receiving more attention, various researchers have focused on the specific role of opportunities in the process of venture creation, such as opportunity recognition and discovery. Yet, surprisingly few researchers have systematically investigated the research question of “How do entrepreneurs cognitively evaluate opportunities?”.

We carefully selected our sample of 31 successful entrepreneurs from different industries, including four winners of “The Czech Entrepreneur of the Year” competition. We constructed, and conducted in-depth interviews, followed by a multi-dimensional case study demonstrating a new entrepreneurial opportunity. All entrepreneurs were introduced to a realistic scenario of a new start-up opportunity in the automotive industry, which they subsequently evaluated, while thinking aloud and thus describing their evaluation processes. This enabled us to make an in-depth analysis of the opportunity evaluation processes, as well as the underlying factors.

Our main findings are as follows: (1) Opportunity evaluation processes are influenced by a large variety of factors - individual non-psychological factors such as demography and available social and financial capital; then psychological and cognitive factors such as intrinsic motivation and self-efficacy, and finally contextual factors. (2) The background of the entrepreneur is crucial for the evaluation process.

Especially significant is the role of entrepreneur's social capital and professional experience. (3) Evaluation consists of two parallel cognitive processes: (a) analytical and rational and (b) heuristic and intuitive, triggering emotions and effectuation. (4) Cognitive complexity can have both positive and negative effects on opportunity evaluation. The richness of cognitive scripts enables entrepreneur to grasp an opportunity from different angles. On the other hand, cognitive biases can also prevent relevant judgmental decisions. So, while certain experience in the automotive industry, for instance, might have helped the entrepreneurs to identify the relevant factors for the evaluation of the opportunity, the representativeness bias would construct a misleading picture of the industry.

Further in-depth research into the opportunity evaluation, especially into the four areas identified in our study, is needed. Use of new research concepts such as cognitive mapping, and "thinking aloud" bear the potential to enrich our understanding of the cognitive processes of entrepreneurs.

Reflection on, and understanding of, cognitive and subconscious evaluation processes, and the signals from intuition or emotions can enhance evaluation capabilities significantly. We may thus recommend entrepreneurs to integrate both the rational and intuitive processes into the evaluation of opportunities and to further reflect upon them. Another recommendation is to enhance one's social capital and professional background in order to gain new evaluation perspectives and enrich cognitive complexity.

When the idea passes this first subjective evaluation, it needs to be developed into a *business concept*. The business concept consists of the answers to four basic questions:

- What products and/or services will be offered?
- To whom will the products and/or services be offered and what specific needs of these customers will be satisfied?
- What is unique and will constitute an added value for the customer when compared with what the competition has to offer?
- How the products and/or services will be delivered to the market (i.e., the concept of production and logistics, sales and marketing)?

Afterwards, another evaluation takes place. Its task is to judge well whether the concept has the potential to generate the expected profit, and whether it is worth the effort to prepare a more developed business plan. Timmons (1990) recommends focusing on the following criteria to understand better whether it is a small or big opportunity:

- market criteria (e.g., Are customers loyal to the competition or sensitive to potential new offers? Is the market quickly growing?);
- economic criteria (e.g., Will the break even point be within two years? Are capital requirements low?);
- competitive advantage (e.g., Is it possible to patent the product? Do we have a clear time advantage?);
- entrepreneurial team (e.g., Is the team experienced, what are the results so far?); and
- risk issues (e.g., Are risks low or high?).

### **Expert's view 8.2: Developing start-up ideas**

*Ivan Pilny, private investor, ex-CEO of Microsoft CR*

Idea implementation has three main phases. The first is the idea itself. You need to transform it into a product or service, and then to place it on the market. All this must be done as soon as possible, otherwise somebody else will overtake you.

Maybe the most important thing is to draw mutually intersected circles. The first represents what we want to produce, the second what our competition does, and the third shows what "our" customer needs are. We often yield to the illusion that we have a marvellous product or service that even the competition does not have. Unfortunately, nobody wants it, apparently. If we have competition we compete in the commodities market, and then the price is a key indicator. It is crucial to find a segment where unfulfilled customer needs are. Sometimes we can use marketing and "help" these needs, but it is important to know them.

You must overcome two death valleys. You need to invest money and experience in the creation of your products and services. However, you usually do not have experience or money, and neither banks nor venture capitalists are keen to lend, or to invest. Advice is usually expensive, and there are not many business angels in our parts who would be willing to help you. If you overcome the first valley, and you have something tangible, you must "take the skin to the market". Again, you need money, especially for marketing, and you need to find capable and qualified personnel, which is not for free either. Those who would help you can be divided into two groups. The first, and more accessible, group advises you often with the help of European or national funding; the second and hard-to-find group has the entrepreneurial experience and goes into it with you. You have more hope now, but it is still true that many are called, but few are chosen.



After further work on developing the opportunity, the potential entrepreneur goes from a business concept to the, more or less, detailed *business plan* (see also an investor's perspective in Expert's view 7.1). Some authors (e.g., Morris, 2004) see the business model as a stage in between business concept and business plan. In practice, however, business plans are developed to a different extent, and the term "business plan" is used as a global designation covering both very detailed and less detailed documents. In any case, the aim of the business plan is to present the viability of a business, and therefore it must clearly answer the question of how the products and services will be sold to customers in order to get a higher income than costs, and to achieve expected returns on investment. See Exercise 8.2, which describes the main areas that should be developed in the business plan.

### **Exercise 8.2: 10 areas to think about when preparing business plan**

On the internet, there is a large variety of resources with recommendations on how to prepare a good business plan (e.g., [http://en.wikipedia.org/wiki/Business\\_plan](http://en.wikipedia.org/wiki/Business_plan)). Below I summarize the main areas that should be covered in the business plan, together with a variety of questions that may lead to the finding of the right answers.

#### **1. Products and services**

What products and/or services do you offer? Why are they unique? What are the substitutes for your products/services on the market? What are the disadvantages of the currently available solutions? What will be the price, quality, and added value of your products/services? In what ways will you develop your product/service in the future?

#### **2. Customers**

Who are your customers? Be as specific as possible. What specific need of your customers does your product/service address? How is this need satisfied at present? How many potential customers exist? How will their number develop in the future? How many of these potential customers do you want to serve at the beginning, and in the future? How will the behaviour of your customers change in the future? Who are your potential key clients, and how will you ensure cooperation with them? On which data and experience is your understanding of customers based?

#### **3. Competition and competing products and services**

What competing products/services exist on the market today? What is their price, quality, added value, history? What domestic and international companies offer these products? What are the strengths and weaknesses of your competition and its products/services? What is the market share of

competing companies and what development can be expected? What new competition can enter your market? What is your advantage against the competitors?

#### **4. Sales and marketing**

How will you sell your products/services? Directly or through mediators? Are the sales dependent on season? Will you sell your products/ services also in other countries? When? How will your customers get to know you? What marketing strategies will you use? Be as specific as possible and have the specifics of your customers on mind. Think about guerilla strategies; i.e., how can you do something cheaply and with a large impact on customers? What are the tools, media, networks you will use in order to get the information about your products/services to your customers? Based on which data have you made this decision?

#### **5. Financials**

How will you make money in this business? What are the costs necessary for the start-up? What is your expected margin and costs, and revenues, per unit? How many units will you sell? How comparable is it to other businesses in the field? What are your operating expenses? What is your prediction of total sales revenues from your products/services for the next year? And in the long-term future? Prepare statements per month for the following (at least one) year. What returns on investment do you expect? After how many months or years will your business become profitable?

#### **6. Team**

Who are the co-owners? Do they share the same vision? Do they complement each other? What experiences does your team have with the market of your product/service and with running their own business? What are the responsibilities and areas of competence of individual team members? What knowledge, experiences and skills are lacking in your team? How will you solve the shortfall?

#### **7. Suppliers**

Who are your suppliers (e.g., for production)? Who are the key ones and why? How will you ensure cooperation with these key suppliers? Can the cooperation be exclusive? How will you produce and deliver your products and services? What expertise do you have in production and logistics?

#### **8. Personal goals and personal approach**

What are your personal goals? What is the vision and the goals of your firm and in what time periods? What is your strategy for reaching these goals? Describe your firm's situation three years later. How much time are

you able to devote to the firm now, and in the future? How long are you willing to work in the firm for free and plough all the money back into the firm?

### **9. Risks and sustainability**

What are the major risks you can face? Be as specific as possible. What will you do in the case that these potential risks become realities? How will you protect your intellectual property related to your products/services? How will you analyze your competition's reactions after you launch your products/services? How do you plan to sustain your competitive advantage for the future against potentially stronger competition?

### **10. Investor's proposition**

How much money do you need for a successful start, and for what will it be used? How much of your own, or your family's, money will you invest? Who else besides the investor and yourself will provide financing? How big a share do you offer in the company? How did you estimate this "investment wanted / share offered" ratio? What else besides money do you expect from the investor?

## **8.6 Presenting a business idea to investors**

For entrepreneurs who do not have enough financial resources, or have an idea that has the potential for quick growth, it may be wise to approach experienced investors and offer them a share in the new company in exchange for money and advice. The entrepreneur has often only one chance to attract the investor, therefore he or she should prepare well for presenting the idea. To learn from other entrepreneurs who have already pitched their ideas, is a logical first step. See Exercise 8.3.

### **Exercise 8.3: Dragon's Den**

Dragon's Den is a TV show broadcast in many countries around the world that has become a global phenomenon. Nascent, or young, entrepreneurs come to the den to present their business ideas to five Dragons, multi-millionaire investors, who ask for details and decide whether to invest in the companies presented.

Watch the four scenes from the Dragon's Den (Stylebible.com, Orikaso, Interflush, Bedlam cube):

<http://www.youtube.com/watch?v=Hoc3Z5x5GSo&feature=related>

<http://www.youtube.com/watch?v=LwlKNqFA1y8&feature=related>

[http://www.youtube.com/watch?v=4jp-ypT3\\_30&feature=related](http://www.youtube.com/watch?v=4jp-ypT3_30&feature=related)

<http://www.youtube.com/watch?v=QtGbiLN0tdU&feature=related>

<http://www.youtube.com/watch?v=1zBQa2XyvWE>

<http://www.youtube.com/watch?v=o4sEZ87ezqk&feature=related>

Pay special attention to both the verbal and non-verbal communication of entrepreneurs, the investors' comments, and the ways of dealing with investors. Based on these observations, formulate recommendations for the effective presentation of your business idea. What should you say in the introductory pitch? What mistakes should you avoid? What questions can you expect? What answers were evaluated positively by the investors?

Some more recommendations on how to prepare an efficient presentation are described in From practice 8.1. An experienced investor provides his view on the main mistakes the entrepreneurs make in their pitches in Expert's view 8.3.

### **From practice 8.1: How to present your idea effectively**

Besides the content of the business plan described in Exercise 8.2, it is also important to gain the investor's (positive) attention when presenting him/her with the business idea. Some inspiration can be obtained from watching Dragon's Den (Exercise 8.3), some other recommendations for effective presentation are described below:

- Come to the meeting well prepared. Don't learn your speech by heart, but know well the key areas.
- Be persuasive, enthusiastic and believe in what you are saying. The investors must trust that you are a really motivated entrepreneur.
- Try to get the investors' attention at the beginning with something what arouses their business interest.
- Present your competitive advantage in a positive way; i.e., what you can do, not what your competition cannot do.
- Don't focus much on the details of your products and services, but on how it brings more added value to your customers when compared to the competition.
- In the case of it being possible, show something tangible; a model, picture or a web page of your product or firm.
- Know the numbers! Investors are strong in financial calculations, so do not let yourself get trapped.

### **Expert's view 8.3: Top mistakes of entrepreneurs in front of the investors**

*Ondrej Bartos, Founder and Partner, Credo Ventures*

Back in 2000 in my early days as an entrepreneur I discovered Guy Kawasaki and got hugely inspired by him, his books and presentations, his Bootcamps for Entrepreneurs. Guy surely has been one of my gurus – although I only met him in person in 2009.

Guy's inspiration concentrated primarily on two sources: the first were his Bootcamps for Entrepreneurs; interactive and practical seminars which I copied and modified for the Czech market (they have been successfully running since 2000, and are now in their 2nd decade). The second one was Guy's presentation, "Top Ten Lies of Entrepreneurs"; a brilliant presentation of the ten wrong things that entrepreneurs often say about their business. The presentation was a true eye-opener for me (as well as probably for many other people), the way it, in just 10 slides, explains what entrepreneurs usually get wrong in their business plans, and why it is wrong.

So whenever I am asked what the top mistakes of entrepreneurs in their business plans and investor presentations are, I usually go back and refer to Guy. Which is my way of skipping the frequent complaints from the investors that entrepreneurs don't have a product that addresses the problem, don't know their markets, cannot present competitive advantages and uniqueness, and don't know how to execute.

But there are still three mistakes that are not attached directly to the business proposition, but are strictly about presenting the plans to investors:

The first mistake is to come unprepared. Investors hate it. If your business plan is to sell a new type of energy drink, you better know everything possible about all energy drinks in the market, about the people who buy energy drinks (or are interested in buying them), the differences between different kinds and brands, and what would make your drink different. Think of purchasing motivation, decision making factors, psychology of the customers. Think of how to let them know, think of how to convince them to buy.

The second mistake is to come too early. One of the things that investors look for in entrepreneurs is the magical "Prove It" – the entrepreneur should do everything he/she can do before he/she actually needs the investment. He/she should do market research, create a prototype, register for patent, and get a team signed up. Everything he/she can without additional financing.

Finally, the third mistake is to come for a gamble. What I mean by this is when entrepreneurs are not fully dedicated to their business plans. They are not passionate enough. They are not putting all the money they can into their project. They just come to an investor to try to get the money, and if they don't get it, they just stop trying.

I have seen these mistakes probably a thousand times, and I am losing my patience. So my piece of advice to you: please do not go to any investor and make any of these mistakes. And, of course, read some Guy Kawasaki first ([www.guykawasaki.com](http://www.guykawasaki.com)).

## 8.7 To conclude

In this chapter we first discussed what the entrepreneurial opportunities are, and that they can be characterized by potential economic value, novelty, and perceived desirability. Generally, opportunities involve either unfulfilled market needs, or inefficiently used resources, or both. Then we described the factors that influence opportunity recognition, namely entrepreneurial alertness, prior knowledge, social networks, and national conditions.

Subsequently, the chapter focused on providing readers with practical recommendations on how to look for new ideas, how to work on the development of the idea into the form of a business concept and business plan, and finally, how to present the idea to investors in the correct way.

## 8.8 References

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## Chapter 9

# INTERNET MARKETING FOR NEW VENTURES

Patrycja Rudnicka

### 9.1 Introduction

The importance of internet marketing for business is indubitable these days, as the number of Internet users all over the world is growing, and patterns of communication and consumer behaviour are changing. The Internet is one of the most important, and rapidly developing, channels of marketing. However, its use depends on the nature of the business, products or services, as well as the target audience. Despite these differences, a common thread in internet marketing can be identified.

The goal of this chapter is to present how the Internet can be applied to support marketing processes. It starts with the presentation of the basic internet marketing strategies and tools which businesses can choose from. Then, it deals with issues of proper and efficient creation of customer experience, and, finally, reviews the techniques of evaluation the marketing goals reach.

### 9.2 Internet marketing strategies

There are various marketing applications of the Internet. It is being mentioned as the new medium for advertising and PR; the new channel for distributing products; the opportunity for expansion into new markets, as well as a new way to enhance customer service, and reduce costs (Chaffey et al., 2006). When describing internet marketing, there are also other digital technologies, i.e. mobile technologies, included; these will be discussed later on.

#### **Definition 9.1: Internet Marketing**

The application of the Internet and related digital technologies in conjunction with traditional communications to achieve marketing objectives.

Source: Chaffey et al. (2006)

In this chapter, small and medium enterprises are within the scope of interest, and therefore internet marketing strategies will be presented according to their specific characteristics, such as the limited number of personnel operating the



new technologies, the limited budget, and the huge demands on advertising and building brand awareness.

**From practice 9.1: How to start and maintain the right partnership with your internet supplier**

*Petra Brodilová, Peter Varga, Vlado Hruda, Petr Sadílek and Taťána le Moigne, Google Czech Republic*

Many start-up entrepreneurs try to keep costs low by doing the job of accountants, designers, programmers, marketers, postmen and strategists at the same time. However, later on they realize that it is more beneficial to find a suitable partner who will have enough time, knowledge and experience to carry out some of the activities. If you decide to put your internet strategy in the hands of professionals, you may find the following rules for fruitful and successful cooperation useful.

**1. Knowledge and technologies.** Brilliantly managed technologies and updated knowledge of recent innovations is the feature of a supplier who can advance your web page. Pages must function perfectly and be dynamic in order to be able to flexibly react to the newest services and tools, and to adopt them in your web page.

**2. Information.** No supplier can build a great web without the information which only you can deliver. Due to cooperation with you, a person who knows his/her own business the best, can he/she understand your customers better. Your supplier should involve you in the web's creation and administration.

**3. Long-term partnership.** If you think that the job ends with the web page launch, you are wrong. It is the other way around. Partnership with a supplier should be long-term. Your supplier should be flexible, and not only react to your incoming demands, but also actively come up with suggestions for improving your web page.

**4. Finance.** Even in the world of internet suppliers, it is not always true that a successful web page must also be expensive. The truth is, however, that know-how, time and technological and personnel background are not free of charge, and so, it may be a good idea to invest in them.

**5. Security.** Before you sign a contract with your web or marketing campaign supplier, make sure that transparency and security of all your web activities is a part of the contract. This includes access to logs and ad accounts, ownership of graphical templates, and ensuring security for web page visitors. Make clear in the contract, also, what will happen after the launch, how the web and campaigns will be managed and how much your supplier will charge for working on your new demands.

Apart from size, branch, and other characteristics of the enterprise, internet marketing strategy should always be a part of the general marketing and business plan. Even in the case of businesses oriented towards operating offline, some elements of a web presence, like e-mail or web site are considered a necessity. Furthermore, not being present online is almost impossible anyway. Usually, information about the enterprise, such as its address and telephone from yellow pages, localisation on Google Maps, or independent customer reviews on one of many third party pages, sooner or later will appear on the Internet. Therefore, the best strategy for new ventures is to plan their web presence and internet marketing strategy immediately upon starting up.

**From practice 9.2: 10 tips for nascent online entrepreneurs**

*Petra Brodilová, Peter Varga, Vlado Hruďa, Petr Sadilek and Taťána le Moigne, Google Czech Republic*

1. Start with defining **clear goals** of what you want to achieve with the Internet, and strategically decide on your next steps. If you do not know where you want to get, you will never get there.
2. **Learn from the online businesses in the US and Western Europe**, where some problems you are facing now have been already solved – do not discover America again.
3. **Invest in your web page first**, then in SEO and finally in PPC ads – respecting this order will make your campaign more effective.
4. **Measure the data about your web page** as all big international e-shops do. Such data will help you to identify weaknesses and to deliver information on what online marketing brings the most sales for the lowest costs. Thus, you will be able to focus on activities that function best for you.
5. Not all marketing activities on the internet are paid. **Blogs, Facebook profile, YouTube channel or an internet forum** can be done **free of charge**. Google Apps can save your costs for software licences.
6. Don't try to save a lot of money on **IT people**. A good programmer can be fifty percent more expensive than others, but if he/she does the job without mistakes, and quickly, he/she can be much cheaper in the end, and does not make a mess in your applications.
7. **Use cloud**. You can save both time and money by not having your own servers. Moreover, web pages and emails will function even if your traffic multiplies substantially.

8. When competing with established large businesses, utilize your advantage to **adapt quickly to the market**, and to test new products and/or services.

9. Before going to the venture capitalist, try to get **money from people you know**.

10. **Don't be afraid to make mistakes**. Thanks to such services as Website Optimizer you can test new changes on your web page on a small percentage of users and to find out how to improve your services.

The last issue in the case of small and medium businesses is technology acceptance and its psychological conditioning. Small and medium enterprises are often perceived as opportunistic as regards the use of new media. Apart from structural obstacles; i.e., personnel, know-how, costs; also psychological factors play important role in technology acceptance. There are three related factors, which may influence decisions upon the commencement, or expansion, of technology use: attitudes, level of self-efficacy and anxiety (Rudnicka, 2004). Thus, a review of personnel skills, attitudes and potential threats, which are very often based on anxiety or low self-efficacy, may help in the proper adoption of the technology. For the correct inception of the use of technology, both promotional and educational strategies may be needed. Technology adoption may be facilitated by change agents, people, who are active end-users and enthusiastic for technology. But apart from that, support in training and know-how is a key aspect in the reduction of anxiety and unfavourable attitudes. It is worthwhile to seek professional help in entrepreneurship centres and other governmental, or state, agencies. From practice 9.1 presents another strategy for managing technology by initiating cooperation with internet suppliers.

### **A plan for internet marketing**

In planning internet marketing there are several questions and issues to think over, as they depend on the general business orientation (business-to-business, B2B; business-to-customer, B2C), branch, financial and personnel resources, as well as target customers. The goal of this part of the chapter is to explain how selected qualities of the enterprise, and the qualities of the customer group, will determine the shape of internet marketing plan.

In From practice 9.2, the Czech Google team presents ten tips for startups. In further parts of this chapter some of them will be addressed as well. However, the Internet is also a constantly, and rapidly, changing medium, where new trends are popping up every so often, thus the flexibility of an internet marketing plan is inevitable.

Undoubtedly, the first step in planning an internet marketing strategy is to identify the goals to be achieved. The Internet can be a perfect and cost-

effective solution in one, or all, of three marketing areas: (1) advertising and PR, (2) distribution and selling, and (3) communication and customer service. Apart from distribution and selling, which demands higher investment expenditure, advertising and PR, as well as communication and customer service, are very affordable for small businesses. The main factor which should be taken into consideration is the enterprise's target customer group – their use of new technologies should determine all choices. Do they shop via Internet? Or do they search for information and make their choices based on them? What is their typical activity; searching, web browsing or social media use? To ensure that the entrepreneur understands customers' behaviour, one can conduct a small study among existing, or anticipated, customers. There are also many reports on consumer behaviour published by national and commercial agencies like Eurostat, Internet World Stats, and others. Apart from statistics describing the Internet usage, knowledge about psychological factors influencing customers behaviour online is also useful (see subchapter 9.5). Both cognitive and emotional needs, as well as, expectations aroused by the product, and its online presentation should be considered when planning the company's web presence.

Another step is to decide how the web presence will be organised. There is definitely no need to reinvent the wheel, as there are numerous ready to use and often free or low cost tools on the Internet which can be used by entrepreneurs; see: From practice 9.2 and 9.3. Buying expensive software like Customer Relationship Management (CRM) suite, or Content Management System (CMS) from a big label, ordering complete web solutions from an interactive agency, or hiring a professional to write an e-shop from scratch are no longer the only options. In general, there is a room to refresh one's do-it-yourself attitude as many tools (Google Sites, Office Live Small Business, Weebly, Wordpress) are extremely user-friendly and easy to configure even by a person without professional IT skills. Additional advantages of many ready to go tools are that their integration with social media is simple, design meets usability criteria, and they are very cost-effective. Also, their administration is relatively easy and may be done in-house, or, in case of social media, by a volunteering family member/ employee who is already a keen user of them. However, ready to use tools need at least some basic customisation and personalisation, with business logo, colours, etc. Thus, hiring a professional for graphics design or necessary programming adjustments may be an additional cost, as it was mentioned in From practice 9.2.

The final step in establishing an internet marketing plan is constantly ensuring the monitoring, maintenance, and improvement of services. Especially in times of the domination of customer created content it is profoundly important to monitor how the web presence of the company is

assessed, and to track people's opinions, or even invite customers to participate in dialogue. Also, it is important to establish how often information will be updated, and who will be responsible for doing so on a regular basis. Finally, gathering the feedback from users and adjusting the web performance to their expectations is the last step. To achieve these goals, establishing a web analysis policy is absolutely crucial (see subchapter 9.4). This will allow one to measure objectively the traffic on the site, assess return on investments, and track customers' preferences. The psychological aspects of internet marketing are associated with the medium qualities like speed, openness, and greater user control. Thus providing the up-to-date feedback, and user friendly content as well as orientation on engaging customers (see social media use) will be beneficial.

### 9.3 Internet marketing tools and techniques

The web site is usually the central point of the enterprise's web presence. However there are billions of web sites all over the Internet, and the imperative of having the web site demands a strategy for its promotion.

Promotion of the enterprise web site is most often done by search engine marketing, whose goal is to improve site traffic due to better positioning of search results. The main techniques are search engine optimisation (SEO) and pay-per-click (PPC).

#### **Definition 9.2: Search Engine Optimisation (SEO)**

A structured approach used to increase the position of a company or its products in search engine natural or organic results listings for selected keywords or phrases.

Source: Chaffey et al. (2006)

SEO is based on the use of specific keywords across the web site code, and within its content and cross linking within its own pages, and from external pages (e.g. Twitter page, Facebook profile, affiliate pages, microsites dedicated to product/service, etc.). Sometimes registration in leading search engines is necessary when automatic registration by crawling robots has not been done. In PPC, the search engines display a sponsored link to the web site. Usually they are distinguished from natural search results with colour or position on the page. The name PPC comes from a paid scheme based on clicks by search engine users, and not on number of displays of sponsored links.

Another technique to promote web sites is Social Media Optimisation (SMO), which is being widely applied currently.

SMO allows taking advantage of social media tools for communication with customers, strengthening brand awareness, advertising and drive sales at a relatively low cost, and is a great example of the customer centred marketing approach. The specific uses of social media are discussed in more detail in the next subchapter.

**Definition 9.3: Social Media Optimisation (SMO)**

A structured approach used to attract visitors with the use of social media by its application on site (i.e. RSS feeds, social sharing buttons, providing increased linkability, and the ability to bookmark the site) and/or use as promotional tools (i.e. blogging, participating in social networks, publishing podcasts and videocasts).

As was mentioned before, internet marketing channels also embrace other digital media – thus, optimisation of the web site for smartphones and other mobile devices is a smart choice nowadays. In the case of some web site building tools, the mobile option is offered, for example, in Wordpress.

E-mail is one of the oldest Internet services, but its role in Internet marketing is still important. It is useful as a medium of relatively cheap and effective advertising, or providing customer service. However, e-mail is often perceived as an invasive, spam method. Therefore, providing customers with the opt-in/opt-out option in promotional e-mails distinguishes this medium from spam. E-mail is also often used in viral marketing, when natural channels of customer communication are employed to transmit advertising message – the often used “e-mail a friend” is one example of online viral marketing.

In the case of customer service and communication, the use of Instant Messaging (IM) tools (e.g. ICQ, Skype) is a great alternative, but only if the enterprise is able to handle queries in almost real time. Similarly to the e-mail service, when providing opt-in/opt-out, IM can be used as an advertising channel.

**Exercise 9.1: Internet marketing tools and strategies**

Which Internet marketing tools would you choose in order to promote your product or service? What factors should influence your decisions?

In the past, before social media domination transformed the market, the Internet was mainly perceived as a medium of advertising. There are several advertising techniques which are available; e.g., interactive ads/banners, rich media (flash), and dynamic/behavioural ads, which are presented to selected customers based on their activity online (Chaffey, 2006). Nowadays, internet advertising is even more diverse with campaigns in the social media (often

used for viral marketing). PR strategies are also taking advantage of the social media. This also brings several opportunities for small and medium enterprises, as creative use of social media is far cheaper than traditional internet advertising. Exercise 9.1 will help to organize the abovementioned information about internet marketing tools and strategies in order to apply them to business ideas.

## **9.4 The role of social media**

Social media are linking people, and allow them to create and share online content (photos, video and audio collections, ideas, opinions, links) the easy way. Social media are one of the most rapidly developing, yet well established, Internet trends. The number of users on Facebook or Twitter continues to grow in millions, alike global success of YouTube or Flickr. Other commonly known social media applications are MySpace, LinkedIn, Twitter, Digg, and Delicious. Some of them have been already listed in previous paragraphs as tools of modern internet marketing.

Social media integration seems to be one of the most important trends in e-commerce in 2009. It is already noticeable among the largest companies, as almost 79% of the top 100 companies from the Fortune 500 List do use Twitter, Facebook, YouTube, or corporate weblogs to communicate with customers and key stakeholders (Burson-Marsteller, 2010). Another study conducted among retailers reveals that 47.1% of them are going to increase their use of social media by adding, or improving, Facebook pages (60.3%), Twitter pages (58.7%), or adding or enhancing blogs and RSS feeds (65.6%) (Shop.org, 2009).

In the case of small and medium enterprises, there are no global statistics, but findings from several regions in Europe and Asia have shown that many SME's have yet to seize the opportunities. For example, a Cisco study conducted in the UK revealed that only 37% of their respondents use any social media (i.e. weblogs, Twitter, LinkedIn) to communicate with customers. Among the commercial benefits reported by those who use social media are: a growth in the number of customers, as well as the provision of useful customer service insights (Cisco, 2010). Other small UK studies have pointed out the main challenges reported by SMEs, such as lack of time to implement social media (52%), being unclear about the benefits of social media (33%), and the lack of policy or guidelines (20%) (CloudNet, 2010).

Apart from these findings, social media are a promising new area of marketing because of the growing number of people who use them and their technological potential, which is: high linkability, easy integration, cost-effectiveness and ease of use. The From practice 9.3 illustrates the integrated use of social media by a restaurant.

There are several advantages of using social media in marketing a business. First, social media allow the putting of the business in the context of user created content, like reviews written by customers, localisation services and discussions over third party forums. It is also a good basis for viral marketing and word-of-mouth – the successful Facebook group, Twitter stream, or short videos posted on YouTube can be easily linked and distributed by customers to other people. Thus, the use of social media is an important aspect of brand impression and reputation management – highly linked social media allow firms to provide a lot of additional information about the business which comes directly to target customers, and is also perceived as safe because it is based on personal recommendation. However, it works both ways; campaigns mounted on Facebook, or Twitter, by dissatisfied customers can be devastating to brands or even to whole companies. Therefore, it is important to at least monitor and track discussions on sites such as Twitter and Facebook, via Google Alerts or other tools (see subchapter 9.6). Moreover, it is advised to use these media as an opportunity to intervene when necessary, proactively initiate dialogue with customers, or capture the relevant knowledge exchanged among customers.

### **From practice 9.3: Social media use by a restaurant**

Herbstreet is a bio restaurant located in Dublin, Ireland. Since August 2008 they have been using Twitter. They also have a Facebook profile and Google Maps applet on their site. All these social media are integrated with each other. Real time tweets are presented in their profile on Facebook, and a small widget on their web site. They publish information on events, special offers, menu changes. On Twitter they have garnered 149 followers, while the number of their fans on Facebook hit 200.

They have been inspired to use Twitter after hosting a Dublin's Girl Geek Dinner, an informal meeting of IT female workers. Such choice of social media seems to be reasonable in the context of both target customers – young professionals along with its location in Dublin Docklands; an area where many high tech companies are located. Moreover, all these social media are free of charge, integrate easily and are extremely user friendly – easy to configure by the entrepreneur, and to use by customers.

Source: [herbstreet.ie](http://herbstreet.ie)

Despite their popularity, the choice of specific social media should be a conscious decision based on knowledge of the customers' preferences and behaviour. For example LinkedIn as a platform for communication with customers or building brand awareness would be smarter choice than Facebook for a B2B company. This is because Facebook is perceived as a leisure time network, while LinkedIn is a business/professionally oriented



one. Another example is the use of MySpace as a promotional tool for small companies producing sound system equipment – MySpace is the ‘home’ of DJs, bands, concert organizers etc. There are also differences, which should be taken into consideration when acting on local markets. For example in Spain, Hi5 is the successful competitor to Facebook, while in Poland, Blip is the equivalent of Twitter.

The integration of social media with other tools of internet marketing like, for example, the corporate web site is the easiest part of social media use, as this technology has been designed to facilitate integration. Examples are widgets for Twitter and Facebook, social sharing buttons to embed on web site, and RSS feeds. But it is important to stress that the successful use of social media is based mostly on regular updates, involvement in discussion, providing feedback and attractive content (i.e. photos, videos). Social media demand regularity, and outdated posts and tweets are perceived negatively. Thus, it is worth considering how much time one has for social media, and to choose only some of them. For example using Twitter, and thereby being constrained to 140 character posts may be easier than writing a weblog.

Another aspect of social media is linked with SEO and positioning the business in the Internet. Social media are based on tagging and bookmarking. Each mention of company's web site on Facebook, Twitter, on other pages (i.e. customers' Delicious) is not only targeted and free advertising, but also a source of valuable backlinks, which in turn improve search engine rankings. Hence, the presence of social media buttons on many web sites, providing customers with the opportunity of sharing the content easily. Virtual social media should also be integrated into offline marketing strategies. Whether one is going to use Twitter, Facebook, or YouTube, it is important to make these tools part of the enterprise's real life presence. Putting the name of the Twitter account on business cards, leaflets and other information materials may help to attract new customers to join the business online.

### **Exercise 9.2: Social media use**

User generated content is an important contribution on a typical Amazon product site. Go to amazon.com, search for your favourite book and try to identify as many social features as you can on the dedicated page. Which of these social features could be used on your own business web site?

Social media and user created content could provide valuable input on the corporate website. Many big companies have already integrated users' comments and recommendations into their products or services pages. In Exercise 9.2 there is proposed to search for user contributions on one of the biggest online stores.

## 9.5 Web presence and user experience (UX) creation

Corporate web sites and other internet marketing tools are elements of the company's web presence. They play the important role of being the interface between the customer and the company. Their effective design, apart from being in line with business objectives, should also cater for customers expectations, or even go beyond them to create a distinct impression. These goals are targeted by the creation of a specific user experience (UX), which encompasses all aspects of customer interaction with the company's web presence.

### **Definition 9.4: User Experience (UX)**

Describes the general quality of the interaction between the user and design of a system or product (i.e. web site), based on products' features and qualities (i.e. fulfilment of user's needs, utility, functionality) and emotional response towards the product, influenced by individual and situational conditions.

UX is a term originally coined in human computer interaction science (HCI), and is broadly used in design, psychology, and marketing as one of the most important factors influencing users' attitudes towards products or services, its acceptance, and, in consequence, customers' satisfaction. UX is shaped by almost each element of the web site, like, for example, utility, graphic design, used marketing elements (i.e. flash intro, banners) or even the web site's load time and responsiveness. However, a proper web site UX is not limited to technology. It also demands high quality, reliable, and trustworthy content. The key to success is to strike the balance in design and content, between customer expectations, company marketing goals and technological features. UX can contribute to marketing success by stimulation of positive emotional response, bonding and the creation of a desirable image of the product, service, and company.

### **Elements of customer's online experience**

The online experience of customers embraces all aspects of interaction with the enterprise's web site or other content on the Internet (e.g. Twitter stream, e-mail communication etc). It is based on the fulfilment of three types of customer expectations: rational, emotional, and promised experience (Chaffey et al., 2006). In other words, the design of a web site which appeals to specific rational, emotional and promised experience values respected by customers leads to successful web presence.

Rational values consist of web site's ease of use, its relevance and performance (speed and availability). Web site visual design and tone, as well as credibility and trustworthiness, constitute the group of emotional values.

While promised experience values include the quality of service provided on the web site, level of interactivity and presented product/service qualities (Chaffey et al., 2006). In further parts of this chapter, hints and tips according to the design of certain aspects of the web site in connection to the fulfilment of rational and emotional expectations, as well as the delivery of the promised experience are presented.

### **Usability and information design**

High usability and relevant, accurate, information are crucial for the fulfilment of rational expectations toward the web site made by customers. Their evaluation by customers is based on such objective and measurable indicators as web page loading speed, ease of use, accessibility, and relevance of information. Users assess the ability to achieve specific goals while using the web site, i.e. finding relevant information, or buying something in an online shop quickly and easily. These evaluations also depend on user characteristics, such as previous experience, skills level, or general efficiency. Thus, design should take into consideration the qualities of future users and provide them with clear navigation, search facility, and straightforward operations.

Proper information presented on the web site should be relevant, accurate, timely and up to date, easy to find, clear and personalized. To facilitate the personalisation of information presented on the web page, options for creating personal accounts should be provided. Clear and carefully thought out content of the web site may also contribute to Search Engine Optimisation (SEO).

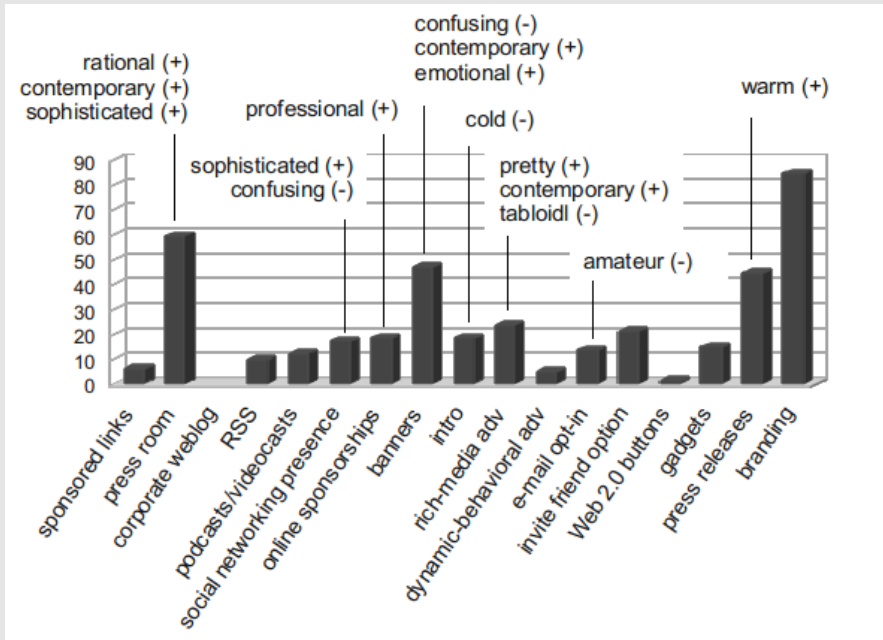
Here are six simple and easy to follow pieces of advice by Steve Krug, which may help in the development of the rational elements of the web site. Krug advises us to: (1) create a clear visual hierarchy on each page, (2) take advantage of conventions, (3) break pages into clearly defined areas, (4) make it obvious what is clickable, (5) minimize noise and (6) omit needless words (Krug, 2006). This advice is based on the observation of customer behaviour. To assess the usability and information design of a web site also the WUS instrument (Muyllé, Moenaert, & Despontin, 2004), mentioned in My research 9.1 frame, can be employed.

#### **My research 9.1: Emotional response towards internet marketing tools**

In 2009 I conducted, with a group of students, a short study to learn how the general usability level and use of specific marketing tools influence the emotional response to the web site.

Our data were obtained through content analysis of 20 web sites selected from the Polish list of Top 500 Enterprises. Each web site was assessed by four users with the Bipolar Emotional Response Test (BERT);

BBC, 2002 with minor modifications), and Web site User Satisfaction Scale (WUS; Muylle, Moenaert, & Despontin, 2004). We have identified 17 marketing tools, and checked whether their use is correlated with specific positive or negative emotional responses. The figure below presents the frequency of use of marketing tools, and significant correlations between the presence of some of them, and users' emotional responses.



The study confirmed that, apart from several neutral internet marketing tools, some of them are correlated with negative, positive or both types of sentiment and may influence emotional evaluation of the web page. Also, rational elements of the web page influence emotional responses to corporate web sites. Proper information design and high usability had strengthened the positive emotional assessment of the web site. Pages with better information quality and higher usability were also assessed as more professional, light, pretty and satisfactory.

Source: Rudnicka (2009)

### Emotional response toward web site

Visual design, tone and style determine the user's emotional evaluation of the web site and brand impression. Moreover, they influence the assessment of credibility and trustworthiness of web site. Many elements of web site design

contribute to the general emotional evaluation carried out by the customer, see My research 9.1.

Emotional response is also influenced by such individual characteristics as gender, age, or previous experience. It is also assumed that preference for specific elements of the web site; e.g. colours, spatial organisation, graphic elements, site features like newsletters or loyalty programmes, as well as hard or soft sell approaches, differs depending on cultural background. Singh and Matsuo (2004) provide a useful framework which identifies the web site element preferences for cultural dimensions; e.g. collectivism, uncertainty avoidance, power distance, masculinity, and low-high context. This framework may be used when the web site is designed for certain cultural groups, or when taking advantage of extending the operations to other countries.

When catering for trustworthiness, attention should be paid to privacy and security, as well. It is undisputed in the case of online retail, as providing secure and recognizable payment facilities is a cornerstone of trust creation. But it is also the case when collecting any data from customers. Providing customers with the option of account creation, satisfaction survey questionnaires, or newsletter offer should be accompanied by information about both the use of personal data, as well as instructions on opting-out.

### **Creation of the promising experience**

Promising experience values respected by customers include product qualities, such as price and promotion, interactivity, e.g. customer journey, fit and flow, and also supportive and satisfactory service (Chaffey et al., 2006). Promising experience is a key success factor of the web site, as it is aimed at meeting customer's expectations.

Provision of the flow experience is based on having a compelling web site design which makes users concentrated and focused, giving them an optimal challenge level when using the web site and provide personal control over the web site. In other words, such web sites engage customers' attention, provide them with easy surfing throughout the site, and also offer additional features like competitions, games, or widgets (Xia, Skadberg, & Kimmel, 2004). To create such a set of values, good navigation, interactivity, and personalisation are necessary.

Increasing the interactivity of the web site by taking advantage of social media seems to be an interesting option, as they allow customers to be proactively involved in the promotion, or even creation, of a product or service. It has been used by Dell, which created an online community called IdeaStorm, where customers discuss ideas and vote for best. The results are 410 ideas which were applied by Dell. Apart from that, with low cost they

acquired a database full of customers' opinions. The wisdom of customers was also employed by Starbucks, while Nokia or Nike organized design competitions.

The last aspect of promising experience is quality of service. It has to be said that standards which the Internet set are high; with the requirement of prompt response and twenty-four-hour availability. There are many ways to provide customer service, ranging from contact forms, providing e-mail addresses to instant messaging, or Skype contacts. However, the key is not the richness of options, but execution of the handling of customers' queries to provide them with timely and efficient information and support. Apart from customer service available through the web site, a more proactive attitude can also be employed by providing help on discussion forums, dedicated weblogs or creating customers space for discussion and mutual help.

### **Steps to successful design**

To summarize the above paragraphs – the foundation for a successful web site is knowledge of users' needs, and good design conforming to usability and accessibility rules. But the key to success is constant monitoring, feedback and adjustment as trends on the Internet are changing constantly.

There are many ways to assess the design of a web site and they should be exercised during the planning stage. In the initial phase it is important to think about potential visitors and their preferences. It will allow the firm to identify technologies and features critical for them. For example, in case of young people, interactive design based on flash animation is appropriate, while older people may perceive it as overwhelming and misleading. At this stage, good knowledge of customer behaviour patterns, their internet skills and attitudes is very helpful.

Professional usability assessment is usually done in well equipped laboratories, using eye-tracking and recording tools, and is based on observation, or focus groups interview. However, simplified usability analysis may be also conducted in a natural setting by observing the behaviour of users (preferably with different level of skill, age and gender) completing simple tasks like searching for information, buying a product etc. Opinions obtained this way may be invaluable. Also, gathering opinions via online surveys is a good method, as it involves customers, and provides them with a chance to express their opinion. However, in this case it is necessary to provide them with feedback and be ready to satisfy their expectations. Other sources of evaluating the design are web analytics which provide information about user's behaviour patterns on site.

## 9.6 Performance monitoring and evaluation

Once the web page is published the gathering of data using web analytics should begin. Web analytics provide the data necessary to evaluate online performance. Proper evaluation of marketing goals achieved, level of growth of the online business, and identification of the weaknesses of Search Engine Optimisation, web site changes or social media presence, are the main advantages of using web analytics. Data collected from web analytics' sites, and other sources, such as satisfaction surveys, or opinion polls, provide the information necessary for making adjustments to the marketing strategy corresponding to the changing conditions on the market.

### **Definition 9.5: Web analytics**

Techniques used to assess and improve the contribution of e-marketing to a business, including reviewing traffic volume, referrals, clickstreams, online reach data, customer satisfaction surveys, leads and sales.

Source: Chaffey et al. (2006)

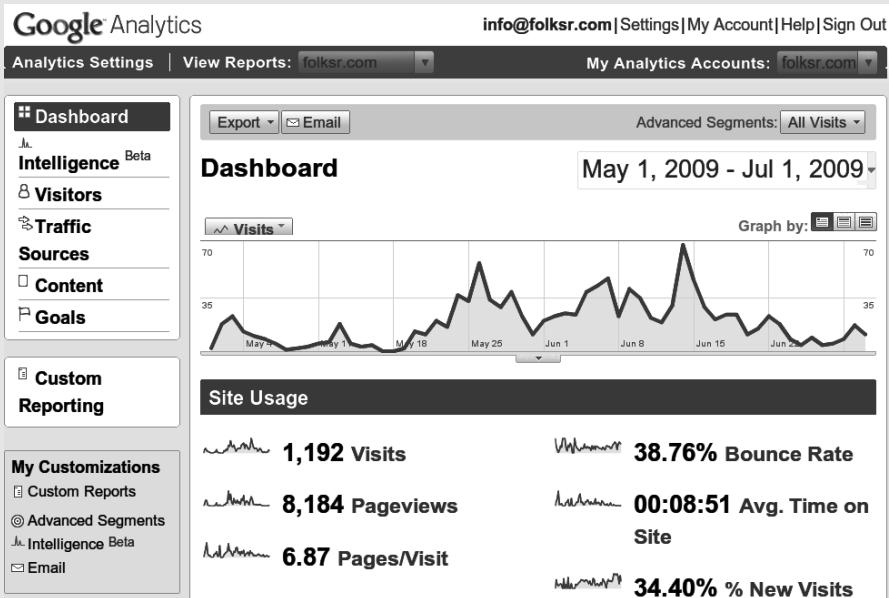
There are many web analytics packages on the market, which differ in features, price and ease of use. A good starting point is Google Analytics, as it is free, rich in options, and relatively easy to use. It is also a good choice in case of using other Google services like AdWords. Other interesting tools are Clicky ([www.getclicky.com](http://www.getclicky.com)), and Crazy Egg ([www.crazyegg.com](http://www.crazyegg.com)), or Click Tale ([www.clicktale.com](http://www.clicktale.com)), which provide eye candy data about customers' online behaviour (clicks, keystrokes, areas of site catching attention, etc.); also, most web site hosting services provide basic analytics tools.

Apart from choosing one or other site, the web analytics package should allow the entrepreneur to collect information about: (1) number of visitors entering the company's page; (2) their behaviour on the web page, i.e. time spent, site's parts clicked, entry and exit pages, (3) their geographical localisation as well as browser and operating system used, (4) referring URL and domain, where they come from, i.e. search engine, a link from other site, direct visit, (5) effective queries in search engines, and (6) paths or clickstream analysis showing the sequence of pages viewed.

At first glance, the amount of information presented on the web analytics site may be overwhelming and hard to interpret. Thus, it is advisable to read FAQs, and search for information in books and web sites to fully utilize the data. From practice 9.4 shows how to identify the effect of Twitter promotional campaigns using web analytics.

## From practice 9.4: Web analytics in use

Folksr is a social media service which link bloggers writing about similar topics. Google Analytics is used to gather information about traffic on site. Below is the screen-shot from their Google Analytics account presenting overview of site usage for May-July 2009. As you can see on the graph below presenting number of visitors in May and June, there were two idle points in number of visits in the last week of May and the second week of June.



In May 2009, the Folksr team started private beta testing for selected bloggers by invitation, hence the traffic. Then in June they started to advertise the service on Twitter and a spike in traffic was observed as a result. To better understand the meaning of this data, the source of traffic and bounce rate should also be taken into consideration, and this information is easily accessed in Google Analytics. Bounce rate describes how many visitors left the site right after entering. In the case of Folksr, the average bounce rate was about 39%, but in June it dropped below 26%. Also the source of traffic, which was Twitter, showed that the advertising campaign was effective in reaching target users.

Source: folksr.com

Apart from servers' data, the buzz in cyberspace also provides useful information, which allow assessing the efficiency of internet marketing



strategy. Google Alerts is a tool which allows the tracking of specific phrases on the Internet, i.e. the name of business or combination of key words. The other one, which focuses only on social media, is Socialmention ([www.socialmention.com](http://www.socialmention.com)). Its interesting feature is that, apart from the popularity ranking for a given phrase, it also displays sentiment measurements; i.e., information about negative, neutral or positive tone of a phrase's use.

Other useful sources of information are outcome data, for example enquiries and customer service e-mails; however, they may be hard to analyse. Finally, traditional methods like questionnaires, opinion polls, interviews or focus groups may be applied online or offline to gather information about internet marketing performance.

Analysis of customer behaviour on site may also provide a lot of information about the quality of design, and its role in achieving marketing goals, i.e. promotion of specific products or information on the web page, use of e-shop elements, etc. In Exercise 9.3 you can try to analyse the use of web analytics data gathered by clicks and keystrokes registration in order to improve the web page design.

### **Exercise 9.3: Web analytics and site design evaluation**

Watch the product demo on [www.clicktale.com](http://www.clicktale.com) and explain how using web analytics data may contribute to better site design.

## **9.7 To conclude**

The next few years will bring further growth of online markets worldwide, and there is still room for small and medium enterprises on the Internet. There are many advantages of internet marketing, and the richness of tools allowing each enterprise to build a unique and tailored online strategy. Future winners will be those who overcome the typical small business weaknesses like tight budgets, lack of time and/or qualified staff, as well as fractional knowledge of internet marketing tools. After all, it is not all that demanding.

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## Chapter 10

# ENTREPRENEURSHIP AND LEADERSHIP

Juan A. Moriano and Jean-Pierre Lévy Mangin

### 10.1 Introduction

The psychosocial study of entrepreneurial activity has placed a lot of emphasis on the personal characteristics of entrepreneurs (Miner & Raju, 2004; Müller & Gappisch, 2005; Rauch & Frese, 2007), as well as on the social and economic factors influencing individuals' entrepreneurial intentions (Liñán & Santos, 2007; Moriano, Palací, & Morales, 2007). However, there are only few studies which analyze the leadership style of entrepreneurs and its impact on the performance and consolidation of the new venture (e.g. Ensley, Pearce, & Hmieleski, 2006).

Leadership and entrepreneurship, both fields have achieved a significant level of development in recent years but they have been analyzed separately without taking into account the many aspects that they have in common (Cogliser & Brigham, 2004). For example, entrepreneurs take advantage of opportunities and convince others of the feasibility, strength and value of their business ideas. These attempts to influence and exploit opportunities can be assigned equally to any leader in any established organization (Vecchio, 2003). In addition, leadership plays a key factor in the entrepreneurial process. In fact, entrepreneurs must persuade others (e.g. potential investors) to trust them even before starting the new venture. Afterwards, when the company is established, entrepreneurs must create and communicate a clear and compelling vision of their business (Baum, Locke, & Kirkpatrick, 1998) in order to attract employees and acquire the necessary resources for developing their new ventures.

This chapter reviews the relationship between entrepreneurship and leadership with an emphasis on how the leadership theories and models can be applied to entrepreneurship. To achieve this goal, we first describe the similarities between entrepreneurs and leaders; secondly, we analyze the transactional and transformational leadership styles that entrepreneurs can adopt during the process of creating and running their own business.

## 10.2 Similarities between leadership and entrepreneurship

Leadership is a phenomenon that has aroused the interest of researchers and thinkers from every culture over the centuries. Nevertheless, there is still no single, consistent, and commonly accepted definition of leadership, as Stogdill (1974) notes “[There are] almost as many definitions of leadership as there are persons who have attempted to define the concept” (p. 259). Similarly, entrepreneurship has experienced the fate of a new field that is characterized by its plurality and multidisciplinary, dealing, as it does, with both personal characteristics and business activity, along with economic and social effects and even cultural aspects.

Leadership and entrepreneurship both initially focused on the individual’s traits that identified him or her as a leader or entrepreneur and distinguished the person from those who were not (Cogliser & Brigham, 2004). Examples of the variables examined in these types of studies on entrepreneurship include the *need for achievement* (McClelland, 1965), *locus of control* (Kaufmann & Welsh, 1995), *risk-taking propensity* (Miner & Raju, 2004), and *general self-efficacy* (Chen, Green, & Crick, 1998) (see Chapter 3 for more details).

**Table 10.1: Leadership and entrepreneurship models**

	<b>Selected relevant leadership models</b>	<b>Selected relevant entrepreneurship models</b>
<i>What is a leader/entrepreneur?</i>	<ul style="list-style-type: none"> <li>• Traits</li> <li>• Charismatic Leadership</li> </ul>	<ul style="list-style-type: none"> <li>• Need for achievement</li> <li>• Locus of control</li> <li>• General Self-Efficacy</li> <li>• Risk-taking propensity</li> </ul>
<i>What does the leader/entrepreneur do?</i>	<ul style="list-style-type: none"> <li>• Task-oriented/relations-oriented behavior</li> <li>• Managerial grid</li> <li>• Transformational Leadership</li> <li>• Authentic leadership</li> </ul>	<ul style="list-style-type: none"> <li>• Entrepreneurial behavior</li> <li>• Opportunity recognition</li> <li>• Innovation</li> </ul>
<i>In what context does the leader/entrepreneur operate?</i>	<ul style="list-style-type: none"> <li>• Path–goal theory</li> <li>• Contingency theory</li> <li>• Normative decision model</li> <li>• Social Identity</li> </ul>	<ul style="list-style-type: none"> <li>• Corporate Entrepreneurship</li> <li>• Entrepreneurial Culture</li> <li>• Family business</li> </ul>
Source: based on Cogliser & Brigham (2004)		

Many leadership scholars have moved the focus from what leaders are, to what leaders do, and towards exploring the context in which the leader operates (Cogliser & Brigham, 2004). Similar to the progression in leadership, entrepreneurship has moved towards what the entrepreneur does during the process of creation and management of a new business (Shane & Venkataraman, 2000; Shaver & Scott, 1991).

In summary, the fields of leadership and entrepreneurship have, in many ways, shared similar developmental routes (see Cogliser & Brigham, 2004 for a review). However, there appears to be few direct links between the two fields at the conceptual level, although entrepreneurs cannot successfully develop new ventures without displaying effective leadership behavior. Thus, entrepreneurship may benefit from a closer integration with leadership research, as suggested recently by leadership scholars (Antonakis & Autio, 2007; Cogliser & Brigham, 2004; Vecchio, 2003).

### 10.3 Entrepreneurs as leaders

#### **Definition 10.1: Leadership**

The process of influencing others to understand and agree about what needs to be done and how it can be done effectively, and the process of facilitating individual and collective efforts to accomplish a shared objective.

Source: Yukl (2002, p.3)

In the context of new ventures, entrepreneurs act as leaders in view of the fact that they initially define the mission of their organizations, set specific goals, and organize and motivate the efforts of their employees. However, all entrepreneurs do not go about leading their new ventures in the same way (Ensley, et al., 2006). Instead, their behavior tends to vary across two dimensions of leadership behavior – designed transactional and transformational; Burns (1978).

#### **Definition 10.2: Transactional leadership style**

Focuses on how to improve and maintain the quantity and quality of performance, how to substitute one goal for another, how to reduce resistance to particular actions, and how to implement decisions.

Source: Bass (1985)

Transactional leaders work through creating clear structures and roles that allows their subordinates to reach goals. The relationship between leader and subordinates is "transactional" (i.e. *I will give you this if you give me that*), where the leader controls the rewards, or contingencies (Bass & Avolio,

1994). In this sense, transactional leaders have various transactions available to them. Transactions based on leaders' knowledge of the actions subordinates must take to achieve desired personal outcomes (e.g., working overtime for a paid vacation) are most common. Consequently, entrepreneurs utilizing transactional leadership capitalize on the self-interest and extrinsic motives of their employees (Ensley, et al., 2006).

### **Measure 10.1: Multifactor Leadership Questionnaire (MLQ–Form 5X)**

**Overview.** Participants are asked to respond to 45 items using a 5-point scale (“Not at all” to “Frequently if not always”). Approximately 15 minutes is required for completion. The MLQ assesses a full range of leadership dimensions:

#### **Transformational Leadership**

1. *Charismatic Leadership or Idealized Influence.* Leaders are role models; they are respected and admired by their followers. Leaders have a clear vision and sense of purpose and they are willing to take risks.
2. *Inspirational Motivation.* Leaders behave in ways that motivate others, generate enthusiasm and challenge people.
3. *Intellectual Stimulation.* Leaders actively solicit new ideas and new ways of doing things. They stimulate others to be creative and they never publicly correct or criticize others.
4. *Individualized Consideration.* Leaders pay attention to the needs and the potential for developing others. These leaders establish a supportive climate where individual differences are respected.

#### **Transactional Leadership**

5. *Active management by exception.* The leader specifies the standards for compliance and may punish followers for being out of compliance with those standards. This style of leadership implies monitoring for deviations, mistakes, and errors and then taking corrective action without delay when they occur.
6. *Laissez-faire.* The leader either waits for problems to arise before taking action or takes no action at all. Such passive leaders avoid providing goals and standards to be achieved by followers.

Source: Bass and Avolio (2000)

On the other hand, transformational leadership refers to the leader inspiring their followers to adopt the vision of the organization as though it were their own, and to focus their energy toward the achievement of collective goals,

rather than just obtaining individual rewards, or the avoidance of punishment. For example, Mao and Gandhi can be considered transformational leaders, according to Burns (1978), for they met their people's initial needs but instead of riding them to power remained sensitive to their higher purposes and aspirations. Bass and Avolio (2000) identify four components of transformational leadership, which are further measured with the Multifactor Leadership Questionnaire (MLQ).

**Definition 10.3: Transformational leadership style**

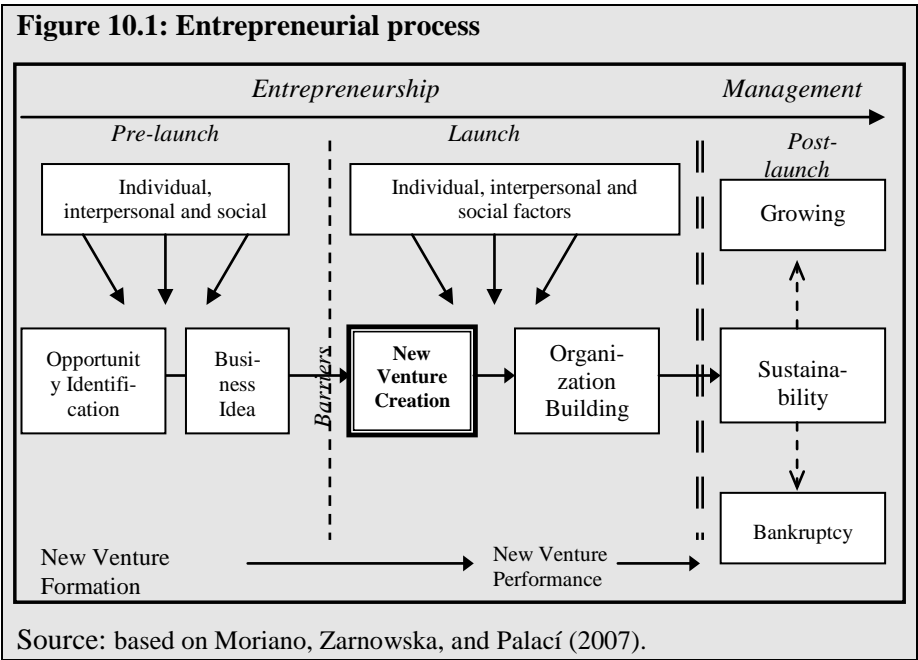
Focuses on how to improve and maintain the quantity and quality of performance, how to substitute one goal for another, how to reduce resistance to particular actions, and how to implement decisions.

Source: Bass (1985)

In relation to the entrepreneurial process, it is important to understand that entrepreneurial tasks, challenges and demands vary according to the phase (see 10.1 Figure), as might the types of effective leadership behaviors. In the first phase (*pre-launch*), the entrepreneur scans the environment and identifies the opportunity to pursue, develops a business idea, and evaluates the feasibility of a new venture. There is not leadership *per se* in this phase, because the entrepreneur does not yet have followers in the traditional sense (Antonakis & Autio, 2007). However, entrepreneurs must create a vision for their business and influence others to buy into their dreams in order to attract investors and acquire the necessary resources for developing their new ventures (Baum, et al., 1998). By way of example, this quote from de Antoine de Saint-Exupéry, French writer and aviator, “If you want to build a ship, don't drum up people to collect wood and don't assign them tasks and work, but rather teach them to long for the endless immensity of the sea” (*The Little Prince*).

The next phase (*launch*) begins with the new venture creation. The building of the organizational structure and networks, accumulation of resources, building of a customer base and the creation of competitive advantage are all necessary elements of the phase. The entrepreneur has to take on leadership roles leading “in” the organization, because he or she cannot rely on the well-defined goals, structure, and work processes of more established corporations. Thus, in the early life of a start-up, transactional leadership may be effective for setting performance expectations and clarifying roles and reward contingencies. Over time, transformational leadership will be needed to provide long-term vision to the entrepreneurial endeavors by bringing meaning to otherwise disconnected activities. To a certain degree, transformational leadership

may also supply a healthy motivational counterbalance to the instrumental focus of transactional leadership by engaging members of the new venture on a basis that extends beyond self-interest. Supplying inspiration, vision, and deeper meaning may also promote incremental contributions through efforts rendered beyond the call of duty (Ensley, et al., 2006).



In the last phase (*post-launch*), the new venture achieves self-sustainability. The organization is generally not so dependent upon the entrepreneur, risk has been reduced, sustainable competitive advantage has been created, the rate of change has been drastically reduced, and repetition in the functions of the organization has occurred. In order to survive, the entrepreneur will have to become more and more a manager. He/she will need the basic management skills, and will also need to exercise control in the sense of plan, organize, command, coordinate and check. Planning is most important in this phase, and effective transitional leadership may lead to an established life cycle company focused on productivity. On the other hand, if the entrepreneur not only seeks to consolidate his/her business, but also the company's growth, then transformational leadership will be need to inspire employees to exploit new opportunities, to innovate and to achieve higher goals.



**Experts's view 10.1: The importance of structure, strategy and people**

*Ivan Pilný, private investor, ex-CEO of Microsoft CR*

For an entrepreneurial leader, structure and strategy are of the utmost importance. From the stage of the "Mongol hordes" where everyone does everything, you switch, if you survive, to delegation. Hierarchy grows and brings, inevitably, more or less bureaucracy. If you are successful, then first restructuring, reengineering, etc. come. If you hold to the principles "business first", and "keep it simple", you are on the right track.

Your strategy should be based on three pillars. The first is a compliance of personal and corporate strategy; the second, clear internal and external communication; and the third, a clear division of roles, i.e. who should do what.

We go up and down with people. Everything starts with the right employee selection. We sometimes rush the recruitment because the vacancy should 'have been filled yesterday' at the latest. During the interview, as always when we want to learn something, we must really listen. It is not exceptional that we hear more than we asked for. The interview is important, but the references and proven skills are as well. We prefer smart and talented people, but brains themselves are not enough. The firm needs to use them to its advantage. Precise job description plays a big role. Candidates must understand what to do and to identify as much as possible with the job; otherwise, we are sending them to their deaths.

Hiring an employee does not mean we stop working with him or her. He/she must be motivated and involved actively in continuous education. The imperative is not only the financial remuneration, but a clear picture of worthwhile and meaningful tasks. Feedback on task completion and the immediate and public appreciation of good work is a *must*. If we wish from someone to behave proactively, we need to provide them with the opportunities to do so. A cog wheel in a machine is not motivated and its teeth often break.

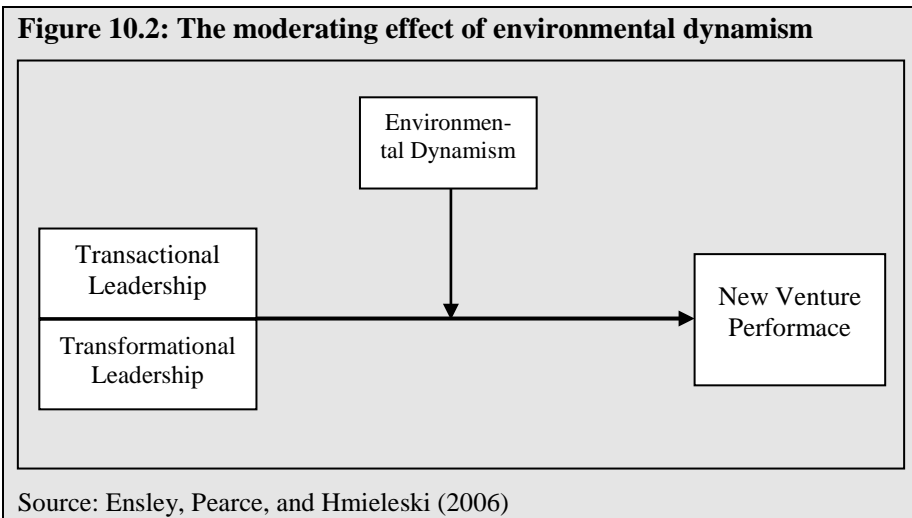
**Definition 10.4: Environmental dynamism**

Dynamic environments are characterized by unpredictable and rapid change, which increases uncertainty for individuals and firms operating within them. Uncertainty is the difference between projected and actual outcomes, and results from the limited availability of information for decision making.

Source: Ensley et al. (2006)

In addition to the characteristics of every phase of the entrepreneurial process, Ensley et al. (2006) noticed that the influence of entrepreneur leadership behavior on the new venture's performance is likely to be moderated by the level of environmental dynamism (see Figure 10.2).

Transactional leadership may be less effective in dynamic environments characterized by unpredictable and rapid change, which increases uncertainty for individuals and firms operating within them. On the other hand, transformational leader behavior may be more effective in dynamic environments, which clearly reinforces the notion that transformational leaders might be able to create, both perceptions of crisis as well as entrepreneurial opportunity (Conger, 1999). Thus, founders of organizations operating within dynamic environments are likely to have an overall positive effect on the performance of their firms by adopting a transformational leadership style.



Further, Hmieleski and Ensley (2007) examined how the interaction between entrepreneur leadership behavior, new venture management team heterogeneity, and the industry's environmental dynamism relates to the performance of startups. It is common that new ventures are created for more than one individual. For instance, in Spain about 40% of all new firms are founded by three or more entrepreneurs (Cámaras de Comercio & Fundación INCYDE, 2003). Research has shown that one individual typically emerges as the leader of the founding team (Ensley, Carland, & Carland, 2000).

### **From practice 10.1: Innovation distinguishes between a leader and a follower**

Steven Paul Jobs (born February 24, 1955 in San Francisco), is the founder and CEO of Apple Computer, and a leading figure in both the computer and entertainment industries. In 1976, when he was twenty-one years old, he saw a computer that Steve Wozniak had designed for his own use, and he convinced Wozniak to assist him and started Apple Computer Co. As Apple continued to grow, the company began looking for an experienced executive to help manage its expansion. In 1983, Jobs lured John Sculley away from Pepsi-Cola, to serve as Apple's CEO, challenging him: "Do you want to spend the rest of your life selling sugared water, or do you want to change the world?"

*On what drives Apple employees.* "We don't get a chance to do that many things, and every one should be really excellent. Because this is our life. Life is brief, and then you die, you know? So this is what we've chosen to do with our life. We could be sitting in a monastery somewhere in Japan. We could be out sailing. Some of the [executive team] could be playing golf. They could be running other companies. And we've all chosen to do this with our lives. So it better be damn good. It better be worth it. And we think it is."

*On whether Apple could live without him.* "We've got really capable people at Apple. I made Tim [Cook] COO and gave him the Mac division and he's done brilliantly. I mean, some people say, 'Oh, God, if [Jobs] got run over by a bus, Apple would be in trouble.' And, you know, I think it wouldn't be a party, but there are really capable people at Apple. And the board would have some good choices about who to pick as CEO. My job is to make the whole executive team good enough to be successors, so that's what I try to do."

*On his demanding reputation.* "My job is to not be easy on people. My job is to make them better. My job is to pull things together from different parts of the company and clear the ways and get the resources for the key projects. And to take these great people we have and to push them and make them even better, coming up with more aggressive visions of how it could be."

Source: based on an interview with Steve Jobs, CEO Apple. Fortune Magazine, March, 2008.

<http://money.cnn.com/galleries/2008/fortune/0803/gallery.jobsqna.fortune/7.html>

Due to the wide array of roles and responsibilities that new venture management teams must take on, it is crucial that their members have a diverse range of educational levels and specializations, business skills, and previous experience. Leadership within heterogeneous teams may be more

effective than that in homogenous teams, because diverse teams have a greater variety of information sources, and are likely to formulate more comprehensive strategic decisions. Especially within complex environments, and for ambiguous tasks, both of which tend to be natural within the entrepreneurial process (Baron, 1998).

Hmieleski and Ensley (2007) found that in stable environments, startups with heterogeneous management teams perform best when led by entrepreneurs that show transformational leadership (i.e. encouraging self-rewards, self-leadership, opportunity thinking, and participatory goal-setting by group members). On the contrary, transactional leadership (i.e. assigning specific goals, and using contingent reprimands to facilitate cooperation from group members) was found more effective in homogenous top management teams.

In dynamic environments, homogenous top management teams were more effective when led by entrepreneurs with transformational leadership behavior. In contrast, startups with heterogeneous management teams were found to perform best when led by entrepreneurs with transactional (i.e. directive) leadership behavior (Hmieleski & Ensley, 2007). It seems that transactional leadership may help to focus the attention of heterogeneous teams in dynamic environments, where conditions are stressful and decisions need to be made quickly. In such environments, startups need to move ahead quickly before missing critical windows of opportunity. Therefore, rational decision-making processes and management team consensus may be less important than in stable environments.

**Key representative 10.1: Michael D. Ensley**

Currently the co-founder of the Executive Assessment Institute (EAI), and leads the organization. He was previously a Tenured Professor at Rensselaer Polytechnic Institute and The University of North Carolina at Charlotte. His research focuses on the development, composition, and dynamics of top management teams in new ventures.



## 10.4 Practical recommendations

The most important recommendation for those who want to follow an entrepreneurship career, or understand the field better, is to be aware of the fact that entrepreneurs cannot successfully develop new ventures without displaying effective leadership behavior (Cogliser & Brigham, 2004). Thus, entrepreneurship may benefit from a closer integration with leadership

theories and empirical studies because leadership as a field has a much longer history than entrepreneurship (Antonakis & Autoio, 2007).

### **Exercise 10.1: Assess your transformational leadership competencies**

Take a few minutes to review the transformational leadership competencies listed below. Think about your own level of comfort and expertise with each competency. Put a check mark beside each competency that you consider as strength. Highlight or underline each competency that you feel you would like to strengthen. Once you have finished, create a personal action plan outlining your goals.

#### *Charismatic Leadership or Idealized Influence.*

- Displays high values and ethics and builds a common purpose
- Instills pride, energy, enthusiasm, passion
- Builds respect and respects others
- Displays confidence; shows the way
- Envisions the future; talks realistically and optimistically
- Behaves courageously, ethically, fairly, authentically

#### *Inspirational Motivation.*

- Acts as a forward looking, motivational visionary
- Self develops, and encourages others to do same; inspires potential
- Establishes outcomes and success milestones
- Asks, listens, understands non-judgmentally
- Behaves with masterful, adaptable, professional technique
- Provides appropriate and diverse coaching resources/skills/experience

#### *Intellectual Stimulation.*

- Communicates clearly; stimulates creative thinking and solution generation
- Teaches, develops, coaches, and leverages others
- Questions processes and thinking to expose other ideas and angles
- Asks for options and new ways of looking at situations/problems
- Makes connections/uncovers possibilities
- Gives constructive feedback

#### *Individualized Consideration*

- Builds confidentiality and trust
- Gets to know others; identifies and responds to their uniqueness
- Provides appropriate recognition
- Demonstrates a safe, supportive, and caring approach
- Behaves as a compassionate, empathetic, honest mentor; develops chemistry

In this chapter, we have described how transformational leadership theory (Bass, 1985; Bass & Avolio, 1994) can be applied to entrepreneurship. However, there are no magic recipes for leadership. The impact of transactional and transformational leadership styles on the new venture's performance will be moderated by the phase of the entrepreneurial process (Antonakis & Autio, 2007), the environmental dynamism (Ensley, et al., 2006) and management team heterogeneity (Hmieleski & Ensley, 2007)

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## Chapter 11

# MANAGING THE GROWING FIRM

Lorraine Uhlaner and Martin Lukes

*„There are three types of people in this world: those who make things happen, those who watch things happen and those who wonder what happened.“*

*(Mary Kay Ash, Founder of Mary Kay Cosmetics)*

### 11.1 Introduction

This chapter introduces the topic of firm growth, especially among younger, smaller and privately-owned firms. Although research is still emerging, the literature to date suggests that psychology plays an important role in determining growth. This chapter provides an introduction to this topic, including: why growth is important, various ways to define and measure growth, and some factors associated with small business growth. The last part of the chapter introduces the Dynamic System Planning Model as one approach to managing growth.

### 11.2 Why growth is important

Small firms play a key role in generating employment and promoting economic growth. Sustained growth of such businesses not only creates new jobs (Smallbone and Wyer, 2000) but also provides their owners with the possibility of wealth, self-fulfillment and independence (Dobbs and Hamilton, 2006). Furthermore, growth increases a firm's chance of survival. One study found that young growing firms are twice as likely to survive compared to those who are not growing (Phillips and Kirchoff, 1989).

In spite of the benefits of growth to the entrepreneur, his or her employees, and to the economy at large, a surprisingly small proportion of all firms in most countries grow beyond a size of one or two employees. Take for example the Netherlands. Figures from the Central Bureau of Statistics indicated that based on 2008 figures, of about 1.015 million businesses, about 640,000 (or about 63% of the total number of businesses) are self-employed individuals with no employees. Another 304,000 (about 30%) have between two and nine employees (including the owner or owners). Somewhat less than 6% have between 10 and 49 employees. Less than about 2% have 50



employees or more. These numbers are due actually to two primary phenomena. It is indeed quite challenging to grow most firms past a relatively small size. But secondly, most company founders lack the desire to grow their firms. We explore both aspects in this chapter: differences in motivation as well as management challenges (and means to overcome them), which help to explain differences in growth rate across firms.

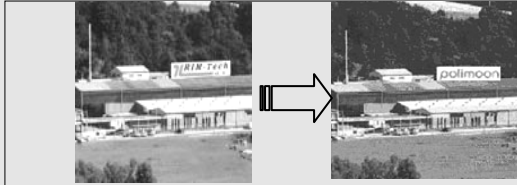
### **11.3 Growth orientation: not for all entrepreneurs**

Firm growth is one of the main goals of many entrepreneurs. However, large differences between entrepreneurs exist regarding their motives for starting and/or running a firm. In a study of US nascent entrepreneurs, less than 20% indicate that they want their “business to be as large as possible.” The rest indicate they want a size they can manage themselves or with a few key employees (Edelman et al, 2010). This is supported by research in other countries, including Sweden and Canada (Wiklund, Davidsson, and Delmar, 2003; Orser and Hogarth-Scott, 2002). Although the numbers fluctuate, it is clear that entrepreneurs have widely varying motives, growth being only one, for starting their own businesses (see also Chapter 6 on the subjective evaluation of entrepreneurial success). That a growth orientation is a predictor of subsequent growth fits in well with various psychological theories of motivation, especially expectancy theory and its variant, the theory of planned behaviour. These theories suggest that more generally behavioural intentions are positively associated with the occurrence of the intended behaviour - in this case, growth. Furthermore, Edelman and colleagues find that growth intentions are associated with certain outcomes of starting a business, including the motivation to innovate and financial success. Other motives, such as independence and recognition, are not associated with growth motivation (see Edelman et al, 2010).

In summary, most company founders start a business, not with the intent of growing a large firm, but as an alternative to unemployment or as a more attractive alternative to working for someone, referred to as the *substitution model* and *income model*, respectively (Morris, Kuratko, Schindehutte, 2001). Entrepreneurs following the *growth model*, who aim for big long term payoffs, may even accept a minimal income in their first years, reinvest all the profits, and look for additional financing in order to become number one in their market and true multi-millionaires. Finally, in a variant of the growth model, Morris and colleagues identify the *speculative model*, which refers to entrepreneurs who want to start a venture, demonstrate its success and viability, and sell it to the highest bid as soon as this can be obtained.

### From practice 11.1: The growth of RIM-Tech<sup>1</sup>

By 1996, RIM-Tech had 20 employees and was able to receive its first loan of 100.000 EUR and Continued to grow. But, in 1998, bus and truck producers started to go bankrupt, resulting in a 30% decline in sales revenues. This could have



*The same company, but the different owner: The successful sale of RIM-Tech to Polimoon in 2005.*

been a disaster for the young firm. However, fortunately, Mr. Vaja sensed the market downturn in time and began to focus the firm on other market segments requiring customized plastic moulding solutions. At this time RIM-tech made several internal changes as well: It sold 50% of RIM-Tech shares to an investment company named EPIC. Even more significant, Mr. Vaja decided to step down as CEO at this point to become RIM-tech's marketing director, responsible for company strategy, sales and technology. Mr Vaja made this change reflecting on his own strengths (intuition, market understanding, vision) and weaknesses (lack of management skills, choleric personality). Mr. Zatloukal replaced him as CEO. These changes led to a growth spurt, with an average annual growth of 25%. The company received an award as "subcontractor of the year 2003". The company now served clients such as Skoda, VW, and John Deer. By December 2005, when RIM-Tech was finally acquired by Norwegian, based manufacturer, Polimoon for €5.8 million, the firm had grown to 200 employees and 9 million Euros in annual sales, and primarily supplying the automotive industry.

Source: This case is based on an interview with Mr. Vaja conducted by Helena Rezacova as well as public information available from the internet

## 11.4 Defining and measuring business growth

In a recently published study, 56 articles were examined for their measurement of growth. The most popular measure used was that of growth in sales turnover (used in 23 studies), followed by growth in number of employees (used in 15 studies). Other indicators included growth intention, growth in profitability, and growth strategies (Achtenhagen, Naldi, and Melin, 2010).

<sup>1</sup> The start-up of RIM-Tech is described in From practice 1.2 and we recommend reading it first.

Although the majority of studies look simply at these sort of changes in sales or number of employees, more recent research has also begun to look at how firms grow and not just the numerical indicators alone (see McKelvie and Wiklund, 2010). These researchers identify “organic” or internal growth, basically growing the firm from its existing structure; acquisitive growth, or growth through acquisitions, and a “hybrid” or mixed model. Although organic growth is most common in small firms, in their study, Delmar et al (2003) found that 10% of firms grew primarily via acquisition.

It is understandable that the longer a firm operates on the market, the slower is usually its growth (Davidsson et al., 2002). On the other hand, research suggests that it is possible to build a successful venture in many geographical locations and different business areas. Many current giants as Google, YouTube or Skype exploited high growth opportunities in the field of ICT. However, in the list of the most quickly growing European firms<sup>2</sup>, the first three places were occupied by a British firm operating in facility management, a Dutch firm focusing on maternity care, and a firm from Iceland specialized in processed food products. These examples illustrate that it is possible to found a successful high growth business in many business areas.

## **11.5 Psychological factors explaining small business growth**

In addition to growth orientation or intention, described earlier in the chapter, research to date provides a variety of other factors that can help to explain small business growth. They fall into four main categories, including management strategies, characteristics of the entrepreneur, environmental/industry specific factors and characteristics of the firm (Dobbs and Hamilton, 2006). This section points out some of those aspects best supported by research findings to date.

### **Management strategies**

The strategic management perspective of small business growth concentrates on policies and strategies associated with growth. A growth objective for the firm, which is often associated with the entrepreneur’s own motives for growth, is an important predictor of actual growth. Some other factors which have been associated with growth include the following:

*Recruiting staff that can grow with the firm.* Successful entrepreneurs must pay close attention to employee recruitment and development. The ability of the firm to attract, develop and retain skilled and capable

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<sup>2</sup> Europe's hot growth companies. BusinessWeek, European edition, October 25, 2004.

employees is an important key to growth. Human resource management practices which involve hiring, training and rewarding people properly mean that the firm has the right people to grow to the next level. Entrepreneurs often make the mistake of hiring people only for current needs, lacking a long term human resource plan. Instead, they need to look for employees who have the desire and ability to grow with the firm (see Expert's view 11.1).

**Expert's view 11.1: Investing in people**

*Ondřej Bartoš, Founder and Partner, Credo Ventures*

Business angels and venture capitalists usually invest in business growth but defining what business growth requires and setting a template regarding what to do in order to grow the start-up business are extremely difficult. Some investment money is usually poured into marketing, the better use of existing expertise, setting up offices in other markets, and occasionally, acquisitions. But whenever I am asked what start-ups should spend the most money on, I say PEOPLE.

The best investments, however, in my view are made in bringing in the best people available, in order to create the best team possible, which can lead the company to great success. Sometimes venture capital is characterized as investing into people, which shows how important the selection of the right entrepreneur is. Investors don't look for people who "think they could make it" or for those who "are willing to give it a try". The entrepreneur who all of the investors dream of and spend all their time looking for is the one who is passionately determined to make it happen - those who are 100% committed to do everything and anything to succeed, and at the same time who are honest, transparent, who have integrity and who never cheat. Only those have a solid chance to hit it big and make it happen.

No wonder that those investors who invest their money in people push them to do the same. So if you are a start-up entrepreneur, go ahead and do everything possible to find and hire the right people, the best people, the people who will help you to build the temporary monopoly in your ventures.

No marketing, sales, or distribution investments can ever be more efficient and useful in terms of future growth and success of a company than investment in people. Get the best people and you will win.

*Staying focused on innovation.* There is considerable evidence that firms that develop new products or services in existing markets, enter new markets with existing products, or develop improved processes, grow faster than those which do not. Innovative ideas often come from outside the organization, especially from more casual acquaintances and contacts versus close associates such as long-term customers, employees, close family or friends (see also Chapter 8).

## **Expert's view 11.2: Using innovations for growth and brand**

*David Vrba, CEO of 3M Czech Republic*

*Product innovation vs. Management innovation.* Product innovation is what most companies do or intend to do. This is also what I had a chance to experience in my career. The “next level” is Management Innovation. It can be defined as a departure from traditional management principles and ways of doing things or a departure from a traditional organizational structure. It is a total turnaround, which accelerates growth and elevates a company to a different level. Not too many companies manage that successfully. I wish to live through such a change one day as I believe this must be a unique managerial experience. Perhaps a little naively, I even dream of driving such a change myself.

*What the future brings.* Innovation and entrepreneurship have long been at the top of the agendas of all growth-driven companies. It is clear this is not going to change for the upcoming decade either. Companies will be hunting for the best talents and the best ideas. Speed will be of the highest importance. More than ever, the maxim “grow or die” will hold true. More than ever leaders will have to be capable of creating compelling visions and strategies. And last but not least one can expect new and innovative approaches with respect to innovation as a way of doing things.

*Open innovation as an example.* The world is getting faster. All companies, 3M included, are striving to get new products out of the door faster and potentially at lower cost. “Open innovation” encourages R&D personnel as well as marketers to think more from the outside. This means accessing external knowledge, ideas, and technologies when needed to advance internal activities. It is obvious that searching externally for new ideas is a growing trend, which companies need to consider and accelerate.

*Innovation, brand awareness and reputation.* Companies that actively pursue innovation generate more growth than companies that do not. Those companies usually enjoy higher brand awareness and reputation. All recent surveys confirm that companies that are considered most innovative are also most respected. Firms like J&J, P&G, Google as well as 3M with its strong innovation track record are usually found high up on those lists.

*Think Big.* Innovation is often driven by leaders who “think big”. It means looking at the big picture of the business – looking beyond the existing scope (products, customers and competitors) is very important. Those that succeed have a natural competitive advantage. Last but not least, the beauty is that innovation can come from anywhere or anyone inside or outside an organization. Just have your eyes open.

*Starting a company with other people.* Other things being equal, companies started by a team of founders are more likely to succeed than companies started by individuals. This is due to the team's ability to pool and share experience and expertise (Dobbs and Hamilton, 2006). Preferably, the team should cover the following roles (rarely all found in one person): the *entrepreneur* (who sees the opportunities), the *technician* (who knows how to make or deliver the products or services), and the *manager* (management, administration, staff issues, cash flow) (Gerber, 1986). Especially in rapid growth firms, the manager role is often most challenging as responsibilities can increase and change quickly with growth.

In all but the simplest of firms, it is rare for people to excel in all three roles. Regarding the optimal size at start-up, research seems to parallel more basic research in group dynamics. Too small a group lacks diversity. However, too large a group may lead to greater conflict and difficulties in coordination. Keeping the three essential skill sets in mind, it is helpful to start with at enough people to cover the core roles described above. It is important that partners are sought which complement, rather than duplicate each other's skills and abilities in these three areas. Sometimes the product or service is simple enough or one individual is talented enough to cover two of the roles. But especially for companies with growth potential, it is unusual to find all three roles embodied in the same individual. According to the experience of Timmons and Spinelli (2009), it is very difficult to grow beyond a firm with 20 employees and a few million dollars in sales without a team of two or more key contributors. On the other hand, co-ownership brings its own issues and challenges as can be seen in From practice 11.2.

#### **From practice 11.2: The case of the broken window**

Tomas built his first business, a retail network of shoe outlets, together with a business partner in the late 1990's. However his firm eventually went bankrupt partly due to an underestimation of Asian competition and more importantly because his business partner took out a substantial amount of money from the company for personal use. In spite of this first failure, the entrepreneurial spirit remained with Tomas. His next firm focused on sales of windows, doors and related equipment. He worked with a margin at about 8 per cent and sales revenues below 20 million CZK (approximately 800,000 Euros in today's currency). Although this provided him with a decent living, he saw a bigger potential in window production. Manufacturing would provide higher margins. Furthermore, the market was growing and there was a new technology in Germany allowing production of windows without steel reinforcements, which provides better heat-insulation for about the same cost. Therefore he prepared a business plan and convinced CMZRB (a state owned bank with a mission to support new

businesses) to provide loan guarantees for his business idea. He had 3 million CZK (about €120,000) and needed an additional 20 million CZK to build a production facility. Nevertheless, commercial banks were reluctant to give him a loan, because they said the business is risky; he lacked a convincing enough track record in his industry, and had insufficient proof that this new type of product would be wanted by customers.

To solve his dilemma, Tomas made a deal with Karol, a Slovak entrepreneur with a strong track record in the window market in Slovakia. Karol's existing firm had sales revenues of over 120 million SKK (about €1 million in today's currency). Karol also agreed that after the start of production, he would take 20% of the production and sell it in Slovakia. They both agreed that Karol would invest 6 million CZK and Tomas an additional 3 million CZK in order for each to have equal shares in the new venture. The partners further agreed that Karol would work on business development and Tomas would take on the responsibility for the construction site of their factory, staffing and supplier relations. Simultaneously, in order to provide stable income for himself in the meantime, Tomas kept running his existing window sales company.

During the next year, the factory was built; however, misunderstandings and conflicts between the co-owners grew. Tomas was disappointed because Karol did not work on business development; his only contribution to the business was financial. On the other hand, Karol became increasingly concerned at how quickly his initial investment as well as added capital (8 million CZK in total) was absorbed in building the factory. There were problems obtaining a final building approval. Furthermore, Tomas was not able (or willing) to show Karol complete accounting documents. Because of this, Karol began to suspect that Tomas used money intended for the joint venture to finance his own window sales firm. As a result, Karol stopped investing in the venture and started to plot how he could reduce Tomas' influence in the company. But in a countermeasure, when Karol was abroad for a 2-month vacation, Tomas removed Karol from the position of executive director. After his return from his holiday, Karol filed a legal complaint accusing Tomas both of fraud and of carrying out his removal illegally. Tomas countered with a complaint that Karol had not kept to his side of the partnership agreement, especially the obligation to take and sell 20% of production through his other company. Karol countered that the windows were too expensive for his customers because Tomas overstated the price. In short, after two years of the partnership, neither owner was satisfied. Furthermore, the new venture was suffering. It was producing at well below capacity and well below break even, due to low sales, only producing 50 windows per day whereas the break even point was 70 windows per day and full plant

capacity was 360 windows per day (in 3-shift production). Furthermore, the firm had unpaid liabilities of 15 million CZK and had not yet approved accounts from the previous year.

Source: the interviews of the second author with both co-owners

Notice: the names of both co-owners are changed

### **Exercise 11.1: Discussing the Case of the broken window**

Reviewing some of the points from this chapter, what do you think went wrong in the partnership between Karol and Tomas? Could some of the eventual problems have been avoided? If so, how? What would you have done differently, if you had been in Tomas' position at the start? And if you had been Karol?

As can be seen in the case above, venture performance depends largely on entrepreneurial team's effectiveness. Team members with heterogeneous and complementary industry experiences (see also Chapter 10), educational backgrounds, managerial skills and abilities increase the effectiveness. On the other hand, co-owners should match in their vision and business philosophy. Their values, growth ambitions, attitude to debts and personal time devoted to the business as well as the expected exit strategy should not, in an ideal case, differ. However, in most start-up teams, some differences in co-owners' expectations exist. In such a case, all team members should be as explicit as possible in stating their expectations concerning future business functioning and their expected role in it. Rich communication, both in quality and quantity, helps to find a common ground and to avoid future unpleasant disappointment. Generally, the more information co-owners put on paper (and include in a signed agreement), the better.

### **Personal qualities of the entrepreneur**

In addition to the management strategy factors, a number of personal characteristics of the founder may influence a firm's ability to grow. In an article titled *Why Entrepreneurs Don't Scale*, John Hamm identifies four reasons why most entrepreneurs are not able to grow their firms beyond a handful of employees. He bases his ideas on personal experience working with over 100 entrepreneurs during a four year period (Hamm, 2002). Ironically, he argues that these are exactly the qualities which help in the start-up phase but later become liabilities (see From practice 11.3).

### **From practice 11.3: Why entrepreneurs do not scale**

1. *Loyalty to Comrades*. At start-up, the new firm is often trying to infiltrate the competition, and as such is like a combat unit trying to move behind enemy lines. Blind loyalty is an asset at this stage, but can become a



problem as the company grows, especially if some employees do not have the skills to grow with the company.

2. *Task Orientation.* The founder is often the “technician”, the one that understands the product the best, and has perhaps also been its developer. But excessive attention to detail can also distract the founder from paying attention to other, often more strategic issues as the company grows.

3. *Single-mindedness.* Founders often succeed because they focus on the quality and uniqueness of a new product or service. But this single-mindedness can also blindside the founder as the company grows. As the company grows, the founder may not listen to those who disagree, either with his or her product or other aspects of the firm’s organization.

4. *Working in isolation.* Finally, at start-up, the secretiveness and brilliance of the founder may lead to being first to market about an important discovery. But this same ‘loner’ style may become a liability when communication with other employees becomes key to growth.

Source: Hamm (2002)

It is important to realize that the management style at start-up often requires an entirely different management style as the company grows. Some entrepreneurs have the flexibility to shift their management style as the company expands, typically to a more professional management style. But as Mr. Vaja wisely discovered (see From practice 11.1), the transition is often far more difficult than the founder realizes.

### **Exercise 11.2: Case discussion - The growth of RIM-Tech**

- Review the both parts of RIM-Tech case and identify the key decisions of Mr. Vaja that helped the firm to be successful?
- Based on the case, which management strategies were followed that seem consistent with other research on small business growth?
- In which role(s) did Mr. Vaja excel? Was it a good decision for him to step aside and allow Mr. Zatloukal to take over as CEO? Would you be able to make the same decision?

One alternative is to keep the company small. Another is to keep the firm growing, is to bring in someone better suited to such a position. Successful execution requires a more disciplined approach to management than is usually seen in the early phase of a business. It requires a more hierarchical organizational structure, with clearly defined tasks and responsibilities, and brings the need for more formal and tighter control mechanisms. The entrepreneur also needs to delegate responsibilities and to develop human

resources in order to create a space for himself/herself and then to grow together with the company.

As can be inferred from RIM-Tech case (see From practice 11.1), successful organizations must have both effective entrepreneurship and effective management. Whereas entrepreneurship is about exploration, setting a direction, leading change and transition, redefining and breaking constraints, management is on the other hand about exploitation, continuity and efficiency and requires ability to work within constraints (e.g., Benner and Tushman, 2003).

### **Exercise 11.3: Discussing potential co-ownership**

Imagine that you want to start your own business. Also imagine that you wish to start your business with a friend, neighbour (or classmate) in the same sector, and that you both are looking for a co-owner. Write down whether you two would be good partners in the business. Consider not only the complementary skills and roles that you each would fulfil but also the similarity of your business philosophy (e.g., values, growth ambitions, attitude to debts, personal time devoted to business, exit strategy). Be as specific as possible.

## **11.6 The stages of growth vs. dynamic states: The Dynamic System Planning Model**

One of the persistent myths perpetuated in the entrepreneurship research literature (and in entrepreneurship texts), is the existence of stages or developmental phases. Such models assume that organizations grow as if they were organisms, have a specific number of progressive stages similar to the human being (birth, adolescence, maturity, decline) coupled with a predetermined order or program of development. Yet, in a review of over 100 such studies between 1962 and 2006, Levie and Lichtenstein (2010) conclude that there is no support for stage models, and that the idea should be dropped once and for all. What they do find is that growing firms must adapt over time both to changes in the external environment, and to the changes created by internal growth. Yet the firm can go through any number of states in any type of order (for instance growth followed by a plateau, decline, and resumed growth).

### **The Dynamic System Planning Model**

The Dynamic System Planning (DSP) Model (Hendrickson and Psarouthakis, 1998) is a dynamic states model based on open systems theory, and which identifies the types of issues which may have to be managed differently as a firm grows.

The DSP model is derived from two key principles of open systems theory. The first principle is that the organization is a dynamic social system. This means first of all that it is embedded in larger social systems, the implication being that as its environment changes, the firm must adapt to those changes to remain viable and effective. The second key principle of open systems theory is that an organization must combat *entropy* to survive. Entropy relates to the Second Law of Thermodynamics, that things tend toward disorder, rather than order. To combat entropy, the firm must obtain inputs (of people, materials, information and money) on a continual basis, transform those inputs into outputs (that is, products or services) and once again back into inputs (by selling such products for instance).

To carry out these two principles, a firm must address seven core issues including resource acquisition, resource allocation work flow, human relations, technical mastery, market strategy, and public relations. According to the DSP model, appropriate management of these seven issues at any point in time guarantees the *financial viability* of the firm— its profits, (growth of) assets, and long term survival (see Figure 11.1). The first six issues (which relate to different aspects of the input-transformation-output cycle), include resource acquisition (acquiring people, materials, information and money to

**Figure: 11.1 The Dynamic System Planning Model**



Source: Hendrickson and Psarouthakis (1998)

operate the firm), market strategy (identifying which products or services it can provide in exchange for new inputs), work flow (dividing and coordinating work amongst the members of the organization), employee relations (motivating employees to make sure that their individual efforts of employees contribute to the overall goals of the firm), resource allocation (distributing resources most efficiently around the firm to accomplish its goals), and technical mastery (producing products and services to a technical standard, both with respect to the quality and quantity, that will satisfy customer demands). The seventh issue, public relations (proper relations with the broader environment) relates to the second principle, regarding the firm as part of a larger social system (beyond immediate external stakeholders such as customers, suppliers and investors), and can include such groups as the government or the community-at-large.

According to the DSP model, furthermore, to be most effective, the firm's management (sometimes just one director in a small firm or a management or executive team in a larger firm) must have an overall vision or direction for the firm's future. Furthermore, the way in which the management chooses to manage each of the seven issues should contribute toward, and be consistent with, this vision. Depending on both internal and external changes, the way in which these issues are managed must be compatible with the situation. The solutions need not be expensive, and they need not change every day. But ignoring any one area may eventually create a breakdown in the input-transformation-output cycle, or even the firm's survival within its sphere of other social systems.

In one example given by Hendrickson and Psarouthakis (1998) they describe the entry of McDonald's in Moscow in 1990. The negotiations alone took 12 years before an agreement was reached, with two additional years to build the first processing plant. Yet to recruit personnel, it was only necessary to place a one-line advertisement in the primary Moscow newspaper, for which 27,000 applications were received. However, to resolve other issues, such as adequate supply of potatoes and meat, McDonald's headquarters sent experts from around the world to work with local farmers to boost their production and quality levels.

### **The seven issues of the Dynamic System Planning (DSP) Model**

The seven issues included in the Dynamic System Planning (DSP) Model are all derived from two basic principles of open systems theory, to assure that a firm can combat entropy (or the tendency toward chaos) and to assure a smooth integration into the larger social system(s) to which a firm belongs. Below is a more detailed description of each issue, and common ways used by firms to resolve them, both at start-up and as the firm matures (Hendrickson and Psarouthakis, 1998).

*Resource acquisition.* The management must develop effective strategies to obtain financial resources, people, materials and external information. Strategies for recruitment, investor relations, purchasing, and research and development are all part of this issue. Start-ups often turn to family, friends and other previous acquaintances to hire personnel, obtain starting capital and even to obtain information about customer needs. But as the firm grows, it generally turns to more formal and sophisticated means to obtain such resources. Having sufficient resources to operate the firm is the key indicator for effective resource acquisition.

*Resource allocation.* Once inputs enter the firm, a first step in the transformation process is to assign or allocate those resources appropriately throughout the organization. Whereas start-ups often use intuition or the 'squeaky wheel' approach (whoever complains loudest gets the resource), larger firms usually shift to more formal budgeting and corporate planning techniques. Adequate cash flow, and having the right material at the right place in the organization, are two indicators of effective resource allocation.

*Work flow* is the third issue faced by management, including the assignment, division and coordination of the work to be done. Work division is often done in an ad hoc manner at start-up, with everyone jumping in to take care of the tasks to be done. As a firm grows, roles become more formal and specialized. One can think of the work in a company (especially with several employees) as a giant jigsaw puzzle with each individual standing on a piece. Overall effectiveness requires the smooth and timely fit of these pieces into the whole picture. If work slips through cracks, work is delayed, or too many people are saying, "That's not my job," work flow is probably not being handled properly.

*Human relations* is another aspect of the transformation process, also referred to as social-psychological integration (Georgopoulos, 1986). At any stage of development, a firm must assure that employees meet their own needs and wants while fulfilling company goals at the same time. When the firm is small (the founder and one or two employees), this task is often easily accomplished. But as a firm grows, the connection and excitement with the founding often dissipates and more formal approaches are needed to assure loyal, satisfied, motivated employees, including proper incentive systems, open communications, and a strong corporate culture. Low absenteeism, turnover (especially of higher-performing employees), and high employee satisfaction are three indicators that the firm is effectively managing the human relations issue.

*Low Technical mastery.* At the interface between the transformation process and the output part of the Input-Transformation-Output (I-T-O) cycle, technical mastery requires that the firm produces its output with adequate quality, speed, quantity and with the appropriate technical features. Many if not

most start-ups rely on the expertise of the founders. But as the firm grows, hiring and training people with the right technical skills, investing in appropriate tools and materials, and in-house product testing and development are some of the strategies that can be used to enhance technical mastery.

*Market strategy* is the sixth issue related to the I-T-O cycle. Market strategy involves decisions about which products or services to offer, with what benefits, customers and markets to target, and at what prices. As products and services exit the company, the management must assure that there is adequate customer interest for its products or services. Quite simply, enough customers must be willing to pay a sufficient price not only to cover costs, but also to generate added revenues to assure cash flow and funds to invest in further growth. Effective market strategy is reflected in total sales, rate of sales growth and steadiness of sales growth. Unlike some of the other issues which become more complex over time, market strategy is one of the greatest challenges facing the start-up entrepreneur.

*Public Relations.* The seventh and final DSP issue requires that the firm relate effectively with any systems in its external environment, apart from those stakeholders such as customers, suppliers, and investors, who are directly involved with the I-T-O cycle. These might include various local or national government entities, the communities in physical proximity to each company location, and in many companies, the family from which ownership may draw. Litigation, fines, tax delinquency and bad publicity are all signs of inadequate management of this area. Positive public image, general goodwill, and community acceptance of a company's existence are positive signs.

The DSP model can be used as an analytical tool to review the strengths and weaknesses of the existing firm, to pinpoint its core competitive advantages (such as a super strength in one of these areas) and to identify opportunities for future company growth (either strengthening existing competencies, or correcting certain weaknesses). Although these seven issues are only a starting point, because they are derived from the open systems framework, they provide a comprehensive basis for analysis.

## **11.7 To conclude**

In this chapter we focused on the topic of venture growth. First, we discussed motivation of the entrepreneur to grow his/her business, because ambitious goals and brave visions of the entrepreneur can drive the organization forward. We illustrated different aspects of growth and also strategies and founder behaviours which stimulate or hinder a firm's growth. Finally this chapter presents the Dynamic System Planning (DSP) model as an analytical tool to assess strengths and weaknesses of a firm as well as opportunities for future growth.

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## Chapter 12

# CORPORATE ENTREPRENEURSHIP

Juan A. Moriano and Martin Lukes

### 12.1 Introduction

The global economy is creating profound and rapid changes for organizations and industries all over the world. The answer to today's fast-changing and competitive environments is adaptability, flexibility, risk taking, proactiveness, competitive aggressiveness and innovativeness - in one word: *entrepreneurship* (Lumpkin & Dess, 1996; Morris & Kuratko, 2002).

This chapter focuses on innovation and entrepreneurship inside existing organizations. We start by describing the different forms that corporate entrepreneurship can take, and then discuss the differences and similarities between corporate and independent entrepreneurship. We further analyze the barriers and dilemmas connected to innovative and entrepreneurial activities, and explain the dimensions of entrepreneurial orientation as well as the stages of the innovation process. We then focus on the role of individuals in entrepreneurial efforts, and offer recommendations for the effective support of corporate entrepreneurship.

#### **Definition 12.1: Corporate Entrepreneurship**

Term used to describe entrepreneurial behaviour inside established medium sized and large organizations. Researchers have conceptualized corporate entrepreneurship as embodying entrepreneurial efforts that require organizational resources for the purpose of carrying out innovative activities in the form of product, process, and organizational innovations.

Source: Morris & Kuratko (2002); Sathe (2003)

Entrepreneurship inside organization can have various forms. We can distinguish between strategic renewal, external and internal corporate venturing (Sharma & Chrisman, 1999).

1. *Strategic renewal* relates to entrepreneurial efforts inside organizations, whose results are substantial changes in a business model, strategy or structure of the organization.
2. *External corporate* venturing describes entrepreneurial efforts leading to the creation of a new business unit. It is often connected to the exploitation of new markets, offer of new products or both. The output

is the existence of partially, or fully, autonomous units operating outside the existing organization, e.g. joint ventures or spin-offs.

3. *Internal corporate* venturing is focused on the creation of organizational entities operating inside the existing organization, e.g. new departments, divisions or cross-functional teams.

## 12.2 Corporate and independent entrepreneurs

The famous definition of entrepreneurship by Stevenson and Jarillo (1990, see Definition 1.1) emphasizes the similarity between corporate and independent entrepreneurship. As Morris and Kuratko (2002) argue, the basics are the same. Both independent and corporate entrepreneurship involve opportunity recognition, and require a unique business concept that takes the form of a product, service, or process.

<b>Table 12.1: Differences between independent and corporate entrepreneurship</b>	
<i>Independent entrepreneurship</i>	<i>Corporate entrepreneurship</i>
Entrepreneur takes the risks	Company assumes the risks, other than career-related risk
Entrepreneur owns the concept and all or much of the business	Company owns the concept, entrepreneur has no equity or a small percentage in the company
Potential rewards for the entrepreneur are theoretically unlimited	Rewards for entrepreneur have clear limits
Wrong step can mean failure	More room for errors, company can absorb failure
Vulnerability to external influences	More insulated from outside influence
Entrepreneur is independent	Interdependence of corporate entrepreneur with many others
Flexibility in direction change and experimenting, quick decision making	Rules, procedures and bureaucracy, longer approval cycles
Few people with whom to talk, concerns about information sharing	Extensive network for bouncing around ideas
Limited scale and scope, at least initially, resource limitation	Access to different resources, potential for quick business growth
Source: adapted from Morris & Kuratko (2002), p. 63.	

Similarly, both find the entrepreneur encountering resistance and obstacles, necessitating perseverance, the ability to formulate innovative solutions and develop creative strategies for leveraging resources. Both involve significant risk and ambiguity, and require risk-management strategies and the ability of the entrepreneur to balance vision with managerial skill, passion with pragmatism, and proactiveness with patience. On the other hand, there are some differences between independent and corporate entrepreneurship as well. These are summarized in Table 12.1.

The comparison of the pros and cons of independent and corporate entrepreneurship in Table 12.1 can be helpful in choosing the right career for entrepreneurial people who want to create and implement new ideas, however they may lack the courage to do it independently.

#### **Exercise 12.1: Independent or corporate entrepreneurship**

Go patiently through each row of Table 12.1 and take note of how important the specific advantage, or disadvantage, is for you. Are you able to accept risks, face a potential business failure, and start with limited resources to become an independent entrepreneur? Or, on the contrary, are you able to cope with the rules and bureaucracy, and to accept that your employer will own your idea and have the majority of potential benefits?

### **12.3 Barriers to corporate entrepreneurship**

Organizations create standardized rules and procedures that enable them to increase efficiency in the key areas of their business. They engage in long-term planning, manage effective utilization of resources, avoid risky activities and judge future steps on the basis of past experience. The power relations and alliances also develop inside organizations, and employees with conforming behaviour are often promoted. Time also often brings lethargy, which lowers the tendency to leave the comfort zone and try new things. All these issues result in the creation of strategic, systemic, behavioural and political barriers (Lumpkin, 2007; Morris & Kuratko, 2002).

*Strategic barriers* are caused by the absence of innovation goals. Company vision may be lacking, or blurred, or strategy may prefer non-innovation areas. Even in a situation in which the importance of entrepreneurial orientation is declared, the effort may be in vain because effective top management support does not exist. Such support requires managers who are visionary, and who perceive their firm and its employees, as “how they can become “not” how they are.

*Systemic barriers* are the consequence of formal managerial systems of established firms developed over the years with the goal of bringing efficiency and stability to a complex business environment. For instance,

planning, important for entrepreneurial success (see Chapter 7), can become a barrier by putting too much emphasis on supporting analyses, or on the preference of format to content. Specific examples of systemic barriers are bureaucratic routine reporting, or the necessity of signing one document by five different people, who are often abroad, and so it takes ages to proceed. Other examples may be connected to the wrong type of remuneration systems that reward compliance rather than new ideas, or inflexible budgeting that can make a great idea useless and old a year later. Hierarchical levels slow down the information flow, especially in the bottom up direction. Information is then missing for quick and efficient decision making, with the result that good entrepreneurial ideas get stuck somewhere in the process.

*Behavioural barriers* may be connected to functional blindness. Managers and specialists often perceive organizational reality through the prism of their function. Human resources managers emphasize how important it is to invest in employees, financial managers focus on reducing costs, whereas marketing managers want great marketing campaigns to attract customers. Such biases, or limitations, in understanding of the complex situation often arise with the appearance of situations or demands that are new, unsecure and require a quick decision. And taking into account that such decisions may have consequences for one's personal career success, it is not surprising that employees are not willing to accept responsibility for potential failure, are resistant to change and prefer current issues, to the future ones. They can also have low self-efficacy, and perceive that they do not have enough time or the necessary skills.

*Political barriers* are caused by power relations and the issues of control and authority within the organization. For instance, a manager who has invested a lot of work and effort in his current project will, naturally, be reluctant to support a new project started by someone else. The fear that his project might be put aside can lead to his withholding information and keeping resources inside his own project. The potential success of a new project always leads to a change in the power structure of the organization, which presents a possible threat to the higher-rank managers. Similarly, existing departments may feel threatened by new departments, or cross-functional teams, created to pursue entrepreneurial opportunity. Another difficult question is; 'who will lead the new entrepreneurial project'? A member of the top-management may want to become a project head in order to get acknowledgement for the success of a new project that starts promisingly.

However, even when innovation barriers are low, it is not easy to manage new innovative activities. The difficulty lies in the fact that results

are uncertain and require a lot of time and financial resources. The innovation process is long, and non-linear (van de Ven et al., 1999), requiring multiple decisions by different people and its success cannot be guaranteed.

### **From practice 12.1: Innovation dilemmas**

Sharma (1999) identified several innovation dilemmas organizations face when managing innovations.

*Seeds versus weeds.* Firms must find mechanisms how to select the right innovation projects before they invest a substantial amount of money in unsuccessful innovations.

*Experience versus initiative.* Organizations must decide whether projects will be led by experienced, but more risk-averse managers, or by younger employees with less experience, but greater enthusiasm and drive.

*Internal versus external staffing.* Organizations can hire either people from internal human resources who have more contacts inside the organization, and know how it functions; or new people from external human resources who are able to think outside the organizational box and so, can bring new knowledge. Such external hiring can, however, worsen relationships inside organization.

*Building capabilities versus collaborating.* Organizations may try to develop new skills internally (which costs time and money), or acquire them through business partnerships. However, there is a risk of dependency on an external partner, and the development of internal capacity is limited.

*Incremental vs. pre-emptive launch.* Incremental launch is less risky, because it requires fewer resources and can serve as a market test. On the other hand, the competition learns more quickly about company innovations, and thus it is less probable that a temporary monopoly will be achieved.

Source: adapted from Sharma (1999)

The dilemmas presented in From practice 12.1, and the barriers described above suggest that innovation management may be difficult even in successful firms. In the next parts we will focus on suggestions as to how barriers may be overcome and entrepreneurial activities in the organization supported.

## 12.4 Organizational entrepreneurial intensity

### Key representative 12.1: Michael H. Morris

N. Malone Mitchell Chair in Entrepreneurship, professor and head of the Department of Entrepreneurship and Emerging Enterprises at Oklahoma State University. He is the author of six books, and over one hundred academic articles in leading journals. Recognized as one of the top entrepreneurship professors in America by *Fortune Small Business*.



Corporate entrepreneurship has attitudinal and behavioural components. Attitudinally, it refers to the willingness of an individual, or organization, to embrace new opportunities and promote innovation (Robinson, Stimpson, Huefner, & Hunt, 1991). This willingness is sometimes considered to be an “entrepreneurial orientation” (Lumpkin & Dess, 1996; Rauch, Wiklund, Lumpkin, & Frese, 2004). Behaviourally, it includes the set of activities required to evaluate an opportunity, assess and acquire the necessary resources, and then create an innovative venture (Stevenson & Jarillo, 1990). Underpinning entrepreneurial attitudes and behaviours are the three key dimensions: innovativeness, risk-taking and proactiveness (Morris & Sexton, 1996).

### Definition 12.2: Innovativeness, risk taking and proactiveness

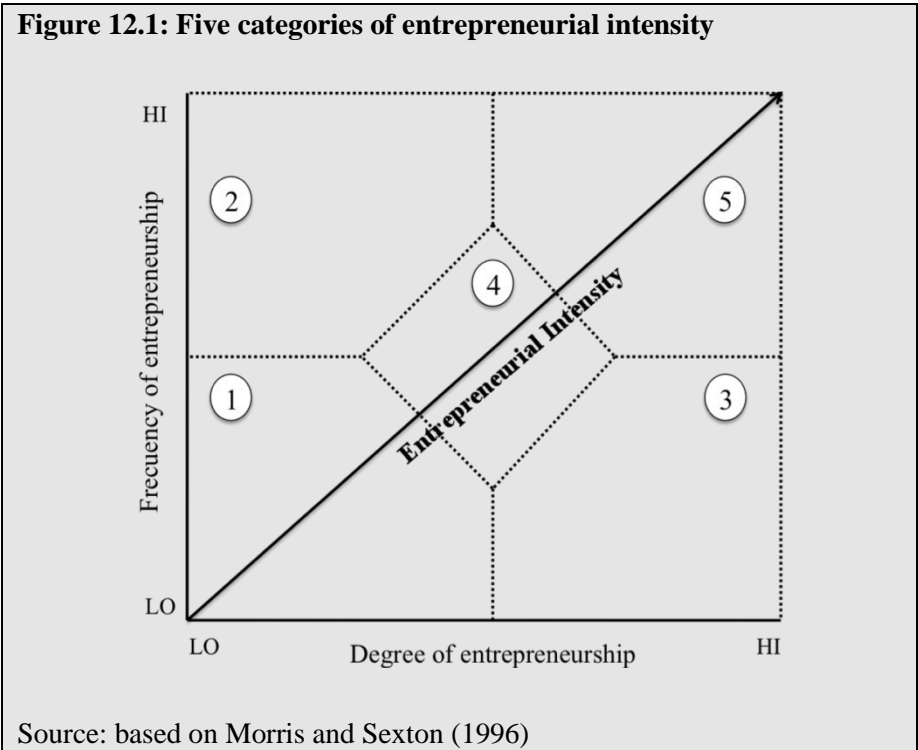
*Innovativeness* refers to attempts to embrace creativity, experimentation, novelty, technological leadership, and so forth, in both products and processes (Lumpkin & Dess, 1996).

*Risk taking* consists of activities such as borrowing heavily, committing a high percentage of resources to projects with uncertain outcomes, and entering unknown markets (Lumpkin & Dess, 1996; Morris & Sexton, 1996). These risks are typically moderate and calculated (McClelland, 1965).

*Proactiveness* relates to forward-looking, first mover advantage-seeking efforts to shape the business environment by introducing new products or processes ahead of the competition (Lumpkin & Dess, 1996). It usually involves considerable perseverance, adaptability, and willingness to assume responsibility for failure (Morris & Sexton, 1996).

Corporate entrepreneurship is not an ‘either/or’ determination, but a question of ‘how often’ and ‘how much’ (Morris & Sexton, 1996). All companies fall into a conceptual continuum that ranges from highly conservative to highly

entrepreneurial. Entrepreneurial companies are risk-taking, innovative, and proactive. In contrast, conservative companies are risk-averse, are less innovative, and adopt a more ‘wait and see’ attitude. The position of a company on this continuum is referred to as its entrepreneurial intensity (Morris & Sexton, 1996).



As illustrated in the Figure 12.1, the concept of entrepreneurial intensity is introduced to capture the combined effects of both the frequency and degree of entrepreneurial behaviours within established organizations. Using these factors, a two-dimensional matrix can be created with five possible scenarios: 1) Periodic/Incremental, 2) Continuous/Incremental, 3) Periodic/Discontinuous, 4) Dynamic, and 5) Revolutionary (Morris & Sexton, 1996). For example, an organization that is responsible for numerous corporate entrepreneurial events that are highly innovative, risky or proactive will fit into the revolutionary segment and will exhibit the highest levels of entrepreneurial intensity. Firms like Apple or Google would be good examples of this revolutionary segment (5).

### Measure 12.1: Entrepreneurial Intensity

The Entrepreneurial Intensity Scale captures the extent to which the firm's strategy is innovative, proactive and risk seeking. High scores on this scale indicate that the firm values innovation and proactiveness and has a high tolerance for risk.

*In the past five years:*

... my firm has marketed no new products/services.	1 2 3 4 5	... my firm has marketed many new products/ services.
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*In dealing with its competitors, my firm:*

... seeks to avoid competitive clashes and prefers "live-and-let-live" posture.	1 2 3 4 5	... has a very competitive "beat- the-competitors" posture.
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*Top managers of my firm have:*

... a strong tendency for low risk projects (with normal rates of return).	1 2 3 4 5	... a strong tendency for high-risk investments (with chances for very high rates of return).
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Source: Weeravardena (2003)

## 12.5 Innovation process in organizations

Concerning the innovation process, stage models were often used to outline the pathway from idea generation to final innovation results. Van de Ven et al. (1999), on the other hand stressed the disorganized and dynamic quality of innovations. They claimed that there are numerous decisive tasks performed by many people over time. Detailed plans on idea implementation need to concur with the flexibility to change the implementation activities if unexpected events arise (Bledow et al., 2009). The innovation process can stop at any stage, return to a previous stage; it can be modified, new players can enter and initiators can leave. Thus, our aim is to describe the organizational innovation process, and its critical components, as such. Depending on what the focus of the innovation is, the innovation process may be differentially complex; we posit that, nevertheless, the main components can be found in each process, and a description of these components can help organizations to pinpoint the strengths and weaknesses of their employees' innovation capabilities. In the following piece, we derive the main components of the innovation process (Lukes, Stephan and Cernikova, 2009).

The first stage is *initiation - idea generation*. Traditionally, researchers connected this phase to the creativity of an individual, and the



different factors influencing it (e.g. Hunter, Bedell & Mumford, 2007). The trigger of an innovative activity can lie in the individual himself/herself, e.g. in intrinsic motivation, personal initiative (Frese & Fay, 2001), or in the organizational environment that can be influenced by management (e.g. Bledow et al., 2009). However, innovation needs more than creativity. Creativity can refer to the idea generation only, whereas innovation includes both idea generation and implementation (e.g. Hunter, Bedell & Mumford, 2007). The individual can come up with an idea due to his/her own creative invention, and/or due to the search for a good idea in his/her environment.

*Idea search* has received more attention at firm level (e.g. Katila & Ahuja, 2002) in relation to the adoption of new processes and practices, as well as product innovations. However, people are the ones who engage in the search for good ideas, so more emphasis should be put on such employee behaviour. Innovative activities require a search for various sources of knowledge.

### **My research 12.1: Innovative behaviour and innovation support**

In the CID project, we have developed a theoretical model of innovation at work that consists of innovative behaviour, innovation outputs, and contextual determinants of innovative behaviour. We further developed, and validated, the Innovative Behaviour Inventory and Innovation Support Inventory. Both inventories are reliable, and show satisfactory factorial, criterion, convergent and discriminant validity, and are cross-culturally equivalent.

Innovative behaviour at work is conceptualized and empirically confirmed as a second-order factor that is composed of idea generation, idea search, idea communication, the start-up of implementation activities, involving others and overcoming obstacles. Managerial support is the most proximal influence on the innovative behaviour, and mediates the effect of organizational support. Both organizational and managerial support in turn mediate the influence of the national culture. Our research added the value to the understanding of the multi-faceted innovation process and factors influencing it, as well as having provided efficient measures enabling the identification of company strengths and weaknesses related to employees' innovative behaviour.

Source: Lukes, Stephan and Cernikova (2009), Culture and Innovation dynamics project (Lukes et al., 2009)

When an employee already has a new idea, he/she must decide whether it is worth taking the initiative towards implementation (Frese & Fay, 2001). In particular, employees in organizations will not be able to implement ideas on

their own, and often have to receive permission to do so from their managers. Thus, the next step in the innovation process is to *communicate the idea* to colleagues and the manager (Binnewies, Ohly, & Sonnentag 2007). At that moment the *second stage starts*. The idea is for the first time externally evaluated, and either rejected or accepted by a responsible manager or specialist. More information might be required for a managerial decision. Companies also differ in how much individuals must adhere to company rules in the innovation process (Lukes et al., 2009). For some ideas, especially ideas requiring a considerable amount of resources, a *feasibility analysis* may be required. When the managerial decision is positive, further resources (time, money, people, etc.) are allocated for the implementation, which constitutes the third phase.

### **Measure 12.2: Innovative Behaviour Inventory**

One of the measures developed and validated in the CID project was the Innovative Behaviour Inventory. It consists of seven subscales and 24 items. These are answered on a Likert-type scale from 1 (fully agree) to 5 (fully disagree). The item examples and Cronbach's alphas are presented below for all the subscales.

*Idea creation* ( $\alpha = .69$ ), 3 items, e.g. When something does not function well at work, I try to find new solution.

*Idea search* ( $\alpha = .73$ ), 3 items, e.g. I try to get new ideas from colleagues or business partners.

*Communicating ideas* ( $\alpha = .83$ ), 4 items, e.g. I try to show my colleagues the positive aspects of new ideas.

*Start-up of implementation activities* ( $\alpha = .78$ ), 3 items, e.g. I develop suitable plans and schedules for the implementation of new ideas.

*Involving others* ( $\alpha = .75$ ), 3 items, e.g. When I have a new idea, I look for people who are able to push it through.

*Overcoming obstacles* ( $\alpha = .85$ ), 4 items, e.g. I usually do not finish until I accomplish the goal.

*Innovation outputs* ( $\alpha = .81$ ), 4 items, e.g. I was often successful at work in implementing my ideas and putting them in practice.

Source: Lukes, Stephan and Cernikova (2009), Culture and Innovation dynamics project (Lukes et al., 2009)

The *implementation stage* starts with the *selection of an innovation champion* – a key individual who either takes the lead due to his/her own initiative (Howell, Shea & Higgins, 2005), or is selected by management for

leading the implementation phase (e.g., Lukes et al., 2009). This can be the initiator who came up with the idea, but also anybody else who is perceived by management as more appropriate to do the job. Coming up with the idea and implementing it may be two very different activities (e.g., Bledow et al., 2009).

The innovation champion prepares *plans for implementation*. Problems must be anticipated and dealt with proactively, often by using new procedures in a self-starting sense. The champion further *acquires resources* (e.g., Scott & Bruce, 1994), *launches the project* and *involves other key people* in the implementation. He, or she, communicates a vision of what the innovation could be, or do, and displays enthusiasm and confidence about it (Howell, Shea & Higgins, 2005). Essential activities at this phase are *monitoring the project development*, making any necessary changes, and *overcoming obstacles* together with the implementation team. The champion must be persistent in order to overcome barriers and resistance (Frese & Fay, 2001; Howell, Shea & Higgins, 2005) until the final version of a product, service, process or business model is ready, and innovation outputs are achieved.

However, great innovation does not mean automatically great entrepreneurship. The timing must be right, customers must be aware of the innovation, and enough of them must be willing to pay more for it than it costs. For more information on exploiting entrepreneurial opportunities see Chapters 1 and 8.

## **12.6 Organizational factors that foster entrepreneurial activities**

Researchers have identified some of the organizational factors that can affect a company's pursuit of corporate entrepreneurship, such as the company's incentive and control systems (Sathe, 2003), organizational culture (Hisrich & Peters, 1989), organizational structure (Covin & Slevin, 1991), and managerial support (Kuratko, Hornsby, & Bishop, 2005).

### **From practice 12.2: Innovation support in Bosch**

Bosch is a global firm renowned for its focus on innovations. In 2007, Bosch allocated 7.7% of its budget (i.e. 3.6 billion EUR) for R&D activities which resulted in 3,300 patents in 2007, and 77,000 active intellectual property rights worldwide. Its specific ownership structure (family owned foundation) enables even long-term innovation, because the management is not pushed to short-term profitability by investors. Corporate principles start with "Bosch regards innovation as something

more than exceptional product quality, functionality and design" ([www.bosch.com](http://www.bosch.com)). There is a concern-wide slogan *BEQUIK - BEtriebsergebnisse, QUalitaet, Innovation, Kundenorientierung* (company results, quality, innovation, and customer focus). Innovations are the way to differentiate the company from the competition; e.g. in the power tools division, the new products represent 40% of sales revenues.

*Pro-innovative organizational culture.* One of the firm's values is innovative behaviour, and it is formally embedded in the firm's documents: "Innovation strengths: The cornerstone and engine of our development is our will to create new, creative, and technological solutions that provide high added benefit for the customer." In Bosch's management principles, innovative behaviour and stimulation of employees towards creativity is emphasized.

*Innovation types.* Bosch develops different types of innovation – product (e.g., use of lithium batteries for power tools), process (e.g., innovative way of communication with a warehouse) and service ones (e.g., to complete after-warranty service for power tools in a maximum of five days).

*Innovation process.* The Continuous Improvement Process (CIP) is implemented across the firm, and if there is a topic found suitable for innovation, a so called CIP workshop is organized where employees brainstorm ideas. Team discussion is facilitated by an experienced CIP facilitator. Discussion outputs are recorded, structured and then the direction for further work is selected based on a vote. Work groups are established to complete the task. Deadlines, responsible persons and control mechanisms are set up.

The impulses for innovation also lie in „customer satisfaction index“; a study periodically conducted with customers that brings specific suggestions as to what to innovate. The innovative idea is analyzed with regard to its contribution, then its feasibility is tested and the ways are sought how to overcome barriers, and to realise the idea. There is also a simple system for suggesting ideas. Moreover, employees are financially motivated – if their idea brings positive economic outcome, they receive a share of this outcome.

Source: interviews with Bosch managers conducted as a part of the EU FP6 project Culture and Innovation Dynamics (Lukes et al., 2009); [www.bosch.com](http://www.bosch.com)

An organizational environment supportive of innovation tends to have strong antecedents of entrepreneurial activities, while an environment that dismisses innovation and its importance shows weak antecedents of entrepreneurial activities (Hornsby, Kuratko, & Zahra, 2002).

### **My research 12.2: Recommendations for fostering entrepreneurial activities**

In the second phase of the CID project, we conducted in-depth interviews with 50 managers (half of them Chief Executive Officers) from 34 Czech branches of successful international companies. The interviews focused on the topic of organizational culture supporting employee innovative behaviour. Based on the interviews, we were able to formulate numerous recommendations for companies willing to foster their entrepreneurial activities. We select the following:

1. To **emphasize innovation** in the firm mission, values and management presentations.
2. To set **clear, simple** and comprehensible **processes** so that all employees know how to proceed with a new idea.
3. **Internal communication** should cover all employees, but also emphasize the role of managers, employees in direct contact with customers, and specialists developing new products and services.
4. Line employees perceive organizational support through support from their direct superior, **managers should be trained and motivated** to support innovative ideas.

Source: Lukes et al. (2009)

### **Management support**

Management support refers to the willingness of managers to facilitate and promote entrepreneurial activity in the firm (Kuratko, et al., 2005). This support may take many forms, including the championing of innovative ideas, providing the necessary resources, or expertise, or institutionalizing the entrepreneurial activity within the firm's system and processes.

### **Exercise 12.2: Personal experience with managerial support**

Remember your direct manager, either from the current job or from the last one. What did he/she do in order to motivate you to come with new innovative ideas? Was it effective? What happened after you introduced your idea? Formulate, what were the strengths of your manager's approach and what could have been done better.

Furthermore, middle managers play a vital role in developing and maintaining entrepreneurial behaviour within an organization. Middle managers can not only develop entrepreneurial behaviours resulting in entrepreneurial activities, but they can also influence their subordinates' commitment to these activities once they are initiated. In a similar way,

Kuratko, et al. (2005) found that as the entrepreneurial behaviour of managers increased, subordinates' satisfaction with supervision increased.

### **Work discretion**

Work discretion refers to the degree of autonomy given in working methods, judgment, and decision making for entrepreneurial activities (Hornsby, Kuratko, & Montagno, 1999). In this sense, Kuratko, et al. (2005), found that work discretion leads to higher perceived job satisfaction, and that this heightened satisfaction results in increased entrepreneurial activity. Therefore, top and middle managers must tolerate failure, and provide decision-making latitude and freedom from excessive oversight in order to promote employees' entrepreneurial behaviour.

### **Rewards and time availability**

An effective reward system that promotes entrepreneurial activity must consider goals, feedback, emphasis on individual responsibility, and results-based incentives (Hisrich & Peters, 1989; Sathe, 2003). The use of appropriate rewards can also enhance employees' willingness to assume the risks associated with entrepreneurial activity. In addition, the availability of resources for innovative activities encourages employees' experimentation and risk-taking behaviours (Hornsby, et al., 1999).

Organizational time norms also influence employees' attitudes towards undertaking entrepreneurial activities and practices related to corporate entrepreneurship in the organization (Lerner, Zahra, & Kohavi, 2007). When employees view a company's time norms as supporting corporate entrepreneurship, they will feel motivated to develop and propose innovative ideas. Examples of companies using relatively loose time norms are 3M or Google (see From practice 12.3).

#### **From practice 12.3: Innovation time off in Google**

Google is known for its informal corporate culture that embodies such casual principles as "you can make money without doing evil," "you can be serious without a suit," and "work should be challenging and the challenge should be fun". As a motivation technique, Google let its engineers spend one day per week (20% of their work time) on their own projects. This practice has delivered some of Google's newer services, such as Gmail, Google News, Orkut, and AdSense. In fact, Google declares that 50% of the new product launches originated from the 20% innovation time off.

Source: [www.google.com/corporate](http://www.google.com/corporate)

## **Organizational identification**

The Social Identity Theory developed originally as a theory about intergroup relations (Tajfel, 1982), but in recent years there has been increasing interest in its application to organizational processes (e.g., Haslam, 2001). Identification with the organization can lead individuals to adopt the interests and goals of the collective as their own, so that people would be mainly interested in the organizational goals instead of their own.

### **Definition 12.2: Organizational identification**

The sense of oneness individuals have with an organization, and the degree to which individuals define themselves as organization members.

Source: Ashforth and Mael (1989)

Moriano, Topa, Valero, and Levy-Mangin (2009) found that organizational identification mediates the influence of organizational factors (management support, work discretion, rewards and time availability) on employees' intrapreneurial behaviour. Therefore, if employees identify themselves with the organization where they work, it is more likely that they will take risks to pursue innovative actions that will be to the advantage of the whole organization.

### **Expert's view 12.1: Innovation and entrepreneurship in 3M**

*David Vrba, CEO of 3M Czech Republic*

Does innovation really matter in the everyday battle of the marketplace? This is a question I have asked myself many times since I joined 3M, a company in which innovation and entrepreneurship are mantras. I have now seen for myself, that through innovation, 3M creates a long-lasting advantage, and produces an important shift in the competitive landscape. Some companies make it to the top performers group, some remain mediocre. The question is why.

*The basics.* There are many definitions of innovation. I personally like the one I learned during one company training for new Managing Directors from one top 3M executive: "Innovation is the art of identifying human needs, aspirations and desires, and connecting them with ingenious and practical solutions that generate sustained and valued transactions." This means that the outcome of innovation must be "something" valuable, new and differentiated, which can be traded: products, services, knowledge (intellectual property), marketing campaigns or manufacturing and logistics processes. In short: no value for the customer – no innovation. Unfortunately companies often accumulate patents and churn out inventions which fail to meet the customer's needs, aspirations or desires. Rather than innovating, they're actually wasting money.

*Major hurdles and traps of innovation.* Invention does not yet equate to innovation. Take, for example, all those inventions that do not meet the cost expectations of the market. The thing is that technology must be elegant, and this implies simplicity. Elegance in technology (often the biggest asset for companies like 3M) then drives the lowest cost. Some say that having the lowest cost is today's ultimate competitive advantage. But let's start from the beginning; from strategy. If strategy fails, the company does as well. Here are some lessons learned:

- When innovating, do not consider only product innovation. There are many other opportunities for innovation in marketing, distribution, logistics, and ways to reach the customer.
- Not every innovation must be a blockbuster like the iPod. Do not set your expectations too high.
- Always have plenty of ideas in the hopper and prioritize them rigorously.

Also, it is important to remember that since innovation is not a traditional process, typical project management practices like planning, budgeting and reviewing cannot always be applied. Management needs to accept that there will be deviations and failures on the way. And to maintain an innovative, entrepreneurial culture, it is often necessary to acknowledge and celebrate those failures. Otherwise nobody will be willing to take risks, or the initiative.

Last but not least, a company may boast the very best R&D personnel, but it will not achieve its targets without strong leaders with advanced communication and relationship skills. Innovation needs leaders who know how to connect, how to find partners inside or outside of the company. Innovation needs a culture that encourages collaboration. This is often what differentiates the best from the tail.

*Is innovation a process?* There are many opinions on the subject in literature. Some say yes, some no. I believe that innovation is similar to art. As in the art world, when an invention is too far ahead of the times, it is as useless as if it were behind. How many artists were not recognized in their own life time? The organizational culture, the skills of people (in R&D and marketing), the leadership qualities of management, and the ability to create a vision for the company are more important factors than the process itself. On the other hand, a process must exist for a timely and orderly commercialization of invention. Only when this happens can we speak of innovation. For the commercialization process, different techniques like, for instance, 6 Sigma can be used. That is also what we practice at 3M.



## 12.7 Employee behaviour in corporate entrepreneurship

Organizational, as well as managerial, support is an important factor influencing employee entrepreneurial behaviour. However, it is also important to understand the different roles that employees play in corporate entrepreneurship activities, and personal strategies and tactics that can be used in order to implement successfully a good new idea.

### The role of individuals in corporate entrepreneurship

Individual employees can play various roles in the process of corporate entrepreneurship (Lukes, 2007; Morris and Kuratko, 2002). The *initiator* starts entrepreneurial activity by creating his/her own idea, or by identifying somebody else's good idea. However, the initiator does not necessarily become an innovation champion, who plays the key role. The champion takes the lead, coordinates the project, keeps it viable and leads the innovation towards implementation (Howell, Shea & Higgins, 2005; Lukes, Stephan and Cernikova, 2009; for more information, see also subchapter 12.5 on the innovation process). Also, he or she should find support from a so called *sponsor* (Morris and Kuratko, 2002). The sponsor is normally a high-level manager who believes in the champion's vision, and functions as the advocate of entrepreneurial activity. The sponsor's role lies in advising the champion, helping to find resources and information, supporting an innovative project with personal authority, and to function also as a protecting buffer when the champion must go against some company rule in order to overcome a barrier and proceed with the innovation. Therefore, the selection of the right sponsor is for the champion of utmost importance.

#### Exercise 12.3: The selection of the right sponsor

Remember the organizational structure of your current (or last) employer, and the various high-level managers of this organization whom you know. Who of them would support you most effectively if you wished to engage yourself in leading a new innovative project?

The following questions may help you to select the right person: Is the sponsor able to cope with inconsistent demands from different sides? Is he/she focused on the innovation? Can I gain his/her respect? Does he/she understand how decisions are made in this organization? Do other top-managers respect him/her?

Source: based on questions suggested by Morris and Kuratko (2002)

The opposing role is the *devil's advocate* (Lukes, 2007), whose role is to objectively criticize new projects, focus on weaknesses, and ask for clear unemotional explanations. Such a person must be tough as the basic role is to save money for the employer. The role is often played by financial

managers, or by heads of competence centres (Lukes et al., 2009). The last role that we deal with is the *member of entrepreneurial team*. The champion cannot make it alone. The more ambitious the innovation is, the more team members with heterogeneous experience are needed.

### **The interpersonal aspects of the corporate entrepreneur's behaviour**

A corporate entrepreneur must be trusted by management, and be able to prove that the opportunity in question exists, will satisfy market needs and is in line with company objectives. Therefore, he or she should be looking for new contacts and maintain the existing ones, as one of the key issues is to build social capital and credibility (Morris and Kuratko, 2002). It is based on the corporate entrepreneur's own influence, past successful results, or the support from important others.

How to do it? To share information, create interesting opportunities for others, offer one's own help, or to coordinate mutual activities. Political skill is one of the crucial assets. According to Ferris et al. (2007), it consists of social astuteness, interpersonal influence, networking ability, and 'apparent' sincerity.

The corporate entrepreneur uses political skill in a wide variety of tactics, for instance, in personal persuasion, assertive demands, involving people from other departments, advancement through allies, asking for written statements, ignoring unreasonable demands and mentioning help given in the past. Political tactics are often discussed with the sponsor, or the whole team. The use of these tactics differentiates an independent entrepreneur from the corporate one to a large extent. The independent entrepreneur has substantially more freedom to enforce a new and good idea.

## **12.8 To conclude**

This chapter focused on innovation and entrepreneurship inside existing organizations. It described the various forms these activities take, both on the individual and organizational level. It provided practical examples from successful companies, and suggestions both for organizations and for corporate entrepreneurs to increase the efficiency of entrepreneurial efforts. Finally, it described the different roles and tactics of individuals engaged in corporate entrepreneurship.

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