Success factors of small and medium sized enterprises
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Chapter 1
Introduction

This dissertation addresses two general objectives. First, to develop a general model of small-scale business success, which should coherently relate to the empirical literature. Second, some hypotheses were tested using data of a longitudinal study. Thus, the dissertation tries to identify key variables that make success of small-scale enterprises likely.

Chapter 2 starts to develop the Giessen-Amsterdam model of small business owner's success and it provides a detailed review of the literature on small-scale enterprises. The review identified five broad areas most frequently studied in entrepreneurship research-business owner’s personality, human capital, goals, strategies, and environmental conditions. The model presented in Figure 1.1 shows how these areas are inter-related. Some of these arrows have clearly controversial implications. For example, there are no direct arrows from personality or human capital to business success although such relationships have often been studied. The reason is that it is assumed that there is no success without actions. Actions are mainly determined by goals and strategies. However, goals and strategies may turn out to be wrong or miss-placed in a certain environment. For that reason, the environment moderates the effect of goals and strategies. Thus, all the influence of personality and human capital on success are mediated by goals and strategies and moderated by the environment.
The model is inter-disciplinary as it integrates approaches of various disciplines, such as economics, sociology, and psychology. Similarly, variables and operationalizations used in this dissertation reflect the customs in entrepreneurship research rather than focusing on purely psychological constructs. For example, the concept of human-capital was studied instead of measuring skills and knowledge of business owners. One reason is that our knowledge about small businesses can not be obtained by focusing on criteria of one single discipline, such as psychology (Cunningham & Lischeron, 1991). A second reason for using concepts common in entrepreneurship research is that I wanted to make policy implications possible and this was easier when using a terminology common to professionals in this field.

In this dissertation, the theoretical assumptions of the Giessen-Amsterdam model of small business owner’s success were tested empirically. Accordingly, I analyzed the relationships of business success with personality characteristics, human capital, planning, human resource management, and environmental conditions.

The relationship between personality characteristics of small-scale business owners and success have been frequently studied (see Chapter 2; Rauch & Frese, 2000). While some personality characteristics are related to business success (Rauch & Frese, 2000), the interpretation of these findings is discussed highly controversial. Gartner (1985) argued that
the diversity among entrepreneurs is much larger than differences between entrepreneurs and non-entrepreneurs. Since there is no average entrepreneur any personality description is questionable and therefore, one should stop looking for personality variable of successful business owners. On the other hand, both approaches- the personality proponents and their critics- can be criticized because they have overlooked the significant advances that have been made in personality research during the last 20 years. Theoretically, one can not expect strong main effects for several reasons. First, a general trait can predict behavior only through certain mediating processes (Epstein & O’Brian, 1985). Second, prediction of personality measures is much higher when using specific person measures rather than broad trait measures (Fishbein & Aizen, 1975). Third, the impact of personality can vary depending on situational conditions (Magnusson & Endler, 1977; Michel, 1968). In Chapter 3 these arguments were addressed by analyzing personality characteristics of business owners that are theoretically related to the domain of entrepreneurship. Moreover, strategic process characteristics (planning) were included in the analysis to explain, through which mediating processes owners’ personality relates to success.

A second major area of empirical analyses of this dissertation was business owners’ planning and its effect on success. A large part of teaching and research in entrepreneurship is taking it for granted that planning is important for small firms’ performance (e.g. Ryans, 1997). This premise sounds reasonable because planning enhances decision making, for example by formulating targets explicitly, by gathering information systematically, by anticipating fluctuations in sales and customer demands, and by exploring alternative ways of action. However, planning has disadvantages as well. Planning is an investment in terms of time and money. Moreover, by planning one is focusing attention on formal and rigid action plans, targets, and information gathering when flexible and creative actions are more appropriate. Therefore, planning in small-scale enterprises has advantages and disadvantages. Consequently, empirical studies did not lead to consistent results. While some studies found positive correlations between small business planning and success, there have been contradicting results as well (Rauch & Frese, 2000). In a meta-analysis, Schwenk and Shrader (1993) reported a small, positive relationship between planning and success and concluded that other variables might moderate the planning-success relationship. One objective of the empirical part of this dissertation is to explore the moderator effect of environmental conditions on the planning-success relationship. In Chapter 3, I look at the cultural environment and find that the relationship between planning and success is dependent on the cultural context. Chapter 4 presents analyses of the effect of the specific perceived business
environment of small businesses on the planning success relationship using data from a longitudinal study.

The dissertation further analyses effects of human capital of small business owners on success (Chapter 5). Human capital of business owners consists of knowledge and skills of business owners that help in the task to run a business and to learn more about it. While the positive function of human capital is empirically supported (see reviews by Cooper & Gimeno-Gascon, 1992; Rauch & Frese, 2000), studies hardly address the mechanisms (mediators) and contingencies (moderators) of the effect of human capital on success. To establish a full theory of human capital it is also theoretically important to answer the question in which way human capital leads to success. One assumption is that human capital helps business founders to be more efficient in organizing and managing production processes or in attracting customers and new capital of potential investors, which results in higher profits (Brueederl, Preisendoeper, and Ziegler, 1992). Therefore, one goal of Chapter 5 was to look at the processes by which human capital is functioning. An additional issue was to look at moderators. By analyzing seven studies quantitatively, Rauch & Frese (2000) found an average correlation between human capital and small business success of .09; this coefficient was small and significant indicating, however, that there may be moderators that influence human capital’s function for business success. Therefore, a second goal of Chapter 5 was to analyze under which circumstances the human capital-success relationship holds.

The important role of small-scale enterprises for employment growth is widely recognized (Drucker, 1985) and empirically well established (Birch, 1987; Mulhern, 1995). Surprisingly personnel management of small businesses is widely ignored in popular textbooks as well as in empirical research. However, employee effectiveness might be even more important in small enterprises compared to bigger companies. A weakness of small enterprises is their low labor productivity combined with lower than average wages (Mulhern, 1995). Moreover, task differentiation is low in small-scale enterprises and employees have to work in various areas. Improving company’s effectiveness through rationalization is hardly possible because of weak financial resources and a limited number of employees. Consequently, an optimal utilization of employee’s knowledge, capacities, and motivation is essential for small-scale business success. On the other hand, investing in personnel management costs time and/or money and these costs might neutralize the positive effects of personnel management. Human resource management is a useful concept to analyze personnel issues in small-scale enterprises because human resource management involves practices that ensure that employee’s collective knowledge, skills, and abilities contribute to
business outcomes (Huselid, Jackson, & Schuler, 1997). The literature on larger companies suggests that there is a positive relationship between human resource management and success (Arthur, 1994; Huselid, 1995). While human resource management is concerned with developing skills and knowledge in a firm there is, of course, already a certain amount of human resources in each firm consisting of human capital of employees and of the owner. An objective of analyses presented in Chapter 6 was to test the effects of human resources management and human capital on business success. In Chapter 7 the overall results of this dissertation will be summarized and discussed.

The dissertation is based on my core articles published, in press or submitted during my work at the University of Amsterdam. Other publications that we prepared and published prior or during my dissertation, which are not used in this book are Rauch, 1998a; Rauch 1998b; Utsch, Rauch, Rothfuss & Frese, 1999; Utsch & Rauch, 2000.