7 New entrepreneurs and social networks

Mini contents list

Key learning objectives

By the end of this chapter you should:

- Understand the importance of nascent entrepreneurship and social networks to the business start up process
- Be able to critically evaluate nascent entrepreneurship and social networks.

I wanted to be an editor or a journalist, I wasn't really interested in being an entrepreneur, but I soon found I had to become an entrepreneur in order to keep my magazine going.

Richard Branson, founder of Virgin

7.1 Introduction

In Chapter 6, we considered the importance of new businesses and the issues in defining and measuring such businesses. In this chapter, we will examine two approaches principally used by organisational theorists to explain the business start up process (see also Chapter 2). The first approach is based upon identifying the role of nascent entrepreneurs in that process. These are individuals involved in an attempt to start up a business. The central question asked here is: ***how*** is it that individuals set up in business? To answer this question, we examine both the theoretical and empirical evidence on nascent entrepreneurship.

A second approach of organisational theorists is to examine the social processes involved in setting up a business. The focus here is on the social relationships (networks) that individuals make use of when establishing their business. In short, how do individuals use their social networks to help with business creation? We explore the basis of this issue and discuss the advantages and disadvantages of the social network approach.

7.2 Nascent entrepreneurship

The focus on nascent entrepreneurs (those in the process of setting up a business, usually for the first time) is the result of an interest in how organisations emerge. This is important because countries throughout the world are interested in easing the transition from turning a business from a 'dream' into a 'reality'. For this reason many countries have programmes that directly seek to raise the awareness and skills of people thinking of setting up a business.

Universities, too, nearly all now offer courses in setting up and running a new business. Katz (2003), for example, identified that the number of US university entrepreneurship courses had increased from around 300 in the early 1980s to around 2,200 courses 30 years later (see Chapters 19–21 on public policy for further information).

There are three questions that are typically asked in relation to nascent entrepreneurship. These are:

1. How is it that individuals go about creating a business?
2. What actually triggers them to go about starting a business?
3. How many individuals are actively involved?

This section examines each of these questions in turn.

Question 1 How is it that individuals go about creating a business?

The best known model for explaining organisational emergence is provided by Katz and Gartner (1988). This suggests four main 'properties' of emerging organisations:

- **Intentionality** – those seeking to set up a new business have to form some intentions towards explicitly setting up their business.
- **Resources** – resources (e.g. workers, finance) have to be identified, collected, assembled and used.
- **Boundary** – the creation of deliberate psychological (e.g. telling family or friends) or official (e.g. registering a business) boundaries.
- **Exchange** – making transactions (e.g. sales).

Katz and Gartner argue that successful organisational emergence is dependent on developing these four properties. Brush *et al.* (2008) have identified 26 'proxies' for these four properties. These are set out in Table 7.1. First, an individual discovers their intention to set up a business. They may, therefore, commit full time to the business and undertake some training.

Table 7.1 Proxies for Katz and Gartner's Four Properties of Emerging Organisations

Intentionality	Resources	Boundary	Exchange
Prepared business plan	Organised start-up team	Opened bank account	Started marketing efforts
Identified opportunity	Applied for a patent	Applied for a phone listing	Made sale
Prepared financials	Bought raw materials	Applied for a credit rating listing	Reached profit
Started working full-time	Bought equipment	Filed income tax	Paid salaries
Taken workshops	Saved money		Paid social security taxes
	Invested money		Paid insurance taxes
	Asked for funds		
	Applied for a credit		
	Arranged for childcare		
	Hired employees		
	Level of new product development		

Source: Brush *et al.* (2008).

They may then decide to buy equipment and hire employees. Subsequently, they may open a bank account and seek out a phone listing. Finally, they may make sales and pay appropriate taxes.

The reality is that *how* organisations actually emerge is likely to be very different from one case to another. Reynolds and Miller (1992) examined 3,000 established businesses in the USA. They found that the emergence or 'gestation' of these businesses showed substantial differences in the length and in the pattern of 'organisational emergence'. There was also no evident order to the sequencing of activities. Some people who had set up a new business had done so by first making sales (exchange) and then working 'backwards'. A good example of this is a hobbyist. Someone with a passion for making clothes may find that these prove popular with friends and family. They sell a limited number and subsequently decide to set up in business. The heterogeneity of the start up process was confirmed by Carter *et al.* (1996) who looked at 71 nascent entrepreneurs. They, again, found no evident logical pattern to how organisations emerge.

Sarasvathy (2001) has argued that organisational emergence is not always a causal, logical process. To illustrate this she uses the analogy of how a chef cooks a meal. In a causal process, the chef follows a set recipe. If the chef does not have the necessary ingredients, she will go out and get them first so that she can follow the directions contained in the recipe. The alternative approach is to follow what Sarasvathy calls an 'effectuation' process. Here the key difference is that people take the ingredients that they have in their kitchen cupboard and then proceed to *imagine* what their meal should look given the ingredients they have. Once they have successfully realised how and what they are going to cook, they then proceed to cook the meal. This is rather like someone having resources (e.g. money or equipment) and wondering how to make use of them successfully.

Brush *et al.* (2008) confirm that there is a considerable variety of ways in which organisations emerge. They specifically test for organisational emergence using Katz and Gartner's (1988) model. They find that '. . . organizing a new venture is not a patterned or linear process but rather is simultaneous, messy and iterative' (p. 548). In other words, there might be a recipe but it may not be followed attentively or at all depending on the ingredients and way that someone chooses to set up a business.

However, it may not be terribly complicated as the box below on Innocent Smoothies shows:

Illustration How Innocent Smoothies started up

In the summer of 1998 when we had developed our first smoothie recipes but were still nervous about giving up our proper jobs, we bought £500 worth of fruit, turned it into smoothies and sold them from a stall at a little music festival in London. We put up a big sign saying 'Do you think we should give up our jobs to make these smoothies?' and put out a bin saying 'YES' and a bin saying 'NO' and asked people to put the empty bottle in the right bin. At the end of the weekend the 'YES' bin was full so we went in the next day and resigned.

http://www.innocentdrinks.co.uk/us/?Page=our_story (accessed 16 Sept. 2008).

Question 2 What actually triggers them to go about starting a business?

The second typical question asked is what triggers nascent entrepreneurship? Notice here that the unit of analysis shifts from the 'in-vitro', 'gestating' or 'emerging' organisation to that of the individual. The interest is in understanding why some people are actively involved in setting up a business and others are not.

The most common way of defining this is to use the following Global Entrepreneurship Monitor (GEM) survey question: 'Are you, alone or with others, currently trying to start a new business?' The advantage of this question is that it is easily understood by those asked it and, because of the prominence of GEM, widely accepted as a workable definition.

Studies specifically examining nascent entrepreneurship tend to look at two types of questions.

1) What distinguishes nascent entrepreneurs from the general population?

Delmar and Davidsson (2000) found that Swedish nascent entrepreneurs were more likely to be male, be young, have had prior self-employment experience, better education levels, more management experience and higher income levels compared with the general population. Davidsson and Honig (2003) also find similar results for Sweden in terms of sex, education, age, prior start-up experience and years of work experience. They also found that parental self-employment background, encouragement by friends/family and having close friends/family in business lead to a higher incidence of nascent entrepreneurship activity.

Koellinger *et al.* (2007) found in their cross-national study of 18 countries, that nascent entrepreneurs display overconfidence in their assessments of their skills, abilities and knowledge. Such optimism distinguishes them from those not involved in the start-up process. Carter *et al.* (2003), however, found it difficult to distinguish the reasons why US adults created a new business. They found little difference between nascents and the general population in terms of factors such as 'self-realisation' (e.g. the ability to lead and motivate others), financial success (e.g. size of income), innovation (e.g. the ability to develop an idea for a product) and independence.

In essence, this suggests there are differences between the general population and nascent entrepreneurs. However, these differences are similar to the differences between 'actual' new business founders and the general population. This begs the question of what is the economic value of studying nascent entrepreneurs? Since nascent entrepreneurs appear similar to actual new owners, is it not more appropriate to study people *actually* creating economic value than those *considering* creating economic value? From an economic perspective, it is unclear whether those who do not go on to set up a new business have any significance.

A second criticism of the study of nascent entrepreneurs is that the number of new businesses created is perhaps unrelated, or only weakly related, to economic development because only a tiny proportion of new businesses have a significant economic impact. Unless the study of nascent entrepreneurs can provide insights into the characteristics of these businesses, either at start up or early in their life, then studying nascent entrepreneurs does not add to our economic understanding. Indeed, it may be that focusing upon the number of businesses created, or even the businesses in gestation, only diverts attention away from the real role of entrepreneurship which is to enable businesses to grow quickly, enhance productivity and so transform the economic landscape.

2) Why is it that some nascent entrepreneurs make the transition into business and others do not?

The focus of the this second question is on distinguishing those nascent entrepreneurs who go on to create a new business from those who abandon their attempt or are still trying to set up their business. van Gelderen *et al.* (2006) identifies that Dutch nascent entrepreneurs who went on to actually start a business – compared with those that abandoned their nascent

business idea – were more likely to be full-time in the business and be manufacturers. They also find that successful nascents used less money to set up the business and chose lower risk options. Parker and Belghitar (2006) report – using US data – that financial capital (e.g. established credit with suppliers, owning a home) is an important factor in explaining the transition into operating a business. Henley (2007) also points to UK differences between those who aspire to set up a business and those that actually make the transition. He finds that those that aspire to set up are more likely to come from an ethnic minority, are divorced and have lower education attainment levels.

Again, however, the criticism is that it would be a better use of time and resources to study those that actually start a new business. On balance, the differences between those that remain nascent, those that make the transition to new business status or those abandon their efforts are small. For example, Henley (2007) finds that both those that aspire and those that actually do make the transition into self-employment are similar. Again, this suggests the 'returns' to studying 'nascents' have been modest to date.

Question 3 How many individuals are actively involved?

The third reason for studying nascent entrepreneurship is that it gives a better understanding of the scale of entrepreneurial activity. It does so in three ways:

1. It is *people* who *do* business not businesses. Official statistics on entrepreneurial activity are based on businesses. This is likely to underestimate entrepreneurial activity, if only because people may own more than one business.
2. Nascent entrepreneurship is a fundamental part of human activity. Reynolds *et al.* (2004) suggests that in the USA 10.1 million people said they were attempting to set up a businesses. This means that nascent entrepreneurship is a more common phenomenon than birth or marriage in the United States. Reynolds (2005) has further claimed that 'up to half a billion people in the world are actively involved in either the start-up process or in managing a new business, (p. 362).
3. Studying nascent entrepreneurship potentially gives a clearer understanding of how individuals make the transition to new business formation. This is important because, as we noted in Chapter 6, there is believed to be a relationship between new businesses and economic growth and development. So, by understanding nascent entrepreneurship, the hope may be that the barriers (e.g. regulation or finance) that prevent people from setting up their new business are either lowered or removed. Table 7.2 shows that there are different outcomes for nascent entrepreneurial activity. These vary internationally (see also van Stel *et al.* 2005). The issue is what motivates these differences and how can they be changed.

Table 7.2 What happens to nascent entrepreneurs after one year?

Outcome	PSED	Carter *et al.* (1996)	van Gelderen *et al.* (2001)	Diochon *et al.* (2003)
Still Nascent	159 (47%)	21 (30%)	89 (27%)	51 (39%)
Operating	112 (33%)	34 (48%)	155 (47%)	45 (34%)
Gave Up	69 (20%)	16 (22%)	86 (26%)	36 (27%)
Total	340 (100%)	71 (100%)	330 (100%)	132* (100%)
Country	USA	USA	Netherlands	Canada

Numbers of cases appear as the first cell entries, with sample percentages in parentheses.
Source: Parker and Belghitar (2006).

A criticism of the rates for those who either are still nascent, or gave up, is that there is little point in studying those who failed to set up a new business because they have limited economic significance. We also have seen that those that actually make the transition are, perhaps unsurprisingly, similar in profile to existing new business founders.

Another criticism of nascent entrepreneurship is that fails to properly specify the transition into setting up a new business. At its simplest, the criticism is that intention is a poor proxy for behaviour. Parker and Belghitar (2006) suggest that amongst 'nascents' there are a number that might be better called 'dreamers'.

Mueller (2006) also provides an interesting perspective on nascent entrepreneurship status. Her data allowed her to ask German individuals to estimate how likely they were to become self-employed in the following year. Some people classified themselves as being 100 per cent likely to be self-employed in the following year whilst others classified themselves as being anything from 90 per cent to 0 per cent likely to be self-employed. She then found differing results depending on the level of intention. So, those with 100 per cent intentions were more likely to one year later become actual new business owners, compared with those with lower scores. The problem is that the GEM question is black and white: you are either intending to set up a business or you are not. This makes it hard to easily identify if someone is likely to be a 'nascent' entrepreneur.

But, even if nascent status was uniform, is it true that individuals have to form an intention prior to setting up a new business? The simple answer is no. Katz (1990) identified that some people who actually start up a new business had no intention of setting up a business. Henley (2007) confirms this. He finds, using longitudinal data from the British Household Panel Survey, that nearly half of people who become self-employed did not declare a year earlier their intention to become self-employed or embark on any formal training.

Mueller (2006) reported similar findings. She found that 66 per cent of those that actually become an entrepreneur never classified themselves as 'nascents'. In other words, the decision to become a business owner was taken 'at the last minute' and so such individuals never appeared as 'nascents'. The implication of this is that examining self-styled nascents could easily provide a biased understanding of how people come to create new businesses.

There is also the likelihood that there is always an underlying cultural bias in questioning intentions. Hayton *et al.*'s (2002) review of the relationship between different cultures and entrepreneurship suggests that there is a wide body of evidence that points to cultural differences. Therefore, it would be surprising if there were not major differences between respondents in different countries being willing to report to an outsider whether they were actually preparing to set up a business.

The final criticism is that, in practice, the nascent 'score' of a country seems to be rarely documented. Instead, the favoured entrepreneurial score measure is TEA which, as we have seen is a combination of both nascents and baby-businesses.

In summary, this section has sought to examine three questions:

1. How do individuals go about creating a business?
2. What triggers nascent entrepreneurship activity?
3. How many individuals are actively involved?

In terms of the first question, we introduced Katz and Gartner's (1988) model of the four properties of organisational emergence. We also saw that there was no uniform pattern or sequence to how organisations emerge. Sarathasavy (2001) argues that this can be achieved by both linear (following a recipe) and non-linear (e.g. looking in the cupboard) processes.

The second question asked what was distinctive about nascent entrepreneurs. The evidence suggested that there were differences between nascent entrepreneurs and the general population. These differences were, however, similar to the differences between new business founders and the general population. Evidence also identified that there were few differences between those nascent entrepreneurs who made the transition into setting up a new business

and those that did not. The criticism here was that there was little point in studying nascent entrepreneurship because there was no guarantee that nascents generated economic value. The argument is that it is far better to concentrate on those individuals who actually had made the transition into enterprise and were growing quickly.

The third question identified that the scale of entrepreneurial activity is far greater if we examine nascent as well as actual entrepreneurship. This is, arguably, an important endeavour because new businesses are important to economic growth. The criticism of this is that nascent entrepreneurship is a poor proxy for the transition into setting up a new business. Some people have a doubtful intention to actually start up a new business and some never acknowledge that they were nascent entrepreneurs. The criticism, therefore, is that focusing on nascent entrepreneurship is an inexact mechanism for understanding the process of new business creation and of questionable economic and social value.

7.3 Social networks

In the last section, Table 7.2 showed that between one-half and two-thirds of nascent entrepreneurs had either abandoned their attempt to set up a business or were still in the process of actively attempting to set up their business two years later. One reason for these high percentages is that these 'failed' or 'failing' nascent entrepreneurs may lack the necessary human capital attributes. Human capital attributes typically refer to factors such as the education and background experiences of the individual. A second explanation is that individuals lack the financial resources necessary to buy capital equipment (e.g. machines), fund their day-to-day living costs or pay for market research. Organisational theorists recognise that these are important aspects of the new business formation 'process'.

However, organisational theorists suggest that there is a third type of capital that is important in explaining the new business activities. This is social capital. Social capital may be defined as '. . . the sum of the actual and potential resources embedded within, available through, and derived from the network of relationships possessed by an individual or social unit. Social capital thus comprises both the network and the assets that may be mobilised through that network' (Nahapiet and Ghoshal 1998: 243).

Organisational theorists hold that social capital and the networks that are the basis of such capital are important in explaining new business formation because, fundamentally, setting up a business is a social process. Besides the employment of human and financial capital, individuals access, and make use of, their social resources to establish the business. Drawing upon such resources enables a business to overcome the 'liability of newness' (Stinchcombe 1965) which reflects the lack of credibility to customers and suppliers of a business with no 'track record'. Nascent and new entrepreneurs, for example, have to be seen as being 'legitimate' before they can effectively trade (Aldrich and Fiol 1994). The iterative process that the new or nascent enterprise undergoes to overcome this lack of credibility is referred to as the 'credibility carousel' (Birley 2002). It is reproduced in Figure 7.1.

In essence, what Birley (2002) suggests is that individuals use their networks to gain 'legitimation' and resources for their nascent business. Without the benefit of such support, the implication is that very many nascent businesses would be stillborn.

Hoang and Antoncic (2003) provide a useful overview of the ways nascent and existing entrepreneurs use networks to support the development of their business. In their view: '. . . social networks are defined by a set of actors (individuals or organisations) and a set of linkages between the actors' (Hoang and Antoncic 2003: 168). They go on to identify three areas of networks that are particularly appropriate to entrepreneurship.

Network content. by this they mean how entrepreneurs access resources. This may be in terms of financial or physical resources but more typically it is intangible resources such as

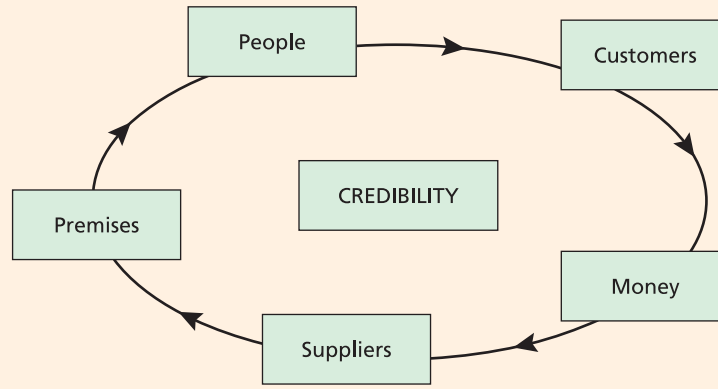

Figure 7.1 Birley's credibility carousel

Classic research — Birley's credibility carousel

Birley (2002) uses the example of Peter, who is a television producer who needs funding:

> Peter is a producer of television programmes working for one of the major companies. He has a vision for a series about the development of the brain that he **knows** will work and is convinced that it could command major international sales. But he is tired of working for others and wants to use this as the foundation for a new, independent production company. He also knows that he will need £3 m because that is how much the series will cost to make. He has heard that there is no point in approaching venture capitalists since they are not interested in project financing and, anyway, he is not asking for enough money for them to be interested. So, he goes along to his bank manager and broaches the possibility of a loan. Of course, he is laughed 'out of court'. The bank manager says . . . 'That is much more than I can lend on the security of your house (assuming that your wife would agree) . . . and, anyway, who else is involved in this, . . . and, most important, your business plan is just a dream . . . where is the order?'
>
> Undeterred, Peter approaches a couple of producers in other companies with his 'concept'. They express interest. They usually do. It is a way of keeping their options open! But they are not able to commit without a more detailed 'Proof of Concept', and a fully resourced plan. In other words, what is the evidence that this will syndicate worldwide, what is the technical team that Peter plans to use, who is going to 'front it', and who will provide the scientific support. So, he approaches the acknowledged world expert on the brain, the best animators, technicians and camera crew. To a person, they ask (or imply) 'What is in it for me, how do I know you can make this work, and where do you plan to set up the studio?' Still undeterred, he scours the available studio facilities, but the landlords are not interested in talking until Peter is prepared to sign a lease, produce guarantees, and pay a deposit. He also talks to camera and computer manufacturers that he has dealt with previously about the arrangements for leasing or buying equipment, but finds a very different reaction when they realise that this is a new venture. No longer can he negotiate special discounts and credit. Now they want full price and cash up front.
>
> . . . In order to have a chance of moving forward, he needs to persuade someone to believe in him and to break the credibility carousel. For example, the world expert on the brain commits to the idea and begins to persuade others, his previous employers to agree to let him use an old studio, or a rich maiden aunt agrees to provide bank guarantees. Slowly, people begin to believe in him and the project gains credibility. It also gains more reliable data.
>
> How did he do it? Almost certainly through his personal network, the people who know him personally or have been introduced to him by someone they trust. For example, the world brain expert just happens to play golf with his father! Now the dream is becoming a reality. More importantly, the business concept is becoming a business plan, with increasingly credible assumptions and costs.

Source: Birley (2002: 138–40).

advice, information or emotional support. For example, because setting up a new business is often stressful, individuals may rely on their family and friends for emotional assurance and seek advice from banks and accountants on ways to properly store and account for their money.

Network governance. The key word here is trust. Instead of relationships being governed by money, organisational theorists hold that a far more prevalent and useful 'glue' is that of mutual trust. This 'allows both parties to assume that each will take actions that are predictable and mutually acceptable' (Hoang and Antoncic 2003: 170). The key benefit of a governance arrangement that relies on trust is that it makes it 'cheaper' for people to do business with each other because they do not have to monitor so closely the activities of others.

Network structure. This refers to the nature of ties that bind people together. There are strong ties and weak ties. Strong ties are close relationships that have been formed between people (e.g. family and friends) whilst weak ties are often more distant and perhaps informal (e.g. acquaintances). In examining these ties, organisational theorists also look at the size of the network, its density (the number of connections in relation to its potential number of connections), its diversity (mix of strong and weak ties) and where the individual sits in a network (centrality).

All of this implies that individuals use networks to reduce the cost, time and effort in setting up a business. Fundamentally, this is because individuals make use of 'socially embedded' ties with others who can provide support and guidance. Organisational theorists see this as being a more important feature of economic activity than 'market based' interpretations. To illustrate this, the American sociologist Uzzi (1999) found that entrepreneurs who had a long term account with a bank enjoyed favourable interest rates on their loans. He suggests that this benefit is due to the entrepreneur's close relationship with the bank manager.

From a network perspective, what is also key are the *networking* activities of individuals. Models of such processes (e.g. Larson and Starr 1993; Hite and Hesterly 2001) argue that organisational emergence is an evolutionary process. Individuals essentially move from a network of strong ties to one in which there are a greater mix of weak ties. What this involves is a process of adding ties, upgrading ties and dropping ties so that, in relation to the earlier example of Peter the television producer, there is a need for him to 'reconfigure' his network to set up the business (Elfring and Hulsink 2007).

Criticisms of the network approach

There are five main criticisms of the network approach: definitional issues; the compensation thesis; empirical evidence; the 'costs' of networking; and social embeddedness. We examine each of these in turn.

Definitional issues. One problem with network theory – like social capital theory – is that it ranges over differing units of analysis. The basic tension in network theory is that it is never quite sure if the focus should be on the individual or the business. To illustrate this, consider the three following definitions.

> '. . . social networks are defined by a set of actors (individuals or organisations) and a set of linkages between the actors' (Hoang and Antoncic 2003: 168)
>
> 'A network consists of single nodes (actors) and connections between these nodes (dyads), which as a whole form the structure of a network' (Witt 2004: 392)
>
> '. . . a firm's set of relationships with other organisations' (Perez and Sanchez 2002: 261)

These differences in focus between the individual and the business may seem to apply less to organisational emergence because the nascent business may be simply seen as an extension of

the individual setting up the business. However, Witt (2004) suggests that they may not take full account of the socially embedded nature of start ups. Very many businesses are set up by more than one individual. This is not a perspective usually covered by the network approach. The reason for this is that it becomes increasingly difficult to first quantify and then disentangle the network of relationships between individual members of the entrepreneurial team.

This is largely because 'networks' or 'networking' are subjective. Chell and Baines (2000) suggest that 'networking does not have an objective existence independent of the person who is networking. It is a social construction that exists only so far as the individual understands and uses it' (p. 196). The implication is that the network content or structure may be prone to 'recall biases' by nascent or actual entrepreneurs. For example, one member of the start up team may identify that a particular contact is a 'strong' tie whilst another may identify them as a 'weak' tie. This raises definitional issues, making it hard to appropriately capture the network relationships. If 'entrepreneurship' is a slippery concept, this is even truer for definitions of 'networking'.

Compensation thesis. Network theory usually focuses on the benefits of networking. Witt (2004) identifies that this may assume that all individuals start with the same human and financial capital. This is clearly not the case. Some people may be better able to process information perhaps because they are better educated. Some may also have larger pools of individual financial capital. Individuals who 'network' may only be doing so because they have to 'compensate' for their lack of human and financial capital. In this case, networking is not a positive choice but is forced upon individuals who recognise their resource constraints.

What is also clear is that some people are better 'networkers' than others. Networking 'talent' is unequally distributed across the population. It is, therefore, quite rational for some individuals, who recognise that they may be net-losers from networking to avoid interacting with others, and seek to avoid those whom they view as effective networkers. As we shall show shortly, networks can be a 'two-way street' in which there are losers as well as gainers.

Empirical evidence. When entrepreneurs are asked about the reasons they set up in business, they typically list independence as a prime motive (Birley and Westhead 1994). Yet, network theory suggests that new entrepreneurs make use of extensive support and assistance. Similarly, networking often assumes that relationships with the outside world are voluntary. This is not always the case. Curran *et al.* (1993) identify that very many relationships are 'compulsory' in that in setting up or running a business individuals often have to speak to, and often be heavily reliant upon, an accountant, a bank manager or the tax authorities. Curran *et al.* also point out that individuals running their own businesses are notorious 'non-joiners' even of organisations where they might expect to meet others with whom the can network, such as trade associations.

The empirical evidence on whether 'strong' or 'weak' ties are important in starting up is also contradictory. Some have found a positive relationship between strong ties (e.g. Brüderl and Preisendörfer 1998; Jack 2005) whilst others have found weak ties to be more important (e.g. Greve and Salaff 2003). Part of the reason for the differences in findings may be the difficulty of actually identifying and quantifying the network (Johannisson 2000). In other words, it is difficult to identify the role played by networks in setting up a business.

Costs of networking. A further criticism of networking is that it appears to only consider the benefits of networking and to ignore any costs. One such cost is the 'returns to scale'. Network theory often seems to assume that the investment in networks (time, energy) results either in positive returns (increasing returns to scale) or constant returns to scale. So, the assumption is that if an individual invests 20 hours developing a relationship with a client then this is likely to reap equal (constant returns) or greater (increasing returns) returns than investing 10 hours with a client. However, in reality, it may, of course, be that such investments lead to

diminishing returns. At some point, the time or energy invested – even if this could be easily matched with returns – is prone to tail off in value.

To illustrate this, Altinay (2005) found in his discussions with Turkish entrepreneurs that there was a 'darker' side to networking:

> I have been sharing business information with my friends for a long time, but to be honest with you I have never seen anything positive come out of it because every business is different.
>
> You should not share any information with Turkish friends. One day I was talking with my friend in the Turkish club and I told him that my café was doing very well and I will do even better in the future . . . the next thing I know . . . he bought the shop next door and opened a café.

The implication of this illustration that networks are a 'two-way street' is that for those individuals with superior networking skills the benefits may considerably outweigh the costs. For others, the reverse may be true. It is tempting to infer that individuals with strong networking skills will also have strong entrepreneurial skills but, to our knowledge, that has yet to be demonstrated.

Social embeddedness? Central to networks are trust, a willingness to respond positively to the positive actions of others (reciprocity) and the use of strong and weak ties to shorten and cheapen the cost of the market. Earlier, to illustrate this we used the example of Uzzi (1999) who found that entrepreneurs who had a long term account with a bank enjoyed favourable interest rates on their loans. Network theory explains this by suggesting that this is evidence of a strong tie, glued together by mutual trust built up over many years.

The alternative interpretation is that this is an *over-socialised* view of how people do business. What matters in relationships is their economic content. In the case of the entrepreneur and the bank, why the entrepreneur gets cheaper finance is because the monitoring costs of the bank are lower. Cheaper monitoring costs effectively lowers the cost of finance because the bank is confident it can judge borrower quality with accuracy. The potential borrower can clearly signal their quality by being prepared, for example, to offer collateral such as their house to the bank (Han *et al.* 2009). However, as we will show in Chapter 17, the bank also collects information from transactions and may be able to use that information for imposing a higher, rather than a lower, interest rate on the borrowing business.

In summary, the evidence suggests that network theory may be a powerful way of explaining organisational emergence. The advantage of the theory is that it provides an account of how some people use their social capital to overcome the 'liability of newness'. It is also nicely aligned with many of the 'real life' stories of new business foundation. The main disadvantage of the approach is that it can place too much emphasis on the positive benefits of networks. This may ignore the costs of networks and the economic basis of why it is people go into business.

Summary

This chapter examined two approaches that explain how businesses emerge. The first of these was nascent entrepreneurship. The second was social networks. The advantage of both these approaches is that they emphasise the importance of 'how' individuals work through the sometimes messy process of starting up a business. The main disadvantage of these approaches is that they provide an imprecise and incomplete understanding of such processes. They address the issue of the ***process*** of formation but offer only limited insights into the question of ***who*** starts a new business.

In the next chapter, we examine the 'economic' approach to business start up. As this chapter shows the focus of economics tends to be on *who* actually starts a new business rather than on *how or why* businesses are begun. The *why* question is simple for economists: people start businesses because they think it is the best option for them. It is their choice which is made by comparing business ownership/self-employment with paid employment, unemployment, or departing from the labour force altogether.

Questions for discussion

1. What insights does the concept of the nascent entrepreneur provide in improving our understanding of the process of new business creation?
2. Why do many nascent entrepreneurs never actually start a business?
3. Does it matter if so many nascent entrepreneurs never start a business?
4. What is the 'liability of newness?' How can social networks overcome this liability?
5. What key insights into the entrepreneurial process are illustrated by Birley's credibility carousel?
6. Is networking a 'two-way street'? Does this have implications for the willingness of individuals to share information with one another?

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