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Strategic Entrepreneurial Decision-Making in Small Firms

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Abstract

About 75% of the small businesses in the world fail within first five years of commencement. Research has revealed that poor management rarely causes failure of small business especially in developing countries. Small enterprises play a key role in alleviating poverty through generating employment in country. The role of decision-making has traditionally been attributed to executive managers in large firm but all of the decisions of small firm are taken by the entrepreneur of the business. This paper develops an argument on the basis of theories from developed literature, and results of previous researches, to help understanding entrepreneurial decision-making in small firms. Results of this study will help in understanding entrepreneurial decision-making process and will help in identifying some of the most important factors that affect the process of entrepreneurial decision-making.

Keywords

Entrepreneur, Environment, Small Firms, Strategic Decision Making

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1. Introduction

A typology of entrepreneurial decision making is used in this paper to refer to the decision-making process of entrepreneurs in small firms. This research studies entrepreneurial decision making in small firms. Most of the studies in this dimension assume that all entrepreneurs possess same characteristics. But existence of different types of entrepreneurs has also been supported empirically through research of Wennekers and Thurik (1999).

Small firms play a key role in development of modern economies of the world (Lee, Yoon, Park, & Park, 2010). Small enterprises, like large enterprises require strategic business planning to succeed in marketplace (Duhan, 2007). Small businesses can be defined as those businesses that have fewer than 500 employees as mentioned by most of the Small Business Administration Programs in United States. (Lee, Yoon, Park, & Park, 2010). Small businesses are considered instrumental for economic development of countries and key management positions in these businesses are owned by the entrepreneur of the business (Gibcus, Vermeulen, & de Jong, 2006).

Previous studies on strategic management have focussed on large firms and a very little amount of research has been conducted on the process strategic decision making in small enterprises. According to academic researchers and practitioners of the field, strategic decision-making process in small firms is different large firms and many studies have provided empirical evidence on this argument including Papadakis et al. (1998), Brouthers et al. (1998) and Gilmore and Carson (Gilmore & Carson, 2000). According to Busenitz and Barney (1997), decision making process used by entrepreneurs is different from the decision made by managers of large firms on the basis of their approach. They use more heuristic and biased approach to decision making due to the limited access to the information and limited access to opportunities in market (Brouthers, Andriessen, & Nicolaes, 1998).

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None of the studies in history have attempted to categorize different types of entrepreneurs but the evidences collected from this study will also attempt to categorize different kinds of entrepreneurship in different situations. This will be a contribution to not only academic research but it will also provide insight to the practitioners in the field. Results of this study will be significant for practitioners and policy makers. It will also help the newly entering entrepreneurs. It will help as a guide to improve on their skills of strategic decision making. It is very important for the entrepreneurs to develop this very important skill of management to survive in modern business world.

2. Research Design

This research is a theoretical study based on established theories in literature. A conceptual framework will be developed which will help in establishment of argument based on theories in literature, and supported by results of previous studies. This will help us develop understanding entrepreneurial decision-making process in small firms.

Purpose of the research is to study the process of decision making in small firms. In small firms, the decision making process is usually carried out by the entrepreneur of the business because of lack of strategic managers in small firm (Gibcus, Vermeulen, & de Jong, 2006). Small firms are very important in the economy and they contribute a great deal in economies of the countries (Charles, Ojera, & David, 2015). In large firms, strategic and executive managers are involved in decision making process. Decision-making process in large firms has been studied comprehensively in history, but decision making in small firms is still under-studied.

3. Conceptual Framework

Strategic decision making is important for every kind of firm (Gibcus, Vermeulen, & de Jong, 2006). Different scholars describe strategic management from different point of view. Many of the modern scholars view strategic management in small firms as different from strategic management in large firms; and many of these scholars have proposed separate approach to describe it (Charles, Ojera, & David, 2015). Process of decision-making and strategic management in small firms does not follow any set rules or procedures; rather, every small business follows a plan which entrepreneur finds suitable for his business (Hill and Gareth, 2012).

Schoemaker (1993) defined strategic decision-making to be "intentional choices of programmed responses about issues that materially affect the survival prospects, well being and nature of organizations". Strategic decisions are those decisions that decide the future line of action of the firms. Many academic researchers and practitioners have attempted to identify the significance of strategic decision making and most important and relevant work in the field was carried out by Eisenhardt and Zbaracki (1992), Schwenk (1995), Schoemaker (1993) and Hendry (2000). These are the studies that provide deep insight on strategic management through thorough literature review (Gibcus, Vermeulen, & de Jong, 2006).

Most of the theories on strategic decision making revolve around general model of decision-making which have three variables: Characteristics of decision which is to be taken by the manager, decision-taker and the environment that influences the decision-taking by a particular decision-maker. Researches related to these theories include Mintzberg et al. (1976), Papadakis et al. (1998) and Mador (2000). All of these independent variables are actually inter-related and have impact on each other (Gibcus, Vermeulen, & de Jong, 2006).

It is important to have a look at historical perspectives of different theorists on strategic decision making process. Perspective of rationality, bounded rationality and political perspectives are two most important perspectives that need to be studied in this regard. According to perspective of rationality, a decision-makers or actors involved in the process of decision-making have all the information which is collected from reliable resources, sorted by the process of evaluation of all available alternatives and best alternative has been chosen by the decision-maker (March & Simon, 1958). According to bounded rationality perspective, individuals involved in the process of decision-making cannot have all the relevant information due to cognitive limitations, and decisions are made on whatever the information is available to the individuals involved in the process (Simon, 1957). According to Schoemaker (1993), authoritarians are involved in rational decision-making process.

According to political perspective, many actors with conflicting opinions are involved in the process of decision making and they use process of coalition to protect their interests in decision-making process (Eisenhardt & Zbaracki, 1992). But most of the studies presented previously have discussed the decision-making process in large firms. Studies regarding these theories have never addressed small firms, perhaps because of irrelevancy of rational, bounded rationality and political theories to the small firms (Gibcus, Vermeulen, & de Jong, 2006). According to Brouthers et al. (1998) and Byers and Slack (2001), most of the decisions taken by small firms are not taken on rational basis.

Strategic decision making processes in small firms differ from large firms on the basis of three reasons (Gibcus, Vermeulen, & de Jong, 2006). First reason discussed by Hambrick and Crozier (1985), Covin and Slevin (1989) is that the entrepreneurs in small businesses face environment which is more uncertain as compared to large businesses. Managers and entrepreneurs in small firms do not have access to information which is accessible to large firms. Large firms are supported by huge staff and managers which make environment less uncertain for large firms (Busenitz & Barney, 1997). Complexity and dynamism in environment is greater for small firms as compared to large firms. (Busenitz & Barney, 1997). In large firms, managers have schedules for making decisions but in small firms, entrepreneurs do not have such schedules and decision-making in small firms is mostly based on opportunities (Gartner, Bird, & Starr, 1992). Third reason discussed by Mador (2000) is that, most of the times, people involved in decision-making in small firms are entrepreneurs, rather than managers, so they have different approach to decision-making, which make the process of decision-making in small firms different from large firms.

In order to make deep understanding of process of decision-making in firms, it is necessary to consider all independent variables discussed above i.e. nature of decision to be taken, entrepreneur and environment that can have an impact on decision (Papadakis, Lioukas, & Chambers, 1998). Similar factors have been studied by other researches to impact the process of decision making (Elissaveta & Gibcus, 2003). So we can divide the decision-making process at three levels: strategic decision level, a characteristic of decision taker and environment in which decision-making process is carried out (Elissaveta & Gibcus, 2003). Human being performing the function of decision making is studied, in this context, under the influence of behavioural, environmental and personal influences. According to Pajares (2002), these influences have been interpreted differently by different individuals. Major elements affecting the process of decision-making in small, as well as large firms have are shown in the figure below:

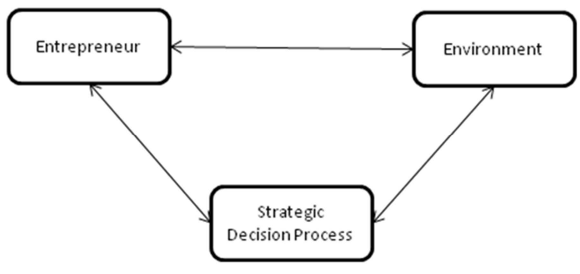

Fig 1. Conceptual Model: Levels of Analysis in Decision Making Process

Relationship between different components of conceptual model has been discussed below:

a. Relationship between strategic decision-making process and entrepreneur

"Entrepreneur... they not only see the system as it is, but as it might be." (Mitton, 1989). Different kinds of entrepreneurs use different kinds of decision-making approaches in different situations (Charles, Ojera, & David, 2015). Emotional, rational or intuitional decision-making approach used by entrepreneur decides the parameters of strategic decisions taken by entrepreneur (Gibcus, Vermeulen, & de Jong, 2006). Decision, in turn, has an impact on experience and knowledge of an entrepreneur by turning out to be a good or bad decision (Gibcus, Vermeulen, & de Jong, 2006). Cognitive decision-making process of entrepreneurs is shaped by the strategic decisions of past and their outcomes (Gibcus, Vermeulen, & de Jong, 2006).

b. Relationship between Environment and Entrepreneur

Environment is one of those factors that have greatest impact on decision-making of an entrepreneur because it is the environment that provides entrepreneur with opportunities of venture creation (Gibcus, Vermeulen, & de Jong, 2006). Environment is also significant because, in addition to opportunities, environment is largest source of threat as well. Entrepreneur also has an impact on environment in the form of his act of creation of venture. Issues like risk perceptions and risk propensity are of major concern for entrepreneur.

c. Relationship between Strategic Decision-Making Process and Environment

The impact of strategic decision-making process on environment can be observed in the form of innovation and production of goods/services. Diversification in market and growth in economy are the major impacts that a strategic decision-making process can have on its environment. Environment has an impact on strategic decision-making process in the form of uncertainties and threats. Due to these uncertainties, most of the decisions taken by entrepreneurs are mostly satisfactory, rather than being optimal (Gibcus, Vermeulen, & de Jong, 2006).

A query that may arise at this stage can be about identification of most important factor. According to an empirical study carried out by Papadakis et al. (1998), organizational context, or environment in which decision is being carried out is the most important factor of all that has the impact on final outcome.

4. Decision-Making Process in Small Businesses

Major difference between decision-making process in large and small business is that large businesses have managers for this specific purpose while in small business, these and every kind of other decisions are taken by entrepreneur of the business (Gibcus, Vermeulen, & de Jong, 2006). Decisions taken by entrepreneurs are mostly impatient and action oriented and McGrath et al. (1992) called them "rugged individuals". Contrary to managers of large firms, entrepreneurs do not make deep analysis and their decisions are not very comprehensive (Smith, Gannon, Grimm, & Mitchel, 1988). Cultural studied carried out by McGrath et al. (1992) showed cultural differences between the entrepreneurs of different region. Same studies showed some similarities as well, such as entrepreneurs are usually risk takers, they favour individualism, and they are not democratic. They are authoritarian in their decision taking approach (McGrath, MacMillan, & Scheineberg, 1992).

Busenitz and Barney (Busenitz & Barney, 1997) found that every entrepreneur is unique in his characteristics e.g. perception of risk of each entrepreneur is unique from any other. They used deductive approach for making decisions, also they are not trained as managers, so the decision they make is usually reflecting over-confidence in self (Gibcus, Vermeulen, & de Jong, 2006). Different studies have revealed, with empirical evidence, that entrepreneurs are different from managers, at large firms but all entrepreneurs share some predictable values in their characteristics (McGrath, MacMillan, & Scheineberg, 1992). The features they share in common are those which actually distinguish them from common people (Gibcus, Vermeulen, & de Jong, 2006).

5. Roles of Entrepreneur

Academic researchers in economic research have suggested different roles for entrepreneurs in their theories. According to Jean-Baptiste Say (1839), entrepreneur is the basic unit of market economy and he is the one who bears the responsibility of coordinating and combining resources of production. It was Say, who considered entrepreneur to be fourth factor of production (Casson, 1982).

Kirzner (1973) identified the role of entrepreneur to be 'arbitrageur'. Arbitrageur is the one who has the capability of perceiving profit in the opportunities and he has the potential to earn profit from them. According to Gibcus et al. (2006), entrepreneur is the one who has the capability to sell some good at price greater than its cost. Schumpeter (1954) identified role of entrepreneur to be the directing the market towards equilibrium position. Another added by Schumpeter (1954) to characteristics of entrepreneur was being 'innovator'. According to Casson (1982), "entrepreneur" was first introduced in field of Economics by Adam Smith, and role assigned to entrepreneur by Adam Smith was the role of 'uncertainty bearer'. He bears the risk and uncertainty of starting a new and innovative business venture.

All of these roles of entrepreneurs were summarized by Shapero and Sokol (1982) who identified the roles of entrepreneur to be: (1) Risk-taking, (2) Relative Autonomy, (3) Management, (4) Consolidation and combining or resources and factors of production and (5) Initiative-taking. We can see that management is also taken to be responsibility of entrepreneur in this definition. Management is responsible for decision-making in businesses. This definition assigns the crucial process of strategic decision-making to entrepreneurs in small businesses.

6. Conclusion

Small businesses play an important role in economic and social development by providing employment, sustainable growth and development of economy, diversification and innovation in markets, social inclusion and joint efforts of society to build knowledge-based economy through use of high technology. In contrast to most of the quantitative research on entrepreneurial decision-making, which studies the relationship among the factors affecting decision-making, a conceptual framework was developed, based on review of established literature and results of previous researches. Relationship was established between entrepreneur, environment in which decision is take and strategic decision making process. This framework helped us identify most important factors that affect on entrepreneurial decision-making as well as understanding of entrepreneurial decision-making process as a whole. This will not only benefit the academic researchers but also the newly entering entrepreneurs in the field.

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