Entrepreneurs’ Role in Creating Purposeful Business Networks

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ABSTRACT

Networks provide vital resources for any business but perhaps more so for entrepreneurial ventures. This paper uses the case of a successful Australian entrepreneur to explore the processes by which networks are developed for the purpose of starting and growing new ventures. From the formation stage to growth stages of business, the entrepreneur’s strategic development of purposeful networks is instrumental in the success of his business. Findings of the case suggest the importance of pre-existing network relations in the early stage of business but referrals play an instrumental role as the business expands. Multiplex relations are evident from the formation stage of organization to growth stages. The development of networks is a combination of chance encounters and proactive cultivation.

Keywords: Entrepreneurial Strategy, Growth, Internationalization, Networks, Resources

The growing number of studies on entrepreneurs and entrepreneurship covers a myriad of topics and perspectives. Many studies examine entrepreneurs’ personality traits and orientations (Lee and Tsang, 2001; Tiessen, 1997; Wang, 2008), ethnicity (Werbner, 1999; Zhou, 2004) and gender (Birley, 1989; Fischer et al., 1993). Some scholars view entrepreneurship as the domain of small businesses with entrepreneurial ventures seen as the engine of growth for most economies (Lumpkin and Dess, 1996). Others suggest that entrepreneurs contribute to economic growth through innovation, productivity and job creation (Drucker, 1985; Frederick et al., 2006).

A central issue to the study of entrepreneurship is one of business growth and the resources required to generate rapid growth (Gundry and Welsch, 2001; Majumdar, 2008). The ability to generate growth is typically resource dependent (Jarillo, 1989). As resources are often limited, there is a clear need for entrepreneurs to acquire external resources. These external resources can be tangible, as with funding, production of goods or supply of labor. External resources can also be intangible such as technical know-how, marketing and management skills (Eisenhardt and Schoonhoven, 1996). Jarillo (1989 p.145) suggests that the “ability to use external resources” to achieve business growth “becomes a critical entrepreneurial skill”. Research suggests that entrepreneurs tap their personal and business networks to acquire external resources (Birley, 1985; Hite and Hesterly, 2001; Larson and Starr, 1993).
While a number of studies highlight the value of networks, most focus on the resources and opportunities that networks offer such as funding, knowledge and new markets. Few studies examine how entrepreneurs develop their networks in the first place and little is known about how entrepreneurs source new networks when existing networks are unable, or not available, to provide required resources.

Accordingly, this research examines the role of networks as an entrepreneurial strategy in forming and growing entrepreneurial ventures. Specifically, the main aims are 1) to explore the processes by which entrepreneurs create and manage networks for the purpose of starting and growing entrepreneurial ventures, both in domestic as well as in international markets and 2) to identify the types of actors involved at different stages of the entrepreneurs’ ventures. The paper begins by building on the formative entrepreneurial work on the role of networks in the formation (Larson and Starr, 1993) and growth (Birley, 1985; Hite and Hesterly, 2001) of organizations. After a review of literature, data from a case study is presented and analyzed. The results suggest that while pre-existing network relations of family and friends are fundamental, new business networks of suppliers and distributors are created through strategic search and referrals as the entrepreneur grows the venture. The paper ends with some limitations and suggestions for further research.

**LITERATURE REVIEW**

Entrepreneurial ventures require resources to start and grow and typically are dependent on external sources for funding and finance, knowledge and markets, labor and production (Jarillo, 1989; Pfeffer and Salancik, 2003). Acquiring and using external resources underpin the resource dependency theory of organizations. Resource dependency theory argues that no organizations are completely resource self-sufficient and that some organizations are better resourced than others (Pfeffer and Salancik, 2003). Entrepreneurs’ networks can provide critical access to external resources required for new ventures (Jarillo, 1988). A network is formed when two or more actors, whether individuals or organizations, are connected by social or business relationships (Birley, 1985; Bollingtoft and Ulhoi, 2005; Johannisson and
network relations as “those ties in the overall personal network that small-business person establishes and maintains in order to identify opportunities that may be exploited in the future”. An entrepreneur’s personal network consists of all individuals and organizations with whom the entrepreneur has direct relations (Dubini and Aldrich, 1991). Typically an entrepreneur’s direct links are with his family, friends and business colleagues. Most personal networks also provide indirect access to additional individuals and organizations not directly known to the entrepreneur. For instance a friend might refer the entrepreneur to a venture capitalist or a current supplier might refer a potential new distributor to the entrepreneur. Studies show referrals to play an instrumental role in business growth, allowing entrepreneurs to gain access to opportunities such as new markets (Reingen and Kernan, 1986; Yu and Singh, 2002; Yu and Singh, 2003).

Networks appear to be important even prior to the organization formation stage. At the sense-making stage of planning and developing business ideas, an important task is to identify, mobilize and acquire resources (Learned, 1992). Larson and Starr (1993) present a three stage network model for forming an organization. The model explains how simple dyadic relationships, typically one-dimensional social relations, can transform into multidimensional and multilayered relationships of social and economic exchanges. The first stage of network development focuses on dyadic relationships where the entrepreneur turns to social networks of family, friends and informal networks of prior business contacts. This stage, while providing essential resources such as information, advice and moral support, has potential for instrumental and economic purposes. At the end of the first stage where critical resources are identified and essential relationships are built, Larson and Starr (1993) propose that the entrepreneur moves to the second stage where dyadic ties transform into multidimensional ties of socioeconomic exchanges. Some social relationships take on business aspects, for example a family member invests in the entrepreneur’s venture, and some informal business relationships become formalized as contractual agreements take the place of casual discussions. The business interests of the actors become more
apparent, working and collaborative relationships start to form and business norms appear clearer in terms of mutual gains and reciprocity. At the same time, some newly formalized business relationships take on a personal or social dimension when the parties interact outside of work. This gradual crystallization of networks evolve to the third stage where the thrust is more strategic and links are dropped or strengthened through additional layers of exchanges, such as a vendor supplying new support services, a banker offering additional credit lines or a supplier engaging in joint research projects.

Like Larson and Starr (1993), Hite and Hesterley (2001) argue that socially-embedded, “identity based” network ties dominate when an organization is in its emergent stage and typically includes pre-existing relationships of friends and family (cf Greve and Salaff (2003 p.4)). Hite and Hesterly’s (2001) study suggests that, as an organization evolves from the emergent stage to growth stage, its networks become more “calculative” and provide a broader range of resources, such as more substantial finance and more economic exchanges. Calculative networks are more market-led, are less dense, and have a more diverse set of ties, which are typically weak. While the studies of Larson and Starr (1993) and Hite and Hesterley (2001) suggest a shift from affective ties to calculative ties, this suggestion contrasts with the findings in a longitudinal study by Jack et al., (2010). In the authors’ study of the configuration and reconfiguration of a network, findings show that ties evolve from being calculative to affective which suggests the importance of social connections in a network. Other studies, however, do not feature this shift in network orientation. For example, Coviello (2006) argues that economic (calculative) network ties dominate in all stages of business formation, from the emergent stage and into the internationalization stage.

Many organizations include internationalization as part of their growth strategy. Internationalization is a dynamic process and international markets present new opportunities. Market expansion increases the potential to access higher profits through economies of scales (Knight, 2000; Kotler et al., 2007). Bell (1995) observes a strong network approach in the export behavior of 187 firms, noting in particular, the firms’ relationships with suppliers which provides a platform for their export
businesses, thus supporting the view of Welch and Luostarinen (1993) that suppliers’ added value and services offer opportunities to export markets. For knowledge-based and high technology firms there seems to be a pattern of relying on network relations in their internationalization process (Bell, 1995; Jones, 1999; Mort and Weerawardena, 2006). Furthermore, studies indicate that firms with diverse networks tend to internationalize more rapidly than firms with limited networks (Chetty and Stangl, 2010; Loane and Bell, 2006). Freeman et al., (2010) suggest that internationalizing firms use pre-existing relationships as well as newly formed relationships to generate rapid internationalization.

Internationalizing entrepreneurs regard government agencies as networks of information as well as providing links to international markets through trade exhibitions (Ramirez-Pasillas, 2010; Kontinen and Ojala, 2011). For family-run entrepreneurial firms, trade exhibitions provide the primary context to internationalize (Kontinen and Ojala, 2011). Clearly, evidence shows that networks provide critical resources to entrepreneurs but studies are needed to understand the processes by which entrepreneurs develop their networks and to examine who are the key network actors at different stages of the business.

**RESEARCH METHODS**

One of the concerns put forth by researchers who examine entrepreneurs’ networks is the preference for quantitative rather qualitative studies (Jack, 2010). The preference for quantitative work may be a result of such criticisms of qualitative work as its limited statistical generalization and difficulties in studying networks beyond dyads (Johannisson, 1995). Recent studies suggest that qualitative, together with quantitative, research is more promising in exploring the role that networks play in connecting entrepreneurs to resources (Gartner and Birley, 2002; Jack, 2010; Jack and Anderson, 2002). Indeed, Hoang and Antoncic (2003) plead for more qualitative work so as to stimulate new theoretical ideas. Qualitative approaches are valuable in exploring network development and in explaining types of relationships and contacts (Birley, 1985; Huggins, 2000). Rather than just providing measured responses, qualitative research facilitates in-depth understanding of issues, giving opportunities to explore and
explain the context of the interplay between business and social ties and how actors connect with one another.

Accordingly, this research adopts the qualitative approach of a single case study. A case study allows an investigation to retain the holistic and meaningful characteristics of real-life events (Yin, 1994). Case studies are particularly useful in examining the “why” and “how” of situations, processes and decision making. Furthermore, richness of detail and in-depth knowledge are revealed in case studies (Rouse and Daellenbach, 1999). Although Yin (1994) proposes that multiple case studies are preferred as a more robust research design, each case study gathers evidence and directs attention to issues to be examined. In addition, Eisenhardt (1989) suggests a single case study allows focus on understanding dynamics within a single situation.

**Research Context**

The Australian healthcare industry provides the context for this study. Healthcare exhibits many entrepreneurial characteristics such as creativity, innovations and risk taking. Datasets of organizations in the Australian healthcare industry (Austrade, 2011a; Austrade, 2011b; CHC, 2011) show many are owner-managed, suggesting a high level of entrepreneurship. Healthcare is a knowledge-based industry and is considered one of the most science-intensive segments of the economy (Cockburn and Henderson, 1998). It is an industry that requires networks to collaborate in sharing knowledge as well as in sharing the high cost of research and development (Bower, 1993; Depret and Hamdouch, 2000; Powell, 1998; Staropoli, 1998). In addition, studies show that knowledge based and technology intensive industries tend to exhibit higher levels of networking activities to source opportunities for business growth (Keeble et al., 1998; Mort and Weerawardena, 2006).

**Sample selection**

As random sampling is not appropriate for qualitative work, a combination of purposive and convenient sampling was used to select the entrepreneur and the entrepreneur’s organization for the case study.
(Miles and Huberman, 1994). Selection was based on entrepreneurs in the Australian healthcare industry who 1) started their own organizations, 2) continue to manage their organizations and 3) whose organization involves multiple network connections. An Australian entrepreneur, and a prior business contact of one of the researchers, was approached to participate in the study, code name Beacon. Beacon fits the concept of a serial and habitual entrepreneur (Alsos and Kolvereid, 1998; MacMillan, 1986; Wright et al., 1997). Beacon started his first company in 1990. The company develops and markets a range of functional skincare products registered with the Australian Therapeutic Goods Authority (ATGA). The company started small and was initially managed by Beacon and his wife. The company’s first export was to Canada in 2001. Beacon built his company to a level where he was able to sell his company’s brand and product range to a multinational company in Australia in 2003. Since the sale, Beacon started two other companies with one of them focusing on international markets. Currently, Beacon’s products are available in over 20 countries with UK and USA being his two largest export markets. Sales offices have since been set up in London to service the UK and European markets and Miami to service the US and Canadian markets.

To obtain Beacon’s agreement to participate, first contact with Beacon was by telephone where the researcher briefed him on the aims of the research and advised that participation involved an hour to one and a half hour face interview. On Beacon’s agreement to participate, the researcher scheduled the interview time which was confirmed by email. In the email, a letter of information and consent together with a semi structured questionnaire guide were attached for Beacon’s information. The next contact was the face interview. Extensive notes were taken during the one and a half hour interview with the interview being audio recorded to assist and ensure accurate transcription. Following the face interview a number of phone contacts and emails took place to verify and expand the data collected.

**ANALYSIS**
Analysis started with the process of coding, categorizing, abstracting, comparing and integrating the qualitative data from the interview (Miles and Huberman, 1994; Spiggle, 1994). At the first level, data were coded into chunks of information which included Formal Networks, Informal Networks, Business Growth, Exports, Strength of Relationships, Intentional Creation of Relationships and Chance Relationships. These chunks of information were further analyzed, segmented and categorized based on commonalities (Spiggle, 1994) such as domestic sales functions among different networks of distributors and relationships across the different stages of the business (i.e., planning, emergent, growth at domestic and international markets). At the second level of coding, patterns, themes and concepts were identified. An iterative process of reviewing the coding and cross checking with notes and audio recording was done to achieve analytic closure (Miles and Huberman, 1994).

RESULTS

Beacon’s business model is based on outsourcing all key functions of manufacturing, logistics and selling while he focuses on product development and marketing. Beacon’s business philosophy is to “outsource everything but passion for the business”. In line with this business philosophy Beacon actively and deliberately pursues relationships with business partners. Beacon sees his entrepreneurial role as focusing on seeking knowledge and information that lead to opportunities. In his own words, he is always “…in permanent information gathering mode” as each network actor is a source of information and offers potential connections to other sources and resources. Diagram 1 shows Beacon’s key network actors based on business functions from the stages of planning (stage 1) to emergent (stage 2) and growth (stage 3).
Diagram 1: Key network actors based on business functions from planning to growth stage

Stage 1: Planning

Beacon’s network development starts with family and friends. At Stage 1 - a cluster of family and friends as well as consultants dominate the network relations, for example, when Beacon is planning his venture, his aunt, who is a pharmacist, helps him develop and refine product formulations. This is consistent with Greve and Salaff’s (2003 p.4) suggestion that at planning stage, entrepreneurs limit their
networks to close friends and family. Unlike Larson and Starr’s (1993) stage one where network ties are limited and perform a single function, Beacon’s networks from stage one are multidimensional. His aunt, for instance, is both family and assists in product development, and his accountant is also a friend. His other key sources at stage one are government websites and government agencies, such as AusIndustry and Austrade. He also is a member of business and industry associations and from these networks he gathers information on business consultants, manufacturers and suppliers.

**Stage 2: Emergent**

At stage two where the organization emerges, Beacon focuses on establishing formal business network relations to start operating such as regulatory consultants, contract manufacturers and sales brokers. These formal business ties involve contractual agreements to supply goods and services. Even as these core operating activities are put in place, he strategically cultivates other relations, both formal and informal, through constant listening and asking questions, to access valuable market intelligence and opportunities. For instance, a supplier introduces him to a new ingredient that can give Beacon a competitive edge in new product development which confirms Welch and Luostarinen’s (1993) point that entrepreneurs should choose suppliers carefully for their value added services and knowledge. In this emergent stage, Beacon’s proactive network activities are motivated by a need to gain legitimacy (Elfring and Hulsink, 2003) and overcome newness and size related constraints: “We really have to work very hard to convince our network partners to work with us because we were a nobody”. As the business expands, the role of certain networks such as family and friends becomes less important as depicted in gray and italics in Diagram 1. At the same time networks of key business functions start to become more prominent, suggesting a shift from affective ties to more calculative ties (Hite and Hesterly, 2001; Larson and Starr, 1993). The participant’s motivation for extensive networks is not only for resources and services but for knowledge, information and market intelligence (O'Donnell, 2004). By his own admission, valuable market intelligence and opportunities are gained through constantly meeting people, asking questions, listening and constantly being in “permanent information gathering mode”.
Stage 3: Growth (Domestic and International)

While some network ties are dropped and new ones added as the business expands (Larson and Starr, 1993), the majority of Beacon’s networks remains with his business from planning to growth stage: “… it’s a challenge because we were nobody and we didn’t have much of a business to start with but … we are genuine people, we pay our bills and we are growing and so we develop relationships …and now we have very strong trust relationships with our contract manufacturers and they have been able to grow with us”. This is consistent with Greve and Salaff’s (2003) findings that effectiveness of existing network ties reduces the need to search for new ties. At the domestic growth stage of business, Beacon’s focus moves to sales and marketing networks of distributors and sales brokers. At this stage, his key source of service and information comes from distributors and retailers whom he meets regularly. In addition, existing networks provide referral opportunities for Beacon. For instance, a sales broker who started with him in New South Wales connects him with contacts in Queensland, thus enabling Beacon’s products to be marketed in Queensland.

While Beacon’s initial network relations are instrumental in the start-up and domestic growth of his business these same networks are unable to provide links to international markets. Consistent with Loane and Bell’s (2006) study, Beacon has to create entire new networks in expanding his international ventures. His first export market comes from an unsolicited enquiry from Canada. From this one source, he expands his international business through frequent oversea travels and just “… really getting out there and asking questions...really slogging at it.” In the early stage of his international ventures Beacon participates in government sponsored international trade fairs and exhibition but as his international ventures grow he finds government sponsored programs less effective: “I actually found them to be more of a distraction because they’ll take us in all directions and almost like, well …just less beneficial and that’s why we don’t do that anymore”. While a number of studies suggest the positive role of government agencies in helping entrepreneurs to internationalize (Ramirez-Pasillas, 2010; Kontinen and Ojala, 2011), other studies suggest limitations especially in providing useful links to international networks (Loane and
Bell, 2006). Beacon’s international ventures expand through a network of international distributors which he purposively acquires as a result of frequent market visits, asking questions and seeking referrals. For instance, Beacon’s Canadian distributor introduces him to contacts in the Swedish market and his French distributor helps with the Spanish market. Referrals play a major role and have been effective and instrumental in Beacon expanding his international ventures: “…we have clients so, you know, they have many other clients … so we keep asking the right questions, maybe gave us a couple of names and clients in other markets”.

Beacon was further asked to identify the level of deliberation in pursuing the network relationships. He identified relationships he proactively cultivated, those that were fortuitous and those that occurred through luck and effort. Beacon also indicated the strength of each relationship based on a Likert scale from 1 to 5 with 5 being the strongest. Table 1 gives a summary of the network actor characteristics reported.
Two major observations emerge. While Beacon admits the role chance plays in network development, he emphasizes the advantages gained from proactively pursuing essential contacts as well as prospective ones. Secondly, Beacon identifies over fifty percent of his network relationships as strong, suggesting a high level of trust and a willingness to help each other, “...we have very strong trust relationships, they have been able to grow with us where literally, you know, they’ll drop everything else to help us, and we ... help them”. This is consistent with studies that indicate strong relationships, as opposed to weak
relationships, encourage trust resulting in the sharing of fine-grained information and tacit knowledge (Coleman, 1988; Uzzi, 1997).

**DISCUSSION**

A key insight resulting from this research is the importance of active engagement in continuous and extensive, proactive development of business networks at every stage of an entrepreneurial venture. Beacon’s business model is simple and that is to outsource as many key business functions as possible while he focuses on product development and brand building. For his business model to be effective, he has actively sourced and pursued instrumental networks. His development of networks are purposive and strategic (Hite and Hesterly, 2001) whether in seeking resources or simply sourcing information and knowledge for future use (Johannisson and Monsted, 1997 p.113). Beacon’s network of business relationships comprising consultants, manufacturing and logistics services, suppliers, distributors and retailers are invaluable in the emergent as well as growth of his business. Equally important is his network of family and friends. His network of informal personal and business relationships both in the domestic and international markets provide much diverse and useful information, connections (Granovetter, 1973; Hite and Hesterly, 2001), and referral opportunities in expanding his business, for instance, New Sales Wales sales brokers referring the participant to their Queensland network of sales brokers and at an international level, the Swedish distributor was referred to the participant from his Canadian distributor to name some examples.

**CONCLUSION**

Specifically, this study explores how networks are used as an entrepreneurial strategy in forming and growing entrepreneurial ventures and identifies key network actors involved. It is evident that networks present critical resources for entrepreneurial ventures. In the Beacon’s case, networks are his most important resources from planning to growth stage in domestic as well as international markets. Through
strategic and purposive development of business networks comprising key network actors such as family, friends, consultants, contract manufacturers, distributors and retailers, Beacon successfully starts and expands his business venture. Consistent with studies on entrepreneurs’ network, pre-existing personal networks of friends and family dominate the planning stage. As the business grows and existing networks are not able to provide required resources, Beacon actively develop new networks through referrals and consistently meeting people and asking questions.

Despite the main limitation of using a single case study approach, this study presents valuable insights to the processes by which entrepreneurs develop instrumental networks that provide access to critical external resources. This paper contributes to empirical knowledge and theory building by demonstrating the processes by which entrepreneurs strategically develop purposive networks, first by tapping into their pre-existing networks relations and when pre-existing networks are inadequate or insufficient, entrepreneurs develop new networks through active search and referrals. Some studies suggest that one-dimensional network relations dominate in the early stages of organization formation. It is evident from this research, however, that multiplex network relations are instrumental in the entrepreneurs’ venture, from early stage of organization formation and into the growth stages.

Future research should cover multiple cases and across different industries to examine differences and similarities in the study of entrepreneurs’ networks.

REFERENCES


