

The Impact of Economic Environment on Small Business Owners' Perceptions of the Future

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Abstract

While the body of research into small business activity has grown impressively over the last decade, some areas remain relatively unexplored. Much research has been offered to explain how managers act and how they feel about their business activities. This research relates the effect of the economic environment on those feelings. Further, it explores a variety of personal variables that might be expected to have some influence on small business owners' perceptions.

The results indicate strong support for a moderating effect due to the economic environment. In addition, significant support for age and education variables was evident. Different from many previous studies, variables such as religion, gender, marital status, and country of origin showed no significant difference in the owner's perception.

Small businesses represent an essential element of the economy of the United States. They provide about 70% of the new jobs and significantly contribute to the growth of the nation (Sexton and Kasarda, 1992). Small firms constitute more than 95% of U. S. business organizations (The State of Small Business, 1990). Small business owners are a major source of creative, or entrepreneurial activity. They are among the most active innovators and the driving force of expanding current organizations, starting new businesses, and changing the manner of doing business (Schumpeter, 1934). Therefore, understanding small business owners' behavior has a significant importance for academic researchers, government policy makers, and business practitioners.

Research on small firms is often divided along the lines of small business and “entrepreneurial firms”. This often accomplishes little more than to try to identify significant differences between the two, turning on semantic interpretations (Wortman, 1987; Miner, 1990; Begley, 1995). Existing research in both areas seeks to identify special traits such as race, ethnic background, education, age, and gender, that distinguish entrepreneurs from others (Wilken, 1979; Meyer, Tsui and Hinings, 1993).

Despite 30 years of searching, the result is disappointing. Researchers have been seeking new avenues. Increasingly, scholars pay attention to the relationship between the social environment and managerial actions. It is well recognized that entrepreneurs' perception on the nature of the economic environment determine their business decisions (Piore and Sabel, 1984;

Covin and Slevin, 1991). However, little is known about how the economic environment affects entrepreneurs' perceptions.

Smith and Miner (1983) found significant relationships between a firm's pattern of growth and the motivation of its managers. Campbell, Converse and Rogers (1976) have examined how managers react to the environment. They found that environment had a significant influence on business owners' satisfaction. Kuratko, Hornsby and Naffziger (1997) identified four factors that explained the small business owners' motivation for continuing the enterprise, but not across different environments. Penning's (1982) seminal work on the differences in entrepreneurial activity across differing urban environments provides a sound base for this study. He found that "the quality of life" influenced the frequency of the creation of new firms, but his research did not consider existing organizations. Numerous other studies have examined the perception of individual managers in small firms (Brockhaus, 1982, MacMillan and Day, 1987; Covin and Slevin, 1991), but did not control for variations in their environments.

Many important business decisions are made based on business owners' perception of the future. To understand how small business owners make their decisions we need to know how they perceive the environment and what factors influence their perception. This research project seeks to answer the question of whether differences across economic environments may be reflected in small business owners' perception of their business futures.

A THEORETICAL MODEL

According to Piore and Sabel (1984), the number of small business is a function of the economy. They have claimed that when the economy is growing and monetary returns increase,

business owners will be more optimistic and they will continue their businesses or invest in new business ventures. When the economy is declining and monetary returns decrease, business owners will be more pessimistic and reduce their investment in new businesses or divest existing businesses.

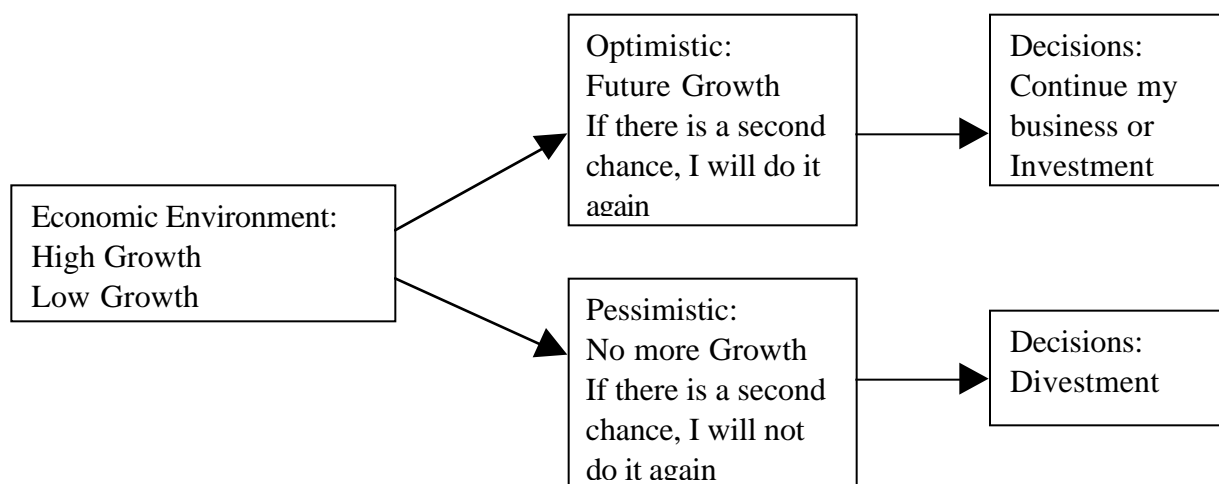
Based on their theory the decisions of continuing existing businesses, investing in new ventures, or divesting old businesses will respond to the economic environment.

In the body of strategic management literature, the theory of population ecology leads to similar conclusions. Drawing insights from the dinosaurs in natural history, this theory claims that when the economic environment changes from favorable to unfavorable conditions, many businesses, especially small organizations, are doomed to fail.

In the 1930's a group of economists developed an approach for understanding the relationship between a firm's industrial environment, its behavior, and its performance. (Mason, 1939; Bain, 1968). The theoretical framework that developed out of this effort became known as the structure-conduct-performance model (Sherer, 1980). This framework indicates that the structure of an industry defines the range of options and constraints facing a firm. In some industries, where perfect competition almost exists, firms have very few options and face many constraints. However, in other less competitive industries member firms face fewer constraints and a greater range of options. If industry affiliation does have a significant impact on firms' strategic options, when economic factors are less favorable a difference between firms in competitive and less competitive industries should be evident. Firms in a less competitive industry will have a better chance to survive than in a very competitive industry.

However, many researchers pointed out that during the recession in the early 90s, while many large corporations were forced to downsize, the number of small businesses was actually increasing and small businesses provided the badly needed jobs for Americans. Light and Karageorgis (1995) argue that economy may not be the critical factor for the creation of entrepreneurs.

Those theories developed in multiple disciplines regarding to the positive relationship between economic conditions and small business performance have not been empirically tested. It is this research project's intention to test a theoretical model based on those theories linking the economic environment, small business owners' perceptions, and their business decisions together.



HYPOTHESES

To test those basic theories across different economic environment, we formulated 2 hypotheses.

Hypothesis 1: Small business owners' perception of their business future will not differ across different economic environments.

Hypothesis 2: Small business owners' perception of their business future will not differ

significantly across different industries.

METHODOLOGY

This study examines the perception of small business owners across five New England states that had significantly different economies in 1992.

A statistical model is employed to examine a data set collected by Fleet Bank in 1992. The data set contains 1,100 cases. Each case consists of 42 measures regarding small business owners' background, perception of themselves, and perception of their business future. The data collected represent five New England states and sixty two cities and counties in New York state. Because the data were collected through a questionnaire all data are categorical.

The region, like the rest of the United States, was beginning to emerge from a period of recession. The individual states had implemented programs to hasten that process and it could be discerned in the economic climates.

Economic information from "Statistical Abstract 1994" that measured the GDP growth rate consists of the indicator of relative economic situation of each state in 1992. This group of data does not include New York because the same economic information is not available for counties and small cities.

DEPENDENT VARIABLES

Two dependent variables were used to measure small business owners' perception of the future of their businesses. The questions asked on the survey were:

1. Do you feel your company has grown more or less as large as it ever will, or you

anticipate further growth?

2. If you had to do it over again, would you still own your business?

Those two questions were then converted into dichotomous variables. They are identified as FUTUREGR for the first question and DOITOVER for the second question.

The questions have two possible answers, therefore each of the variables has two values; 1 and 2 representing pessimistic and optimistic perception of the future respectively. For example, for question 1, answer 1 means "my business has grown as large as it ever will" and answer 2 means "I anticipate further growth".

INDEPENDENT VARIABLES

The independent variables consist of the economic condition indicators constructed for each state and industry identification numbers. In addition, the demographics of the individual respondents; family background, education, gender, age, income, religion, country of ancestry, race and marital status are included in the statistic test as control variables. The independent variables are coded as STGDPGW (state GDP growth rate) and INDUSTRY (the industry the business is in). The control variables are EDU (education), AGE (age), INCOME (business income), SEX (gender), FAMILYBK (family background), RELIGION (business owners' religion affiliation), COUNTRY (the country their ancestors immigrated from), RACE, and MARITAL (married, single, divorced, or other).

THE STATISTICAL TEST

Because of the nature of the data, chi-square test is employed.

Conventional statistical techniques such as multiple regression and discriminate

analysis are not used because they are inappropriate when the dependent variable can have only two values; as examples, yes and no, or positive and negative. Under such circumstance the assumptions necessary for testing hypotheses in regression analysis are violated. It is not acceptable to assume the distribution of errors is normal. . Another statistic tool, Log Linear Analysis, was not used because of the nature of the independent variables (they are not continuous variables).

The chi-square test is essentially concerned with the differences between the frequencies that are obtained from the sample survey and those that could be expected to be obtained if there were no true differences among the categories of the variables. In other words, the chi-square test intends to identify whether the perceived findings are real or the result of sampling error. With reference to the hypotheses, under the assumption of no difference, we would expect that the overall percentage of those who are pessimistic or optimistic would also be the percentage of such as their sex, their educational level, and family background etc.. The fundamental meaning of the assumption is that if the percentages associated with the categories are the same as those associated with the entire distribution, it may tell us that the two variables in the contingency table have no relationship to each other. For example, the economic conditions would have no impact on business owners' perception on their business future.

Calculation of the chi-square statistic (χ^2) consists of measuring the difference between the expected frequencies and those obtained through the survey process. The equation looks like the following:

$$\chi^2 = \sum \frac{(f_o - f_e)^2}{f_e}$$

Where f_o is the frequency obtained in each cell and f_e is the frequency expected in each cell under the assumption of no difference.

RESULTS

The test ran FUTUREGW first then DOITOVER next. The statistics are coming from several contingency tables. Two summarizing tables are listed as following:

Table 1. Summary statistics for Future Growth (FUTUREGR)

Variable	Pearson Chi-square	Likelihood Ratio	Significance
STGDPRW	10.466	9.989	.033*
EDU	30.462	28.469	.000**
AGE	32.506	32.760	.000***
INCOME	7.855	8.207	.249
SEX	1.531	1.463	.216
FAMILYBK	16.166	16.064	.003**
INDUSTRY	15.174	16.834	.175
RELIGION	6.088	6.342	.298
COUNTRY	2.501	2.726	.962
RACE	1.062	1.118	.900
MARITAL	5.560	5.388	.234

Table 2. Summary statistics for Do it Over (DOITOVER)

Variables	Pearson Chi-square	Likelihood Ratio	Significance
STGDPGW	9.989	9.069	.041*
EDU	4.134	3.754	.388
AGE	13.228	13.766	.010*
INCOME	8.280	9.727	.218
SEX	1.504	1.098	.220
FAMILY BK	3.422	3.306	.490
INDUSTRY	.490	3.080	.669
RELIGION	1.200	1.435	.945
COUNTRY	5.283	6.903	.727
RACE	2.279	3.541	.685
MARITAL	.785	.803	.941

*Hypothesis rejected at < .05 level

**Hypothesis rejected at < .005 level

DISCUSSION

The statistic results indicate that economic conditions have a significant impact on small business owners' perception of their future. STGDPGR is significant for both dependent variables. It is quite likely that a more promising environment fueled by heightened business activities provides a positive outlook. The alternative hypothesis that favorable economic environment will generate optimistic attitudes is confirmed.

Similarly, age of small business owners also has a significant impact on both dependent variables. A clear pattern shows that the older the owner is, the less positive his or her responses are regarding to the future.

Regarding to future growth, those who have more years of education felt much more positive than those who have less education. We propose that the group of respondents who have more education feel that they will be able to leverage education as a resource in a knowledge economy, therefore they will be more optimistic about their future.

Results of the family background indicate that the first and second generation respondents, new immigrants, felt less optimistic than respondents whose families have been living in the U.S. for more than three generations. The impact of family background may come from the insecure feelings of the first and second generation of immigrants.

Overall, the results for the first hypothesis tested reveal that in the majority of the cases the null hypothesis could not be rejected.

It is surprising that no significant difference occurs across industries. This may be explained by the fact that 55% of the sample is from manufacturing industry and 70% of the

sample is from manufacturing and retail businesses. Each of the rest of 10 industries only count for 1.6%, 1.5%, 3.9%, 2.2%, 7.4%, 1%, and 5.4% respectively. When taking the manufacturing industry and the industries that count for less than 1.5% of the sample out of the picture, the chi-square becomes significant at .05 level.

This study finds that contrary to some studies that showed religion and country origin to be important factors in starting small businesses, there is no difference in this sample. Neither marital status nor race or gender or income is significant. These findings are also somehow controversial to previous findings.

CONCLUSION

Through their independent contribution to the economic development and growth, small business operators play an important role in our society. A complete understanding of how small business owners and/or managers make their decisions will significantly contribute to the existing management theory and practices. It will also help to improve government policy to encourage the creation and continuation of small business organizations in different regions.

This research project clearly demonstrates that economic environment affects small business owners' perception of their future. It tells us that there is a positive relationship between economic growth and small business owners' positive perception of their business future. This finding may provide a theoretical framework for many future research projects on entrepreneurs' decision-making processes.

Industry may be an important factor influencing small business owners' decisions. However, due to the structure of our data this impact is not obvious, further research is needed.

The relationship between age and small business owners' perception of their future is also very interesting although it is not the focus of this paper. The younger the small business owners are, the more positive perception toward their business future they have.

In summary, this research project has found confirming evidence and made a positive contribution to existing knowledge about how economic environment affects small business owners' perception of their future and their business decisions. The results will be beneficial for both business owners and government policy makers.

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