

# Dynamic Pattern of Entrepreneurial Networks in Developing Countries

## A Managerial Approach

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The paper evaluates the dynamic pattern of entrepreneurial networks in small business development. The pattern emphasizes importance of different types of entrepreneurial networks in different phases of development of a small firm. In this paper, members of entrepreneurial networks are classified into three components: namely, social, professional, and inter-firm actors. It is assumed that members of social network are important in pre-start-up phase of a firm, and members of professional are important in the start-up phase while actors inter-firm strategic network play a major role in the on-going phase. The results of the study, however, indicate that while social networks are important in every phase of a small firm in Sri Lanka, the professional networks play a minor role. The role of inter-firm networks is crucial during the on-going business phase. The empirical evidence of the study is based on extensive interviews with 303 small business entrepreneurs in Sri Lanka, which is considered as a less developed country.

Networks can be defined as a set of nodes and the relationships that connect them (Fombrum 1982). Alternatively, as Dubini and Aldrich (1991: 305) put it, a network is a set of 'patterned relationships between individuals, groups, and organizations'. Importantly, however, networks are not static: they are dynamic (Birley and Cromie 1988, Butler and Hansen 1991). Relationships, as Grabher (1993: 5) reminds us, are 'continuously constructed and reconstructed during interaction'. While the entrepreneurial network often becomes 'amplified' as the firm grows, entrepreneurs typically encounter difficulties in extending and sustaining appropriate relationships (Venkataraman 1989). To understand networks, therefore, requires an understanding of the dynamic pattern of networks.

### ENTREPRENEURSHIP RESEARCH AND SOCIAL NETWORK APPROACH (SNA)

Entrepreneurship research has been guided by different schools of thoughts (see Kent, Sexton, and Vesper 1982; Veciana and Clarke

1996). Some of them focus on psychological aspects, researching behaviors or traits, or both. In this view, an entrepreneur is seen as a set of traits and characteristics (Brockhaus 1982; McClelland 1965). Some pay their attention to economic aspects, examining economic rational behavior of entrepreneurs. According to their view, the entrepreneur, motivated by the desire to maximize his personal utility function, with perfect information and a clear vision of his goals, makes the decision to start a business (Kahneman, Slovic, and Tversky 1982). The others focus on socio-cultural aspects, studying the social and cultural backgrounds of entrepreneurs. They describe entrepreneurship as influenced by membership in certain ethnic, religious, political, or occupational groups (Shapero and Sokol 1982). The common weaknesses of these traditional approaches mainly

relation or transaction. Sociologists, anthropologists, social psychologists, and organizational theorists have used this approach to study the relationship between people and organizations. The SNA has been suggested (Aldrich and Zimmer 1985; Birley 1985; Johannisson 1986) to explain why some people are more successful in initiating and maintaining businesses, discounting the personal, economic and socio-cultural factors. Furthermore, this approach was supposed to be more appropriate to explain entrepreneurship in Sri Lanka since Sri Lankans are collectivists and group-dominated. In such a collective society, it is natural to use the SNA to study entrepreneurship (Chu 1996; Redding 1990).

People might, sometimes, have some ideas, skill, but to start a new business they also need influence, encouragement, etc. In other words, a single person usually does not have all the necessary resources to start his own business. According to the SNA, most resources have to

TABLE 1

Different Networks for Different Business Phases

Business Phase	Type of Networks	Role of Networks
Entrepreneurial Phase	↔ Social Networks	↔ Opportunity identification
Business Start-up Phase	↔ Business-focused Networks	↔ Business formation
On-going Phase	↔ Inter-organizational Strategic Networks	↔ Linkage firm to other organization.

include the unrealistic assumption that resources including information are freely available. This unrealistic assumption guided researchers in recent years to develop a thought for the study of entrepreneurship, focused on the mechanisms through which the entrepreneurs obtain necessary resources. The new thought is named as the Social Network Approach.

The logic of SNA on studying entrepreneurship starts at the point where two people establish a

be obtained from outside or his external environment through the entrepreneur's personal networks. In this regard, entrepreneurial process involves the gathering of scarce resources from external environment and entrepreneurs usually obtain these resources through their personal network (Birley and Cromie 1988; Curran *et al.* 1993, Ostgaard and Birley 1996). The existing literature suggests that the entrepreneur's personal network is really an *opportunity set*, which helps new entrepreneurs

to access both tangible and intangible resources (Butler and Hansen 1991, Falemo 1989).

By its nature, firms, however, face different problems and requirements in different phase of their development. Firms therefore need different resources and support in different phases. Before starting a new business that, according to Butler and Hansen (1991), is an entrepreneurial phase, entrepreneurs develop their ideas. Afterward, at the real start-up stage of a firm, an entrepreneur starts planning the business in detail, which includes

working on financing the business, setting up business deals and agreements, etc' (Bridge, O'Neill, and Cromie 1998; Gibb and Ritchie 1982). At this business start-up stage, start-up tasks such as finding initial capital, suitable site for the new firm, selecting supplier and buyers must be completed. After the business starts its operation, firms not only seek raw material, markets and various other supports, but also try to minimize transaction costs as well as risks of failure. In this regard, Butler and Hansen (1991) identified a model to evaluate different types of networks, their role and impact on different phases of a firm development. According to their model, three phases of business development have been identified: namely (1) entrepreneurial phase, (2) business start-up phase, and (3) on-going business phase. Three different types of networks are shown to run parallel to the three phases of a firm development. They are social networks, business-focused networks, and inter-firm strategic networks respectively. Relatively similar identification has been made by Birley and Cromie in 1988. According to Birley and Cromie (1988), entrepreneurial network development moves from start-up networks, where social network relationships predominate, to a growing network, where professional network relationships predominate. Social network includes relatives and friends with whom the entrepreneur interacts to primarily on social level, while professional network consists of all those individual relationships that are primarily concerned with business. Inter-organizational network includes supporting agencies (such as government agencies, NGOs, banks, etc) and other business firms.

The main research question for this study is, 'how does small entrepreneurs develop and utilize their networks at different entrepreneurial stages'. Applying the SNA to study and explain entrepreneurship in less developed

**TABLE 2**  
Network of Small Entrepreneurs in Sri Lanka

Phases of Entrepreneurial Development	Phase I: Pre-start-up	Phase II: Start-up	Phase III: On-going
Influential Actors	Relatives, Friends, Former co-workers	Relatives, Friends, Former co-workers, Supporting agencies	Other firms Supporting agencies
Types of Networks	Social	Professional	Inter-firm
Relational form Density Centrality Reachability	High High High	Medium Medium Medium	Medium Low Medium/Low

countries is relatively new. Only limited studies (Chu 1996; Wong 1992) have been based on this approach in context of less developed countries. The purpose of the study is to examine the dynamic pattern of entrepreneurial network in different phases of small enterprises in Sri Lanka, a South Asian developing country, which is considered as less developed country (<http://www.worldbank.org>).

#### DATA

The population of this study is small business in Sri Lanka. The definition of a small firm<sup>2</sup> according to the Department of Census and Statistics in Sri Lanka is one employing 25 or fewer workers. Apart from the Department Census, various organizations<sup>3</sup> involve different kinds of programs and activities for small business firms' development. They also use different definitions according to their purposes and programs. Some organizations provide training programs for entrepreneurial development. Some provide financial and other facilities for small business firms. In addition to these national-wide institutes, other local information was also used to identify small businesses.

In this study, 303 small business owners/entrepreneurs were interviewed. An interview schedule with questions related to the firm background, personal background of the entrepreneurs, network members relational content and form was designed and tested prior to data collection. Regarding the basic characteristics of the sample, most of the enterprises are manufacturing firms (70 percent of the respondents); 81 percent of firms are located in rural area; and 78 percent of owners are male. The number of average employees of the firms is 7; and the average lifetime of the firms is 8 years.

#### FINDING AND DISCUSSION

With regard to the phase of entrepreneurial development, the network actors change as indicated in

**Table 1.** As noted earlier the different phases include pre-start-up, start-up, and on-going phases. In the pre-start-up phase, potential entrepreneurs develop their ideas, and seek advice, initial capital, and moral support from their relatives, friends, and former co-worker, etc. These actors and relationships with them have been identified as social networks (Aldrich and Whetten 1981; Aldrich and Zimmer 1986; Brown and Butler 1993; Butler and Hansen 1991). In the second phase, entrepreneurs develop professional networks,

which include also relatives, friends, ex-co-workers, and supporting agencies (see Table 1). In developed countries, the professional networks consist of expertise such as lawyers, accountants, banks, etc. Since the nature of small enterprises in Sri Lanka is more informal, these types of professional services are mostly not necessary and thus the services are being done by relatives, friends, former co-workers, and supporting agencies such as NGOs, government officers. In the on-going phase, inter-firm networks predominate. The networks include other firms (small and large) and supporting agencies. This study considers banks as supporting agencies because banks provide various types of supporting services including finance to small scale enterprise sector in Sri Lanka.

With regard to relational forms of entrepreneurial networks, the study measured network density, centrality and reachability. We found that in pre-start-up phase where the social networks are predominant, the relational forms tended to be high among the small enterprises in Sri Lanka. In the start-up phase, the relational form is medium on density, centrality, and reachability. However, in the on-going phase, the relational form is different from the previous two phases: density is medium, centrality is low, and reachability is recorded in between medium and low (see Table 2)

It is very common for small entrepreneurs in Sri Lanka to follow such as evolutionary network model to meet the different needs of different phases of entrepreneurship. As noted above, an entrepreneurial network consists of three types of actors, namely social, professional and organizational. In entrepreneurial phase, a larger part of entrepreneurial networks comprises of social actors such as relatives, friends. Accordingly, the study found that entrepreneurs discuss with their relatives, friends

and formal co-workers before they practically start their business. These discussions help for new entrepreneurs to identify business ideas, to find initial capital and a site for a business. Besides, these discussions also encourage new entrepreneurs. This is the stage where business ideas are developed and social support is sought (Bridge O'Neill, and Cromie 1998; Butler and Hansen 1991; Larson and Starr 1993). Professional and organizational actors play very small role in this phase when compared to other two phases (see Figure 1).

In literature, we found that professional actors play a major role in creating a new business (Birley and Cromie 1988, Butler and Hansen 1991, Chu 1996), but this study identifies that social actors still are important for small entrepreneurs in Sri Lanka. The reason is that, as argued above, small entrepreneurs do not look for such professional services since government regulations such as registration, taxation, etc mostly do not affect these small firms. Our study further found that if those services are necessary, small entrepreneurs consult their relatives, friends and ex-co-workers.

Finally, in on-going phase, other organizations including other small and large business firms are the major and important components of entrepreneurial networks. Theoretically, social actors play little role in this phase. Nevertheless, as shown in Figure 1, social actors still play a major and important role in Sri Lanka. We found that small firms in Sri Lanka are often looking for supports from relatives and friends rather than from formal organizations. These small enterprises look for customers through the social actors. They find and start subcontracting works through their social actors. Even if they need some support from formal organizations, first they look for someone (friends or relatives) who is familiar to those organizations. It could be due to the existing bureaucratic system in Sri Lanka.

As mention above, networks are not static. They are constantly changing and evolving, and a major challenge for the entrepreneurial firm becomes the handling of changing criticalities arising from growth: indirect or new links may become more centrally important; other, previously critical links, become less so. As the patterns of importance change, the entrepreneur faces the need to reshape the network in order to improve its efficiency and effectiveness. Growth, in other words, is frequently associated with evolving criticalities and thus raises, again, the managerial problem of handling network overload whilst gaining diversity; but, this time, with the complication of having to reshape the network to align it with new requirements.

### CONCLUSION AND IMPLICATIONS

Network linkages are very significant for a collective society. The social network approach can be used to explain entrepreneurship in such a collectivist society. As Sri Lanka is a collectivist and group-dominated country, entrepreneurs use their social network relationships for the success of their business. Particularly small entrepreneurs obtain adequate and timely support as well as resources through their network members. In this study, it is however found that during different phases of entrepreneurship, different network members become more important. The study therefore suggests that combinations of network strategies are more appropriate when promoting small enterprises. For instance, in pre-business start-up and start-up phases, social network members are more important while inter-organizational network members, particularly inter-firm strategic networks are more significant for on-going business phase. The findings of the study are consistent with past studies (Butler and Hansen 1991, Birley and Cromie 1988, Chu 1996). Nevertheless, the importance of professional network members is not significant among the small entrepreneurs in Sri Lanka. It is basically due to the informality of the small enterprises. The role of the

professional network is mostly done by relative and friends. Another interesting finding of the study is that social network members play a very important role even during on-going business phases. One of the reasons is that corruption, fraud, favoritism and nepotism are rather common in Sri Lanka. These things allow a few members of society to acquire unfair profits and benefits by bribing officials. Personal trust and loyalty are also important concepts in such a society. The study found that the social network relationships are particularly very important when small entrepreneurs dealt with subcontracting businesses. In this regard, business deals come after social relationships; thus social bonds become business bonds. In conclusion, it is worth reiterating the crucial importance of social network member in each phase of a small firm in Sri Lanka, though the members of entrepreneurial networks change over firm's life cycle.

However, since the social, cultural, and economic structures differ country by country, the small firms as well as the nature of entrepreneurial networks in Sri Lanka are not identical with the small firms and the entrepreneurial networks in other countries. Hence, more comparative studies are also suggested in the area of small entrepreneurs' networks in less developed countries in order to understand these socio-cultural and economic variations of small firms and entrepreneurial networks. The study also suggests that further theoretical insights are needed in order to get a better understanding of the dynamic pattern of entrepreneurial networks and their impact on business development process.

### Footnotes

<sup>1</sup> However, the boundary between the entrepreneurial and the start-up phase is relative/unclear. Greve (1995) suggests that the entrepreneurial phase is *motivation phase* where the entrepreneur is thinking of starting a business. Butler and Hansen (1991) identified it as *opportunity identification phase*. Then the start-up phase is defined as a time when practical steps are taken to start a business.

<sup>2</sup> However, the definition of small firms was a problematic issue particularly in commerce and service sectors.

<sup>3</sup> These organizations include government agencies, non-governmental organizations, and private firms. For example, Department of Small Industries (DSI), Industrial Development Board (IDB), National Craft Council (NCC), National Design Center (NDC), Sri Lanka Handicrafts Board (SLHB), National Youth Co-operatives (NYSCO), Export Development Board (EDB), Development Finance Institutions (DFIs), SANASA, Sarvodaya, Women's Development Center, etc.

FIGURE 1

### Dynamic Nature of Entrepreneurial Networks in Sri Lanka

