From Profit to Philanthropy

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Abstract

The following case is intended to supplement and apply concepts from entrepreneurship and/or management coursework tying in the importance of philanthropy and service-mindedness. Students are asked to think creatively and critically to maximize profits, which are then shared with a charity of their choice. The instructions for the activity are presented first to give a quick understanding of the teaching design. Then, the importance and relevance of these topics are briefly discussed, followed by the full experiential exercise information.

Keywords: Entrepreneurship, Start-up team, Team building, Philanthropy, Corporate social responsibility

Introduction

The following case is intended to supplement and apply concepts from entrepreneurship and/or management coursework tying in the importance of philanthropy and service-mindedness. Students are asked to think creatively and critically to maximize profits, which are then shared with a charity of their choice. The instructions for the activity are presented first to give a quick understanding of the teaching design. Then, the importance and relevance of these topics are briefly discussed, followed by the full experiential exercise information.

Student Activity Instructions

With no more than a $10 investment from each team member, your team must identify a way to make money and maximize profit of at least $X (with or without an initial student investment; *threshold is set by the instructor, but a minimum of $50 is recommended to inspire hard work*). Your team needs to be creative and collaborative in finding a business opportunity and use it to make a respectable profit. Examples of prior successful student projects include making/selling crafts (e.g., ornaments, t-shirts), décor (e.g., plants, flowers), food products, and activities/experiences (e.g., hayride, pumpkin painting station). Other service-focused projects might include fitness training, sports lessons, culinary training, and meal preparation/diet consultations. Students may choose a business opportunity *with* or *without* any tangible assets. Upon completion of the project, your team will donate the profit to a local charity of your choosing.

Introduction to Experiential Exercise: Foundational Knowledge

Entrepreneurship is the process of creating, developing, and managing a new business venture to create value, generate profits, and achieve success. In other words, it is "the pursuit of opportunity beyond resources controlled" (Eisenmann, 2013, pp. 1). It is an essential aspect of the study of management and leadership, as it encompasses a wide range of skills, knowledge, and practices that are crucial for building and growing successful organizations. Entrepreneurs are typically the driving force behind new ventures, and they bring a unique set of skills and knowledge that are essential for identifying market opportunities, developing innovative ideas,

and creating products and services that meet the needs of consumers. Since entrepreneurship serves as a key driver of economic growth and innovation, it is therefore critical for managers and leaders to understand how to foster and support entrepreneurial activity.

Entrepreneurship is important because it can help organizations to become more innovative and adaptable in the face of changing market conditions. By fostering a culture of entrepreneurship within an organization, managers and leaders can encourage employees to think creatively and take risks, which can lead to the development of new products and services, as well as new business models and strategies. In this way, entrepreneurship can help organizations to stay ahead of the curve and remain competitive in the long run. Rather than relying on established procedures and routines, entrepreneurs must be comfortable with uncertainty and ambiguity, and be willing to take calculated risks to achieve their goals. By studying entrepreneurship, managers and leaders can learn how to cultivate this mindset within themselves and their teams, and develop the skills and knowledge needed to succeed in an increasingly dynamic and competitive business environment. By understanding the unique challenges and opportunities associated with entrepreneurial activity, managers and leaders can gain valuable insights into how to create, develop, and manage successful organizations.

For this experiential exercise, students are asked to apply these entrepreneurial concepts to start a small business of their own. These skills, even when applied in a small-scale course activity can help learn applicability of creativity, innovation, market identification, and risk management, all of which can be carried over into personal careers.

Further, philanthropy and corporate social responsibility (CSR) are also important components of the modern business landscape, and they are becoming increasingly essential to the success of companies. Philanthropy refers to the act of giving time, money, or resources to support charitable causes, while CSR involves integrating social and environmental concerns into a company's operations and decision-making as a form of compliance with laws and ethical standards (Adrian et al., 2013). Philanthropy is important for companies because it allows them to give back to their communities and support causes that are important to them. Through philanthropy, companies can help to address social and environmental challenges and make a positive impact on the world.

According to Carroll (1991), philanthropy is one of the four components of CSR, which also includes economic, legal, and ethical responsibilities. By engaging in philanthropic activities, companies can meet their CSR obligations and demonstrate their commitment to social

responsibility. In addition to the social benefits, philanthropy can also have a positive impact on a company's bottom line. Research has shown that consumers are more likely to purchase products from companies that are socially responsible (Du et al., 2010). By engaging in philanthropic activities, companies can enhance their reputation and improve their brand image, which can lead to increased sales and customer loyalty.

One of the key benefits of philanthropy and CSR is that it can help organizations attract and retain top talent. Employees are increasingly looking for employers who demonstrate a commitment to social responsibility, and companies that prioritize CSR are more likely to attract and retain the best and brightest employees (Waddock & Bodwell, 2004). In addition, CSR can also improve a company's financial performance, as socially responsible companies are more likely to attract long-term investors and secure financing (McWilliams & Siegel, 2001).

The final step of this experiential exercise requires that students donate all profits to a charity of their choosing; they also have the option to donate their initial seed money. By exemplifying the importance of philanthropy as embedded in this activity, students can practice skills and see the positive impacts first-hand. This foundational knowledge should be shared with students in related courses to lay the groundwork and emphasize the importance of these topics. Then, to facilitate leaning and application of management and leadership through the lens of entrepreneurship and philanthropy, the following class activity is proposed.

Learning Goals

1. Build an entrepreneurial start-up team.
2. Work as a start-up team to explore business opportunities and assess/generate ideas.
3. Apply necessary entrepreneurial skills to begin a small business and create revenue streams.
4. Manage money flow and revenue sources.
5. Think creatively to solve problems and find solutions.
6. Emphasize the importance of philanthropic giving and the overall benefits of giving back.

Approximate Timing

75 minutes – *initial activity assignment given in class*

30 days/4 weeks –*complete activity and debrief*

Materials Needed

Student handouts, including Resource Profiling Sheet, Instructions, and Peer Evaluation Form.

Preparation Needed for Students and Instructor (*Three Parts*)

1. Self-Introduction (20 minutes)

The class is presented the following questions. Every student should stand and answer the above five questions to complete their self-introduction.

1. What is your name?
2. What is your major?

3. Where are you from?
4. What is your near-term career plan (within five years after graduation)?
5. What is your long-term career plan (five years and onward after graduation)?

2. Resource Profiling (20 minutes)

After self-instructions, all students are provided the following handout.

Resource Profiling Sheet

Student Name:		**Major:**		**Meeting Availability:**	
Identified Problems	**Hobbies**	**Specialties**	**Access to Tangible Resources**	**Social Network**	**Other**
1.	1.	1.	1.	1.	1.
2.	2.	2.	2.	2.	2.
3.	3.	3.	3.	3.	3.

Students are instructed to write down their name, major, and times during the week that they are available for team meetings. Each cell under the second-row headers represents a question requiring three answers:

- ***Identified Problems*** – Students identify opportunities for products and/or services that are not readily available in the area (e.g., within 20-mile radius of the campus).
- ***Hobbies*** – Students list three things that they are most passionate about and/or are willing to spend a significant amount of their spare time working on.
- ***Specialties*** – Students list unique skills, training, activities, or knowledge of subject matter.
- ***Access to Tangible Resources –*** Students list valuable, physical resources to which they have direct access. For example, perhaps a student owns a pickup truck that can be used for large deliveries or has access to a uniquely pure mountain spring.

- ***Social Network*** – Students write down the names of their top three unique, valuable social network connections. Instruct students to focus on individuals from whom they can directly benefit (e.g., advice or help in building/broadening a business network).
- ***Other*** – In this column, students list any other pertinent information they want to provide to the team.

3. Team Formation (25 minutes)

Upon finishing the Resource Profiling Sheet, students are instructed to post their completed work on white boards, classroom walls, or a digital platform (if the class is online). Then, students should go around the classroom, read the posted sheets from their peers, and, using their disciplined imagination, decide who they want to approach regarding team formation.

Based on self-introductions and resource profiles, students will form their own teams of 3-5 members (depending on the class size). The following factors are recommended in team formation:

- Select team members based on resource profile information that may be conducive to a business idea.
- If possible, form a team of diversity in terms of major and sociocultural backgrounds.
- Ensure that the team meeting availability provides adequate time during the week for all members.

Review Activity Instructions with Students (10 minutes)

With no more than a $10 investment from each team member, your team must identify a way to make money and maximize profit of at least $X (with or without an initial student investment; *threshold is set by the instructor, but a minimum of $50 is recommended to inspire hard work*). Your team needs to be creative and collaborative in finding a business opportunity and use it to make a respectable profit. Examples of prior successful student projects include making/selling crafts (e.g., ornaments, t-shirts), décor (e.g., plants, flowers), food products, and activities/experiences (e.g., hayride, pumpkin painting station). Other service-focused project

examples might include fitness training, sports lessons, culinary training, and meal preparation/diet consultations. Students may choose a business opportunity *with* or *without* any tangible assets. Upon completion of the project, your team will donate the profit to a local charity of your choosing.

Requirements for Making Money:

1. Your actions must be legal and ethical.
2. Your quest for profit must involve creativity and innovation. That being said, asking friends or family for donations is not creative.

As with any entrepreneurial start-up team, contribution from each team member is critical for success. To encourage participation, you will be provided peer performance review forms which are used to gauge team member contributions (handout included directly below).

Your team will be required to prepare a final presentation, graded upon two factors: (a) the ***quality*** and completeness of the final presentation, and (b) the ***peer evaluation*** of your own contribution. This is how it works. First, your team will receive a grade for the presentation. Suppose your team's presentation grade is 80%. Then, this grade will be adjusted based on the peer evaluation points. For example, if a team member receives 80% of all the possible points on the peer evaluations, then this team member's grade will be calculated as 80% * 80% = 64% of all the possible points for the presentation.

A 10% tolerance shall be employed for peer assessments. In essence, when a team member garners a minimum of 90% of the total attainable points in peer evaluation, it strongly indicates substantial contribution. Consequently, this individual will receive the group grade. Conversely, if the said member accumulates 89% or less of the total available points in peer evaluation, it implies compelling evidence of inadequate contribution. Thus, the group project grade for this member will be modified as previously mentioned.

If a team member's lack of contribution is impeding the team's progress, the member may be fired by a unanimous vote of all team members. If this happens, the fired team member will be assigned to new, individual written analysis assignment by the instructor.

Peer Evaluation Form

Instructions:

1. Write all of your team members' names in the first column. Do not include your own name.
2. Using the provided scoring scale, assign scores to each of your teammates, and sum the Total Score.
3. Write any additional comments on the back of this page about the effectiveness of any or all of your team members.
4. Return your completed form to your instructor. Your responses will not be revealed to your teammates in any form in which you will be identifiable.

Peer Evaluation Form Continued[1]

Scoring Scale:

1 = Caused Major Problems 2 = Not Enough 3 = Enough 4 = Most of the Time 5 = All of the Time

Team Members' Names ⟶ *(Do not write in your own name)*				
1. Attends all classes, meetings, and events, and is on time or early.				
2. Notifies other members if going to miss class or a meeting, or if s/he will be late.				
3. Is professional and polite. Treats others (and their opinions) with respect. Doesn't make anyone feel stupid or left out.				
4. Completely fulfills his/her obligations by established deadlines. Does what he/she agreed to do.				
5. His/her **written work** is high quality.				
6. His/her **research** is high quality.				
Total Score:				

Write any additional comments on the back of this page.

[1] Thank you to colleagues at the University of Central Florida who made this form available to an author of this case.

Debriefing

Student teams conclude the project with a 15-minute in-class presentation to answer the following questions, which tie directly back to the learning goals:

1. How did your start-up team self-select? On which resource profiles did you find similarities/differences?
2. What are the some of the ideas that your team considered to raise capital?
3. What was the selected idea and how/why did the team choose this option?
4. How was your project implemented, step by step?
5. How much did it cost (up front), how did you manage your revenue streams, and how much money did the team make?
6. What would your team have done differently?
7. What are the important takeaways from this project? *Key tiebacks to entrepreneurship and philanthropy topics*
8. To which charity did your team donate the profit (*must provide receipt*)?
9. Why did your team choose this charity?

Optional Class Discussion Questions

These questions are intended to help facilitate dialogue and tie in weekly lectures to anchor learning in entrepreneurship and philanthropy as the students work on the project (or after the project is completed). These questions might be included either as an in-class discussion, as a Discussion Board assignment, or as a reflection paper assignment to complement learning.

What resources (capital, or otherwise) are being/were used in the project?

Interestingly, some teams may have used very little or no money at all. Rather, they may have mostly capitalized on their specialties and/or social network to make a profit. This demonstrates two critical take-aways. First, financial constraints are not the number one constraint for start-

ups; the knowledge and creativity in opportunity exploration, evaluation and resource combination are. Second, in line with resource-based view (Barney, 1991), intangible resources (e.g., specialties and social network) are more important than tangible resources.

What is the relationship between profit and philanthropy?

Even though students are instructed to donate their profits, some teams may have donated their seed money as well. Ask the students directly whether they will "close down" their business (analogous to their seed money) and donate to a charity. Students will likely say no. They will need to understand the pyramid of corporate social responsibility with economic responsibility at the base (Carroll, 1991).

Notes to Instructors and Conclusion

The student teams' project outcomes exhibit a range of results in terms of generated profit, thereby influencing the donation amount, as well as the quality of their presentations. To gauge the success of these teams, a comprehensive assessment incorporating both quantitative and qualitative measures is recommended, as deemed appropriate by the instructor. For instance, a profit/donation amounting to $50 should not be inherently deemed inferior to a $150 contribution, as the $50 profit may have been the result of significantly greater effort and strategic experimentation during the phases of entrepreneurial opportunity exploration and assessment. Alternatively, it might demonstrate greater sustainability over a time frame extending beyond a single semester. Consequently, a qualitative evaluation is also suggested to underscore the collective team endeavor and the caliber of work. The creativity of the team in choosing a business venture often determines the monetary success of the project; even when the business doesn't thrive as students expect, important lessons are learned.

In a broader context, drawing from our prior experiences, variations in the outcomes of this scenario align well with discussions surrounding the question of "*What resources (capital or otherwise) are being/were used in the project?*" In essence, the amalgamation of resources, coupled with the exploration and assessment of opportunities, stand as fundamental pillars in the initiation of a new business venture.

Through engagement with this practical case, students are expected to achieve two primary objectives: 1) to gain hands-on exposure to entrepreneurship and demystify the intricacies of starting a business, and 2) to actively embody the principles of corporate social responsibility.

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Family Businesses and Performance: The Effect of Intangible Resources

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Abstract

This research seeks to examine possible advantages that may lie with family firms and their intangible resource base. Drawing upon the Resource-Based View (RBV) of the firm, we investigate the relationship between three intangible resources regarding performance in family versus non-family businesses. Knowledge, organizational and human resources are analyzed using survey data collected from a sample of 430 Small and Medium-sized Enterprises (SMEs) from family and non-family firms in the United States and Australia. We attempt to find answers to three questions: 1) which, if any, intangible variables have the strongest effect on firm performance; and 2) which of these relationships will be stronger in the case of family firms. Controlling for size and age using hierarchical regression, we find that knowledge resources were significant for both family and non-family firms, however, human resources were also significant for family firms. It is argued the presence of certain intangible resources, particularly human resources as found in the concept of *familiness*, could be a key factor in the advantage of the family firm.

Keywords: family business, non-family business, resource-based view, intangible resources, knowledge, human, organizational resources, SMEs, performance.

Introduction

Family firms are the dominant form of business organization in many countries, contributing for example to more than 60 percent of employment in the United States (Bressler, Campbell & Elliot, 2014). They add value due to their comparative longevity, and therefore understanding how family firms achieve high performance has implications for owners, managers, employees, and the economies in which they operate. The family firm tends to be unique compared to their non-family counterparts, as Stafford et al., (1999) suggested "it is not the business that makes a family firm unique from other business arrangements; rather it is the family" (p. 206). In trying to understand the uniqueness of family firms, it may be explained by

its combination of resource bundles, which can create competitive advantage and distinguish them from competitors, allowing them to be entrepreneurial and innovative (Barney, 1991).

The Resource-Based Theory, or RBV, suggests that resources should not only be acquired but leveraged to create competitive advantage. It argues that while the resource profile of a firm is obviously important, but that these resources must be integrated and deployed effectively to achieve competitive advantage and in particular, its resources must be managed to increase the difficulty for competitors to imitate or develop substitutes for these resource bundles (Kahn, Yang & Waheed, 2019). Resources that provide family firms with strategic advantages are often considered to be intangible, as they allow for a dynamic and complex structure in which to operate, and this can create sustained competitive advantage within the family firm.

Family firms as an area of study are unique in many ways. Many of their attributes create distinct advantages, such as their ability to survive and adapt given a multitude of environments (Schulze & Gedajlovic, 2010). Conversely, the same unique criteria of close involvement and connections can lead to poor performance due to personal conflict (Shukla, 2014). A term used to describe this uniqueness of the family firm is 'familiness' or a unique bundle of resources created by the interactions that occur between the firm and its family members (Habbershon & Williams, 1999). However, this bundle of distinct attributes has been difficult to determine for researchers and remains elusive (Huybrechts et al., 2011). Therefore, comparative studies of family and non-family businesses can add to the existing body of literature by determining possible causal relationships between family and non-family variables (Collins and O'Regan, 2011). Additionally, it is hoped these findings can add to the discourse of family firm literature as we examine the results with the context of existing family firm research.

Therefore, the purpose of this research is to examine the effect of intangible variables that may influence the performance of SMEs in either family or non-family firms. Specifically, we attempt to answer two questions: 1) Which intangible variables have a positive effect on performance of SMEs; and 2) that these relationships will be stronger in the case of family firms. Finally, we discuss if and how these findings can add to our understanding of the differences between family and non-family owned businesses and how the results can contribute to our understanding of the field.

Literature Review

Family Business

Early family research focused on SMEs and the influence of ownership and management of family members (Davis, 1982). Chua, Chrisman and Sharma (1999) saw family firm behavior at the core of a family business, and it being the differentiator between family and non-family businesses. Their well-accepted definition of a family businesses is described as "governed and/or managed with the intention to shape and pursue the vision of the business held by a dominant coalition controlled by members of the same family or a small number of families in a manner that is potentially sustainable across generations of the family or families" (p.25).

Literature on SMEs often involves family firms, as SME resource constraints frequently resemble those encountered by smaller-sized family firms (Eddleston, Kellermans & Sarathy, 2008). For example, family firms often lack capabilities with infrastructure, technology and management knowledge similar to that experienced by SMEs (Chirico et al., 2011). Entrepreneurship scholars have investigated the family firm as this is often where entrepreneurial behaviour begins, with many new firms being founded by two or more individuals who are related (Sharma, Chrisman & Chua, 2012).

An important concept in the family research field is the concept of 'familiness' that originated with Habbershon and Williams (1999) and was created through the lens of the resource-based view (RBV). The concept attempts to capture the 'unique bundle of resources' developed through the 'systems interaction between the family, its individual members and the business' (p. 11). Since this seminal article, there is yet a measure that captures its essence, most likely as it is still an evolving concept and remains a challenge in the discipline. Scholars agree that the 'familiness' of the firm is an important and critical point of difference, but due to the heterogeneous nature of family businesses, which resource bundles affect family firm performance require more research and an appropriate method of inquiry (Tabor et al., 2018).

The family firm concept has been studied in greater depth in the last two decades (Chrisman, Steier & Chua, 2006; Kraus, Harms & Fink, 2011; Tokarczyk et al., 2007) and has led to new theories about how and why family firms are unique. For example, stewardship theory suggests the family firm has an advantage as people in the organization are often motivated members that wish to work together collectively, for a greater good, and achieve organizational goals (Davis, Schoorman & Donaldson, 1997). Family firms often have an altruistic outlook by family members, which tends to lead to high involvement and collaboration, enhancing organizational success (Eddelston & Kellermans, 2007). Interestingly, these same associations can be a disadvantage for family firms when these relationships produce conflict and create negative results (Shukla, Carney & Gedajlovic, 2014). Additionally, many family firms choose not to incorporate, wanting instead to maintain the reigns of control, but this can lead to a shortage of additional resources, particularly financial, and this can leave them more vulnerable to failure (Azila-Gbettor et al., 2018). This leads us to attempt to understand which resources could be most valuable to family (and non-family) firms.

The Resource-Based View (RBV) and Intangible Resources

Scholars have widely acknowledged that the Resource-Based View (RBV) of the firm is one of the most prominent and powerful theories in understanding the organizational relationships and performance of firms (Barney, 1991; Barney, Ketchen & Wright, 2011; Crook et al., 2008; Penrose, 1959; Wernerfelt, 1984). The RBV is an internal focus on the firms' resources and each organization is perceived as a bundle of resources that focuses on different resource combinations (Connor, 1991). These resources are valuable, rare, inimitable and non-substitutable, or otherwise known as the VRIN attributes (Barney, 1991). Barney (1997) altered the VRIN framework to the VRIO framework, and this included that resource creation is a dynamic process and 'inimitability' described the organization of resources as critical. In either case, the RBV provides an established and accepted approach to research in family business.

The RBV analyzes the firm or business unit through a specific resource or set of resources that can be complex and intangible (Barney, 1991). It often requires the firm to combine or bundle resources to configure them into complex combinations, so as to yield competitive advantage (Brush, Greene & Hart, 2001). Resources should not be viewed as homogenous but as heterogeneous and variable, meaning that the value of these resources depends on the combination with other resources (Barney, 2001). Because family firms have been said to be complex, dynamic and rich in intangible resources, the RBV offers a suitable approach for examination. The RBV provides a framework for research investigating the unique essence of the family firm structure (Xi et al., 2015).

There has been a great deal of research regarding intangible resources as they are considered the most likely sources of firm success (Molloy & Barney, 2015). While the RBV does not distinguish between resource types, the most influential appear to be intangible (Hitt et al., 2001) and are therefore used in this research. We define intangible resources as a subset of resources (tangible or otherwise) under the RBV umbrella, which combines assets as well as capabilities. Resource categories fall into two distinct classifications involving tangible and intangible aspects, with tangible resources typically referring to input resources, that can include facilities, raw materials, equipment, location, finances and technology; among others (Wiklund & Shepherd, 2003). However, research suggests that tangible resources have less importance than intangible resource stocks due to their tendency to be more easily imitated (Amit & Schoemaker, 1993; Barney, 1991; Sirmon & Hitt, 2003).

Intangible resources may be more important for promoting sustainable competitive advantage in both family and non-family firms because they are difficult to imitate, thus facilitating differentiation (McEvily & Chakarvathy, 2002). They must be valuable, rare, be difficult to imitate, and non-substitutable (Barney, 2001) and therefore they play an essential role in the firm's ability to be entrepreneurial and improve venture performance (Crook et al., 2008). Intangible resources can provide characteristics that Barney (1991) suggests are necessary to provide a sustained competitive advantage and their relationships have been largely supported in the literature (Galbreath, 2005; Sirmon & Hitt, 2003).

This research investigates intangible resources that may be found in the concept of familiness and add to the advantage of the family firm and propose three unique intangible resources that may contribute to competitive advantage for family firms: human, organizational and knowledge resources.

Human Resources

The importance of human resources in enhancing firm performance has been widely studied (Ployhart & Moliterno, 2011; Nolan & Garavan, 2016) and there is little disagreement that human capital constitutes an important element in the 'bundle' of resources that a firm owns (Sirmon & Hitt, 2003). To increase or maintain these advantages human capital theory suggests that effective organizations encourage employees to invest in themselves, through education, skills and industry knowledge to develop synergies towards competitive advantage (Nerdrum & Erikson, 2001; Nolan & Garavan, 2016).

There appear to be several human resource advantages that family firms may have over their non-family counterparts. For example, turnover rates in family firms have been found to be lower than that of non-family firms (Miller & Le Breton-Miller, 2006), which means that knowledge and experience is preserved within the business for a longer period. Family members and their descendants often get involved in the family business at a young age, which gives them an opportunity to develop deep, firm-specific knowledge so that they are familiar with tasks and job duties (Ward, 2016). Additionally, family-owned businesses often have a stronger commitment to their job that is greater than that of non-family employees and are often willing to sacrifice time for training in order for the firm to succeed (Dyer, 2006).

Human resources represent the tacit knowledge that is embedded in the minds of its members and their ability to interact appropriately for the benefit of their organization (Kong, Chadee, & Raman, 2013). By leveraging the unique family-firm human resource advantages, organizations can increase firm performance, as human resources are often the glue that hold or bind other resources together (Mathis, Jackson & Valentine, 2015). Following research by Carmeli and Tishler (2004), human resources advantages are measured using various attributes, such as the level of education of employees, mastering job duties, familiarity with tasks, adequate training and suitable work experience. Therefore, the first hypothesis is:

Hypothesis 1: Family firms will place a stronger value on human resources than non-family firms.

It is not likely that a firm's advantage relies solely upon a single resource, even if that particular resource is viewed as critical. Heterogeneity among family firms suggest that other factors will be involved (Garcia-Castro & Aguilera, 2014). Another intangible variable that may offer competitive advantage is organizational resources.

Organizational Resources

Organizational resources are described as a combination of resource elements that often includes systems and policies, as well as organizational routines, culture and structure (Dollinger, 1995; Greene & Brown, 1997). They can be described as processes that are constantly changing whether consciously or unconsciously, or more simply a way of working (Teece, 2003). A firm's ability to alter, reconfigure and integrate other resources of the firm add to its competitive advantage (Grant, 1996). For example, a firms' long-term success such as Walmart (Stalk, 1992) and Southwest Airlines (Porter, 1996) cannot be explained through a single factor; as evidenced by their business models being ineffectively copied in different situations over several years. By having a number of elements that positively interact with one another a firm can reduce the possibility of imitation, even in the case of elements that are easily copied.

Organizational abilities such as these can be particularly critical for small and family firms, as they seek complementary external resources as their internal resources are comparatively weak compared to larger firms (Arregle et al., 2007). Family businesses develop a unique culture surrounding their firms, stemming from varied behavioral and historical circumstances embedded in the family itself (Dyer, 2006). While the non-family organization model has been characterized by an extended hierarchy, narrowly segmented job design, rule-bound procedures and a lack of employee autonomy (Peters, 1988), family firms differ due to their ability to use a unique internal structure to strategically configure these resources in such a way that creates competitive advantage (Dawson & Mussolino, 2014).

Similarly, unique interactions between family members and business systems may create organizational advantages, including organizational culture (Olson et al., 2003). Family firms have distinctive intangible resources that merge with tangible firm assets to create an environment that is difficult for competitors to copy. As can be seen, several factors can contribute to a firm's unique organizational resource bundle. Therefore, the second hypothesis is:

Hypothesis 2: Family firms will place a stronger value on organizational resources than non-family firms.

Another intangible variable that may be critical for family and non-family firms are knowledge resources.

Knowledge Resources

It has been suggested that knowledge has the greatest ability of all resources to serve as a source of sustainable differentiation (McEvily & Chakravarthy, 2002; Villasalero, 2017). Knowledge permits firms to predict more accurately the nature and commercial potential of changes in the environment and the appropriateness of strategic actions, and without knowledge an organization is less capable of discovering and exploiting new and emerging opportunities (Cohen & Levinthal, 1990). In family firms, knowledge can take various forms and are generally classified as being abundant (Habbershon & Williams, 1999). The long term-orientation of family firms suggests that much of the knowledge resources lies with family members, who have a strong inclination to disseminate with others.

Knowledge management is defined as the process of creating, storing/retrieving, transferring and applying knowledge, and this continuous process is critical as it is used to identify and exploit existing and acquired knowledge as well as develop new opportunities for the firm (Alavi & Leidner, 2001). Knowledge resources for SMEs can lead to the development of other important resources, one of the greatest challenges of new and small firms. For example, complex, intangible knowledge resources possessed by founders who are often leading family firms, are instrumental in acquiring other tangible resources such as financial and physical capital (Brush, Greene & Hart, 2001). A key role of management is to identify and evaluate

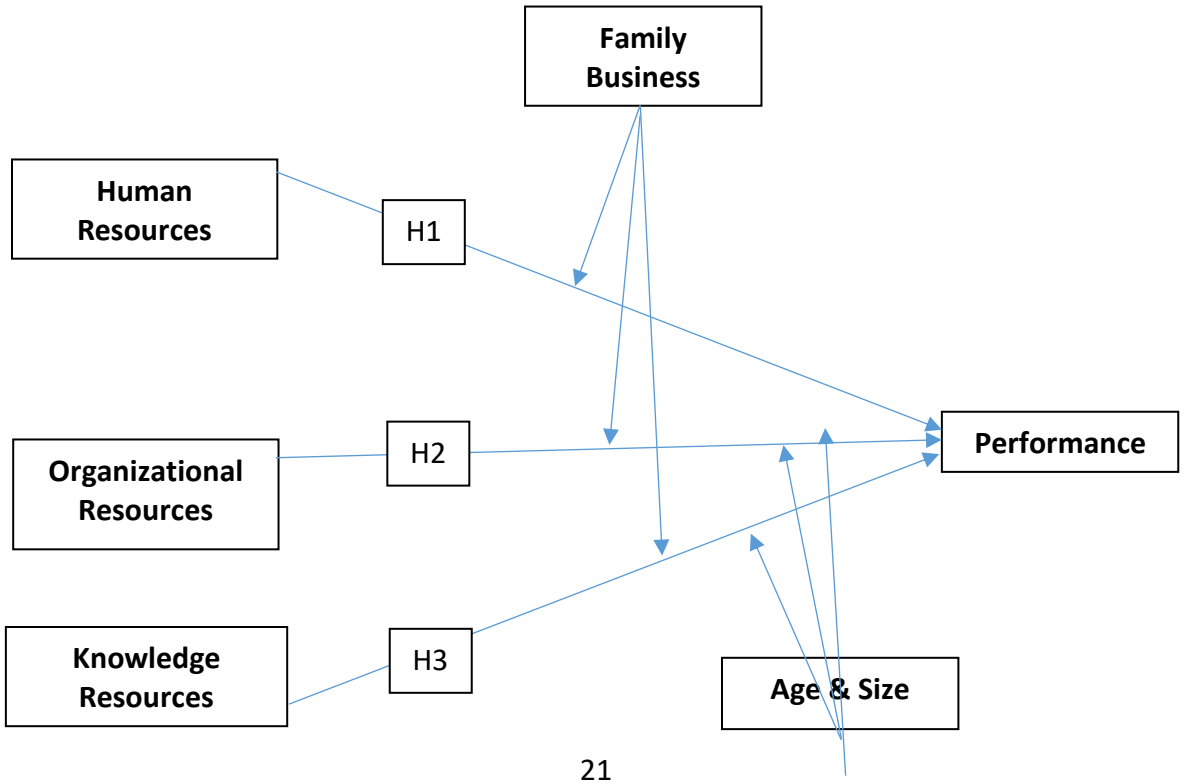
resources, and this resource may explain a potential source of competitive advantage in family firms that improve their efficiency and effectiveness (Barney, 1991; Price & Stoica, 2015).

Therefore, knowledge resources represent a resource of competitive advantage for family businesses. High levels of knowledge resources in family businesses often lie with certain individuals, most commonly the business founder, and thus knowledge resources are key to understanding the potential advantages within the family business. Therefore, the final hypothesis is:

Hypothesis 3: Family firms will place a stronger value on knowledge resources than non-family firms.

The final model and hypotheses for this research is shown in Figure 1 below:

Figure 1: Model and Hypotheses



Methodology

This study utilized combined samples of SMEs from Australia and the United States and this approach was implemented for two main reasons. First, research suggests that Australian and the US societies share many of the same characteristics; economically, culturally, politically, etc., and hold similar western individualist values that give priority to personal goals (Harrison et al., 1994). Second, from a methodological perspective, by combining the two samples, greater stability can be achieved through an increase in the sample size. The benefits of an increased sample size outweigh the disadvantages, through developing a more reliable sampling group. Research suggests this method can be appropriate when the research design is consistent by ensuring constant definitions, measurements, models, and variables (Kish, 1994). Dubbed "*multipopulation design*", the combination of samples is permissible, and indeed very efficient, if the sample design and allocation are adhered to (Kish, 1994, p. 168).

All respondents must have been an owner/manager within the business. The SBA (US) defines a small business as any firm with fewer than 500 employees and this definition was applied to both samples. The bulk of the Australian responses were obtained from a database of SMEs participating in a state government program that had received government incentives during the early stages of their development. Additional surveys were completed using traditional mail through local networks, word of mouth and random in-person delivery. In total, 201 total responses were received, of which 114 were family-owned and 87 non-family. The majority of the US sample was collected via email from a database of a small business member organization. Similarly, physical distribution via local networks, other partner institutions and word of mouth created the aggregate total. This generated 229 useable responses of which 179 were family-owned businesses and 50 non-family. In total, 430 responses were obtained using this method, often termed snowball sampling (Cavana, Delahaye & Sekaran, 2001). The total number used in the final sample was 293 family businesses and 137 were non-family.

Questions included in the survey were sourced from existing scales within the entrepreneurship, management and strategy literature. The questionnaire was developed by using seven-point Likert scales that were pre-tested with a representative set of respondents in order to reveal errors in questionnaire design prior to administering the survey (Cavana et al., 2001). A portion of the pretesting was conducted by personal interviews to ensure direct observation of respondent behaviors (Bassili & Fletcher, 1991). The questionnaire was then pilot tested in two phases. In the first phase, a small sample of four business owners and three academics and one business development specialist from an SBDC were asked to complete a hard copy of the survey instrument. Each of the respondents consulted with the researchers to deliver their recommendations. Entrepreneurs who participated in the pilot test survey were asked not to participate in the final survey. Final versions of paper and online surveys were completed and distributed via email, mail or in person in both countries.

The scale to measure knowledge resources followed a ten-item knowledge management process as described by Alavi and Leidner (2001) that included knowledge creation, acquisition, conversion and integration of knowledge. Organizational resources were measured following a scale developed by Edelmen, Brush and Manolova (2005), the five-item scale included firm technology, employee characteristics, strategic alliances, customer service ability and

products/services offered. The scale used for human resources followed a scale by Carmeli and Tishler (2004) that included 12 items referring to level of education, mastering the job, familiarity with the task, training, work experience and job performance. All scales were tested for reliability and validity utilizing Cronbach Alpha and factor analysis and the samples ranged from 0.71 to 0.92. Factor analysis led to some items being deleted leaving nine items in the human resources scale, four items in organizational resources and eight items in knowledge resources. Firm size and age were added to the final model as control variables, firm size was measured using the number of employees and firm age using years in business.

With the differences between industries in the sample acknowledged, subjective performance measures were utilized to measure performance. Using a seven-point Likert scale based on the Typology of Strategy scale by Miles and Snow (1978), perceptions of performance goals were measured including exceeding sales goals, positive future intentions towards growth, increased production, opening new locations and the introduction new products/services.

Results

Descriptive Statistics:

A total of 430 completed questionnaires were available for analysis. The sample consisted of 201 respondents (46.8 percent) from Australia and 229 (53.2 percent) were US-based SMEs that included 293 family businesses and 137 non-family businesses. Table 1 shows the distribution of type of businesses for both family and non-family firms. Retail businesses represent the highest share in the sample for both type of firms, followed by professional and technical and manufacturing. The χ-square test performed showed no significant difference between the two types of business.

Table 1: Firm characteristics – Industry type

Type of Business	Primary NAIC Code	Businesses participating in the study			
		Family		Non-Family	
		Number	%	Number	%
Agriculture	1	12	4.1	1	0.7
Construction	2	20	6.8	15	10.9
Manufacturing	3	28	9.6	12	8.8
Wholesale	4	14	4.8	3	2.2
Retail	5	112	38.2	46	33.6
Transportation	6	1	0.3	1	0.7
Information	7	14	4.8	7	5.1
Finance & Insurance	8	14	4.8	11	8.0
Real Estate	9	7	2.4	6	4.4
Professional & Technical	10	31	10.6	16	11.7
Health & Social	11	3	1.0	5	3.6
Arts & Entertainment	12	7	2.4	5	3.6
Accommodation & Food	13	26	8.9	5	3.6
Other Services	14	4	1.4	4	2.9
Total		293	100.00	137	100.0

The SBA (US) defines a small business as any firm with fewer than 500 employees. Most family businesses have between 1 and 10 employees (Table 2), with a small number in the sample have zero employees and businesses with more than 50 employees represented 2 percent. For non-family businesses the distribution shows 56 firms having between 1 and 10 employees (41.8 percent) and 47 firms between 10 and 20 employees.

Table 3 shows the age distribution for both family and non-family firms. Fewer businesses are older than 20 years (8.8 percent for family and 10.2 for non-family), and most businesses are relatively young in both samples, with over 60 percent of family businesses between 4 and 14 years old. The same is true for the non-family firms (60 percent). There is no statistical difference between the two samples.

Table 2: Firm characteristics – Size (number of employees)

Characteristic	Range	Family Businesses % (n = 293)	Non-Family Businesses % (n = 137)
Number of Employees	0	46 (15.7%)	4 (3.8%)
	From 1-10	200 (68.1%)	56 (41.8)
	From 10 to 20	34 (11.6%)	47 (33.2%)
	From 21 to 50	7 (2.4%)	20 (14.4%)
	More than 50	6 (2.0%)	10 (7.1%)

Table 3: Firm characteristics – Age (in years)

Characteristic	Range	Family Businesses % (n = 293)	Non-Family Businesses % (n = 137)
Number of Years in Business	1 to 3 years	58 (19.8%)	24 (17.5%)
	From 4 to 6	74 (25.2%)	51 (37.2%)
	From 7 to 9	46 (15.7%)	14 (10.2%)
	From 10 to 14	56 (19.1%)	24 (17.5%)
	From 15 to 19	33 (11.2%)	10 (7.3%)
	20 & above years	26 (8.8%)	14 (10.2%)

Analysis:

The firm-level data was entered into a hierarchical regression model with performance as the dependent variable. The variables in the model included control variables age (AGE) in years and size (SIZE) as number of employees. Independent variables included in the analysis are human resources (HUMAN), organizational resources (ORGAN), knowledge resources (KNOW), with the dependent variable performance (PERF). The results are shown in Tables 4 and 5.

Table 4. Hierarchical Regression Results. Family Businesses

Dependent Variable: Performance

	Model 1		***Model 2***		***Model 3***	
Control Variables	***β***	***t***	***β***	***t***	***β***	***t***
Age	-0.05	-0.42	-0.03	-1.05	-0.20	-1.12*
Size	0.02	-0.19	0.21	.99	-0.22	-1.19*
Independent Variables						
Human Resources (HUMAN)			0.26	2.73**	0.16	3.01**
Organizational Resources (ORGAN)			0.18	.87		
Knowledge Resources (KNOW)			0.36	4.09**	0.18	4.13**
Adj. R^2	0.03		0.39		0.44	
F value	5.77***		19.89***		28.94***	
Delta R^2			0.36		0.05	

*p< .10, **p< .05, ***p< .01

Table 5. Hierarchical Regression Results. Non-Family Businesses

Dependent Variable: Performance

	Model 1		***Model 2***		***Model 3***	
Control Variables	***β***	***t***	***β***	***t***	***B***	***t***
Age	-.053	-0.68	-0.13	-1.09	.11	-1.54*
Size	-.00	-0.09	-.04	-0.87	.07	.089
Independent Variables						
Human Resources (HUMAN)			.13	1.10		
Organizational Resources (ORGAN)			.31	1.98*	.33	2.17**
Knowledge Resources (KNOW)			.44	4.65***	.47	5.63***
Adj. R^2	.04		.33		.39	
F value	4.83**		20.07***		33.83***	
Delta R^2			.29		.06	

*p< .10, **p< .05, ***p< .01

As shown in the preceding tables the control variables do not affect performance (Model 1). Less than 5 percent of variance is explained in the size and age for both family and non-family businesses. Model 2 added the three main independent variables, and the results show that the addition of these variables increased the variance explained by the model (adjusted R-square) and increased the result to 0.39 for family businesses and to 0.33 for non-family businesses. The F-ANOVA test is significant for both tables. Therefore Hypothesis 3 cannot be supported, as Model 2 shows strong results for both family and non-family businesses, with non-family slightly stronger. The variable human resources is significant for family businesses (β = 0.26, t = 0.273, $p < 0.05$) but not significant for non-family businesses ($\beta = 0.13$, t=1.10). Therefore hypothesis 1 is supported but to a weaker extent. Organizational resources is not significant for family businesses ($\beta = 0.18$, t =0.87) but is significant for non-family businesses but again to a lesser extent ($\beta = 0.31$, t = 1.98 at $p < 0.05$). Therefore Hypothesis 2 is not supported in Model 2.

Model 3 eliminated the weaker variables (ORGAN for family businesses and HUMAN for non-family businesses) in order to understand which variables have the strongest predictive power. Results show a slight increase in performance (adjusted R-square increases in Table 4 to 0.44 and in Table 3 to 0.39). Age of the firm remains marginally significant in Model 3 for both tables. This means that younger businesses for both family and non-family businesses tend to perform better.

Discussion and Implications

The results show strong support for knowledge resources for both types of firms. Knowledge represents a key resource in organizations independent of their ownership, and this finding is consistent with the strong support shown for knowledge resources in the literature (Dalkir & Beaulieu, 2017; West, & Noel, 2009; Wiklund & Shepherd, 2003). The creation of new knowledge or transferring knowledge into the family business can help to exploit opportunities and add to sustainability, even though the development of knowledge resources can be a complex and time-consuming process. As knowledge resource features are often firm-specific and difficult to imitate, they are potential sources of competitive advantage. The bundle of resources that creates a unique and sustainable competitive advantage for the firm must be constantly assessed and managed, and the organization must invest in replenishing knowledge resources as suggested by Grant (1996).

While our hypotheses posited that this effect would be stronger for family firms than non-family, our findings suggest that the importance of knowledge resources remains constant for any organization. A distinction of knowledge is that the acquisition of knowledge can be tacit (gained through experience and application) or explicit (which is acquired via communication and abstractness). Tacit knowledge is often found in family members (and often with the founder/entrepreneur) and is critical as it requires a knowledge transfer process to ensure succession and to maintain competitive advantage. Founders/owners should transfer that knowledge between generations as it represents a strategic asset that a family firm can develop and transfer more efficiently and effectively than non-family firms (Cabrera-Suárez, De Saa-Perez & Garcia-Almedida, 2001).

The findings here highlight the importance of knowledge resources as the ability to manage knowledge is becoming increasingly crucial in today's knowledge economy (Jansen, 2017). The management of knowledge resources, both for family and non-family firms, require the development of systems to ensure the full application of an organization's knowledge base, together with the potential of individual skills, competencies, thoughts, innovations, and ideas to create a more efficient and effective organization. The sharing of knowledge involves providing other employees, whether or not family members, with explicit and tacit knowledge to help others accomplish goals, collaborate with others to solve problems, develop new ideas, or implement policies or procedures (Wang, Noe & Wang, 2014).

Human resources were also supported in family firms, and this represents an important source of competitive advantage for family businesses. The concept of familiness was

introduced as a potential source of differentiation between family and non-family firms and this may play a role in furthering our understanding of the concept. This partially begins to answer the question posed by Pearson, Carr and Shaw (2008) in trying to understand the specific resources that are unique and embedded in the concept. The stronger effect of human resources for family firms contributes to our understanding of stewardship theory, which suggests that family firms possess an advantage over their non-family counterparts as their family employees are more likely to exhibit mutual trust and work harder for the greater good of the organization (Davis et al., 1997). Their intimate and innate knowledge of the organization form an intricate web of knowledge and relationships.

Human capital represents a far-reaching construct that is intertwined with knowledge, and human capital helps facilitate a constant flow of external knowledge into internal organizational learning processes (Nolan & Garavan, 2016). These qualities are more critical for family firms, and its human resource base places more importance on the creation, diffusion and utilization of collective human knowledge for strategic decision making (Bontis, Crossan & Hulland, 2002; Eddelston & Kellermans, 2007). Family firms with a focus on human resources are more likely to sense and understand the need for acquiring additional external knowledge, and this is compounded by the innate ability of family members to manage knowledge resources that aid in other important strategic decisions. In short, human resources – or the makeup of employees in the firm – is concerned with understanding the development of internal intellectual resources that can benefit the organization with activities such as how external knowledge is strategically acquired and managed (Kong, 2014). Furthermore, strategic perspectives of individual CEOs can be influenced by their family interactions, and this can affect competitive advantage (De Massis, Kotlar & Frattini, 2013).

Results obtained when using Model 2 showed family businesses put less emphasis on organizational resources than non-family businesses (Table 4). While human capital within the family firm is a beneficial resource (Dawson, 2012), both family and non-family organizations require systems to properly leverage the human capital resource advantage. The answer may lie in the 'informal' procedures that are often present in family firms where relational governance based on family social capital and trust informs decisions rather than formal systems (Mustakallio, Autio & Zahra, 2002).

Family firm members often have a unique advantage as they can acquire firm knowledge at an early age by learning at home or part-time work separate from formal procedures, giving them understanding that provides tacit knowledge that is difficult to transfer to outside employees (Memili et al., 2011). Further, this ability and tenure can lead to other advantages such as building a deeper trust with customers and suppliers, creating an emotional attachment with the firm lowering absence from work (Block et al., 2015). It is these advantages that may help explain the lack of significance for organizational resources.

Table 5 (Non-family Businesses) showed human resources having some influence in the results, but marginally, as Model 3 eliminates the human resource variable and results improved. This suggests that a mediation effect may be present that was not analyzed and may be an interesting area for future research. However, organizational resources were significant for non-family firms and an explanation may again lie in the informal networks that exist in family firms.

That is, non-family firms that lack the informal network for knowledge management must create their own formal systems to achieve operational efficiencies.

This research strongly supports the notion that both family and non-family firms possess a tendency for the successful management of knowledge resources, and that human resources are also a key factor in successful family firms, while organizational resources are more significant for non-family businesses. Intangible resources and in particular, knowledge resources, are a strong predictor of firm performance in SMEs, family-owned or otherwise. As can be seen, there appears to be a strong interconnectedness between variables and relationships, as suggested in the literature (see Hult & Ketchen, 2001). Firms should create an organizational learning process to manage these resources as they are likely a key to business success.

Limitations, Contributions and Further Research

As with most research, limitations exist and require acknowledgment. This research included findings that are drawn from a convenience sample across multiple industries, and the cross-sectional nature of the data collection limits potential findings. It is unclear if similar results would be found in a comparison of larger-sized companies, and a longitudinal approach would offer insight as to how resources are accumulated and managed over time. The use of combined samples offered several advantages and benefits due to the increased sample size, but can limit the generalizability, further examination through SEM path analysis would help in explore relationships in more detail. Thus, the results should be considered within these acknowledged limitations.

This study utilized the variable 'performance' as a subjective measure as opposed to other more common measures such as profitability or sales. However, family businesses often pursue non-economic goals that may not be wholly consistent with the pursuit of economic performance (Ward, 2016) and thus this measure was deemed appropriate. Other limitations might include the selection of the samples from two countries, albeit similar cultures, but future research could eliminate such bias.

Theoretical contributions are made to the further development and in the growing area of family firm research. The family firm business model has been shown to be a unique resource in of itself, that is sustainable and non-imitable (Habbershon, 2006). The similarities and differences between family and non-family firms found in this research are necessary for understanding how family firms, and the potential resource advantages that come with them, can influence their strategic management process and performance. Knowledge resources in particular were found to be just as significant to non-family firms as family-operated enterprises. At its core, knowledge is typically an individual action, and an organization can attempt to influence this knowledge base but the act lays ultimately with the employee (Simon, 1991). Fortunately, family employees tend to have interests that are more closely aligned with the firm, and family members learn to behave in the best interests of the firm as their own personal goals are bested by that of the firm, instead choosing to follow relational contracts that govern behavior (Dawson, 2012).

Human resources, while not as significant as knowledge, were of more value to family firms. Hoy and Sharma (2009) developed a taxonomy of human capital that categorizes the concept to include both psychological and intellectual dimensions that include integrity, compassion, commitment and forgiveness. Human resources help facilitate a constant flow of external knowledge into internal organizational learning processes and allows new knowledge to emerge from interactions within and across networks. Thus, human resources places importance on the creation, diffusion and utilization of collective human knowledge for strategic decision making and thus is a source of knowledge capability, innovation and strategic renewal in of itself (Bontis, Crossan & Hulland, 2002)

The natural advantages of human capital from family employees combined with a common theme of promotion due to succession plans, necessitate procedures such as fair processes that work to both family and non-family employees. Van der Heyden, Blondel and

Carlock (2005) suggest that the fair and equitable allocation of resources within a firm minimizes potential conflict among employees. Socially responsible HR practices tend to be a major concern for many family firms, not only to reduce conflict, but to improve or maintain the reputation of the firm and create an innovative and supportive atmosphere (Bammens, Notelaers & Van Gils, 2015). Samara and Arenas (2017) extend these notions of fairness and develop a 4-step model that encourages family firms to offer equal opportunities and to incorporate equitable practices in the workplace.

While it is true that family employees are afforded many advantages, their non-family counterparts have opportunities to contribute in other ways, and a diversity of family and non-family employees can be advantageous for the family firm. Non-family employees may often have a greater range of skill-sets as they come from a wider range of talent and backgrounds (Chua, Chrisman & Bergiel, 2009) or family members may simply not possess the skill required for a job (Kidwell et al., 2013). Furthermore, family employees with advantages of tacit knowledge and experience may never exhibit the skill or initiative to exploit the opportunity afforded to them (Gilding, Gregory & Cosson, 2015).

Stewardship theory examines situations in which executives, as stewards of the company, are motivated to act in the best interest of the principal (Donaldson & Davis, 1991). Given the numerous objectives of the shareholders' objectives, the steward behavior is considered as organizationally centered (Davis et al., 1997) and therefore sensitive to intangible resources. By combining RBV and stewardship theory, we argue that superior performance can be obtained in family-centered businesses. While the RBV suggests that intangible resources contribute to superior performance, stewardship theory research in family firms (Eddleston & Kellermanns, 2007) suggests that family firms would be better stewards of certain intangible resources (e.g. knowledge resources), and the family has a social effect on related processes and outcomes relative to those resources that would be standard across both family and nonfamily contexts (such as organizational resources).

Competitive advantage in today's economy may depend more on a deliberate and systematic approach to ensure the full utilization of the organization's knowledge base, combining human resource factors such as individual employee skills, competencies, idea generation, innovative capacity and willingness to create more efficient and effective organizations. With these different perspectives in mind, perhaps there is no single, universal formula for managing knowledge, rather each organization must develop its own design and approach (Dalkir & Beaulieu, 2017).

By investigating a pool of SME companies, we examined which intangible resources are stronger for both family firms and non-family firms. Utilizing a hierarchical regression analysis, these specific resource categories are applied to family firms and non-family firms to quantitatively examine their possible relationships with performance. These three resource variables have not been previously considered in the context of family versus non-family SMEs and can be an important contribution to the field. While much recent research has focused on family relationships, and how these relationships can be critical to operating family businesses, it is how these relationships affect performance that is most important. Thus, through the lens of the RBV, this research has presented important intangible resources and attempted to investigate

their possible relationships with performance. The complex and heterogeneous nature of the family firm suggests that multiple factors can contribute to their success and failure, but intangible resources, particularly knowledge and human resources, may play a critical factor in their future success.

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Appendix A

Survey questions used in research (all questions utilized a seven-point Likert scale)

Knowledge

1. Our company exchanges knowledge with our business partners
2. Our company can acquire knowledge about new products/services within our industry
3. Our company can acquire knowledge about our competitors within our industry
4. Our company can convert competitive information into plans of action
5. Our company takes knowledge from individuals and uses it in the organization
6. Our company can integrate different sources and types of knowledge
7. Our company can apply knowledge learned from our mistakes/experiences
8. Our company can use knowledge to develop new products/services
9. Our company uses knowledge to improve efficiency
10. Our company quickly applies knowledge to critical competitive needs and problems

Organizational Resources

1. This company has up-to-date equipment and computer technology
2. We have employees with international experience
3. This company has strategic alliances/linkages
4. This company has key customer service abilities
5. This company has unique products & services

Human Resources

1. Our employees have a suitable education to fulfill their jobs
2. Our employees are well trained
3. Our employees hold suitable work experience for accomplishing their job successfully
4. Our employees are well skilled professionally to accomplish their job successfully
5. No one knows their job better than our employees
6. Problems here are easy to solve once employees understand the consequences of their actions, a skill they have acquired
7. Our employees do not know why, but sometimes when they are supposed to be in control they feel they are being manipulated
8. If anyone can find an answer, it is our employees
9. Employees go home the same way they arrived, feeling they've not accomplished much
10. Considering the time spent on the job, employees feel thoroughly familiar with their tasks
11. Doing this job well is a required in itself
12. Mastering their jobs meant a lot to our employees

Performance

1. Our company is exceeding our sales goal.
2. Our company is exceeding our growth goal.
3. Our company is performing well.
4. We perform better than our competitors
5. We intend to significantly increase production
6. We intend to open new locations
7. We intend to introduce new products/services

Influences of Political Leanings, Business-Friendly Policies, and Diversity on Entrepreneurship Across U.S. States

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Abstract

Entrepreneurship, widely considered an engine of local and economic development, occurs on many levels. This study is focused on its U.S. state level manifestation, as captured through the Kauffman Foundation Early-Stage Entrepreneurship (KESE) Index. Given the business-friendly policy differences that many associate with Republican versus Democratic-led states, we theorize that state political leanings is positively related to the Kaufman Early Stage Entrepreneurship (KESE) Index through the mediating mechanism of "business friendliness," which we define as the average of a state's Tax Foundation State Business Tax Climate Index (TCI) and the Fraser Institute Economic Freedom Index (EFI). Also, due to the increased probability of creative collisions being associated with more diverse populations, we theorize that demographic diversity is another key driver of state-level entrepreneurship and hypothesize that it is positively associated with the KESE Index. Our structural equation modeling provides evidence to support our hypotheses. Together, our theory and findings offer evidence-based insights for policymakers aiming to create the right regulatory conditions conducive to early-stage entrepreneurial activity.

Keywords: Entrepreneurship, Political Leanings, Diversity

Introduction

Entrepreneurial endeavors are important for supporting net job creation, innovation, growth, and development of local economies. A recent article in Forbes reporting compiled data from the Bureau of Labor Statistics and the United States Small Business Administration (SBA), indicated that small businesses employed 61.7 million workers in 2022, or 46.4% of all U.S. employees. Further, 99.9% of businesses across the U.S. were identified as small businesses and those small businesses have added over 12.9 million jobs in the last 25 years (Main, 2022). State level policy makers have aimed to set policy in support of entrepreneurial ventures and growth.

Factors contributing to entrepreneurial start-ups and survival rates have been widely studied. In the U.S., one of the more complex questions of high relevance to policy makers, business leaders, and other key stakeholder groups is why entrepreneurial start-ups and survival rates vary markedly across regions of the country. For example, the 2021 average monthly business start-up rate, as measured by the percentage of startups relative to existing businesses in a state, was .55% in New Mexico, but .39% in neighboring Arizona and only .17% in West Virginia. Likewise, 2021 one-year survival rates for new start-ups ranged from 84.8% in Illinois to only 76.4% in Nebraska (Ewing Marion Kauffman Foundation, 2022). While general variations in the health of state economies as well as variations in industry mixes may impact these figures, research has suggested that other factors may influence entrepreneurial activity as well.

One such factor may be state-level political affiliation. Given the possibility that more conservative policies may be good for entrepreneurial activity, and that a state's political affiliation is associated with those policies, we theorize and test a mediation model in which a state's political affiliation is the independent variable, business friendliness is the mediating

variable, and the Kauffman Foundation Early-Stage Entrepreneurship (KESE) Index is the dependent variable. The KESE index is a composite measure of four state-level indicators including: 1) the rate of new entrepreneurs, 2) the opportunity-share of new entrepreneurs (i.e., the percentage of new ventures started by entrepreneurs to capitalize on an opportunity versus. the percentage of new ventures started by entrepreneurs out of necessity), 3) start-up early job creation, and 4) start-up early survival rate. We define business friendliness as the average levels of a state's Tax Foundation State Business Tax Climate Index (TCI) and the Fraser Institute Economic Freedom Index (EFI).

In addition to political affiliation, we also examine the role of demographic diversity as core factor in fostering state-level entrepreneurial activity. Prior research suggests that diverse populations contribute to higher levels of creativity, innovation, and knowledge spillovers, which are essential drivers of entrepreneurship (e.g., Florida, 2012). For example, regions with more diverse populations have been shown to create conditions for "creative collisions," where individuals from different backgrounds share ideas and perspectives, spurring innovation (Ofem et al., 2023). Accordingly, we hypothesize that greater demographic diversity within a state is positively associated with the KESE Index, reflecting higher levels of early-stage entrepreneurial activity.

Together, these considerations lead us to our two central research questions: (1) How does political affiliation influence early-stage entrepreneurial activity across U.S. states through business-friendly policies? and (2) How does demographic diversity, as an additional state-level factor, directly influence this entrepreneurial activity? By addressing these questions, we aim to elucidate the combined and unique roles of political, economic, and demographic factors in fostering an environment conducive to entrepreneurship.

Literature Review

Political Leanings of Regions and Entrepreneurship

In the U.S., popular rhetoric has often focused on how political leanings of regions impact economic growth and development, including impacts on new entrepreneurial start-ups. For example, a 2020 pre-election poll by Gallup found that 41% of small business owners indicated that their businesses would be better off if a Democrat won the U.S. presidency, while 52% indicated that their businesses would be better off if a Republican won the presidency (Brenan, 2020). But despite popular beliefs by small business owners, very few studies have empirically examined relationships between political leanings and elements of economic development including actual small business start-up and survival rates. One exception is a study by Hoelscher and Elango (2012) that provided empirical evidence that, in the period between 2003 and 2007, U.S. states with Republican governors had higher business start-up rates than states with Democratic governors. The researchers attributed this finding to Republican administrations perhaps having more business-friendly policies.

Conversely, Blinder and Watson (2015) found that the U.S. economy has performed best when the president is a Democrat. But after controlling for factors including oil price shocks, general productivity increases, and overseas economic growth, there was no difference in economic performance based on the political affiliation of Presidents.

A study by Chien and Bennett (2021) also found no significant differences in levels of government spending across U.S. states based on political leanings across the categories of education, social services, public safety, and environment and housing. However, the researchers did find that Republican leaning states tended to spend more per capita on transportation. But the

authors attributed that finding to many Republican leaning states being more sparsely populated thus having a relatively heavier reliance on transportation infrastructures.

Likewise, in a study examining political leanings and support for proposed transportation tax increases in California, Hannay and Wachs (2007) reported that Democratic voters were more likely to support those increases for transit, bicycle, and pedestrian measures, but were less likely to support tax increases associated with improvements to highways. Thus, results of this study indicated that the impact of political leanings on tax measures was dependent on how the tax money might be used.

In a more recent study by Mian et al., (2023), the researchers reported that individuals show more confidence in the economy when they are more closely aligned politically with the party in the White House. But while expectations rose and fell with different presidents over time, no significant shifts were found in the actual household spending of respondents.

Generally, the above results do not provide much in the way of consistent insight into how political leanings may impact entrepreneurial activity. Since most studies have focused on the U.S. as a whole, they also provide little in the way of insight into the variations in rates of entrepreneurship across individual U.S. states.

Tax Rates and Entrepreneurship

Conventional wisdom holds that a state's tax rate likely has a negative impact on economic growth. A common belief among many individuals is that business taxes likely have a negative impact on regional economic growth in the U.S. despite the potential benefits of productivity-enhancing public expenditures financed with the tax receipts. While evidence of negative long-run tax-price elasticity is commonly reported in the literature, estimates of the magnitude of this relationship vary. A study measuring the impact of state and local business

taxes for 15 manufacturing sectors in 20 states found that during the 1990's, a reduction in potential tax liability on new investment within a state was associated with an increase in value added for the manufacturing industry (Funderburg et al., 2013).

Several studies have examined relationships between tax rates and various measures of entrepreneurial activity. For example, Bartik (1989) used U.S. state level data to examine the impact of various state characteristics on small business start-ups. Among the characteristics studied were taxes, public services, financial markets, unionization, education, and labor costs. Among the relevant results, the researchers reported that state-level taxes negatively impacted start-up rates. The study concluded that, generally, state level tax cuts had a positive but modestly sized effect on small business start-up rates and that higher property taxes negatively impacted small business start-ups. Higher corporate tax and higher sales tax on equipment also had negative effects on start-up rates.

Other researchers have found either non-linear or negative relationships between various types of taxation and entrepreneurship. For instance, a study by Georgellis and Wall (2006) reported U shaped relationships between marginal income tax rates and entrepreneurial activity. The researchers noted that, initially, an increase in tax rates reduced start-up rates. But once tax rates became high enough, incentives for individuals to shelter income promoted more investment in entrepreneurial ventures.

Similarly, Cullen and Gordon (2020) found that tax cuts reduced entrepreneurial activity. Utilizing U.S. income tax return panel data, they noted that various tax cuts reduced the level of income taxes that could be saved from individuals being able to deduct business losses. Tax cuts thus became a disincentive for individuals to invest in entrepreneurial ventures.

Gentry and Hubbard (2000) also examined U.S. income tax panel data and found little support that there was a direct relationship between income tax levels and rates of entrepreneurship. However, they also reported that progressive tax structures were negatively related to entrepreneurial activity. The researchers noted that, throughout the U.S., income tax brackets were the same for wage earners as for entrepreneurs earning the same income and, hence, an increase or decrease in tax rates applied to all. However, progressive tax structures presumably acted as a disincentive for individuals to attempt to earn additional income through entrepreneurship. Conversely, Kourouniotis and Greece (2021) suggested that entrepreneurs may not give enough consideration to tax positions during the start-up phase as their focus is likely on creating a market, gaining market share, and growth.

As policy makers attempt to incentivize local economic growth through tax breaks and subsidies, some argue that policy makers are creating a barrier to free markets and in fact, may impede growth by crowding out existing business expansion and potential start-ups. Partridge et al., (2020) found that when looking at county level data, incentives for export industries and for manufacturing are negatively associated with the change in total start-ups. Prillaman and Meier (2014) also examined the impact of state-level business taxes from 1977 to 2005 on overall economic development and business growth and found that business tax cuts had no positive impact on business start-ups, job creation, personal income, or poverty rates in states.

The Tax Foundation Business-Friendly Index was used by Kaya (2020) to examine if small firm characteristics in business-friendly states differed from small firm characteristics in less business-friendly states. This state-level analysis concluded that states ranked as more business-friendly had more firms with 2 - 20 employees than less business-friendly states. The researcher also compared “ease of start” within a state and concluded that “ease of start” affected

all examined firm characteristics including operational area, age, size, and industry. In another study by Kaya (2021), it was concluded that business-friendly states have more female and experienced business owners when compared to less business-friendly states.

Overall, previous research linking state-level tax policy to entrepreneurial activity has netted mixed results. While conventional wisdom and media talking points may infer that policies associated with higher taxes can have a negative impact on entrepreneurial activity and subsequent economic growth, the evidence is mixed, providing little guidance to policy makers.

Economic Freedom and Entrepreneurship

Broadly speaking, economic freedom can be defined as a lack of government interference or involvement in markets through taxation, spending and regulation. According to the Fraser Institute (2022), economic freedom is founded in personal choice, free markets, voluntary exchange and freedom to enter and compete in markets.

Past research has examined relationships between various elements of economic freedom and entrepreneurship both across countries and across U.S. states. For example, in an assessment of the effects of several aspects of governance on entrepreneurship across 126 countries, Abegaz et al., (2023) reported that government ability to promote private sector development was positively related to business start-up rates. The ability of governments to control corruption, higher degrees of citizen voice and high accountability of businesses to the public were also positively related to entrepreneurship. This result suggests that some constraints on business behavior may facilitate a more stable economic environment and hence, promote entrepreneurship.

In a study of economic freedom and entrepreneurship in 29 countries, Bjornskov and Foss (2008) found that government size, as measured by government expenditures relative to

country GDP, was negatively associated with entrepreneurial start-up rates. However, sound monetary policy, as measured by the rate and variability of inflation, was positively related to start-up rates across countries. Interestingly, levels of regulatory freedom, international trade barriers, and the nature of legal environments were non-significant predictors of entrepreneurial start-ups.

Similarly, Nystrom (2008) found that more stable legal structures, including security of property rights, was positively related to entrepreneurship (as measured by rates of self-employment) across 23 different Organization for Economic Co-operation and Development (OECD) countries. However, the study also reported that less regulation of credit, labor markets, and businesses were positively related to entrepreneurship.

In an examination of the economic impacts of economic freedom within the 50 U.S. states, Ashby and Sobel (2008) found that higher levels of economic freedom were associated with higher income levels as well as higher rates of income growth. Additionally, states with more economic freedom had lower income inequality levels. While this study did not explicitly assess growth in rates of entrepreneurship, many other studies have reported positive associations between income growth and entrepreneurship.

Wiseman and Young (2013) found a strong and significant relationship between U.S. state per capita real income levels and entrepreneurial activity. They found no evidence of a relationship between U.S. state-level economic growth and entrepreneurial activity but provided evidence that economic freedom supports entrepreneurship.

Hall et al., (2013) examined the relationship between economic and personal freedom on entrepreneurship. They concluded that the combined effect of the two types of freedom had a positive and significant impact on entrepreneurial activity. Once the researchers separated

personal and economic freedom, they found that economic freedom has a significant impact on the level of entrepreneurship activity. Their findings further suggest that when examining the impact of fiscal policy and regulatory policy on entrepreneurship, fiscal policy has a much stronger effect on entrepreneurship. Overall, they concluded that government spending and taxation has more impact on the allocation of entrepreneurial talent than regulation.

Shakya and Plemmons (2021) examined the impacts of various elements of the Fraser Institute's Economic Freedom Index on the Kauffman Foundation Early-Stage Entrepreneurship (KESE) rankings across the 50 U.S. states. They reported that increased government spending and higher taxation were associated with lower start-up rates. Additionally, states with less labor market regulation (including lower minimum wages) had higher start-up rates. Powell and Weber (2013) used the Economic Freedom of North America (EFNA) index to investigate the impact of economic freedom on five measures from the Kauffman Index of Entrepreneurial Activity (KIEA). Using a panel regression, they found that higher average levels of economic freedom led to higher average business birth rates. In addition, they concluded that smaller government is important for higher levels of business births.

Overall, previous research generally supports the concept that aspects of increased economic freedom may encourage or support entrepreneurial initiatives. With increased entrepreneurial activity as a potential driver of economic growth, policy makers should consider the potential impact of policy decisions associated with levels of taxation, spending and regulation on entrepreneurial activities.

Diversity and Entrepreneurship

Analyses of policy decisions made to drive entrepreneurship at the state-level also necessitate encompassing an understanding of the demographic changes and entrepreneurial

opportunities for diverse populations. Lee et al., (2017) examined the state-level changes in U.S. racial and ethnic diversity from 1980 to 2015. Their findings confirm that all states in the U.S. are more racially and ethnically diverse now than they were 35 years ago. In fact, people of color are now projected to comprise much of the U.S. population by 2044 (Lee et al., 2017).

With the considerable and continual growth of demographic diversity in the U.S., it is important to consider the economic challenges of minority groups as they relate to entrepreneurial behavior. For example, the 2020 U.S. Census Bureau's Annual Business Survey (using 2017 data) reported that only 2.16% of U.S. businesses were African American-owned, yet the 2020 U.S. Census (Menchaca et al., 2023) indicated that 12.1% of the population in the U.S. were African American. Similarly, 5.6% of businesses were reported as Hispanic American owned (U.S. Census Bureau's Annual Business Survey, 2020) while 18.7% of the population were Hispanic (Menchaca et al., 2023). Authors Liu and Parilla (2020) discuss this disparity further emphasizing that while 40% of the U.S. population is comprised of people of color, only 20% of our businesses with employees are owned by minorities. The authors also reported lower revenue for minority owned small businesses coupled with decreased access to capital through financial institutions. These numbers indicate an underrepresentation of people of color as business owners in the US and demonstrate the need for further research examining factors that contribute to this disparity.

The urgency for research exploring the relationship between diversity and entrepreneurship was exacerbated by COVID-19. During COVID-19, the number of African American owned small businesses decreased by 41% and the number of Hispanic American small businesses decreased by 32%. During this same time period, non-minority owned small businesses decreased by 17%. (U.S. Small Business Administration Office of Advocacy, 2021).

Thus, evidence suggests that, in addition to disparities in business ownership by race, business survival rates may also be lower for businesses owned by minorities.

Despite the disparities between minority owned and non-minority owned businesses ownership rates in the U.S, many studies have reported positive relationships between levels of diversity and broader-based entrepreneurial activity across regions. For example, in a study of cultural diversity and entrepreneurship across regions of Germany, Audretsch et al., (2010) found that more diverse regions had higher tech firm start-up rates. The researchers attributed this finding to high levels of diversity creating higher levels of knowledge and ultimately, "knowledge spillover," in which existing firms do not capture all new knowledge, thus creating new entrepreneurial opportunities in regions.

Bruton et al., (2023), reviewed past studies on race and entrepreneurship and reported that previous research findings suggest that racial minorities may be more likely to become entrepreneurs out of necessity or as an avenue to escape workplace or labor market discrimination. Further, the researchers highlighted some disadvantages that minorities may have to overcome including workplace discrimination, restricted access to quality education, restricted access to capital, and potential biases in lending practices.

Karlsson et al., (2021) also reported a positive relationship between diversity and entrepreneurial activity. They noted that the more diverse knowledge base associated with cultural diversity created both knowledge spillover as well as more diverse pools of talent, ultimately promoting innovation and entrepreneurship.

Utilizing U.S. state-level data, Hoelscher and Elango (2012) found that the percentage of population who are foreign born was positively related to new venture creation, while unemployment rates were negatively related to new venture creation further supporting the

notion of many individuals pursuing entrepreneurship due to a lack of other economic opportunities.

Nadarajah et al., (2022) used state-level data to analyze the relationship between the individualistic nature of each state in the U.S. and workplace diversity policies. They found that highly individualistic states were less likely to adopt workplace diversity policies which resulted negatively in firm performance. Making the link between diversity and firm performance can further be emphasized by Hossain., (2019) who found that individual firms were more innovative and performed better when workplace diversity policies were in practice.

In a study of 165 multinational manufacturing companies located across 20 different countries, Boone et al., (2019) reported significant positive relationships between the national diversity of top management teams and rates of innovation and entrepreneurial initiatives within firms. The researchers noted that access to globally dispersed knowledge supported both innovation and entrepreneurship within the sample of firms.

Sobel et al., (2010) also reported positive relationships between cultural diversity within U.S. states and rates of net business creation, per capita venture capital investments, and per capita number of patents. They indicated that diversity creates the introduction and sharing of new knowledge into regions which, in turn, leads to higher rates of entrepreneurship.

Combined, results of the above studies provide evidence that diversity of regions may make a significant contribution to levels of entrepreneurship and may be a contributing factor in explaining variations in rates of entrepreneurship across U.S. states.

Research Hypotheses

As illustrated in Figure 1, and building on the research discussed above, we propose the following two hypotheses. The first hypothesis (H1) posits a mediation effect, where the political

leaning of a state government—whether Democratic or Republican controlled—impacts the KESE Index through the mediating mechanism of business friendliness. This hypothesis is grounded in the idea that political parties influence the regulatory and tax environments that affect entrepreneurial activity. Previous research (Hoelscher and Elango, 2012) found that Republican-controlled states often implement policies favoring lower taxes, reduced regulation, and other business-friendly measures, which support higher levels of entrepreneurship. Given that such policies are central to the Republican platform, we expect that Republican-leaning states will foster a more conducive environment for business start-ups and survival, resulting in higher levels of business friendliness. In turn, these business-friendly environments are likely to drive higher KESE Index scores, which measure various aspects of early-stage entrepreneurship. Therefore, we expect political leaning to influence entrepreneurship indirectly via business friendliness.

> ***Hypothesis 1***: Business friendliness mediates the relationship between political affiliation and the KESE Index, such that Republican-led states tend to have a higher business friendliness, and in turn, a higher KESE Index.

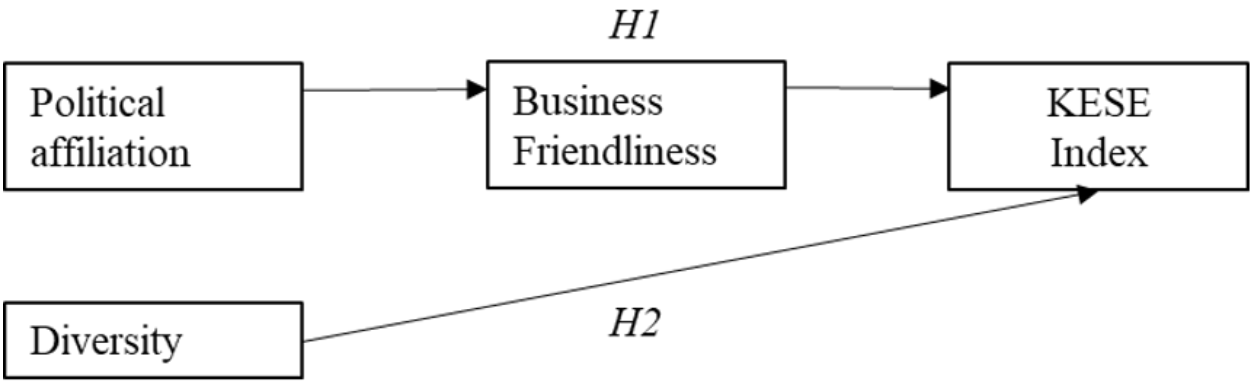
The second hypothesis proposes a direct effect between state-level diversity and the KESE Index. Research shows that diverse populations generate more creativity, innovation, and knowledge spillovers, which are critical to entrepreneurial success (Florida, 2012; Audretsch et al., 2010). Regions with higher diversity bring together a broader array of skills, perspectives, and experiences, which can lead to the development of new business ideas and opportunities. For instance, studies have shown that cultural and demographic diversity contribute to higher rates of technological innovation and start-ups, as well as enhanced knowledge spillover effects

(Karlsson et al., 2021; Sobel et al., 2010). Based on this research, we expect that states with higher levels of diversity will exhibit higher levels of early-stage entrepreneurial activity, as reflected in the KESE Index.

Hypothesis 2: Diversity is positively associated with the KESE index.

Figure 1

Theoretical Model Predicting State-Level Entrepreneurship



Methodology

Data and Sample

We built our state-level dataset from a variety of data sources, including the Ewing Marion Kauffman Foundation for the Kauffman Early-Stage Entrepreneurship (KESE) index; the World Atlas for measuring education levels; the U.S. Bureau of Economic Analysis for measuring income levels; the Tax Foundation for measuring TCI; the Fraser Institute for measuring EFI; and the U.S. Census Bureau for measuring diversity. The final sample consists of a cross-sectional dataset of these variables from all 50 U.S. states.

Dependent Variable

As noted previously, our dependent variable is the 2019 KESE index, which is an equally weighted composite measure of four indicators: 1) the rate of new entrepreneurs, 2) the opportunity share of new entrepreneurs, 3) start-up early job creation, and 4) start-up early survival rate. The rate of new entrepreneurs is the percentage of the adult, non-business owner population that starts a business each month. The opportunity share of new entrepreneurs estimates the percentage of new entrepreneurs who created their business out of opportunity instead of necessity. Start-up early job creation measures how many total jobs are created by start-ups in their first year and is normalized by the population. The start-up early survival rate is an early-stage indicator of business performance that measures the percentage of new employer establishments that are still active after one year of operation (Fairlie et al., 2019). Collectively, the four state level indicators are used to calculate the Kaufman Early Stage Entrepreneurial (KESE) index.

Independent Variables

Political affiliation. Political affiliation is measured using three distinct operationalizations to capture the nuances of political control at the state level. Legislative

Control reflects the partisan control of state legislatures, where states with both chambers controlled by Republicans are coded as 1 (Republican-leaning), those with both chambers controlled by Democrats are coded as 0 (Democratic-leaning), and split control (one chamber controlled by each party) is coded as 0.5. Governor's Party captures the partisan affiliation of the state's governor, with Republican governors coded as 1, Democratic governors as 0, and Independent or nonpartisan governors as 0.5. Finally, State Control is a composite measure that averages the scores from Legislative Control and Governor's Party, creating a single index reflecting the overall political leaning of the state government. States fully controlled by Republicans receive a score of 1, those fully controlled by Democrats receive a score of 0, and states with mixed control receive intermediate values.

Business Friendliness. Business friendliness is the average level of a state's Business Tax Climate Index (TCI) and Economic Freedom Index (EFI). The TCI is a state level ranking of business tax structures. The goal of the index is to provide a means of comparison on how well states structure their tax systems at the state level. The index considers a variety of factors including state and local taxes such as sales tax, unemployment tax, property tax, and corporate and personal income taxes. Higher ranking states are more "tax-friendly" in that they provide a start-up location for entrepreneurs with a more preferred tax structure. Lower ranking states have a less desirable tax structure, often represented by higher taxes. The EFI is produced by the Fraser Institute and is based on three main components: government spending, taxation, and labor market restrictions. The government spending component measures the size of government in each state, as well as spending on specific areas like welfare programs, education and healthcare. The taxation component measures the tax burden on individuals and businesses in each state, including measures of personal income tax rates, sales tax rates, and business tax

rates. The labor market restriction component measures the level of regulation and restriction on labor markets, including measures of minimum wage laws, union density, and the level of occupational licensing. Since both TCI and EFI are associated with a more supportive business environment, we take the average of these two measures to operationalize business friendliness.

Diversity Index. The diversity index measures the probability that two people chosen at random in a given state will be from different race and ethnicity groups. It is based on 2010 Census data. As a percentage, it ranges from 0 to 100, where 0 means everyone in the state is the same race and 100 means that everyone in the state is from a different race and ethnicity group.

Control Variables

Given that average levels of education may affect start-up rates, we controlled for Education Level, measured as the percentage of each state's population with an advanced degree (i.e., beyond a bachelor's degree). We considered models that operationalized education at the bachelor's or above level but found that it did not have a significant effect like the former. We also initially controlled for average Income Level, as income could influence access to capital and entrepreneurial opportunities. However, after testing its effect, we found that Income Level did not significantly impact the dependent variable. Therefore, to maintain parsimony and preserve degrees of freedom, given the small sample size, Income Level was omitted from the final analysis.

Analysis

We first calculated the summary statistics and correlations of all the variables used in our analysis, as presented in Table 1. To test our hypotheses, we employed structural equation modeling (SEM) in STATA 17, specifying three models that tested the effect of different operationalizations of political leaning. These operationalizations were Legislative Control,

Governor's Party, and State Control, capturing various dimensions of partisan influence at the state level. Each model included paths from political affiliation to business friendliness (as the mediating variable) and from business friendliness to the KESE Index (the dependent variable), with diversity as an exogenous predictor directly influencing the KESE Index. The three models were analyzed to assess both the direct effects of political affiliation and diversity on the KESE Index, and the indirect effects of political affiliation through business friendliness, providing a test of mediation. R-squared values were also recorded to measure the explanatory power of each model. In each case, we compared the strength and significance of paths associated with political affiliation to understand how state-level political structures influence entrepreneurship through their impact on business environments.

Results

Table 1 below reports the summary statistics and correlations for all the variables in our analysis. The KESE Index has a mean of 0.63 and a standard deviation of 2.24, indicating variability in early-stage entrepreneurship across states. Notable correlations include a positive relationship between Business Friendliness and the KESE Index ($r = 0.32$, $p < 0.05$), supporting the idea that states with more favorable business environments tend to exhibit higher levels of entrepreneurship. Additionally, Legislative Control is significantly correlated with Business Friendliness ($r = 0.31$, $p < 0.05$) and with State Control ($r = 0.81$, $p < 0.01$), highlighting the interconnectedness of political control and the business environment in a state. State Control is also strongly correlated with Governor's Party ($r = 0.97$, $p < 0.01$), as expected given that it is a composite measure of political affiliation

Table 1

Summary Statistics and Correlations

		Mean	SD	1	2	3	4	5	6
1	KESE	0.63	2.24						
2	Legislative Control	0.57	0.42	0.18					
3	Governor's Party	0.14	0.99	0.18	0.63**				
4	State Control	0.36	0.36	0.2	0.81**	0.97**			
5	Business friendliness	5.75	0.76	0.32*	0.35	0.31*	0.35*		
6	Diversity	49.04	14.52	0.21	-0.26	-0.17	-0.21	-0.11	
7	Advanced degree	0.1	0.02	-0.21	.30*	-0.18	-0.23	-0.06	0.30*

*** p<0.01, * p<0.05*

N= 50

Table 2 reports the SEM path analysis for the three political affiliation measures: Legislative Control, Governor's Party, and State Control. In the Legislative Control model, the path from political affiliation to business friendliness is positive and statistically significant ($\beta = 0.62$, $p < 0.01$). This indicates that a one-unit increase in political affiliation (i.e., moving from a fully Democratic-controlled legislature to a fully Republican-controlled legislature) is associated with a 0.62-unit increase in the business friendliness score. This suggests that Republican-controlled legislatures tend to implement policies that create a more favorable environment for businesses. Similarly, the path from business friendliness (BF) to KESE is also positive and significant ($\beta = 0.93$, $p < 0.05$), suggesting that a one-unit increase in business friendliness is associated with a 0.93-unit increase in the KESE Index. The indirect effect of political affiliation on KESE through business friendliness is significant ($\beta = 0.57$, $p < 0.05$), providing evidence of mediation. This implies that the impact of political affiliation on KESE is channeled through its influence on business friendliness. Specifically, a one-unit increase in political affiliation leads to a 0.57-unit increase in KESE indirectly, through its positive effect on business friendliness.

Given that the mean KESE score is 0.63, this indirect effect represents a substantial portion of the overall variation in early-stage entrepreneurship across states. The direct effect of political affiliation on KESE ($\beta = 0.40$) is not significant, indicating that political affiliation primarily influences KESE through its effect on business friendliness, rather than having a direct and independent effect.

In the Governor's Party model, the results are similar. We observe a significant positive path from political affiliation to business friendliness ($\beta = 0.24$, $p < 0.01$) and from business friendliness to KESE ($\beta = 0.92$, $p < 0.05$). The indirect effect is also significant ($\beta = 0.22$, $p < 0.05$), again indicating mediation. The direct effect of Governor's Party on KESE is not statistically significant ($\beta = 0.21$), reflecting a full mediation, where the entire effect of political affiliation on KESE is explained by its impact on business friendliness.

The State Control model shows a significant positive path from political affiliation to business friendliness ($\beta = 0.41$, $p < 0.01$) and from business friendliness to KESE ($\beta = 0.90$, $p < 0.05$). The indirect effect is significant ($\beta = 0.37$, $p < 0.05$), providing further evidence of mediation. The direct effect of State Control on KESE is not significant ($\beta = -0.34$), again indicating a full rather than partial mediation.

For Hypothesis 2, the direct effect of diversity on KESE is significant across all models. In the Legislative Control, Governor's Party, and State Control models, diversity positively impacts KESE with coefficients of $\beta = 0.053$, $\beta = 0.052$, and $\beta = 0.53$, respectively (all $p < 0.05$), providing support for the hypothesis. The R-squared values for the models indicate that the explanatory power is relatively consistent, with the models explaining between 24% and 26% of the variance in KESE.

Despite census data noting disparities between minority owned and non-minority owned businesses ownership rates in the U.S., our results provide additional evidence of positive relationships between levels of diversity and broader-based entrepreneurial activity in regions as measured by indices such as the KESE.

Table 2

SEM Path Analysis Using State-Level Political Affiliation Measures

Effects	Legislative Control (1)	Governor's Party (2)	State Control (3)
Political -> BF	0.62**	0.24**	0.41**
	(0.24)	(0.10)	(0.15)
BF -> KESE	0.93**	0.92**	0.90**
	(0.38)	(0.38)	(0.38)
Political -> KESE	0.40	0.21	-0.34
	(0.72)	(0.30)	(0.47)
Diversity -> KESE	0.053**	0.052**	0.53**
	(0.021)	(0.02)	(0.24)
Advanced Degree -> KESE	-24.25*	-24.70*	-24.25*
	(11.72)	(11.81)	(11.91)
Indirect Effect (*effect of Political on KESE through BF*)	0.57*	0.22*	0.37*
	(0.32)	(0.132)	(0.21)
R-squared	0.26	0.24	0.26

*** p<0.01, * p<0.05, with standard errors in parentheses*
N= 50

Robustness Check

To ensure the robustness of our findings, we conducted an additional analysis using an alternative operationalization of political affiliation, based on presidential voting patterns. Specifically, we coded states based on the results of the 2016 U.S. presidential election, with

Republican-leaning states coded as 1 and Democratic-leaning states coded as 0. The results, presented in Table 3, were consistent with those obtained using the state-level political operationalizations. The path from political affiliation to business friendliness remained positive and significant ($\beta = 0.62$, $p < 0.01$), while the path from business friendliness to KESE was also positive and significant ($\beta = 1.04$, $p < 0.05$). The indirect effect of political affiliation on KESE through business friendliness was statistically significant ($\beta = 0.65$, $p < 0.05$), further supporting the mediation hypothesis. The direct effect of political affiliation on KESE was not significant ($\beta = -0.18$), suggesting full mediation. Additionally, the direct effect of diversity on KESE ($\beta = 0.05$, $p < 0.05$) and the negative impact of advanced education on KESE ($\beta = -27.40$, $p < 0.05$) were consistent with previous models. The R-squared value of the model was 0.29, indicating similar explanatory power as the main analysis. These findings demonstrate that our results are robust across different operationalizations of political affiliation.

Table 3

SEM Path Analysis - Robustness Check with Presidential Election Results

Effects	Presidential Voting
Political -> BF	0.62**
	(0.20)
BF -> KESE	1.04**
	(0.40)
Political -> KESE	-0.18
	(0.69)
Diversity -> KESE	0.05**
	(0.02)
Advanced Degree -> KESE	-27.40**
	(12.92)
Indirect Effect (*effect of Political on KESE through BF*)	0.65*
	(0.021)
R-squared	0.29

*** p<0.01, * p<0.05, with standard errors in parentheses*
N= 50

Discussion

This study identified key state-level differentiators that promoted high levels of entrepreneurship. It should thus provide value to policy makers and other stakeholders seeking to better promote and sustain entrepreneurship within given geographic areas.

Despite a paucity of empirical research, significant political debate in the U.S. revolves around which political party in the U.S. is more business-friendly and thus contributes more to development of policies promoting growth and entrepreneurship. Consistent with Hoelscher and Elango (2012) who found positive associations between Republican governorships in the U.S. and rates of business start-ups, our results also provide evidence that Republican leaning states, as measured by Legislative Control, Governor's Party, and State Control, tend to foster a more business-friendly environment. These state-level political variables, particularly when

considering the partisan control of both state legislatures and the governor's office, were shown to significantly impact the business friendliness of a state, which in turn positively influenced entrepreneurial activity. By using these refined measures of political affiliation, this study provides a more detailed understanding of how political structures at the state level can create favorable conditions for entrepreneurship.

Furthermore, this study advances this stream of work by utilizing a novel operationalization of a state's business friendliness, the average of a state's TCI and EFI. Our theory and analysis demonstrate substantial explanatory power in predicting overall levels of early-stage entrepreneurial activity with this construct and indicate that it is a key mediator in linking a state's political affiliation to its levels of early-stage entrepreneurial activity.

As hypothesized, our findings also suggest that, even after accounting for influences of other variables in our model, diversity is a significant predictor of entrepreneurship. As expected, our results support findings of most previous studies reporting that high levels of diversity in regions creates higher levels of knowledge; ultimately leading to new entrepreneurial opportunities. Our findings also provide support for the seminal work of Florida (2012) who found that openness to different types of people was a key driver of creativity and economic growth in U.S. metropolitan regions. Overall, our results bear out that, in addition to the impacts of policy and political leanings, there is also a central element revolving around people that supports entrepreneurial growth and sustainability across U.S. states.

Our findings indicate a significant, positive association between demographic diversity and early-stage entrepreneurial activity across states. Consistent with our theoretical model, our findings suggest that diversity may foster environments rich in "creative collisions,' where varied perspectives stimulate innovation and opportunity (Ofem et al., 2023). This aligns with

Florida's (2012) view of diversity as a driver of creativity and economic growth, underscoring that diverse populations contribute essential knowledge spillovers to entrepreneurial ecosystems. These results suggest that demographic diversity, alongside political and economic factors, is integral to fostering entrepreneurship and economic development across the United States.

Implications and Recommendations for Future Research

Our findings provide evidence that public policy measures, including those comprising the TCI and EFI indices, have a significant impact on entrepreneurship across U.S. states. Additionally, evidence is also provided that elements of TCI and EFI are influenced by political leanings of individual states. Thus, state policy makers should closely assess what initiatives are being employed in states where entrepreneurial growth and prosperity are strongest and consider the feasibility of adopting fiscal and regulatory policies in a manner similar to those states. Of course, there are constraints to this strategy as each individual state has its own set of unique circumstances that impact policy making and budgets. However, it may still be possible for policy makers to adopt a more non-partisan perspective and focus on utilizing certain elements of high entrepreneurship states as benchmarks for adopting measures that are more likely to promote entrepreneurship within their own states.

Our research also supports past findings indicating positive relationships between levels of diversity and entrepreneurship. Thus, the ability of state policy makers to adopt measures to promote diversity, and the associated knowledge spillover that it creates, seem to be essential elements in promoting high levels of entrepreneurship across states.

Future research should also consider different types of economic outcomes in addition to those measures comprising the KESE index and could also focus on entrepreneurship rates across different industries. As is the case with most indices, the KESE is a composite of four

separate indicators and potentially, an extremely high score on one indicator could skew the composite index in a particular direction for a state. There is likely to also be an element of subjectivity in the way that some of the data is collected. In particular, the opportunity share indicator is based on asking a sample of entrepreneurs what their motivations were for starting a business (i.e., out of opportunity or necessity). Additionally, KESE indicators for early job creation and survival are based on the first year of business operation only. Future research could consider the constituent dimensions of the KESE index separately (e.g., rates of new entrepreneurship, opportunity shares, early job creation of firms, and one year survival rates) and assess possible unique drivers of each dimension. Furthermore, future studies could explore additional Kauffman Indicators of Entrepreneurship, such as Contribution, Creation, and Constancy, to gain a more nuanced understanding of the long-term impact of entrepreneurship on job creation and economic stability. This type of research could be useful to policy makers in fine-tuning measures to promote specific elements of entrepreneurship.

Future research should also consider cultural attributes of states by examining potential influences of cultural tightness (e.g., Harrington and Gelfand, 2014) and elements of Florida's (2012) creative class framework (i.e., talent, tolerance, and technology) that were utilized to examine variations in innovation and economic development across U.S. metropolitan areas. Including such cultural dimensions could add additional insight into factors promoting (or hindering) entrepreneurship across states.

As is the case in this study, future research should also consider utilizing combined tax friendly and economic freedom indices. Our analysis demonstrates substantial predictive validity of the combination of these measures in predicting early-stage entrepreneurial activity, and we

encourage future research to similarly adopt this construct and operationalization of "business-friendliness" to further investigate state-level and regional drivers of entrepreneurship.

Surprisingly, education, which was the control variable in our study, had a unique negative relationship with our dependent variable. To uncover what could possibly be the reason for this finding, future research could examine relationships between opportunity shares (what the Kauffman Foundation described as the percentage of new entrepreneurs creating businesses out of opportunity versus out of necessity) and levels of education across states. It is possible that individuals with less education have fewer employment opportunities and, thus, out of necessity of lack of job opportunity, have higher rates of self-employment.

Conclusion

This study demonstrates the predictive validity of a model explaining early-stage entrepreneurial activity at the state level. We find that political leanings of states, related levels of business friendliness, and demographic diversity are key predictors of entrepreneurial growth as measured by the KESE Index. Policymakers should consider these findings when developing strategies to promote local economic development through entrepreneurship. Indeed, our study points to the importance of how features of the institutional, legal, and social environment may facilitate greater entrepreneurial activity within given states. These features of the business environment can be shaped through business-friendly policies, which, in our data set, tend to be associated with Republican-leaning states. We encourage future work to further explore the antecedents of these features, and the mediating mechanisms linking them with early-stage entrepreneurial activity.

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