

Management and Governance in Dutch SMEs

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Small and medium-sized enterprises are important engines to stimulate the economic growth of a country. The survival of these firms is partly dependent on their human capital availability. Using strategic leadership theory, this paper examines the characteristics of the entrepreneur/manager, the top management team and the board of directors in Dutch SMEs. Empirical data identifies the entrepreneurs/managers as the most important decision makers. However, to support their decision-making process in the current competitive business environment, two thirds of the CEOs have created top management teams. CEOs and top management team executives combine their industry and functional knowledge to create the necessary firm know-how. Less than half of the firms have adopted a supervisory board. A reason for this could be the CEO's limited knowledge on the concept of governance. The paper concludes that entrepreneurs/managers of SMEs should be made aware of the strategic knowledge and networking advantages both top-management team and supervisory board members can offer.

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Introduction

In The Netherlands, as well as in most other countries of the world, small and medium-sized companies (SMEs) represent the vast majority (99%) of all enterprises (OECD, 1998). The contribution of SMEs to economic growth, job creation and innovation has been widely recognised (Audretsch and Keilbach, 2004; Van Stel *et al.*, 2005). However, many of these SMEs do not survive their first years in business (Storey 1994; Almus, 2004; Persson, 2004), and as such, do not provide these benefits to society.

Besides macro economic (economic climate) and firm-level characteristics (size, age, resource-based arguments), human capital and managerial behaviour are of fundamental importance in explaining a venture's long-term survival (Gimeno *et al.*, 1997; Berry 1998; Ciavarella *et al.*, 2004; Aragón-Sánchez and Sánchez-Marín 2005). Nevertheless, limited data is available about human capital characteristics of small and medium-sized enterprises. The goal of this paper is to fill this gap in the literature by describing managerial capital characteristics of Dutch SMEs. Subsequently, the characteristics of the entrepreneurs, their top management teams and boards of directors will be assessed.

The remaining part of this paper is structured as follows. First we explore past research on managerial capital in SMEs. Secondly the methodology of the study is described, followed by a discussion of the empirical results. The paper ends with conclusions and managerial recommendations.

Conceptual Development

Strategic leadership theory (Finkelstein and Hambrick 1996) illustrates that CEOs and their top management teams are important decision makers, affecting the performance of their firms. Their reasoning is based on the strategic choice theory (Child 1972) and the 'upper-echelons' perspective (Hambrick and Mason 1984). Finkelstein and Hambrick (1996) claim:

"Executives vary in their experiences, capabilities, values and personalities, and these differences in turn cause executives to differ in their awareness and interpretation of strategic stimuli, their aspiration levels, their beliefs about causation, even their beliefs about what it is they are trying to accomplish and how urgent it is. It follows that executives will differ in their behaviours and choices."

Within the scope of strategic leadership theory, individual executives (manager/entrepreneurs), top-management teams and boards of directors represent the SMEs' managerial capital. Although the CEO/entrepreneur is the main decisionmaker within the smaller venture, the SME literature acknowledges that the management of these firms is a shared effort (Gartner *et al.*, 1994). The business environment in which these SME managers have to operate has become increasingly complex, unpredictable and unstable (Sadler-Smith 2004). In order to cope with this complexity, the CEO's decision-making process seems to be characterized by intuitive decision making (Sadler-Smith 2004), overconfidence and representativeness (Busenitz and Barney 1997). A well-functioning top management team and/or board of directors could add value to the strategic decision-making process, by advising the CEO and making the process less intuitive.

CEO-Manager-Entrepreneur

Strategic leadership studies examining the impact of an individual's personal characteristics on firm performance focus on two aspects: (1) psychological properties and (2) observable executive experiences (Finkelstein and Hambrick 1996). Within an SME or entrepreneurship context, much research has been done on the first subject. Topics investigated are the influence of values (Osborne 1991; Tiessen 1997), cognition (Sadler-Smith 2004) and personality traits (Boone *et al.*, 1996; Ciavarella *et al.*, 2004). Research papers relating these characteristics to firm performance report contradicting results. This paper focuses on the second stage of research, namely the observable experiences of the CEO. Three key variables within this domain are executive tenure, functional experiences and formal education (Finkelstein and Hambrick 1996). Researchers within the entrepreneurship domain (Lee and Tsang 2001; Westhead *et al.*, 2003) report positive growth prospects based on entrepreneur's previous experiences.

Top-Management Team (TMT)

According to Finkelstein and Hambrick (1996), a top management team has three central conceptual elements: composition, structure and process. Within the entrepreneurship or SME domain, only a few empirical TMT studies have recently been published. Nicholson and Cannon (2000), studying the psychological diversity of 44 TMTs in successful independent UK companies, describe the team as one of diverse people bound together by common values. Chowdhury (2004) examined demographic diversity in 79 US-based entrepreneurial teams, and concluded that process variables are more important for team effectiveness than demographic diversity. Four

articles focus on process issues of TMTs (Nicholson and Cannon 2000; Ensley *et al.*, 2002; Chowdhury 2004; Ensley and Pearson 2005), and emphasize the importance of team process variables as cohesion and conflict in explaining performance.

Board of Directors

Strategic leadership theory (Finkelstein and Hambrick 1996) stipulates that boards of directors influence firm performance through the execution of two tasks: (1) monitoring and disciplining top management, and (2) involvement in strategy formation. Board composition and board structure are two of the characteristics influencing board behaviour. Within the SME literature, several researchers (Zahra and Pearce 1989; Borch and Huse 1993; Johannisson and Huse 2000; Daily *et al.*, 2002) acknowledge the importance of well-functioning boards, as good governance practices can improve company performance. Moreover, Jain and Gumpert (1980) stipulate that board members have to provide expertise to compensate for small companies' managerial deficiencies.

The research cited above exemplifies the importance of the SMEs' managerial capital, and the possible impact on the firms' performance. This study will examine CEO, TMT and board characteristics of Dutch SMEs, and formulate recommendations for improvements.

Research Design

To assess the managerial characteristics of Dutch SMEs, a questionnaire was mailed to the CEOs of firms being a member of an important Dutch employer organisation (Limburgse Werkgevers Vereniging). Out of 627 questionnaires mailed, 156 were returned (response rate 24.9%). As only those firms employing less than 250 employees were selected,¹ data on 110 SMEs will be used in this analysis.

Results

In order to put the research results in perspective, Tables 1 and 2 provide some key figures on the SMEs in the sample. On average, firms employ 85 people. Thirty-eight percent of the firms are small ones, employing fewer than 50 people. Their main activities are industrial or service-related. Almost all firms survived the start-up stage.

The SMEs' CEOs perceive their environment as a highly competitive one. Although most of them report that their technology is not changing that fast, they emphasize the importance of having sufficient

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