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From The Editor

The Silicon Valley Review of Global Entrepreneurship Research is a peer-reviewed scholarly journal that focuses on theoretical, applied, and pedagogical research in entrepreneurship from an international perspective. From our geographic editorial home in San Francisco and Silicon Valley, we intend to highlight current issues that affect the way in which entrepreneurship impacts our economic and social contexts. We are delighted to have contributing authors from around the world with expertise in entrepreneurial education, practice, financing, and law. We continually seek out new and vital contributions and encourage prospective authors to contact us with questions or comments on past and future issues. Format guidelines for submissions are located on the last pages of each issue. We look forward to hearing from you.

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Venture Capitalists' Investment Criteria: A Literature Review and Assessment

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ABSTRACT

We review and summarize the evolution of the literature on VCs' investment criteria. Our objective is to articulate the principal questions it posed; to identify the most common and dominant sets of investment criteria VCs utilize; to assess the methods scholars employ to examine VCs' investment criteria and their rationale; and to pinpoint the principal accomplishments and shortcomings of the extant studies. Overall, we seek to bring more clarity as to what has been achieved, what remains problematic, and what vistas could be pursued in the future to strengthen this important area of entrepreneurship research.

Venture Capitalists' Investment Criteria: A Literature Review and Assessment

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INTRODUCTION

In the late 1960s, scholars in the U.S. (Baty 1964; Briskman 1966; Hoffman 1972; Wells 1974; Benoit 1975; Poindexter 1976; Benoit 1975; Hoban 1976) first began to examine the sets of investment criteria VCs employ to pick out the most suitable ventures out of multifarious contenders that apply for their funding. The resulting studies had laid the groundwork for this new area of entrepreneurship research. Not surprisingly, many of them (Wells 1974; Poindexter 1976) continue to influence the VC investment literature. These original examinations aggregated VCs' rankings of investment criteria, and identified some of them, for instance, market-related criteria (Hoffman 1972) or management-related criteria (Baty 1964; Wells 1974) as dominant.

In the 1980s, a number of seminal research papers (Tyebjee and Bruno 1981; 1984; Macmillan, Siegal, and Narasimha 1985; MacMillan, Zemann, and Narasimha 1987) have problematized the field by applying factor analysis and cluster analysis to VCs' rankings of investment criteria. Their goal was to examine the general patterns underlying VCs' investment philosophies as potentially different from the way VCs themselves categorized their priorities, and also to inquire whether VCs fall into groups depending on their intrinsic approaches toward risk management (Driskoll 1974). In contrast, other scholars (Sandberg, Schweiger, and Hofer 1988) employed a verbal protocol analysis to dissect VCs' venture proposal evaluation. They argued that VCs' actual decision making could be at variance with the post hoc accounts provided in VCs' self-reports.

In the 1990s, new studies applied modeling and conjoint analysis (Riquelme and Rickards 1992; Zacharakis 1995; Zacharakis and Mayer 1995; 1998; Muzyka, Burley, and Leleux 1996; Shepherd 1999a) to assess the effectiveness of VCs' decision making (Shepherd and Zacharakis 1998). Scholars reanalyzed VCs' dominant sets of investment criteria (Muzyka, Barley, and Leleux 1996), and tested whether VCs utilize different sets of criteria depending on the stage of proposal evaluation (Fried and Hisrich 1994; Zacharakis and Mayer 1995; 1998); stage of venture development (Carter and Auken1994); and the size of the VC fund (Elango, Fried, Hisrich, Polonchek 1995). Research has also become more theory driven as scholars began to examine VCs' decision making in view of broader conceptual approaches derived from various

disciplines including psychology, economics, strategy and entrepreneurship (Hisrich and Jankowicz 1990; Fried and Hisrich 1994; Zacharakis 1995; Shepherd 1999a). In addition, scholars began to examine whether VCs' investment approaches differ by region (Europe vs. Asia vs. Northern America) and country within a region (Knight 1994; Rah, Jung, and Lee 1994; Pandey, 1985; Muzyka et al.1996; Manigart, Wright, Robbie, Desbrieres, and de Waele 1997; Zutschi, Tan, Allampalli, and Gibbons 1999).

In the 2000s, researchers continued to analyze how VCs worldwide use investment criteria (Mishra 2003; Clarysse, Knockaert, and Lockett 2004; Baeyens, Vanacker, and Manigart 2006). Importantly, recent studies employ a variety of methods from a traditional aggregation of VCs' rankings of investment criteria (Baeyens et al. 2006) to a verbal protocol analysis (De Leon and Guild 2003), factor analysis (Khanin 2006), conjoint analysis (Clarysse, Knockaert, Lockett 2004; Franke, Gruber, Harhoff and Henkel 2007) and modeling (Mainprize and Hindle 2005). Scholars also seek to uncover how VCs' approaches toward venture funding differ by the stage of investment (Khanin 2006); investment philosophy (Clarysse et al, 2004); VC firm status (Roberts and Barley 2004), and whether VCs' choice of investment criteria may affect their profitability (Kaplan and Stromberg 2006).

To sum up, over the last fifty years, research on VCs' investment criteria has significantly grown and spun out in different directions. It has employed a variety of methods and arrived at different and at times contradictory conclusions. In view of such increasing complexity**,** the objective of our paper is to articulate the principal questions posed in the VC investment criteria literature, and to scrutinize how they have been answered. In so doing, we seek to identify the most seminal contributions of the VC investment criteria research and outline some directions for future studies.

PRINCIPAL QUESTIONS

The principal questions raised in the literature on VCs' investment criteria are as follows: What are the common sets of VCs' investment criteria? What are the dominant sets of VCs' investment criteria? Do VCs stress different sets of investment criteria depending on the stage of project evaluation, venture stage of development, stage of VC investment, region and nation, the size of the VC firm and its investment philosophy? Do VCs fall into groups depending on the sets of investment criteria they prioritize? Does VCs' choice of investment criteria as dominant affect their profitability? What methods should be used for identifying and analyzing VCs' investment criteria? Below, we examine how these principal questions have been answered in extant research.

WHAT ARE THE COMMON SETS OF VCS' INVESTMENT CRITERIA?

Sample and Methods

To the best of our knowledge, we have reviewed all the extant studies on VCs' investment criteria in English - from unpublished dissertations (Baty 1964; Briskman 1966; Hoffman 1972; Wells 1974; Benoit 1975; Poindexter 1976; Hall 1989; Zacharakis 1995; Bachher 2000; Khanin 2006) to articles that came out between 1960 and 2006. To identify relevant dissertations and publications, we have conducted an extensive search in various databases, such as EBSCO, Lexis-Nexis, and ProQuest. The resulting sample consists of 52 studies on VCs' investment criteria. It solely encompasses research based on an original dataset. If the author(s) has published numerous studies based on the same dataset, only one of them was included in the sample.

Table 1 provides brief information about the focus of each study, the size of its sample, and methods used to collect and analyze the data. Table 2 summarizes the most common sets of investment criteria VCs utilize for screening and evaluating entrepreneurs' business proposals reported in the reviewed studies, and their rankings (where "1" means the most important set of investment criteria). In compiling Table 2, our primary objective was to identify and compare VCs' preferences in applying a number of common investment criteria. Based on our examination of all the reviewed studies, we have isolated ten most commonly used sets of investment criteria. These include: CEO (entrepreneur); Top Management Team (TMT); Market; Market Growth; Product; Risk; Return; Exit; Deal; Strategy (Business Model); and Competition. In what follows, we will briefly characterize the most common sets of VCs' investment criteria.

Table 1. Studies of VCs' Investment Criteria: Focus, Sample, Data Gathering and Analysis.

	Author(s) and Date	Focus	Sample	Data gathering	Data Analysis
1	Baty, 1964	Initial financing	10 VCs	Interviews	Qualitative
2	Briskman, 1966	Decision to finance	1 VC firm	Proposals submitted	Ranking
3	Hoffman, 1972	Investment process	39 VCs	Survey/interviews	Descriptive
4	Wells, 1974	VC decision making	10 VCs at 7 VC firms	Survey/interviews	Correlation
5	Poindexter, 1975	Efficient markets	91 VCs	Survey	Ranking scale
6	Benoit, 1975	Investment behavior	22 VCs	Survey/interviews	Counting
7	Hoban, 1976	VCs' investments	25 VCs	Survey	Ranking
8	Kryzanowski and Giraldeau, 1977	Selection criteria	68 and 82 VCs	Survey	Ranking
9	Tyebjee and Bruno, 1981	Decision making	46 VCs	Survey/interviews	Factor analysis
10	Tyebjee and Bruno, 1984	Investment activity	41 VC firms	Survey	Factor analysis
11	Hutt and Thomas, 1985	Arizona VCs	4 VC firms	Survey	Mean values
12	MacMillan, et al. 1985	Investment criteria	14 VCs + 102 VCs	Survey/interviews	Factor analysis
13	Goslin and Barge, 1986	CEO qualities	42 VCs	Survey	Central tendency
14	Roure and Maidique, 1986	Prefunding factors and venture success	2 VC firms and 8 ventures	Semi-structured interviews	Counting
15	MacMillan et al. 1987	Successful VC firms	67 VCs; 150 ventures	Survey/interviews	Factor/ cluster analysis
16	Khan, 1987	Decision models	36 VCs	VCs' reports	Actuarial models
17	Robinson, 1987	VC firms' strategies	53 VCs	Survey	Ranking, factor analysis
18	Siskos, Zopounidis, 1987	Evaluation criteria	1 VC firm	From existing research	Modeling
19	Ruhnka and Young, 1987	Venture development	73 VC firms	Survey	Percentage of responses
20	Sandberg et al., 1988	Decision processes	1 VC; thought units	Proposals evaluation	Verbal protocol analysis
21	Rea, 1989	Success and failure	18 VCs	Survey	Tabulation and ordering
22	Dixon, 1989	VCs' appraisal	30 VCs from U.K.	Interviews	Mean scores
23	Hall, 1989	Decision making	4 VCs	Interviews	Verbal protocol analysis
24	Hisrich, Jankowicz, 1990	VCs' intuition	5 VCs (6 proposals)		Repertory grid
25	Roberts, 1991	Decision making	3 VC firms	Interviews/experience	Summary
26	Hogan, 1992	Salient factors	4 VCs	In-depth interviews	Qualitative
27	Riquelme and Rickards, 1992	Decision making	13 VCs	Interview	Modeling, conjoint analysis

28	Ray and Turpin, 1993	VC in Japan	15 VCs	Survey	Sample description
29	Fried and Hisrich, 1994	Decision making	18 VCs	Interviews	Grounded theory
30	Rah, Jung, Lee, 1994	VC in Korea	74 VCs	Survey/interviews	Discriminant analysis
31	Knight, 1994	Investment criteria	31 VCs; 50 SBDCs	Survey	Rankings of responses
32	Carter and Auken, 1994	Venture stage impact	69 VCs	Questionnaire	Factor analysis
33	Elango et al., 1995	How VC firms differ	149 VCs	Questionnaire	Group differences test
34	Zacharakis, 1995	Investment decision	51 VCs	Scenarios, interviews	Regression
35	Muzyka et al, 1996	Trade-offs	73 VCs	Survey/interviews	Conjoint analysis
36	Boocock and Woods, 1997	Evaluation criteria	232 proposals; 1 VC fund	Business proposals	Qualitative
37	Zutschi, et al. 1999	Singapore VCs	31 VCs	Survey	VCs’ ratings
38	Shepherd, 1999	New venture strategy/profitability	66 VCs representing 47 VC firms	Decision making task	Conjoint analysis; OLS regression
39	Bachher, 2000	Technology ventures	100 VCs	Survey/interviews	ANOVA
40	Kaplan and Stromberg, 2000	How do VCs choose their investments?	10 VC firms; 58 investments	Interviews and surveys.	Regression
41	Riquelme and Watson, 2002	VCs’ implicit theories	30 U.K. VCs	Interviews	Content analysis
42	Kumar and Kaura, 2003	VCs’ screening	11 VCs	Survey	Variables’ association
43	Mishra, 2003	Indian VCs’ criteria	40 VCs	Survey/interviews	Rankings
44	Kakati, 2003	Indian VCs’ criteria	27 VCs	Questionnaires	Rankings
45	De Leon and Guild, 2003	Business plans	5 VCs, 2 CEOs	Proposal analysis	Repertory grid
46	Silva, 2004	Small equity markets	1 VC; 16 proposals	Participant observation	Grounded theory
47	Mason and Stark, 2004	Evaluation criteria	3 bankers, 3 VCs, 4 business angels	Proposal analysis	Verbal protocol analysis
48	Roberts and Barley, 2004	Investment criteria	4 VCs	Interviews	Contrasting
49	Clarysse et al. 2004	Early-stage high-tech	68 VCs	Proposal examination	Conjoint analysis
50	Baeyens et al. 2006	Selection: biotech	16 VCs	Survey/interviews	Qualitative analysis and ranking
51	Khanin, 2006	VCs’ pre-investment vs. post-investment	46 VCs	Script assessment	Factor analysis
52	Franke et al. 2007	Start-up teams	51 VCs	Experiments/interviews	Discrete choice analysis

Table 2. Rankings of VCs' Investment Criteria in the Reviewed Studies

#	Studies/Criteria	CEO	TMT	Market	Product	Risk	Returns	Exit	Deal	Strategy	Competition
1	Baty, 1964	1		2	3				4		
2	Briskman, 1966	2		3	4		1				5
3	Hoffman, 1972	2		1	2						5
4	Wells, 1974	1		3	2						
5	Poindexter, 1975	1				3	2		4		
6	Benoit, 1975	1		3	5		2				4
7	Hoban, 1976		1	3	2				4		
8	Kryzanowski and Giraldeau, 1977		1	3	2	4					
9	Tyebjee and Bruno,1981	3		2		4	1	5			
10	Tyebjee and Bruno, 1984	3		1	2			5			4
11	Hutt and Thomas, 1985		1	3	4		2				5
12	MacMillan et al.1985	6		3	4	1	7	5			2
13	Goslin and Barge, 1986	1	2								
14	Roure and Maidique, 1986		1	2					4	3	
15	MacMillan et al. 1987			3		1					2
16	Khan, 1987	1				2					3
17	Robinson, 1987	1		3						2	
18	Siskos, Zopounidis, 1987		3	2							1
19	Ruhnka and Young, 1987	3		2	1					4	
20	Sandberg et al. 1988	3		2			4				1
21	Rea, 1989		3	1	2	6	5		4		
22	Dixon, 1989	5	1	4			2		3		
23	Hall, 1989			1							3
24	Hisrich, Jankowicz, 1990	1		2			3				
25	Roberts, E.B.	2			1					3	

26	Hogan, 1992	1			3		4				2
27	Riquelme and Rickards, 1992	1			2						
28	Ray and Turpin, 1993	1		2		4		3			
29	Fried and Hisrich, 1994	2			1		3				
30	Rah et al. 1994	1		2	3		4				
31	Knight, 1994	1		3	2		4				
32	Carter and Auken, 1994	1		4	3		2				
33	Elango et al.1995	1		2	3						4
34	Zacharakis, 1995	2		1	3						5
35	Muzyka et a 1996	1		2	3		5		6	4	
36	Boocock and Woods 1997	5		2		6	4		3	1	
37	Zutschi, et al. 1999	1		2	3		4				
38	Shepherd, a, 1999		1	3						4	2
39	Bachher, 2000	1		2	3		4				
40	Kaplan and Stromberg, 2000			1	2						3
41	Riquelme and Watson, 2002	1			2					3	
42	Kumar and Kaura, 2003	2		3		1	4				
43	Mishra, 2003	1		2	3		4				
44	Kakata, 2003			3	2	1					
45	De Leon and Guild, 2003	1			2						
46	Mason and Stark, 2004	1		4	3					5	
47	Roberts and Barley, 2004	7		1			3			6	5
48	Silva 2004	1			2						4
49	Clarysse, et al. 2004	2		3			1				
50	Baeyens et al, 2006	4		2			1			3	
51	Khanin, 2006	3	4	1						5	2
52	Franke et al. 2007		1								

CEO (Entrepreneur)

Practically every study of VCs' investment criteria has examined both the objective characteristics of the entrepreneur (CEO), such as track record, education, industry experience, functional background, financial commitment (Poindexter 1975; Robinson 1987; Riquelme and Watson 2002), and the subjective characteristics of the entrepreneur (CEO), such as commitment (Wells 1974), an ability to exert sustained effort and attention to detail (MacMillan et al. 1985; 1987), and desire for success, ingenuity, flexibility and creativity (Khan 1987). Some VCs (Wells 1974) emphasized various functional skills: general management, marketing, finance and manufacturing. Others focused on management expertise and capabilities (Fried and Hisrich 1994). Researchers established that VCs typically prefer to choose seasoned managers (Robinson 1987; Knight 1994) with high risk tolerance (Wells 1974; Kumar 2003).

Top Management Team (TMT)

In addition, many studies discovered that VCs are concerned about the ability of senior management to act as leaders and be recognized as leaders by their team members (Robinson 1987; Kaplan and Stromberg 2000). Furthermore, VCs carefully assess the quality of a management team. Overall, VCs prefer when a management team is balanced, i.e. when it is composed of people with different functional backgrounds and capabilities (Muzyka et al. 1996, Bachher 2000).

A recent paper (Franke, Gruber, Harhoff, and Henkel 2007) has focused exclusively on the characteristics of start-up teams, such as experience in the relevant industry, field of education, university degree, leadership experience, mutual acquaintance, age and prior job experience, and emphasized the strong impact that such TMT attributes exert on VCs' evaluations.

Market

Extant studies revealed that VCs are primarily concerned about whether the market targeted by a venture is accessible (Tyebjee and Bruno1984); whether a venture either satisfies an existing market need or stimulates a new need which may lead to the creation of a new marketplace (MacMillan et al. 1985; 1987); and whether the existing market (or the new market that would be created) is sufficiently large so that a venture has a chance to expand, and generate an adequate cash flow that would justify the VC investment.

Market Growth

Many VCs emphasized that one of their primary criteria is whether the market is growing fast enough to warrant an investment (Muzyka et al. 1996). In addition, Shepherd (1999a) and Shepherd et al. (2000) have demonstrated that VCs prefer a certain level of stability in the marketplace since it may be difficult to enjoy a competitive advantage in rapidly metamorphosing markets. Hence, VCs tend to examine the "key success factor stability." That is, do the requirements necessary for achieving success in the marketplace change rapidly or slowly?

Product

Many studies have established that VCs carefully evaluate the quality of a venture's product using the following criteria: is the product unique or sufficiently differentiated compared to competitors' offerings (Muzyka et al. 1996)? Is the product proprietary (MacMillan et al. 1985; 1987; Zacharakis and Meyer 1998)? Does a functioning prototype of a product exist (MacMillan

et al. 1985; 1987)? Will the product allow a venture to obtain a competitive advantage due to its apparent superiority over the competitors' products or services (Fried and Hisrich 1994; Zacharakis and Meyer 1998)?

Risk

Research has shown that in evaluating prospective investments VCs dissect overall risk into various subtypes they may need to handle in the process of funding a venture. Driscoll (1974) first suggested that the gist of VC investment lies in risk management. Following this approach, MacMillan et al. (1985; 1987) have analyzed the patterns underlying VCs' application of investment criteria as the handling of the fundamental types of risk. Using factor analysis, MacMillan et al. (1985) identified five essential types of risk examined by VCs: 1/ competitive risk; 2/ bail out risk; 3/ investment risk; 4/ management risk; 5/ implementation risk. MacMillan et al. (1987) singled out somewhat different types of risk in a changed order of importance: 1/ management risk; 2/ competitive exposure; 3/ inexperience risk; 4/ viability risk; and 5/ cash-out risk.

Returns

Numerous studies have demonstrated that VCs are extremely concerned about whether the projected returns from investment in a venture will be sufficient to justify a venture's funding (Poindexter 1975). At the same time, many scholars pointed out that VCs do not quite trust entrepreneurs' "overoptimistic" projections regarding future returns, and pay more attention to the market's size and growth rate and whether a product satisfies an existing or emerging market need (MacMillan et al. 1985; 1987; Zacharakis 1995). There is also a substantial difference between European VCs who stress the financial perspective in their assessments of new ventures, and North American VCs who emphasize the strategic perspective in their assessments of new ventures (Manigart et al. 1997).

Exit (Liquidity)

A number of studies have shown that VCs investigate conceivable exit choices before they invest (Tyebjee and Bruno 1984). Since VC funds have a limited life span (typically, up to ten years), VCs are concerned whether they would be able to liquidate their investment in a timely manner (MacMillan et al. 1985). Thus, VCs may or may not fund a venture depending on their estimates of the likelihood and timing of the anticipated exit alternatives (Kaplan and Stromberg 2000).

Deal (Equity)

Another important consideration for VCs is the quality of the deal. Thus, according to several studies, VCs may be keen on a venture, but would invest in it only on the condition that they would be guaranteed a certain equity stake at an attractive price (Poindexter 1975; Muzyka et al. 1996).

Strategy (Business Model)

MacMillan et al. (1985; 1987) have first shown that VCs separately analyze a venture's strategy (for instance, its positioning vis-à-vis competitors) as one of their investment criteria. Other researchers confirmed that VCs carefully evaluate venture strategy (Robinson 1987; Muzyka et al. 1996).

Competition
A number of studies have established that VCs assess the extent of competitive threat in a sector before they decide to invest. Thus, MacMillan et al. (1987) discovered that two underlying factors have been consistent predictors of VCs' financing decisions: a) market acceptance of a new product; and b) the degree of competitive threat. Hisrich and Jankowicz (1990) have found that VCs consider the odds that a venture would be able to hold off competition and whether competitors would be likely to immediately target a venture as soon as it enters the market sector. In addition, Zacharakis (1995) showed that VCs take into account the number and relative strength of competitors in a target market. Finally, Shepherd et al. (2000) demonstrated that management competence and the degree of competitive rivalry dominate VCs' evaluations of new ventures. The next section scrutinizes why VCs may regard a certain set of investment criteria as dominant, and summarizes the dominant sets of investment criteria uncovered in the reviewed studies.

WHAT ARE THE DOMINANT SETS OF VCS' INVESTMENT CRITERIA?

The Fundamental Debate
George Doriot, a cofounder of American Research and Development Corporation (ARD), the first VC firm created in the U.S. in the 1940s that had initiated the formation of the VC industry, is credited with the saying (Sandberg 1986; Sahlman, 1990) that VCs would rather finance an A-grade person with a B-grade project than a B-grade person with an A-grade project. This dictum has entered VCs' lore and is perceived as conventional wisdom. Not surprisingly, when scholars began to examine how VCs make their investment decisions (Hoffmann 1972; Wells 1974), they discovered that VCs overwhelmingly report management-related sets of investment criteria as being predominant.

Consequently, many studies have shown that the entrepreneur's characteristics have a stronger impact on VCs' investment decision than any other sets of investment criteria. Thus, MacMillan et al. (1985) argued, based on their survey, that the entrepreneur (the "jockey") appears to matter more to VCs considering financing of a venture than any other factor: the product ("horse"), the market ("race") and risk ("the odds"). However, when MacMillan et al. (1985) applied factor analysis to examine whether VCs actually practice what they preach, it turned out that the more general patterns underlying VCs' decision making are, in fact, notably different from VCs' own rankings of investment criteria.

Recently, Kaplan and Stromberg (2006) have revisited the ongoing debate regarding VCs' predominant investment criteria arguing that VCs focused on product-market criteria are more likely to be successful than VCs focused on the entrepreneur. The implication of this finding is that different groups of VCs may emphasize different sets of investment criteria, and that such an orientation may serve as a meaningful predictor of a VC firm's success. Earlier, Zacharakis and Meyer (1995; 1998) have demonstrated that VCs' investment preferences change across the stages of the proposal evaluation process. Cross-cultural studies of VCs' investment practices (Manigart et al. 1997; 2000) have also shown that VCs' choices may be influenced by region and country. For instance, some European VCs emphasize the characteristics of the entrepreneur (for

instance, VCs in France and Belgium) whereas other European VCs (British and Dutch) focus on product/market in their assessments of new ventures (Baeyens et al. 2006).

We believe that the discussion as to whether the entrepreneur, the management team or some other criteria (market, product, returns, different forms of risk and competition) have a stronger impact on VCs' investment decision could be regarded as the fundamental debate in the VC investment criteria research. In our view, the arguments as to whether managerial skills and competencies or product, market, returns and competition dominate VCs' evaluations of new ventures should not be dismissed as idle or fruitless. The fact that each new spiral of research has reexamined this subject from a different angle testifies to its enduring importance for VC research.

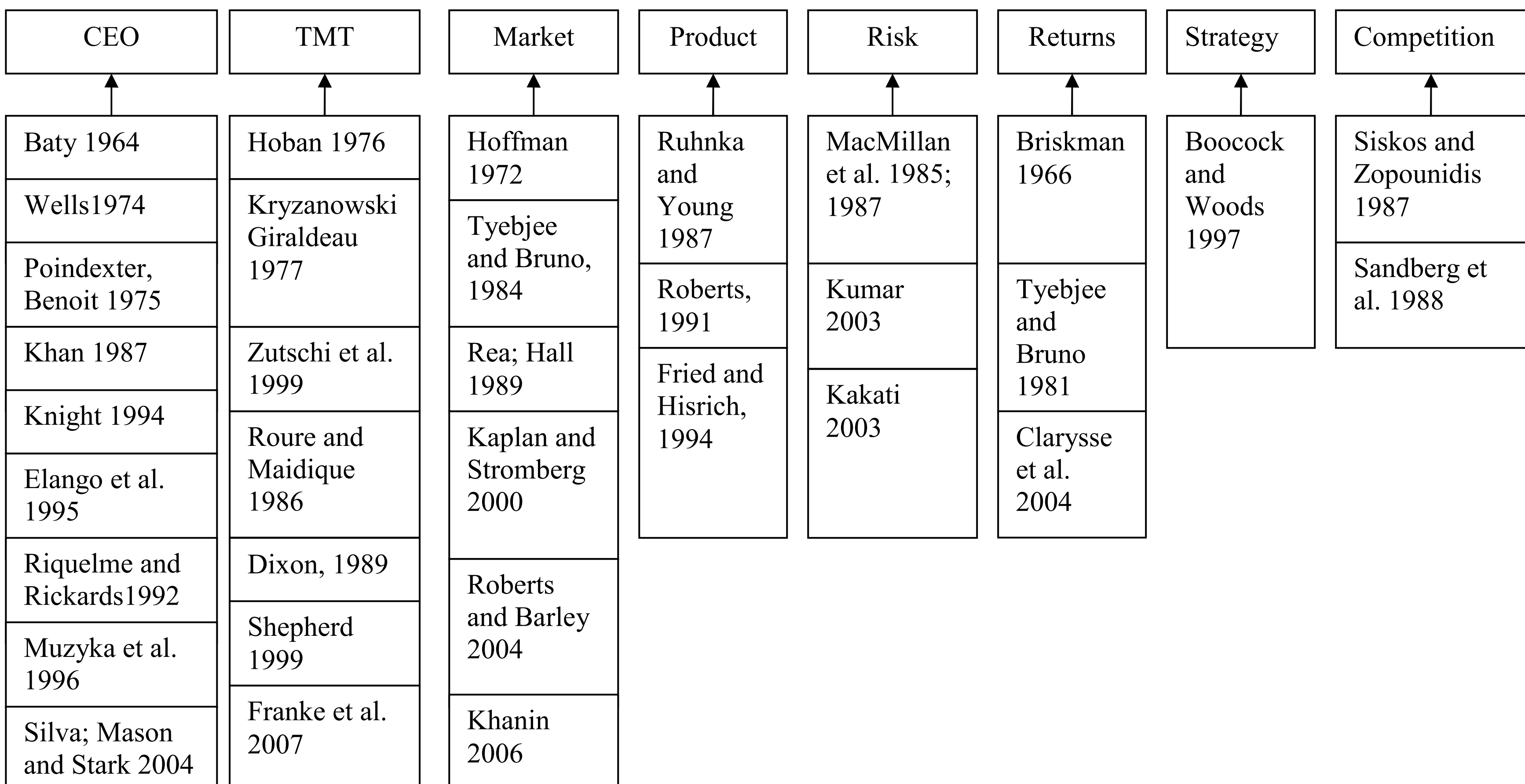
Five main questions have been posed in the fundamental debate. First, what sets of investment criteria dominate VCs' evaluations of new ventures? Second, do VCs emphasize different sets of investment criteria depending on the stage of investment, stage of venture development and other factors? Third, do VCs espousing different investment philosophies employ dissimilar sets of investment criteria as dominant? Fourth, are VCs' rankings of investment criteria influenced by region and country? Fifth, do VCs' preferred sets of investment criteria affect the VC firm's profitability?

The questions raised by the VC investment criteria literature are serious in their implications and deserve additional research efforts. Some recent studies have stated that TMT-related criteria are by far the most important to VCs (Franke, Gruber, Harhoff, and Henkel 2007). However, these conclusions were derived from an examination of merely 14 studies only one of which (Rea, 1989) affirmed that VCs may regard market rather than the TMT as a dominant set of investment criteria. In contrast, there are numerous studies of VCs' investment criteria that have established that CEO/TMT characteristics may play a less significant role in VCs' evaluations (Tyebjee and Bruno 1984; MacMillan et al. 1985; 1987; Zacharakis and Meyer 1998; Shepherd, 1999a). Based on the findings reported in the reviewed studies, we have singled out six sets of investment criteria that have the strongest impact on VCs' decision making. In what follows, we will briefly characterize each of these dominant sets.

CEO

Figure 1 displays the main sets of investment criteria that have been shown to play a dominant role in VCs' evaluations of new proposals. For starters, VCs often emphasize the CEO's characteristics: commitment (Wells1974), financial commitment (Poindexter1975), motivation (Robinson 1987), desire for success, creativity and ingenuity (Khan 1987), experience (Hisrich and Jankowicz 1990), and leadership (Muzyka et al. 1996) as their uppermost investment criteria.

Figure 1. Dominant Sets of VCs' Investment Criteria Identified in the Reviewed Studies.



However, other studies have shown that VCs may only focus on CEO's characteristics at the early stages of proposal evaluation (Zacharakis and Meyer 1995; 1998) and subsequently highlight the expected level of competition and venture product development. Elango et al. (1995) have ascertained that larger funds stress the CEO factor more than medium-size and small-size funds. Even more importantly, research on VCs' investment criteria has shown that while many VCs rank CEO-related factors as predominant, both factor analysis (Tyebjee and Bruno1984; MacMillan et al. 1985; 1987) and conjoint analysis (Shepherd, 1999a) reveal that these investment criteria may play a less prominent role. Furthermore, research has established that management-related criteria strongly correlate with other sets of investment criteria rather than form a separate management factor (MacMillan et al. 1987; Khanin, Baum, and Mahto 2007).

Although MacMillan et al. (1985) have stated that the "jockey" (entrepreneur) matters more to VCs than the "horse" (product), the "race" (market) or the "odds" (risk), their factor analysis tells a different story about VCs' investment preferences. The authors discovered that the first factor underlying VCs' new venture evaluations in their sample was "competitive risk" encompassing such investment criteria as "little threat of competition," "product stimulates existing market" and "proprietary product." "Bail out risk" associated with investment liquidity and venture capitalist familiarity with the new venture's industry ended up in the second place. "Investment risk" combining entrepreneur-related characteristics (attention to detail and track record), venture-related characteristics (significant growth rate), and financial considerations was third in significance. "Management risk" - the entrepreneur's ability to exert sustained effort, and react to risk well and its familiarity with the market - finished in the fourth place. Finally, implementation risk (product-related criteria, such as functioning prototype, and entrepreneur's vision) and leadership risk (entrepreneur's ability to lead) played a less critical role in VCs' decision making.

Overall, VCs in MacMillan et al.'s (1985) study were more concerned about competitive risk and bail out risk than about investment risk, management risk and leadership risk. Conversely, in their second study MacMillan et al. (1987) have established that management risk defined as "the danger that the team will not have the capabilities required to succeed" (MacMillan et al. 1987: 133) was the first factor explaining most variance followed by competitive exposure, inexperience risk, viability risk and cash-out risk. However, the authors maintained that while VCs initially focus on the management risk to weed out unfit entrepreneurs, they are more concerned about such criteria as "degree of competitive threat and degree of market acceptance of product" (MacMillan et al. 1987: 134) that actually serve as the best predictors of VCs' evaluations.

To summarize, it is clear that most VCs emphasize CEO characteristics in their rankings of investment criteria. However, many VCs exhibit little concern about the CEO's characteristics (Muzyka et al. 1996). Both factor analysis and conjoint analysis (MacMillan et al. 1985; 1987; Shepherd, 1999a) show that VCs value CEO-related attributes less than they profess. Finally, VCs may stress CEO-related attributes during their preliminary screenings of new ventures, but the importance of CEO-related characteristics may fade when VCs undertake a more in-depth analysis (Zacharakis and Meyer 1998).

TMT
Ruhnka and Young (1987) have ascertained that CEO characteristics serve as the main object of attention at the early stages of assessment whereas later VCs pay more attention to the quality of the top management team. Many studies have shown that VCs analyze the make-up of the management team as a whole rather than focus exclusively on the lead entrepreneur. In addition, VCs evaluate whether the management team is balanced, complete, and prone to integroup conflicts.

Recently, Franke et al. (2007) have argued that the quality of human capital in new ventures has the strongest impact on VCs' funding decisions. It appears that VCs' rationale for emphasizing the quality of the TMT on the whole rather than the CEO's objective characteristics lies in that ventures rarely have enough resources for attracting the top talent. A balanced TMT sufficiently diversified in terms of members' functional backgrounds and talents signals operational competence of a venture. In addition, an impressive TMT provides some evidence of the CEO's leadership potential, and the CEO's ability to pick the right people to make up for its own deficiencies.

Market
Tyebjee and Bruno (1984) were the first to discover that "market attractiveness" dominates VCs' evaluations of new ventures. By way of factor analysis, the authors have established that such investment criteria (arranged in order of importance) as size of the market, market need for product, access to market and growth potential of the market form one factor that can be described as "market attractiveness." That finding contrasted with Tyebjee and Bruno's (1981) first study that showed a weaker than expected role of the market. Rea (1989) pointed out that VCs often regard investment in a promising new field as a key factor since no single player in the new market may have a competitive advantage over other new entrants. Hall (1989) argued that VCs primarily choose based on industries (markets) at the first stage of the evaluation process, and begin to analyze other investment criteria only if their most important requirements have been satisfied. Roberts and Barley (2004) have recently shown that the leading VC firms habitually start with identifying the market areas in which they are interested, and then begin to consider proposals that focus on the industries and industry segments VCs regard as most promising.

Product
Some VCs, especially VCs financing high-tech ventures, may look at the set of product-related criteria as dominant. Thus, Roberts (1991) affirmed on the basis of his own experience as a VC and a number of in-depth studies of other VC firms that while VCs often stress management-related characteristics they are primarily focused on the product. Fried and Hisrich (1994) also asserted that VCs are heavily focused on the quality of the product, especially at the early stages of evaluation process, and request information from technology experts (some of whom may be affiliated with the VC firm). Leading VCs interviewed by Roberts and Barley (2004) stated that they try to measure the amount of "pain" that the new product created by a venture is seeking to satisfy.

Risk

Starting with Driskoll (1974), studies of VCs' investment criteria have shown that concern about handling different types of risk underlies VCs' evaluation of new proposals and differentiates one group of VCs from another in terms of their investment philosophy (MacMillan et al. 1987). In addition, studies of VCs' decision making in emerging markets (Kumar and Kaura 2003; Kakati 2003) revealed that VCs are more concerned about their risk exposure than any other factor.

Returns

In one of the first studies of VCs' investment criteria, Briskman (1966) has shown that VCs decide to invest or not to invest in a venture on the basis of projected returns. However, according to the follow-up research (Wells 1974; Poindexter 1975), anticipated returns do not play a major role in VCs' decision-making process. In contrast, studies of European VCs have shown that a financial perspective focused on the projected returns dominates their investment decisions. Furthermore, some European VCs appear to be closer to North Americans in their emphasis on the management's qualifications (France, Belgium) whereas other European VCs (German, French) stress that returns play a major role in their decision making (Clarysse et al. 2004; Baeyens et al. 2006).

Strategy

Although many studies have underscored the importance of venture strategy, only one paper showed that this criterion may dominate VCs' evaluations of new ventures (Boocock and Woods 1997). The reason why VCs usually do not consider this criterion as most important is probably that, in their view, they would be able to help a venture develop a strategy once they take on its financing.

Competition

While only two studies reported that competition appears to be the most important factor influencing VCs' decision to take on financing of a venture (Siskos and Zopounidis 1987; Sandberg, Schweiger, Hofer 1988), there is accumulated evidence in the VC investment literature to the effect that VCs regard competition as one of the two dominant factors along with market acceptance of product (MacMillan et al. 1987), and management characteristics (Shepherd, 1999a).

WHY DO VCS USE DIFFERENT DOMINANT SETS OF INVESTMENT CRITERIA?

In this section, we will summarize the answers provided in extant research as to whether VCs may prioritize certain sets of investment criteria depending on the stage of venture development; investment stage, the size of a VC firm; its overall investment orientation, and regional/national tradition.

Do VCs stress different sets of investment criteria depending on the stage of evaluation process?

A number of studies have shown that VCs may regard different sets of investment criteria as dominant depending on the stage of proposal evaluation. For instance, Zacharakis and Mayer

(1995; 1998) have shown that VCs may initially emphasize managerial competence and dedication in order to weed out unfit applicants but later on get more involved in estimating the quality of the target marketplace, the level of competition, etc. Conversely, other studies have shown that VCs may initially use firm-specific criteria, such as the industry or market they target, and subsequently begin to consider the CEO and TMT characteristics (Fried and Hisrich 1994).

Do VCs use different investment criteria depending on the stage of venture development?
Although it seems natural that VCs would apply different criteria to a seed investment compared to a venture at a more advanced stage, Carter and Auken's (1994) study showed that this is not the case.

Do VCs stress different sets of investment criteria depending on the stage of investment?
Khanin (2006) has shown that VCs use the same criteria at the pre-investment and post-investment stages, but some of these criteria may grow (or fade) in significance at the post-investment stage compared to the pre-investment stage. Thus, venture-related criteria, such as management competence and strategy, may become more important when VCs consider a subsequent investment.

Do VCs stress different sets of investment criteria depending on the size of the VC firm?
In their pioneering paper, Elango et al. (1995) have divided VCs into four groups: earliest-stage investors, early-stage investors, mixed-group investors and late-stage investors. VCs belonging to the four groups prioritized different investment criteria. For instance, earliest-stage investors placed emphasis on the proprietary product and market growth rate, but were less interested in the CEO's track record. Conversely, late-stage investors were more interested in the CEO's track record and leadership qualities and were less interested in the product and market growth. Since the authors characterized earliest-stage investors as being predominantly small firms and late-stage investors as being predominantly large firms, the size of the firm (along with the preferred investment stage) could be a factor explaining why VCs regard certain criteria as dominant. However, the differences between VCs' assessments in Elango et al.'s study (1995) were quite small.

Do VCs stress different sets of investment criteria depending on their overall investment philosophy?
Based on VCs' assessments of investment criteria, MacMillan et al. (1985) have divided them into three groups. They called the first group "purposeful risk managers" since such VCs are focused on bringing risk to a manageable level across the spectrum. The second group named "determined eclectics" was proud of its ability to keep an open mind and endorse any venture they liked without abiding too much by any set of investment criteria. The third group described as "parachutists" was also likely to invest money in any type of venture as long as they perceived the investment as liquid. The three groups identified by MacMillan et al. (1985) essentially differ on three interrelated dimensions: 1/ rational vs. intuitive attitude toward investing, 2/ degree of involvement with funded ventures, and 3/ type and amount of risk VCs would be willing to assume.

Thus, "purposeful risk takers" appear to use a very rational and involved approach toward investment and are ready to take on a number of different types of risk as long as none of them exceeds a certain preset level. The "determined eclectics" use an intuitive and less involved approach toward investment and do not limit the number and types of risk to which they may be exposed. Finally, the "parachutists" are rational but uninvolved investors who minimize only one type of risk – liquidity – since they most value the ability to go in and out of investments very quickly.

Murray and Lott (1995) have demonstrated that VC firms may also differ in approach depending on their generalist vs. specialist orientation. For instance, generalists would be less likely to take on high-risk technology ventures because it is more difficult to obtain reliable information there regarding the market and product and entrepreneur's competence due to the untested nature of new technologies. Although a follow-up study (Lockett, Murray and Wright 2002) has shown that more generalist funds have moved toward financing high-tech ventures, some differences in the way the two types of VC firms evaluated technology vs. non-technology investments remained.

More recently, Clarysse et al. (2004) have demonstrated that VCs can be subdivided into three groups. The first group described as "people investors" emphasize the importance of the CEO and TMT. The second group named "finance investors" is exceedingly focused on the return on investment (ROI). Finally, the third group of "technical investors" highlights the level of product protection.

Do VCs stress different sets of investment criteria depending on region and nation?

Numerous studies in the VC investment criteria literature have examined whether there are some differences between U.S. VCs and Asian VCs (Ray and Thurpin1993; Ray, Jung, and Lee 1994), Zutschi, Tan, Allampalli, Gibbons1999; Kumar and Kaura 2003; Mishra 2003; Kakati 2003). Some of these studies have uncovered differences, for instance, Indian VCs' greater concern with risk. However, other studies have shown that VCs in the U.S. and Asia are not different in terms of their commonly used and dominant criteria. More substantial differences have been established between North American (U.S. and Canadian VCs), on the one hand, and European VCs, on the other hand. Furthermore, European VCs appear to use different approaches toward valuation of new businesses due to the differences in their corporate governance and culture (Manigart et al. 1997; 2000). For instance, network-oriented economies (France, Belgium) may attach more importance than market-oriented economies (U.S., U.K.) to business plans and recommendations.

Do VC's dominant investment criteria affect a VC firm's profitability?

Recently, Kaplan and Stromberg (2006) have argued that VCs stressing product-market characteristics (the horse and the race) achieve better results than VCs stressing the entrepreneur (the jockey). This is an interesting new area of research on VCs' investment criteria that has a potential to strongly influence the field in the future. If successful, such studies would also draw more attention to the subject that may otherwise be perceived as having mostly academic interest.

What Methods Should Be Used for Examining VCs' Investment Criteria?

In the 1960s and 1970s, researchers combined qualitative analysis (based on interviews with VCs) and quantitative analysis (based on VCs' rankings of investment criteria presented to them in surveys) to draw conclusions regarding VCs' investment preferences. In the 1980s, Tyebjee and Bruno (1981; 1984) first proposed that the actual patterns of VC investment could be different from the rankings reported by VCs. The scholars applied factor analysis to show that, contrary to their own opinions, VCs are principally guided by the attractiveness of the market rather than by the CEO and TMT characteristics. MacMillan et al. (1985; 1987) used both factor analysis and cluster analysis to argue that VCs' main concern is about managing different types of risk, and that VCs fall into groups depending on their underlying approach toward risk management.

A new methodological orientation (Sandberg et al. 1986; Hall 1989) criticized the prior approach based on analysis of self-reported data for its retrospective bias, and began to examine the actual VC process of proposal evaluation. Using the method called a verbal protocol analysis, they sought to break down VCs' thought process into units, and thus, attain a better understanding of VCs' decision making. One of the major conclusions was that VCs value product-market related criteria more than entrepreneur-related criteria. Another finding was that VCs' investment process has a complex structure: rejection decisions are often made in a fast speed mode whereas acceptance decisions are made cautiously after many phases of project evaluation and reevaluation.

A different approach has focused on modeling VC decision making (Khan 1987; Siskos and Zopounidis 1987; Zacharakis 1995; Mainprize and Hindle 2005), and comparing its effectiveness with the effectiveness of decision aids or specially generated computer programs. The main accomplishment of that method was that it threw into relief the intuitive and inconsistent character of VC decision making. Similar to other types of expert evaluations, it turned out to be fraught with numerous inefficiencies and even inherent biases and errors (Busenitz and Alvarez 2001). Scholars also began to apply conjoint analysis (instead of factor analysis utilized by prior scholars) to expose the actual patterns underlying VC decision making and thus overcome the inbuilt deficiencies of VC self-reporting (Shepherd,1999a; 1999b; Shepherd and Zacharakis 2001).

Currently, scholars use of a variety of methods to examine VCs' investment criteria - from involved participation (Silva 2004) to repertory grid (De Leon and Guild 2003) to factor analysis (Khanin 2006) to ranking (Baeyens et al. 2006) to conjoint analysis (Clarysse et al. 2004) to discrete choice analysis (Franke et al. 2007). It appears that each of these methods has its own merits and shortcomings. Thus, VCs own rankings of investment criteria obscure how VCs actually make their decisions since VCs may not truly understand their own decision process (Zacharakis and Mayer 1998). This approach, however, provides us with a useful understanding of VCs' implicit theories and beliefs (Riquelme 1994).

Factor analysis may not be quite reliable when applied to small samples. However, if used correctly, factor analysis may reveal the underlying patterns of VC investment allowing us to contrast VCs' "in-use" and "espoused" criteria. Similarly, conjoint analysis may have its

methodological problems, but it gives us a good way of testing whether VCs actually have the investment preferences they report. Qualitative analyses often rely on an in-depth study of just one entity (Briskman 1966; Driskoll 1974; Roberts 1991; Silva 2004) but they give us a rare picture of the inner working of the VC firm.

Despite strong polemics in the VC investment literature regarding the advantages and disadvantages of a particular method vs. other method(s) (Sandberg et al. 1988; Riquelme and Richards1992), it appears that an application of a plethora of research approaches would allow generating a more in-depth understanding of VCs' decision making. Given the inherent difficulties of researching the subject, knowledge should be pieced together from various sources by using contrasting methods and sampling different parts of the increasingly varied VC universe.

CONCLUSIONS

In this paper, we have reviewed the findings of 52 studies on VCs' investment criteria. Based on this extensive research, we have identified ten most commonly used and eight dominant sets of VCs' investment criteria. A quick glance at Figure 1 reveals that in most studies VCs' dominant criteria are related either to a venture's CEO or to its TMT. However, there is also plenty of evidence that VCs may actually value other investment criteria, especially market and product, more than they are willing to admit. Importantly, qualitative analysis, factor analysis, verbal protocol analysis and conjoint analysis similarly demonstrate that VCs may exaggerate the impact of the entrepreneurs' qualifications on their decision making. Some studies have shown that the market is more important than the entrepreneur (Tyebjee and Bruno1984; MacMillan et al. 1985). Others have proved that the product could outshine other factors, especially in high-tech industries (Roberts1991; Fried and Hisrich1994). Still others have established that the market (including competition) is at least as important as the entrepreneur (Zacharakis1995; Shepherd 1999a).

The literature also provides mounting evidence that VCs may view different sets of investment criteria as dominant depending on the stage of the proposal evaluation process (Zacharakis 1995), national culture (Manigart et al. 1997; 2000), and investment approach, such as a generalist vs. specialist orientation (Lockett, Murray and Wright, 2002). At the same time it appears that VCs' investment criteria are not strongly affected by the preferred stage of investment and the size of the fund (Elango et al. 1995) as well as a venture's stage of development (Carter and Auken 1994). Finally, a VC firm's investment philosophy may play an important role (MacMillan et al. 1985; 1987; Clarysse et al. 2004) although it is hard to tell what exactly constitutes it: whether it is an underlying approach toward risk management (MacMillan et al. 1987) or proficiency in a certain area: people investors vs. technology investors vs. finance investors (Clarysse et al. 2004).

One of the most important conclusions of this paper that may serve as guidance for future research is that scholars may utilize a variety of methods (from VCs' self-reports to verbal protocol analysis, modeling, content analysis, factor analysis, cluster analysis and conjoint analysis) but that they need to uncover both VCs' "espoused" and "in-use" (Shepherd 1999b)

investment criteria. Furthermore, future scholars should seek to establish the differences in the way various groups of VCs may apply investment criteria and test whether VCs' selection of certain sets of investment criteria as dominant may have an effect on their profitability and success.

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Reputation-Building by New Ventures

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ABSTRACT

In this paper we use a grounded theory-building approach to explore the processes and mechanisms of reputation-building by new ventures (NVs). Specifically, we focus on the factors that determine variations among NVs in their reputation-building efforts and outcomes. Based on exploratory interviews with experienced entrepreneurs, supplemented by secondary data on their NVs, we identify two different types of reputation – direct and generalized, and several types of activities that may contribute to the accumulation of reputations by NVs. We draw testable propositions regarding the role of symbolic activities, investments in human capital, social capital, and product development for NVs' reputation.

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INTRODUCTION

Past research consistently demonstrates that reputation is a valuable intangible resource, which contributes to a firm's competitive advantage (Barney 1991; Dierickx and Cool 1989; Hall 1992), especially under conditions of high uncertainty (Shapiro 1983). New ventures (NVs) are a typical example of highly uncertain entities, because they often enter new or developing markets, introduce new products or services, lack clear business models, and perform novel or non-trivial activities. All these factors make stakeholders uncertain about the quality and potential of NVs. Building reputation with key stakeholders can be extremely valuable for NVs, because reputation can reduce the high level of uncertainty surrounding NVs and can help them attract stakeholders' trust and support. Therefore, the question of how NVs can build reputation deserves foremost attention by both researchers and practitioner.

Surprisingly, prior research has focused primarily on reputation building by old established organizations (Fombrun 1997; Fombrun and Shanley 1990; Martins 2005; Rindova, Williamson, Petkova and Sever 2005), and has almost completely ignored reputation building by NVs. Scholars have found that the reputation of established firms is a function of their past financial performance (Fombrun and Shanley 1990), product quality (Shapiro 1983), and costly investments in pricing and advertising (Milgrom and Roberts 1986).

However, these factors may have limited applicability to NVs for the following reasons: First, NVs lack the history and performance track records to guide stakeholders' evaluations and opinions about them. Second, many NVs start with limited resources (Aldrich 2000), which constrain their ability to invest in costly advertising or other such activities. Third, some NVs take significant time to develop their first product or technology, which makes pricing and product quality inapplicable at the early years of their lives. Fourth, potential stakeholders may not even be aware of the existence and activities of an NV, which would prevent them from forming impressions or opinions about it. Last but not least, because NVs often create value in novel ways by bringing to the market previously unavailable products or services, they may face the additional challenge of stakeholders not being able to understand how such products are going to create value for them (Aldrich and Fiol 1994; Rindova and Petkova 2007). Therefore, the lack of sufficient resources, consistent performance histories, and interaction patterns, present a number of unique challenges that make reputation building a particularly difficult task for an NV to accomplish (Pollock, Porac and Wade 2004; Williamson 2000).

All these obstacles to reputation-building by NVs have led prior research to assume that NVs cannot build their own reputation and, therefore, can only borrow the reputations of other more powerful and better-established industry players by affiliating with them. Specifically, prior research has found that affiliations with venture capitalists, underwriters, and strategic alliance partners is positively related to NVs' performance and survival and has explained these effects with the "reputation-borrowing" by NVs (Pollock et al 2004; Stuart 2000; Stuart, Hoang and Hybels 1999). Arguably, reputation borrowing is a viable solution for NVs that lack reputation or resources to invest in reputation building. Yet, there are anecdotal examples of NVs that manage to develop high reputations very early in their lives, such as Amazon.com, Yahoo! and Google. These examples suggest that some NVs manage to build reputation despite the challenges faced and call for a more careful examination of the process of reputation building by NVs and the causes of variations among NVs in the levels of reputation they manage to build.

Given the limited insights by prior research into the activities through which an NV can accumulate reputation early in its life, we use grounded theory-building from case studies to explore this phenomenon (Eisenhardt 1989; Glasser and Strauss 1994). The insights from this study resulted in a theoretical framework that links strategic investments on part of NVs to their early reputation. We observe that NVs tend to accumulate two types of reputation – direct and generalized. Because of the exploratory nature of this study, the relationships we infer are summarized in propositions that remain to be tested by future empirical research. Specifically, we propose that: (a) symbolic activities can help NVs build generalized reputation, because such activities draw stakeholders' attention to an NV and explain its purpose and activities to them; (b) investments in human capital can help an NV build generalized reputation because such investments serve as a signal that the NV possesses the necessary knowledge and capabilities to deliver intended products or services; (c) investments in social capital can help an NV build both direct and generalized reputations, because such investments allow the NV to establish trust with customers and other key stakeholders and at the same time serve as signals of the NV's underlying quality and potential; and (d) product quality is a necessary condition for building both direct and generalized reputation. We discuss each of these factors below.

METHOD

This study uses an inductive, multiple-case, embedded research design. Multiple cases typically result in a better-grounded and more general theory than single cases (Eisenhardt 1989; Glaser and Strauss 1994), because they allow for using replication logic to confirm or disconfirm inferred patterns of relationships across cases (Yin 1994). Reputation-building activities are broadly defined as any type of activity that informants reported as either being relevant for the reputation of their ventures or not implementing the activity as being a strategic mistake that harmed the reputation of the venture.

We use two sources of data – interviews with experienced entrepreneurs and archival sources – to compile the complete histories of 23 NVs. We conducted eleven interviews with nine entrepreneurs, each of whom has been involved as a founder in at least one venture and as a founder, a CEO, a founding team-member, or a fist employee in at least one other venture. In selecting the informants, we tried to find entrepreneurs with various experiences (both positive

and negative), from diverse nationality, age, and number of NVs started or being involved in. Table 1 presents the summary characteristics of the informants, their ventures, and the capacity in which they were involved. It should be noted that the relatively large proportion of younger entrepreneurs is representative of the population of serial entrepreneurs, who are found to often start their second NV before 30 years of age (Ronstadt 1988). In addition, we used insights from three industry experts and one venture capitalist to better understand and interpret our observations.

Table 1

Summary Characteristics of the Entrepreneurs and Ventures Described

Informants / Venture Characteristics	Total	E1	E2	E3	E4	E5	E6	E7	E8	E9
Age		35	62	48	63	35	35	36	40	63
Number of NVs in which the Entrepreneurs were involved	32	2	5	3	6	3	5	2	2	4
Of them as: - a founder	25	1	5	3	6	2	1	2	2	3
- a non-founder CEO, VP, or the 1st employee	7	1				1	4			1
NVs described in detail	26* (25 NVs)	2	5	3	4	2	3	2	2	3
of them:										
highly successful	8* (7 NVs)		2	1	1		2		1	1
moderately successful	8	1	2		1	1		1	1	1
under-performing	4		1	1	1					1
failure	6	1		1	1	1	1	1		

Note: One highly successful venture was described by two informants independently, leaving 25 distinct venture cases for analysis.

The interviews were semi-structured, allowing both for clarification questions and giving the informants the opportunity to discuss additional issues, which they considered relevant for the reputation of their ventures and for their interactions with critical stakeholders. The interview design provided two major benefits: First, interviewing allowed us to learn not only what informants and their teams did – information that can be also cross-validated from secondary sources – but also what they *did not do* or what they *wish they had done*, as well as *why*. Second, the semi-structured interviews allowed us to gain additional insights by obtaining information about facts or events which the informants considered relevant even though we would not explicitly ask about them. Each interview lasted between 40 minutes and 3 hours, for an average of 1 hour and 20 minutes per interview.

In addition to the interviews, we used both internal and external archives to obtain supplementary materials about the NVs discussed. First, during the interviews we requested from informants archival materials such as company and product-related brochures, articles and interviews with the founders published in local or national press, case-studies or other materials written about the NVs. Second, we collected the informants' resumes and various types of secondary data about their ventures, such as press releases, media publications, case studies published on the Internet, and other documents available from independent sources, to validate the activities and outcomes the informants described during the interviews.

Across all the informants, we were able to obtain information on 32 NVs, 25 of which were described in enough detail to allow for in-depth analysis. As Table 1 shows, there was substantial variance in the success of different ventures and all but one informant had both successful and unsuccessful experiences. Specifically, six informants described at least one highly successful venture; seven informants described at least one moderately successful venture; four informants described one under-performing venture each; and six informants described one failed venture each. As a result, we had for further analysis seven highly successful NVs, eight moderately successful NVs, four under-performing, and six failed NVs. The NVs also vary by industry, type of products, and time period when they were started, which allows for deriving more generalizable observations and conclusions. Two NVs were excluded from the analysis reported below because they were started strictly in response to a request from one big customer and never intended or build reputation with other stakeholders.

A THEORY OF REPUTATION BUILDING BY NEW VENTURES

Two Types of Reputation: Direct and Generalized

Comparisons across the NVs described by informants show that not every venture finds it relevant or necessary to invest in building reputation the same way: Specifically, our analysis suggests that NVs built two types of reputations – direct and generalized. Some NVs developed reputation locally, by relying primarily on direct customer experiences with the NV products and services and word of mouth. Thus, direct reputation is base on the interactions between stakeholders and the NV and the experiences that the stakeholders have with the NV. Other NVs tried to develop a more generalized reputation at the regional or industry level. These NVs had some general idea what stakeholder groups to target but they needed to attract stakeholders and to convince them to enter the first exchange with them. Thus, generalized reputation begins to accumulate before the first direct interactions with customers or other stakeholders and serves to attract them to the NV. Out of the 23 cases we analyzed, seven developed direct reputation, eleven developed generalized reputation, and five failed to develop any reputation.

The grouping of NVs into one of these reputation categories appears to be related to the industry and the type of products that the NVs offered. Specifically, we observed that: First, five out of the seven NVs that developed direct reputation offered relatively traditional products or services for which there was a common understanding about the quality standards. Also, their products were easy to evaluate by potential customers and available immediately after founding. These NV focused primarily on providing the highest quality goods and services and relied on word of mouth for attracting more customers. None of the five NVs intended or achieved industry-wide publicity but rather tried to build good reputations with their local community. Second, all eleven NVs that accumulated generalized reputation (high or moderate level) offered products or services that were difficult for prospective stakeholders to evaluate, because the products or services were unobservable and/or yet to be developed. Further, often the NVs' founders were not even sure who their customers or partners would be, so they focused on building as broad public awareness as possible rather than direct relationships with a smaller set of stakeholders. Table 2 shows NVs by type of product and type of reputation accumulated.

Table 2

Summary of New Venture Investments and Levels of Reputation

	Initial Conditions	**Investments**				**Outcome**
NV#	**Product Characteristics**	**Product Development**	**Human Capital**	**Social Capital**	**Symbolic Activities**	**Reputation**
NV 1						No reputation
NV 2		★		★	★	Direct reputation
NV 3						Direct reputation
NV 4	observable		★			Direct reputation
NV 5		★				Direct reputation
NV 6			★			Direct reputation
NV 7				★		Direct reputation
NV 8			★	★	★	Direct reputation
NV 9		★	★	★	★	High generalized reputation
NV10			★	★		High generalized reputation
NV11			★	★	★	High generalized reputation
NV12			★			High generalized reputation
NV13		★	★	★	★	High generalized reputation
NV14				★	★	High generalized reputation
NV15	unobservable	★	★	★	★	High generalized reputation
NV16		★		★	★	Moderate generalized rep.
NV17		★				Moderate generalized rep.
NV18				★		Moderate generalized rep.
NV19				★		Moderate generalized rep.
NV20			★	★	★	No reputation
NV21		★				No reputation
NV22			★			No reputation
NV23			★	★		No reputation

Note: A star denotes the use of a given type of reputation-building activity by the NV.

Overall, using the replication logic (Yin, 1994), we conclude that NVs that provide relatively observable and easy to evaluate products rely on direct reputation, much like established firms improve their reputations by establishing good relationships with key stakeholder audiences (Grunig, Grunig and Dozier 2002; Yang 2005), whereas NVs with no initial products to offer, as well as NVs offering new and/or difficult to evaluate products tend to invest in a more generalized reputation with large stakeholder audiences. We summarize these ideas in the following proposition:

Proposition 1: NVs that offer observable and easy to evaluate products are more likely to build direct reputation, whereas NVs that offer unobservable and difficult to evaluate products are more likely to build generalized reputation.

Next, we discuss the outcomes of our analysis and comparisons across NVs regarding the relationships between reputation building activities and reputation outcomes. Table 3 summarizes these relationships to allow for easier interpretation of the degree of similarity in the inferred relationships among different cases (i.e., the replication logic).

Table 3
Distribution of New Ventures by Investments in Reputation-Building Activities and Reputation Outcomes

		Direct reputation	**High generalized reputation**	**Moderate generalized reputation**	**No evidence of reputation**
Symbolic activities	Yes	✯✯	✯✯✯✯✯	✯	✯
	No	✯✯✯✯✯	✯✯	✯✯✯	✯✯✯✯
Invested in HC	Yes	✯✯✯	✯✯✯✯✯✯		✯✯✯
	No	✯✯✯✯	✯	✯✯✯✯	✯✯
Invested in SC	Yes	✯✯✯	✯✯✯✯✯✯	✯✯✯	✯✯
	No	✯✯✯✯	✯	✯	✯✯✯
Product completed	Yes	✯✯	✯✯✯	✯✯	✯
	No	✯✯✯✯✯	✯✯✯✯	✯✯	✯✯✯✯

Note: Each star corresponds to one NV.

Symbolic Activities

Qualitative Evidence

We identified a large variety of activities which were directly intended to attract stakeholders' attention to the NV and its resources and to explain how the NV is going to create value for them. We label these activities "symbolic", consistent with prior research (Pfeffer 1981; Westphal and Zajac 1994; 1998). The major purpose of the symbolic activities was "to create a buzz around the startup" (interview quote) and to induce desired images and opinions about the NV. Such activities include: attending trade-shows and conventions; presenting papers and giving speeches at professional conferences; publishing papers, books, and industry newsletters;

hiring VP of public relations or a professional PR-agency very early in the life of the NV; efforts to educate customers about the new technology by expressing authoritative opinions and providing explanations about the new technology; communicating to stakeholders the NV's vision to create value for them; distributing brochures and handouts that illustrate the NV team's skills and capabilities. For example, one informant highlighted the importance of communications for attracting public attention and conveying the NV's vision:
"You need to set a vision of where you're going to be and that vision just can't be painted in words by the senior executive. It has to be embodied in sort of like the literature of and the images of the place, and the vision itself of where you're going to be helps people get there. This is as important for the internal people as for external people. It is one of the transforming vehicles."

Some informants explained that they deliberately targeted major industry events, such as trade shows, conventions, and conferences, to build awareness of their venture and the product or technology it was going to offer. Further, symbolic activities were used to draw stakeholders' attention to key resources possessed by NVs, such as human capital and relationships. As one informant said, "You have to be very active in this, you know … if you're great and nobody knows that, you're not great" Another informant explained how he and his team used symbolic activities to broadcast their knowledge and capabilities, i.e. the human capital of their NV:
"What we did was, for example, we built what we called 'a capabilities brochure' and we took the resumes of all of the individuals who were associated with us and we were academics, so we had written many, many papers and some of those papers had very interesting titles and so we built a brochure that was by subject matter, Design and Computer Communications Network, for example, and we took the papers and we wrote down the names of the papers that we'd written on that, so we built this brochure out of capabilities including us as individuals, our resumes, a description of the business, challenges, up front big world of networking, then the backward applications."

Informants also believed that symbolic activities should be backed up by underlying 'true' quality, because once stakeholders begin interactions with the NV they expect certain level of performance. The following quote illustrates this point:
"It's essential to deliver an impression of what you have but the best quality of public relations with a lousy quality product is like the advertising that goes on for a movie before the movie comes out. But when the movie comes out, all of a sudden people know if it's any good or not … so you have to have the quality."

Based on our empirical evidence, we concluded that symbolic activities can influence an NV's reputation in two ways: First, symbolic activities attract attention and increase public awareness of the NV by active and continuous interactions with potential stakeholders. Thus, symbolic activities influence positively the "awareness" component of NVs' reputations. Second, symbolic activities contribute to a NV's reputation by triggering positive perceptions of the NV and its activities. Such positive evaluations can be stimulated by providing stakeholders with information about the NV and helping them understand and appreciate its actions and resources (Aldrich and Fiol 1994; Rindova, Petkova and Kotha 2007).

Comparisons across NVs

A total of nine NVs invested in at least one type of symbolic activities two out of seven in the "direct reputation" group and seven out of 11 in the "generalized reputation" group. The observation that symbolic activities do not appear to be related to direct reputation could be explained with the fact that the NVs in the "direct reputation" group were the ones that produced more observable and easy to evaluate products. For such products, it might be less relevant to spend time and efforts explaining them, because the products 'speak' for themselves through their quality, which makes symbolic activities less critical for stakeholders to understand and evaluate the quality of such NVs and their products. In the "generalized reputation group", five out of the seven NVs that accumulated high levels of generalized reputation invested extensively in symbolic activities. Only one out of four NVs that accumulated moderate level of generalized reputation invested in symbolic activities. Thus, we conclude that symbolic activities contribute to the accumulation of generalized reputation but have limited value for building direct reputation. Based on these observations, we develop the following proposition:

> *Proposition 2: Symbolic activities are likely to help NVs accumulate generalized reputation.*

Investments in Human Capital

Qualitative Evidence

Investments in human capital include activities, such as building a management team from the very early days of the NV, as well as recruiting an expert with specific skills or proven track-record, such as prior start-up experience, experience with a major firm in the industry, or a degree from a top university. Interestingly, most informants emphasized the signaling purpose of their investments in human capital. For example, one of the informants explained his motivations to recruit two experts for his NV team soon after founding as follows:

"I felt confident in my own consulting abilities, but I didn't have a blue chip management consulting resume. You know, having worked for Diamond Technology Partners, or Cambridge … So the two places I hired in, it wasn't so much I felt weak in the consulting, as I knew how I needed the right reputation."

This is an important difference from prior research, which has established the instrumental role of human capital for the performance and survival of young innovative firms (Eisenhardt and Schoonhoven 1990; Schoonhoven, Eisenhardt and Lyman 1990). Our study shows that founders hired people not only because they needed their expertise but also because they wanted to benefit from the prestige of those individuals.

Investments in human capital can influence positively a NV's reputation because such investments serve to convince stakeholders that the NV is making its best efforts to build the necessary knowledge base for handling the complex process involved with startup and organization for initial production (Boeker 1989; Burton, Sorensen and Beckman 2002). Also, the early accumulation of human capital can be used by stakeholders as evidence that the production processes utilized by the NV are of sufficiently high quality and thus, can alleviate

their concerns with the ability of the NV to deliver valuable outputs (Sapienza and Gupta 1994). For example, one of the NVs that hired experts from major electronics firms was discussed in the media as "promising" and likely to produce the "technology for the 21st century". The same NV was later ranked in the top-10 startups list by an IT-magazine.

Comparisons across NVs
Twelve NVs invested in increasing various aspects of their human capital: they filled gaps in skills, diversified expertise, and recruited people for reputational reasons (e.g., a VP from IBM). Three out of the seven NVs that accumulated direct reputation invested in human capital. This observation suggests that human capital may be useful but not be critical for NVs building direct reputation. Six out of seven NVs that accumulated high level of generalized reputation invested in human capital and none of those that accumulated moderate level of generalized reputation did. This evidence suggests that investments in human capital may help NVs accumulate generalized reputation. In sum, we propose that investments in human capital can contribute to an NV's reputation for NVs that attempt to build generalized reputation.

> *Proposition 3: Investments in human capital are likely to help NVs accumulate generalized reputation.*

Investments in Social Capital

Qualitative Evidence
All informants stressed the critical importance of relationships for their NVs. Several entrepreneurs perceived building relationships as a much more efficient reputation-building strategy than advertising. For example, one founder said:
"My whole management team spent a lot of time networking, spent a lot of time out, going to conferences, meeting people, really developing a personal connection to different people. And that helped develop the reputation more than any branding or marketing ever did."

Further, some informants emphasized the effect of having a relationship with prominent industry players (either partners or customers) for attracting other stakeholders. For example, one informant concluded:

"It is not important, how many of them [customers] sign up. What's important is what is the number of customers that you can use to go out and get ten more. Because what you are trying to do is to build an influence channel."

Three groups of relationships were most consistently identified by the informants – relationships with venture capitalists, partnerships with established firms, and relationships with key customers.

Relationships with venture capitalists. Gompers and Lerner (2001: 1) point to the fact that "Innovations fail to create value when they cannot attract the resources required to develop them". In addition to financial backing, venture capitalists provide the NV with contacts, reputation, and advice. They screen entrepreneurial projects, structure financial deals, and

monitor NVs' performance – activities without which many NVs would never attract the resources they need to turn their ideas into commercial success (Gompers and Lerner 2001). This screening process serves as a proof to other stakeholders that venture capitalists evaluations are reliable, and therefore the fact that a VC firm selected a NV serve as an endorsement of the NV (Hsu, 2004), which suggests that the NV is of sufficiently high quality. In other words, relationships with venture capitalists can influence a NV's reputation by providing other stakeholders with some proof of the NV's quality, because venture capitalists are assumed to be expert evaluators of NVs (Gompers and Learner 2001; Shane and Stuart 2002). Thus, other stakeholders are likely use VC affiliation as a signal that the NV is promising and likely to produce valuable outputs and, therefore, to form positive opinions about the NV and its future prospects.

Strategic alliances and partnerships. Strategic alliances can serve both as a pathway to various resources and as signals that convey social status and recognition of the NV by third parties (Stuart 2000). In the NV cases we studied, the signaling function appears to be the major reasons for NVs to enter a partnership. Further, in the case of two technology-based NVs their alliance partners provided direct recommendations to customers regarding the prospects of the technology that the NVs were developing. Informants emphasized the fact that such recommendations contributed substantially to the reputation building of their NVs. This positive effect of partnerships on NV reputation can be explained with the fact that partners are considered more knowledgeable about the quality of a focal firm than other stakeholders (Stuart et al 1999). Therefore, stakeholders tend to infer that the focal firm is of high quality if major industry players chose to affiliate with it. Such attributions in turn can lead to more positive evaluations of a NV by stakeholders, thus contributing to its initial reputation accumulation.

Relationships with Key Customers. Informants saw relationships with customers as critically important for their NVs' reputation:
"The relationship with the customer is what keeps the venture going, because all the greatest ideas in the world just die on the vine if somebody didn't buy them."

Entrepreneurs explained that they often used the fact that they have a strong relationship with their first customer as evidence presented to subsequent customers to convince them of the NV's reliability and credibility. Examples of key customers include Government agencies, Microsoft, IBM, and Compaq. The informants used the early relationships with a key customer to attract their second/ next customers or, more generally, to build public awareness of their NVs. They relied on the fact that happy customers would share their experience with others and this will bring new customers to the NV. These observations suggest that customers can influence a NV's reputation in at least two ways: First, satisfied customers can share with others their experiences with the NV, thus leading to more people having positive opinions about the NV. Second, securing a major customer can be used by other stakeholders as a signal that the NV's products are valuable (Reuber and Fischer 2005). Thus, more distant stakeholders can form positive expectations or opinions about the NV, which then contribute to its overall reputation.

Fourteen NVs developed at least one type of relationship. Of them, 12 NVs had relationships with major customers, five NVs built relationships with investors, and five NVs established partnerships with major industry players. Further, one NV failed to establish relationship with a

prestigious VC and the informant recognized this as a mistake that eventually turned out to have negative consequences for the NV's reputation and performance. The patterns of relationship between investments in social capital and NV reputation look pretty similar to those for human capital. Specifically, three out of the seven NVs that accumulated direct reputation invested in social capital, all of them in relationships with customers. On the other hand, six out of seven NVs that accumulated high levels of generalized reputation and three out of four NVs that accumulated moderate levels of generalized reputation invested in social capital. What is interesting, though, is that the NVs that accumulated direct reputation reported only relationships with customers, whereas NVs that accumulated generalized reputation developed primarily relationships with strategic partners and investors. These observations suggest that investments in social capital are particularly useful for building generalized reputation. Further, NVs that try to develop direct reputation may benefit from relationships with key customers but such relationships are not critical for their reputation. Therefore, we propose that:

> *Proposition 4: (a) Investments in relationships with customers are likely to help NVs accumulate direct reputation. (b) Investments in relationships with strategic partners and investors are likely to help NVs accumulate generalized reputation.*

New Product Development

Qualitative Evidence

New product development activities discussed by our informants include refining the quality of their products, acquiring a technology from another NV, merger with another NV that already has developed a complementary piece of technology, and generating a pipeline of products (by developing a second/next product or an upgrade). Informants highlighted the importance of product quality for building reputation with customers and other stakeholders. For example, several informants emphasized the quality requirements that customers pose to their NVs: "you have to have the quality", "you have to have some meat". Another entrepreneur, who later on had become an investor himself, said:

"Yes, I would [look at the NV's product]. Because the most powerful determiner of profitability is the product itself, where it fits in the value chain, and how protectable its competitive advantages are"

Comparisons across NVs

Eleven NVs reported investments in new product development activities. Five out of seven NVs that accumulated direct reputation invested in product development activities, especially improving the product quality. Interestingly, all five NVs offered observable products or services which quality is easy to judge (e.g., dry cleaning). These observations suggest that product development activities can contribute to building direct reputation. Only three out of seven NVs that accumulated high levels of generalized reputation and two out of four NVs that accumulated moderate levels of generalized reputation invested in product development activities. Thus, product development activities appear to be less of a factor for NVs that accumulate generalized reputation. One possible explanation for this seemingly weak effect of investments in product development on generalized reputation is that informants might assume that product

development is a necessary investment that any NV would make and did not see it as distinctly contributing to the differentiation of their NV from the other firms in the same industry. Indeed, most informants mentioned product quality as a baseline that has to be in place for anything else to matter. Therefore, we propose that:

Proposition 5: Investments in product development activities are likely to help NVs accumulate direct reputation.

DISCUSSION

This study offers novel and important insights about the critical factors in the process of reputation building by NVs. Several issues deserve particular attention as they may be important for future research on this topic. First, we observe that NVs differ systematically in the type of reputation they attempted to and were able to build. Specifically, NVs offering more observable and easy to evaluate products and services, the quality of which can be judged directly by customers, tended to focus on building direct reputation with a small set of customers through direct interactions with them. In contrast, NVs offering less observable or more novel products and services appear to focus on attracting large-scale public attention to the NV and its offerings and to build a more generalized reputation with distant stakeholders. The fact that some NVs focused on building direct reputation while others invested in building generalized reputation is theoretically important because it confirms our initial speculation that the processes of reputation building by NVs differ from those of established firms. Specifically, prior research has found both types of reputation to be present in established organizations (Rindova et al 2005), whereas NVs appear to invest in one of them early in their lives. This observation is only the first step towards disentangling the complex socio-cognitive processes involved in the construction of stakeholders' perceptions about NVs. Future research should further explore the differences in the formation of other perceptions by stakeholders, such as trust and legitimacy, as well as the differences in the content of the reputations of NVs versus established organizations.

Second, our study suggests that the variations among NVs in the observability of their products influences how much NVs invest in reputation-building activities early in their lives and in what types of activities they invest. For observable outputs, NVs relied extensively on the direct customer experience with the product or service and focused on providing the best quality possible. For such NVs symbolic activities and investments in human capital and social capital did not appear to have a strong impact on the NVs' reputation. In contrast, NVs that offered unobservable outputs tried to invest in at least one type of reputation-building activities – i.e., symbolic activities, human capital, or social capital. Moreover, the NVs that accumulated the highest levels of generalized reputation were also the ones that invested in all three types of reputation-building activities. Our observation that for unobservable products NVs invested in human capital and social capital is consistent with signaling research, which suggests that observable attributes can be used as signals of the underlying unobservable quality of a focal firm (Spence 1973). Our study extends prior research by identifying attributes that are uniquely relevant as signals in the case of NVs and have not been studied by prior research. Given the exploratory nature of our study, we cannot make any definitive statements of the relative importance of each of the reputation building activities we identified. Therefore, one important

direction for future research would be to test which of the reputation-building activities we identified have stronger and which weaker effects in order to validate and refine the theoretical framework we propose in this paper.

Third, some of the activities we identified – investments in human capital, investments in social capital, and product development – have been identified by entrepreneurship research as important milestones in the normal business development of any NV. We contribute to prior research in two ways: (a) we identify an additional function that these activities can play – as factors that influence stakeholders' perceptions about NVs; and (b) we shed some initial light into the signaling role of human capital and social capital. Whereas past research has identified these activities as critical inputs in the organizational processes of a NV, this study provides additional insights about the dual role of these resources. For example, an expert who has worked for Microsoft may bring to an NV, in addition to her/his useful skills based on past experience, the prestige of affiliation with a major player in the software industry. Although most NVs are likely to invest in human capital and social capital as a part of their organizational strategy without considering the reputation effects of these resources, we observe that some founders invested in obtaining a resource they did not necessarily need for operational purposes but tried to obtain this resource solely to increase their NVs' reputation. These founders focused on the 'prestige' component of human capital and social capital. Therefore, our study suggests that NVs can use most wisely their limited resources by investing in a resource that can serve both substantive and signaling purposes and we recommend that future research takes into account this additional role of human capital and social capital.

Fourth, we identified symbolic activities as critical input in building generalized reputation. Although it appears logical that NVs would use symbolic activities to influence public perceptions prior research somehow overlooked the role such activities may have for NVs. Thus, one of the major contributions of this study is that we identified and captured empirically a wide range of symbolic activities that can be utilized by NVs. This is an important contribution both to future empirical research and practice. Future research can benefit from the extensive list of symbolic activities we generated in NV context when operationalizing symbolic activities in future studies. Importantly, entrepreneurs can also benefit from our study, because we offer them specific workable suggestion on how to build initial reputation for their NVs on a relatively large scale. Moreover, most of the activities we identified (e.g., attending conferences, issuing press-releases, developing logo and motto) are quite affordable for NVs, because they do not necessarily require huge investments and at the same time afford significant flexibility in the amount and type of information that NVs disseminate about themselves.

On a final note, we must acknowledge that as every study this one is not without limitations. Specifically, we used a grounded theory-building approach that allows for significant depth of analysis but limits our ability to prove or disprove any hypotheses. Therefore, we encourage future research to test empirically the propositions we derived based on our analysis. Further, it is important for future research to conduct large-sample studies in different industries, in order to establish the conditions under which each reputation building activity is most effective.

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Entrepreneurship and Statelessness: A Natural Experiment in the Making in Somalia

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ABSTRACT

This paper is about the entrepreneurial accomplishments and challenges facing Somali businesses and educational institutions as the country recovers from a devastating civil war and statelessness which have lasted for more than a decade and a half. The paper will attempt to suggest some business and economic policies that the new government of Somalia might consider in order to put the country back on the path to a successful economic reconstruction and development. The proposed policies are derived from a critical reassessment the crucial role globalization plays in spurring and fostering entrepreneurship and economic development in today's integrated and interdependent world economy. The paper will also integrate a number of newly published research on the topic, and suggests policies for creating a business and investment climate that regulates but does not stifle the entrepreneurial spirit of the Somali people which has flourished for the 16 years despite (or perhaps, because of) the absence of government.

Entrepreneurship and Statelessness:
A Natural Experiment in the Making in Somalia

Yusuf Ahmed Nur

INTRODUCTION

After more than 15 years of anarchy, internecine killing, and senseless destruction, after more than two years of wrangling, backstage dealings, and numerous reversals, on the 13th attempt to form a central government, the Somali people have now a Transitional Federal Government mandated to lead the nation for five years. It is a weak government with questionable popular support as it has been established with Ethiopian military might. Thus there are no guarantees that this last Somali attempt of establishing a functioning central government will succeed. One has to only consider the ongoing situations in Afghanistan and Iraq to appreciate the daunting task facing the new government. Despite massive American military presence in Afghanistan and Iraq, and despite America's declared strategic commitment to rebuild those two countries, political stability in both countries has been elusive so far. In practical terms the control of the respective governments established through America's military might is still more or less limited to their respective national capitals.

The new Somali Transitional Federal Government has only two years left on its five-year mandate. However, it is the nature of interim bodies to extend their influence, and their impact may last well past the transitional period allocated to them. The decisions, policies and personalities that the new Somali Government produces will most likely endure well beyond its intended five-year mandate. Therefore, it is absolutely essential that its major political and economic decisions be carefully weighed and scrutinized. The new Somali Transitional Federal Government will need much expert help in order to achieve even the most modest of successes. It is the duty of the new government to accord serious and careful consideration to all economic decisions that it makes, lest they end up stifling the entrepreneurial spirit the Somali people have displayed for the last 16 years of statelessness.

The Years of Anarchy

Despite the anarchy and extensive destruction that ensued soon after Siad Barre (the Somali military dictator who ruled the country from 1969 to 1991) was ousted in a popular revolt in 1991, and despite the lawless and insecurity that became part of the landscape in Somalia, businesses have boomed and many services that were hard to obtain during Barre's 21-year dictatorial near-monopoly of the public sector, have become readily available to anyone who could afford them (Mayoux, 2001). The highly risky business environment has not deterred enterprising domestic and foreign firms from investing in Somalia. The civil war transformed the Somalis from people, who were only 15 years ago utterly dependent for almost everything on an all encompassing and stiflingly pervasive government, to entrepreneurs imbued with

ingenuity, initiative and acute business savoir-faire. If resourcefulness, opportunity recognition, innovation, and creativity are counted among the essential characteristics of entrepreneurship (Rangan, et al, eds., 2007), Somali businesses of the civil war era fully embody them. In some respects, the absence of a central government turned out to be a blessing in disguise. It has unfettered the entrepreneurial spirit of the Somali people in a way that nobody could have imagined or foreseen.

Somali successes are not limited to the traditional small business sector alone. Private clinics, hospitals, healthcare centers, and pharmacies have sprung up everywhere. Private schools at all levels have been established and staffed – some with outside help, others with local initiative and resources. There are at least five universities/institutes in the capital city alone, all of which opened their doors for students in the last six to seven years. These universities offer courses from Arabic and Islamic Shari'ah to business administration and computer science. But these educational institutions suffer from a dearth of qualified instructors and severe scarcity of other resources, and they cannot accommodate even half of the students who apply for admission every year.

These business and educational achievements, however, come at an enormous price. Impressive they may be, but the attained successes have to be weighed against the devastation to the collective body and soul that the Somali people have endured since 1991. No public building, utility or infrastructure has escaped the blatant thievery and unabashed greed of clan militias, unaffiliated robbers, and lawless thugs that still roam the streets and roads of Somalia. The physical environment has suffered much damage. The scant and irreplaceable trees of the Somali semi-desert have been uprooted and burned into charcoal for domestic consumption and exportation to the insatiable markets of the Middle East. There have been widespread rumors that some warlords have been bribed to allow dumping of hazardous wastes in some parts of Somalia (Brons, 2001; Little, 2003.)

The business and educational successes attained during the civil war also have to be weighed against the opportunity costs arising from the insecure climate Somali businesses operate in today. The risky business and investment climate in Somalia allows for only 'bazaar-type' business relationships – a situation not known to have ever led to economic development. The lack of government regulatory protection precludes long term investment and long term business dealings, without which the economy will not develop beyond subsistence level.

The formation of a central government, if successful, could not have come at a more opportune time for the Somali Republic. There are limitless and unprecedented opportunities in today's global economy for nations that create the right business climate and incentives to attract domestic as well as foreign investments. That is the first order of business for the new government. The whole project of reconciliation and nation building may hinge on the successful implementation of policies that can help the new government take advantage of the entrepreneurial opportunities globalization presents. The Somali Republic has a golden opportunity for a new start, and the entrepreneurship the Somali people have displayed for the last 16 years, if fostered properly, could lead the way to an economic prosperity unaccustomed to in Africa.

The remainder of the paper consists of four sections. The first section discusses globalization, the criticisms leveled against it, and the entrepreneurial opportunities associated with it. The second and third sections draw on recently published research carried out under the auspices of the World Bank on the role government business regulations play in promoting entrepreneurship, economic development, and poverty reduction. The second section tackles elements of the regulatory environment governments need to establish in their national markets in order to foster growth. In the third section, the focus shifts to how governments can create favorable investment climates for entrepreneurs. The fourth and final section attempts to identify high priority issues that may need the new government's immediate attention as it takes office.

Costs and Entrepreneurship Opportunities of Globalization

Somalia's civil war has roughly coincided with the flourishing of globalization. Stiglitz (2001) defines globalization as 'the removal of barriers to free trade and the closer integration of national economies.' Countries across the globe liberalized their trade and opened up their economies for foreign direct investments, thus making their economies more integrated with, and more dependent on, the economies of the rest of the world. Globalization is based on the premise that if countries removed trade barriers and opened up their markets for foreign investment, their economies would specialize in those goods and services in which they have a comparative advantage. Globalization was promised to lead to economic growth and poverty reduction all round. Under the exhortations of the World Bank, the International Monetary Fund (IMF) and the General Agreement On Trade and Tariffs (now the World Trade Organization, WTO), large amounts of capital have been flowing from the rich countries of the world into developing countries to exploit the comparative advantages these countries have in untapped markets and inexpensive factors of production.

However, the promises of economic growth and poverty reduction, which were to result from globalization, fizzled out for the overwhelming majority of the Least Developed Countries of the world (LDCs) that followed the prescriptions (the so-called Washington Consensus) pushed by the World Bank, IMF, and the WTO. According to Vietor (2005) the Washington Consensus "prescribe[s] 10 policies for market reform: fiscal discipline, increased public expenditure on health and education, tax reform, interest rate liberalization, a competitive exchange rate, the removal of barriers to trade and barriers to foreign investment, privatization, deregulation, and secure property rights."

In its latest report the UN Conference on Trade and Development (UNCTAD, 2004) demonstrates that the above prescriptions had an "immiserizing effect" on the economies of LDCs. Among the disturbing findings of the report is that the economies of LDCs are more open and more integrated with the rest of the world than are those of members of the Organization of Economic Cooperation and Development – OECD – the exclusive club of the rich countries of the world. (Economic integration as measured by the proportion of GDP that imports/exports account for is 51% for LDCs and 43% for the OECD, – a clear indication that the OECD, which happens to be one of the major proponents of globalization, does not practice what it preaches.)

The report which covers the years 1999 - 2001, also shows that average incomes in the LDCs are only slightly higher than they were in the 1990s when most LDCs opened up their economies. In

real terms, average incomes in some of those countries fell below their 1990s levels. Neither did increased trade improve the lot of the extremely poor in those countries. The countries neighboring Somalia do not seem to have benefited much from globalization and the economic openness it champions. World Bank Development Indicators (paved roads in km per person, electricity consumption in kwh per person, public health spending per person, primary education pupil-teacher ratio) for Kenya, Ethiopia, Tanzania and Uganda for the year 2003 show that these countries barely made any headway in a decade of unprecedented economic openness (World Bank, 2005b).

It is expedient to escape-goat globalization for the dismal performance of the poor countries, but is globalization the real culprit? Globalization has been subjected to withering criticisms from all corners, some of which are specious. There are, however, other more serious and more substantive criticisms against globalization and the ill effects in developing countries that are associated with it. Among the academic and serious critics are: Stiglitz (2001), Rodrik (1997) and Hertz (2001). Stiglitz (2001) takes to task the supranational institutions, the World Bank, the IMF, and the WTO. Stiglitz, winner of the Nobel Prize for Economics, speaks from a position of knowledge and authority. The book, *Globalization and Its Discontents*, is based on his experiences and observations during his tenure as chief economist and senior vice president of the World Bank. Stiglitz exposes the hypocrisy of Western countries which "pushed poor countries to eliminate trade barriers, but kept up their own barriers, preventing developing countries from exporting their agricultural products and so depriving them of desperately needed export income." (p. 6).

Stiglitz goes on to describe how the West manages the agenda of globalization so that more of its benefits accrue to it at the expense of poor and developing countries. In response to critics of globalization, including Stiglitz, Wolf (2004) provides in his book, *Why Globalization Works*, reasonable and logical refutations for the most common charges against globalization. Wolf accepts, however, the seriousness of some of these criticisms. Similar to Stiglitz, Wolf concedes that Developed countries use multilateral agreements to impose trade liberalization on poor countries while keeping their own markets off limits to the products of the poor countries. Another criticism that the two authors agree on is that the supranational institutions entrusted with the global economy seem to exasperate the situation by prescribing rigid and outmoded policies.

The shortcomings of the World Bank, the International Monetary Fund, and the World Trade Organization are well documented. However, the well deserved criticisms of these institutions and their policies should not be confused with globalization itself and the entrepreneurship it fosters. Stiglitz (2001) himself reiterates in his book that he still believes that globalization has the potential to be a force for good. The entrepreneurship opportunities that arise with globalization can be pursued without following the recipes or prescriptions, some of which are ill conceived, of the multilateral institutions mentioned above. The example of Malaysia is a case in point. Malaysia prominently rejected prescriptions of the IMF's in the aftermath of the financial market meltdown the Southeast Asian economies experienced in 1997 (Economist, 1999), instituting its own homegrown policies, which helped it become the first country, among the Southeast Asian countries affected by the crisis, to emerge from the crisis. Moreover, if the rough going of the current Doha round of WTO is any indication, some of the developing

countries, led by Malaysia, China, India and Brazil are finally banding together to stand up to the OECD's hypocritical stance on agricultural subsidies (Economist, 2003).

Globalization is accused of putting too much power not only in the hands of supranational organizations but also multinational corporations (MNCs). Hertz (2001) lists a litany of policies and tactics, both legal and illegal, multinational corporations resort to in order to get their way with governments of developing countries. It is becoming more and more evident, however, that globalization has not diminished the relative power of the nation state vis-à-vis MNCs if the former plays its cards well. After all, the markets and resources MNCs desire are within the boundaries of nation states, and their respective governments have control over access to them.

No Substitute for Good Government

Trade liberalization and economic integration with the rest of the world, by themselves are not going to meet the developmental entrepreneurship needs of countries like Somalia. The countries that benefit the most from the opportunities that globalization offers and that are most successful in minimizing its ill effects do so through the establishment of the rule of law and robust institutions of check and balance, the curbing of corruption, and the maintenance of fiscal and monetary discipline. The Fraser Institute, a Canadian think-tank, in its yearly report of economic freedom of the world, argues that economic freedom, defined by low taxes, protection of private property, freedom of contract, free trade and monetary stability, attract the investment – both domestic and foreign – countries like Somalia need (Gwartney & Lawson, 2004). All of the items that comprise the Fraser Institute's economic freedom require a good and strong government.

The new Somali government should at a minimum focus on two functions of good government: designing proper business regulations, in general, and creating a business climate that fosters investment, in particular. Without these regulations in place, the new government will have a difficult time creating job opportunities for the Somali people, especially the youth – a panacea for the establishment of lasting security. Political stability will not be possible without creating legitimate job opportunities to lure the unemployed youth that now swell the ranks of the private militias. The following sections will expand on the above two functions.

Business Environment

Recently the World Bank undertook a number of studies which culminated in the publishing of the "Doing Business" series. To date, three books of the serious have been published: "Doing Business in 2004," "Doing Business in 2005," and "Doing Business in 2006." Together the three studies, which were carried out in 145 countries, identified, collected data on, and analyzed ten indicators of government regulations that directly impact business activities. The areas indicators apply to are: (1)starting a business; (2) dealing with licenses; (3) hiring and firing workers; (4) registering property; (5) obtaining credit; (6) protecting investors; (7) paying taxes; (8) trading across borders; (9) enforcing contracts; and, (10) closing a business. These indicators have important implications for capital and labor productivities, unemployment, poverty, attraction of domestic and foreign private investments, corruption, and the relative sizes of the formal and informal economies, and thus the efficacy of government tax collection.

In many poor countries business regulations make it so hard to start a business that many entrepreneurs are forced into the informal economy, where they do not have to pay taxes or give benefits to their workers. In order to start a business, an entrepreneur will have to grapple with capital requirements, which could be substantial. The African continent is notorious for its obstacles to starting a new business. By far entrepreneurs there face more complications than anywhere else in the world. Start-up registration and licensing require considerable investment of effort, time and money. If entrepreneurs resist the allure of the informal economy and go through all the hurdles of registering their new business, they then have to grapple with regulations dealing with hiring and firing workers. Rigid hiring and firing regulations force businesses to hire workers under the table, with all of the attendant abuses of the informal economy. Thus, the people that the hiring and firing regulations were supposed to protect end up getting hurt by them.

Besides simplifying rules dealing with starting a business, and hiring and firing workers, the governments should focus on setting up simple and straightforward regulations for the registration and protection of property rights. Entrepreneurs are less willing to invest where property rights are not secure. Protection of property rights link effort with reward. One of the findings of the second report (World Bank, 2005a): the more bureaucratic and cumbersome property regulations are in a country, the more property disputes there are in that country, the more prevalent bribes which business have to pay, and the more assets entrepreneurs and businesses keep in the informal sector. If cumbersome regulations force business people to keep their properties in the informal sector, it will be harder for them to get credit since they cannot use their unregistered properties as collateral.

Obtaining credit is another area where governments can entrepreneurs. The World Bank (2005a) cites a number of studies that point out simple policies that governments can promulgate in order to facilitate the procurement of credit for businesses. Among them are: making access to credit easier, creating credit registries that sort good borrowers from bad ones, and putting in place laws to enforce collateral and debt collection, and bankruptcy.

The alternative to debt financing is equity financing, a proposition which is more appropriate in a country like Somalia with its religion-inspired aversion to interest bearing loans. Both equity and debt financing require robust legal protection for their proper functioning. Thus, without appropriate investor protections equity investment will remain a risky endeavor and the sources of such investments will be limited to family members, close relatives and friends. The study points out three areas of investor protection: (1) disclosure of financial information for individuals and firms seeking investment; (2) legal protection of small investors; and, (3) enforcement capabilities in the courts. Enforcing contracts, yet another indicator, will also require efficient and well functioning business courts – fewer procedures, shorter time to resolve disputes, more efficient judges of good repute and integrity. Finally, the studies identify a number of important reforms that could improve the closure of businesses. Making it easier to close non-productive businesses will free scarce human and financial resources to put to more productive use elsewhere.

All three World Bank studies emphasize that regulatory burdens that businesses have to bear in poor countries are higher than those that businesses have to contend with in rich countries.

These regulatory burdens tend to push businesses in poor countries into the informal economy, which accounts for over 40% of the overall economy in those countries. The studies maintain that in developing countries government red tape presents a significant hindrance to economic growth. The more red tape a country has in place and the more cumbersome the regulations, the more likely they are to foster graft and corruption, which in turn hamper economic development of poor countries.

Transparency International, a non-governmental organization devoted to curbing corruption, has been ranking countries each year since 1993 on how corrupt their governments are perceived to be. Transparency International's Corruption Perceptions Index (CPI) measures 'the degree to which corruption is perceived to exist among public officials and politicians. Corruption is defined as the abuse of public office for private gain. In this year's report Transparency International (2007) estimates that corruption costs the world economy at least $400 billion per year. All members of the Intergovernmental Authority on Development (Djibouti, Eritrea, Ethiopia, Kenya, Somalia, Sudan, and Uganda), with the exception of Djibouti and Somalia, which were not ranked this year, are included among the 60 most corrupt countries in the world out of the 146 ranked this year. Eritrea, Ethiopia, Kenya, Sudan and Uganda scored less than 3 out of a clean score of 10. The report recommends that the best way to fight corruption is to require transparency on the part of both governments and multinational corporations in public procurement. The report takes to task the developed world and its multinationals for not doing enough to curb corruption.

Although the investment climate is a subset of the business regulatory climate, it deserves a separate treatment because of its crucial importance for attracting and keeping domestic and international entrepreneurs. The World Bank (2005b) defines investment climate as "the location-specific factors that shape the opportunities and incentives for firms to invest productively, create jobs, and expand." A good investment climate is essential for growth as well as poverty reduction. By removing unnecessary costs, lessening risks and barriers to competition, governments can create an ambiance in which entrepreneurs feel secure to invest in job creating businesses. Before they decide whether and where to invest, both domestic and international investors scrutinize government policies and behaviors as a whole package. They look at property rights, taxes, finance, infrastructure, and corruption. Having the requisite formal policies in place is not enough; they have to be matched by government practice. Arbitrary regulation and lack of microeconomic discipline on the part of the government can scare away potential investors.

The World Bank (2005b) identifies four basic areas that comprise good investment climate. First, securing political and macroeconomic stability, without which none of the other policies will take root. Thus one of the first tasks the new government has to tackle is reconciliation and the return or compensation of properties unlawfully expropriated during the civil war. The rights to land and other properties have to be verified since they may have changed hands many times since their initial confiscation.

Second, governments should put in place regulation and taxation that would ensure the reconciliation of the interests of firms and broader social needs of the general public. Third, governments should help foster financial markets and infrastructure that connect firms with

lenders and investors. Fourth, they should establish educational systems that can produce a workforce equipped with the necessary skills for a modern economy.

First Things First

The situation in the Somali Republic represents a true natural experiment in the making. All state institutions have been laid to waste, giving the new government a golden opportunity to start from scratch. It is essential that things are gotten right this time around. The new Transitional Federal Government does not have to repeal any formal business laws – in today's Somalia there are no formal laws: everything is in the informal sector. The new government will be starting out with a clean slate with absolutely no red tape, unless it chooses to reinstitute the draconian gridlock of the Siad Barre regime, or go back even further to colonial era laws. (Most developing countries still have in the books colonial-era rules that the colonial powers deliberately designed in order to discourage indigenous entrepreneurship.) Business regulations, however, will need to be promulgated for protecting property rights and the environment, for granting titles, and for establishing fair courts that can enforce contracts and debts. It is vital that these regulations so fundamental to vibrant entrepreneurship and economic development be kept to the absolute minimum necessary. Once a rule is in the books it is not easy to repeal it or reform it. The new government has to balance the need to provide incentives and encouragement for investment with the need to protect the interests of society at large. This balancing act is an ongoing process of improvement that requires regular review and adjustment of policies.

The new government should consider the provision of public good as one of its most important functions. It comes as no surprises that this is the area of public life that suffered the most in Somalia in the absence of a central government. The market left to its devices cannot do a good job of providing public goods. In its broadest sense, public good includes ensuring security of property through the establishment of rule of law, and independence of the legislative and the executive branches of government. This requires the creation and maintenance of such institutions as courts, a police force, and prisons. It is incumbent on the new government to have sound fiscal and monetary policies, which are hard to maintain for any government without a robust and independent central bank. With such institutions in place the new government will be able to curb the excesses of the market – what economists call internalizing externalities.

According to conventional wisdom, it takes many years to establish the institutions that are so indispensable for sustainable economic development. Recently, however, two studies (Glaeser et al, 2004; Hausmann et al, 2004) have suggested that an initial economic growth spur may be achieved through small piecemeal policy changes, which in turn may lead to long-term institutional reforms. The examples cited include the protection of property rights reforms that Deng Xiaoping introduced in China in 1978, which directly led to China's unprecedented economic growth. Similarly, reforms implemented by General Park's regime in South Korea provided the necessary impetus for the boom in private investment in that country. General Pinochet did something similar for Chile in 1983. In all three countries these simple reforms led to more fundamental ones which in turn ensured the successful continuation of economic development. The end results are visible to all.

The new government's efforts should be prioritized, gradual, and incremental. It should build on the few institutions already in existence in the country and that established positive track records during the civil war. New regulations, processes, and institutions should be introduced on need basis and not under the prescription of policies developed somewhere else or developed for some other country, regardless of how that country appears to be similar to Somalia. One of the top priorities of the new government is the protection of the environment. Preserving the environment and controlling pollution are things the market cannot take care without active government intervention. The new government should pass and enforce laws banning exportation of charcoal out of the country. In the longer term domestic use of charcoal should also be curtailed in urban areas. This cannot be done unless the government makes it a high priority to develop modern cooking fuels, especially those that utilize solar energy and wind power. At the present rate of charcoal production where irreplaceable trees are cut down and converted into charcoal, Somalia will turn into a barren desert in less than a generation.

The Somali Republic does not have plenty of trees, but it has plenty of sunshine. In the absence of government, electricity production relies exclusively on fossil fuel burning, 100% of which has to be imported. In the last few decades the technologies that underpin electricity production based on solar energy and wind power have made dramatic advances, rendering such energy alternatives much more affordable in developing countries. For example, at current costs in the West, the $8 million that were reputedly spent on the new Coca-Cola plant in Mogadishu (Grant, 2004) could have provided electricity to over 25,600 households if that money were invested in electricity generating wind turbines.

The fostering of vibrant entrepreneurship and sustainable economic reconstruction will entail repairing and rebuilding the basic infrastructure. The few remaining infrastructure is in total disuse and decay. Roads, soil health, water for irrigation, drinking water and sanitation, and modern cooking fuels will have to be the primary areas of concentration for the new government. In addition, basic health care concerns such as control of malaria, TB, childhood diseases, childbirth, and nutrition should be addressed. Finally, the new government has to put in place accreditation processes for the private schools that at present provide primary and secondary education in the absence of a central government. A skilled labor force is a sine qua non for a modern economy, and proper education is the main ingredient of a skilled labor force.

The Somali Republic needs a strong, relatively corruption-free, and accountable government. Accountability requires transparency, which in turn cannot be had without freedom of expression and a free press. Only a government that encourages the above qualities will be able to create an environment in which people can become more productive. Every report on business entrepreneurship and economic development emphasizes that there are no economic ills that a good government cannot remedy. Corruption and misuse of public funds are what denied Somalia and other developing countries the economic development they sorely need and deserve.

The new Transitional Federal Government has the daunting task of reintroducing security and stability into a country where internecine bloodshed and irredentism became a way of life for more than 13 years. But the new government has also the best potential to succeed in putting in place the necessary government policies and behaviors for cultivating entrepreneurship, economic reconstruction and growth. It is not going to inherit bad policies that need reforming

or scrapping. There is a dire need, however, for government regulations essential for the stewardship of a modern economy. The government should resist the temptation to import regulations from countries or policies put together by consultants or Non-Governmental Organizations that are not well versed in the intricacies of the Somali situation. It should also resist dismantling homegrown institutions under unfounded foreign claims that they pose security threat to one country or another. Instead the new government should build on the wartime institutions that the Somali people themselves established, often without outside assistance. Building on existing institutions will create a sense of ownership and continuity – two ingredients absolutely essential for the success of state building.

One experience that the Somalis learned from their long and costly civil war is that they can accomplish a lot of things without a government. Their undaunted entrepreneurial spirit has been flourishing not only in Somalia proper but in the neighboring countries as well. However, another experience the Somalis gained is that there are a lot of things that are impossible without the supremacy of a central authority. The job of the new Transitional Federal Government is to strike a fine balance between these two experiences: to get out of the way of the people in the former, and to ensure its pervasive presence in the latter. If it does not do that, it is likely the Somali people will resort to yet another experience that the civil war taught: they will not put up with any unnecessary interference from any government, however strong.

The new government should not try to reinvent the wheel. There is a sizeable, readily accessible accumulated knowledge in the world about how best to create the necessary environment for vibrant entrepreneurship, economic reconstruction and sustainable development. The new government should solicit the advice of people who have the requisite knowledge and expertise, and under their supervision judiciously choose and implement the most applicable policies, benchmarking the performance of applied policies against comparable countries that preceded Somali Republic in the path to development and economic prosperity.

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