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The contingent value of social resources: Entrepreneurs' use of debt-financing sources in Western China

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ABSTRACT

This study shows that entrepreneurs' use of debt-financing sources is conditioned by the resources embedded in their social networks. More business or political contacts increase entrepreneurs' probability of using formal financial sources, and more urban ties increases their probability of using informal sources. However, the effects of business and bureaucratic ties are contingent on community-level institutional trust and on firms' age. Business ties have greater positive impact on the probability of using formal financial sources for older firms and for those in regions with a higher level of institutional trust, while the impact of bureaucratic ties on these firms is weaker.

1. Executive summary

Mobilizing financial resources is crucial for the survival and success of entrepreneurial ventures. Although the development of formal and informal financial markets has provided many resources for needy entrepreneurs, firms in less-developed regions still cannot take full advantage of rich external financial opportunities. Their use of financial resources is still heavily constrained by various individual, organizational, and institutional conditions. Previous studies have shown that entrepreneurs' personal networks can help them overcome various informational and institutional barriers to successful mobilization of financial resources. However, fewer studies have explored the impact of the resource aspects of their networks. This study advances this literature by investigating how different types and contents of entrepreneurs' social resources affect their use of debt-financing sources, and how organizational and regional characteristics condition the effectiveness of these social resources.

I adopt the embedded entrepreneurship perspective and argue that entrepreneurs' social networks affect firms' prospects of acquiring financial resources through three mechanisms: first, they help firms discover funding opportunities; second, they enable firms to acquire actual financial resources including resources that are possessed by their social contacts or that can be accessed by using privileges granted by their social contacts; third, they facilitate firms in acquiring legitimacy from key players in the field, which is crucial in allowing financiers to determine the creditworthiness of borrowers. Borrowing insights from social capital literature, I developed the positional generator method by quantifying entrepreneurs' social resources with more precise content measures. I distinguish three types of social ties—urban, business, and bureaucratic—and postulate that these different types of resources will have differential impacts on entrepreneurs' use of debt-financing sources. In addition, I propose that the impacts of these resources will also vary depending on their stage of development and on the level of institutional trust in the local communities.

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I drew data from a large-scale cross-sectional survey conducted in eleven provinces in western China. I identified 3035 entrepreneurs and obtained information about their debt-financing activities in the most recent twelve months. I employed Heckman's selection models to estimate the effects of the covariates. The model results indicate that when entrepreneurs have more urban contacts, they tend to be more likely to borrow from informal sources. Entrepreneurs are more likely to use formal financial resources if they are connected to more business professionals or contacts who hold important positions in the state bureaucratic system because incumbents in these occupations can provide market information, exert social influence on resource distribution processes, and help firms gain legitimacy in the targeted market. In addition, the findings show that business and bureaucratic ties have differential impacts on firms with different characteristics: for older firms and firms in communities with a higher level of institutional trust the positive effects of business ties are stronger, while the positive effects of bureaucratic connections become weaker.

This study enriches the literature on the embedded entrepreneurship perspective by strengthening the theoretical linkage between social resources and entrepreneurial outcomes. It points out that besides social contacts' hierarchical positions or job prestige, the type of resources attached to these positions is also an important predictor of entrepreneurs' choices. This research also sheds new light on the relationship between entrepreneurship, context, and trust. The findings reveal that a low-trust environment restricts market entry and enterprise growth, and encourages unproductive and parasitic entrepreneurship. In these places the value of business ties is discounted due to the higher risks associated with market transactions, and bureaucratic ties emerge as more effective in securing loans from formal banking systems. Lastly, this study suggests that the value of embedded resources does not diminish as firms become more established. What changes is not the value of the network-based business strategy, but the relative value of specific types of social resources.

2. Introduction

Securing resources is one of the crucial tasks of entrepreneurs in order to exploit opportunities they have spotted and to improve the survival chances of their entrepreneurial ventures. This task is even more challenging in places where formal financial markets are underdeveloped and resources from informal sectors are both limited and segregated, e.g., western China. Past studies have shown that while banks, credit unions, and other formal sources serve the needs of a wide array of businesses spread throughout a greater geographic area, informal financial sources, consisting of friends, relatives, network contacts, and local professional moneylenders, provide immediate financial assistance to entrepreneurs via more flexible arrangements (Casey, 2012; Christensen, 1993; World Bank, 1989). When the coexistence of formal and informal financial sectors caters to the heterogeneous needs of various borrowers, the large differences in service scope and lending requirements make it challenging for some entrepreneurs to acquire quality financial resources. Variations in the quantity and quality of entrepreneurs' social resources not only determine the possibility of acquiring loans but can also affect the types of financial resources they can use.

Just as with other entrepreneurial activities, acquiring financial resources can be viewed as a social process that is embedded in a social context and channeled and facilitated, or constrained and inhibited, by people's position in social networks (Aldrich and Zimmer, 1986; Bruderl and Preisendorfer, 1998; Kotha and George, 2012). Previous research on the relationship between social networks and entrepreneurial outcomes has mainly focused on structural properties such as network size, centrality, and diversity, and relational properties such as tie strength (Bruderl and Preisendorfer, 1998; Granovetter, 1990; Hoang and Antoncic, 2003; Shane and Cable, 2002). However, the attention paid to the resource aspect of entrepreneurs' social networks is still inadequate (Batjargal and Liu, 2004; Casey, 2012). According to social resource theory (see Lin, 1982; later referred to as social capital in Lin, 2001), contacts' social resources such as knowledge, expertise, social influence, and wealth have important implications for the outcomes of instrumental actions (Batjargal, 2003). The volume of resources possessed by social actors is unevenly distributed across social hierarchies; the types and levels of positions one holds can thus be used as proxies for one's resources (Aldrich and Zimmer, 1986; Lin, 1999, 2001; Zhang et al., 2012). For entrepreneurs, this suggests that contacts who possess more wealth and rich market information or professional knowledge, have strong social influence, or are high in the social hierarchy will provide the most assistance in acquiring various resources and entrepreneurial opportunities (Aldrich and Zimmer, 1986:13).

This research applies this theory to the study of the effects of entrepreneurs' social resources on their use of debt-financing sources, and explores the factors that moderate the value of these social resources. Borrowing insights from the position and resource generator method, I constructed new variables to measure the content of entrepreneurs' social resources and investigated the contingencies, such as institutional trust and firms' stage of development, on the value of social resources. I found that the degree to which an entrepreneur connects to the urban economy increases his/her probability of using resources from informal financial sources. Meanwhile, an entrepreneur's connections to the business and political fields positively affect his/her probability of using resources from formal financial sources. However, for older firms and firms in communities with a higher level of institutional trust, the positive effects of business ties are stronger while the positive effects of bureaucratic connections become weaker.

This study makes four contributions to the existing literature. First, this study develops the measurement of entrepreneurs' social resources by quantifying it with more precise content measures. It combines both position and resource generators (Lin and Dumin, 1986; Van Der Gaag and Snijders, 2005) and improves the precision of the social resource instruments in measuring goal- and context-specific social resources. Second, this study strengthens the theoretical linkage between social resources and entrepreneurial outcomes. It argues that in addition to social contacts' hierarchical positions or job prestige, the content of such positions, i.e., the types of resources attached to them, is also an important predictor of entrepreneurial outcomes. Third, this