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Research in Small-Firm Entrepreneurial Finance: A Note on Developing a Paradigm

J. William Petty

There is an increased interest in small companies and entrepreneurship among academicians and policy makers. The melting of the cold war and the collapse of the socialist economies of the Soviet bloc, in combination with the interest of the affected countries in imitating some form of capitalistic economy, will make this area one of the key research items of the 1990s.

For finance faculty, this interest is surfacing in the form of the question, "Does what we teach with respect to public capital markets apply to private capital markets?" A related issue is the relevance of financial theory in understanding the valuation and financing of entrepreneurial activities.

To date, the research relating to small-firm finance and entrepreneurial finance has been limited in terms of the level or amount of work being done and, even worse, in terms of quality. With some exceptions, it would not be unfair to suggest that the general quality of research in the small-business finance area is lacking when compared to other segments of financial research.

If the academic profession is to make a difference in the small firm, at least three basic questions must be addressed:

1. Does finance have anything to say to small business and does small business have anything to say to finance? Only if there is potential for a meaningful dialogue do we have a *raison d'etre*.
2. What are the different fundamental perspectives that we may take in our endeavor? Some have been interested in the financial process that evolves through time from the company start-up to the "harvest," while others are concerned with the impact, if any, of firm size on financial behavior. Is one perception better than the other, as some would maintain, or are we dealing with "tastes and preferences"? Furthermore, what other alternatives might be chosen?

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3. What is “good” research? Conventional wisdom teaches us that research should be theory based, where we first develop the theory, build our hypotheses from the underlying theory, which we then test empirically, i.e., deductive analysis. In an emerging, and immature, discipline, where we find ourselves with small-business and entrepreneurial finance, could we not also benefit from the skills of the pure empiricist? In other words, should we not value also inductive logic applied to purely exploratory, empirical research—what William Bygrave calls “enlightened speculation”?

Thus, given where we are, meaningful research in the area of small-firm or entrepreneurial finance must bring us to a better understanding of the characteristics of the small firm and the entrepreneur, such as the small firm’s greater flexibility of changing the asset base and the entrepreneur’s disbelief that product markets are perfectly competitive, or that capital markets are uniformly efficient. It must also recognize the emerging nature of the state of research in the area, which suggests that much exploratory work is in order. Progress will come only through more careful thinking and better empirical analysis, requiring more in-depth field studies, as opposed to another survey on an available population. It is time to give our best thought to the area and develop a willingness to “get our hands dirty” in our empiricism. Herein lies the essence of our task.