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Collective Loans for Bulgaria's Self-Employed: A Field Study of Social and Financial Capital on Enterprise Growth

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The purpose of this paper is to increase understanding of how collective lending strategies leverage social capital to improve firm performance. Drawing on economic and sociological perspectives and fieldwork in Bulgaria, I argue that social capital may enhance the effects of financial capital on firm performance in microenterprises. Findings show that a collective lending strategy facilitates greater firm performance than individual lending—due partially to the increased social capital it creates for the entrepreneur. These findings come from a multi-method field study conducted in Bulgaria, where qualitative data were collected from over 40 business owner interviews. The findings have implications for theoretical and practical application within the field of microfinance.

Introduction

The collapse of communism over a decade ago created a group of rapid-growth nations in Central and Eastern Europe. These nations are known as transition markets because they are committed (in varying degrees) to strengthening their economies through private enterprise growth (Hoskisson, et al., 2000). However, due to the closure of many state-owned firms, millions of people have experienced difficulty in finding employment. Their option has been to either keep searching for employment or go into business for themselves. Many chose the later, and thus gave rise to a new economic group known as microentrepreneurs. The recent emergence of microentrepreneurship in Central and Eastern Europe warrants more research to

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help understand and prescribe methodologies that help these entrepreneurs survive and succeed in spite of their nations' economic difficulties.

While broad agreement exists about the importance of examining microenterprises in transition economies (Aldrich and Reese, 1993; Peng and Lou, 2000), there is very little research that examines how microentrepreneurs' social relations can affect their economic performance. Research that does exist tends to focus more on aspects of financial capital as a source of entrepreneurial opportunity (Bohata & Mladek, 1999; Cook, 1999; Gerard & Prabhu, 2000; Pissarides, 1999) or on the social good that comes from microenterprise lending (see Woller, Dunford, & Woodworth, 1999, for overview of social versus economic arguments in microlending programs). While availability of financial capital is identified as a major concern for entrepreneurial firms in transition economies (Pissaridas, 1999), how financial capital is accessed can offer even more insights into improving the circumstances for such firms (Watchel, 1999).

This paper attempts to combine the economic with the social approach of showing how collective lending strategies facilitate social capital, and thus, impact performance of entrepreneurial start-up firms in transition economies. Unlike financial capital, social capital inheres in the structure of relations between individuals and among individuals. Social capital consists of the social relationships between individuals, and importantly affects how financial capital is used to improve firm performance. Financial capital intermediaries, much like venture capital firms, can be potential sources of personal contacts for young firms (Freeman, 1999; Podolny & Castellucci, 1999). Such contacts often become "the final arbiter of competitive success" (Burt, 1992, p.58). Social capital is especially important for new ventures because they provide information, provide access to more resources, and improve reputation (Burt, 1992, Larson, 1992).

Addressing issues of financial capital and social capital, the paper does the following. (1) Examines the definition of entrepreneurship in transition economies and discusses the need for financing microenterprises. (2) Argues that social relationships also play an important factor in the development and growth of microenterprises. (3) Discusses the methodology used to examine two separate lending strategies geared toward microentrepreneurial firms in Bulgaria. The first method is to offer individual loans, where the borrowing institution is required to have two or more guarantors. This is the more traditional lending model adopted from commercial banks. The second method consists of financial loans within a collective body of firms that is responsible for the repayment of each individual's loan. More specifically, an organization offers collective lending to smaller and potentially higher risk firms as a way to mitigate risk. Firms in collective groups assembled by the lending institution receive individual loans but are responsible for the repayment of all group members' loans. Thus generating a need for support among group members. (4) Examines the findings of exploratory work on young entrepreneurial firms in Bulgaria. And (5) discusses the possible implications of financial and social capital on improving the conditions of microentrepreneurs in Bulgaria.

I. Financing Entrepreneurship in Transition Economies

According to Shane and Venkataraman (2000), entrepreneurship should be studied in terms of sources of opportunities and the actors who discover, evaluate, and exploit these opportunities. Thus, this study examines the entrepreneurship of micro-business owners in how they exploit new opportunities for creating wealth (Aldrich, 1990; Katz & Gartner, 1988; Singh

& Lumsden, 1990). Access to financial capital is one source of opportunity for new entrepreneurial firms. Another source of opportunity for entrepreneurial firms is how this capital is accessed.

Research shows that among small firms the lack of financial capital is an obstacle to firm growth and performance. Central and Eastern Europe, however, are the only regions where lack of financial capital is one of the top three most important obstacles (Brunetti, Kisunko, & Weder, 1997). Pissaridas (1999) argues that this can be greatly attributed to the fact that transition economies are characterized by underdeveloped capital markets in which access to credit is based on historically determined working practices and networks that closely link state banks with state and other large enterprises.

Practically speaking, looking at the various regions throughout the world, Central and Eastern Europe presents a unique situation in that it consists almost entirely of semi-industrialized nations. The education and literacy levels are similar, if not higher than most found in developed market economies. The landscapes are filled with factories and modern equipment used in technology, textiles, mining, and other such industries. This is the only region in the world with high levels of education and modernization, whose small business entrepreneurs suffer from such a lack of access to financial capital.

Offering small loans to the smallest and newest of entrepreneurial firms has the potential to serve as an engine of growth for many transition economies. Jeffrey Franks (1998), of the IMF, states that there is already evidence that lending efforts for small start-up entrepreneurial firms has achieved macroeconomic importance in countries such as Bangladesh, Indonesia, and Bolivia. By focusing on the smallest entrepreneurial firms and supplementing their start-up and early growth efforts, the proverbial entrepreneurial ball starts rolling. Once a business record is established and the firm has built up a credit history, it will be able to obtain credit from larger lending institutions. And thus, contribute to the transition of the economy.

II. An Argument for Social Capital

Clearly, accessing financial capital is a vital source of opportunity for microenterprises in transition economies. However, how this capital is accessed plays an important role in how the microenterprise will perform and develop. If the way in which financial capital is accessed is done so that an entrepreneurial firm is able to not only create new business ties, but strengthen them as well, then this firm is able to build a source of strategic opportunities (Uzzi, 1999). Ties are said to be strong and "social" when elements of trust, reciprocity, and mutual forbearance creep into the business transactions. When a firm creates strong social ties between and among other firms and focuses on material exchanges of resources and information as the basis of exchange, then these ties are said to be structurally embedded (Granovetter, 1985). Embedded social relationships offer a potential link between sociological and economic accounts of firm behavior. It refers to the process by which social relations shape economic actions in ways that some mainstream economists overlook (Crosby & Stephens, 1987). The argument is that structural conditions (e.g., how a lending process is laid out) facilitate the creation of social capital.

As stated by Nahapiet and Ghoshal (1998), social capital is the sum of the actual and potential resources embedded within, available through, and derived from the network of relationships possessed by an individual or social unit. Such relationships are sources of opportunity for a firm to improve performance because they depend on aspects of trust and

goodwill not found in rational economic models. The term "social capital" first appeared around the turn of the 20th century in a community development study conducted by Lyda Judson Hanifan, who argued that "social capital...refer[s] to...those tangible assets [that] count for most in the daily lives of people: namely goodwill, fellowship, sympathy, and social intercourse among the individuals and families who make up a social unit" (Hanifan, 1916, p. 130). Early pioneers of the social capital movement also include Jacobs (1965), Bourdieu and Passeron (1970), and Loury (1977). However, it was not until 1988, when the Chicago sociologist James Coleman developed a comprehensive theory of social capital that imported the economists' principle of rational action for use in the analysis of social systems (Coleman, 1988). His primary goal was not to create a theory of social structure, but to create a theory that builds upon neoclassical economic analysis that admits a social context.

The purpose of social capital, as defined by embedded ties, is to help understand how social structure assists economic performance. In particular, the newfound success of social capital has created new conjectures on how social networks can create competitive advantage over a market-based exchange system (Powell, 1990; Inzerilli, 1991; Perrow, 1992). Thus, while modern economic perspectives offer understanding of how financial and other forms of physical capital improve economic performance, they faintly recognize the influence of social capital on economic performance.

Collective lending can be seen as a tool to increase social capital. As firms understand that their borrowing conditions are dependent upon whether or not others repay, they develop an interest in making sure fellow group members' businesses do well. As they begin to help each other they develop aspects of goodwill, trust, and reciprocity that go on even after the loan cycle(s) is(are) complete. This lending methodology also attempts to break down potentially harmful networks carried over from old economic systems by creating new and varied business groups that can come together to compete against well-connected and established firms. However, one potential downfall of these lending groups is that if and when businesses fail in their loan repayment then the opposite affect of distrust and resentment might occur—creating what many have called social liability or the downside of social capital (e.g., Portes & Landholt, 1996). Below, I report results and formulate arguments that attempt to address how the process in which financial capital is accessed affects the formation of social capital between firms, and thus enhances economic performance of start-up entrepreneurial firms in transition economies.

III. Research Methodology

Field and ethnographic analysis at 44 micro start-up firms and 4 microfinance institutions in 7 separate regions of Bulgaria was conducted. Bulgaria was selected as the research site because of the Central and Eastern European Countries, Bulgaria was the first to receive a financial program that offers loans to microenterprises (Morris, 2000). Thus, while other Central and Eastern European countries have surpassed Bulgaria in the past few years regarding numbers and size of financial institutions offering these micro-loans, Bulgaria has a deeper and more established history of microlending.

The microentrepreneurial sector in Bulgaria, as well as all of Central and Eastern Europe consists of low barriers to entry, which results in firms trying to compete on price because there are few sources of opportunity to create niches in the market. Much of the individuals in the small retail business are self-employed artisans, or engage in service activities, ranging from peddling flowers in street markets to operating a small chain of

computer stores. Because products from suppliers and demands from consumers are limited, economic theory makes strong predictions that social ties should play a minimal role in economic performance (Hirschman, 1970). This type of market setting is thus an extremely cautious setting in which to examine how lending methods facilitate the creation of social capital, and how social capital mediates the effects of financial capital on microenterprises in transition economies.

A representative sample of firms that had received loans from every micro-lending company in Bulgaria was selected (there were only two companies offering such loans). One company offered individual loans in which borrowers were only required to work with the loan officer and get two to three guarantors to vouch for them. The second company offered collective loans in which borrowers were required to form in-groups, where everyone had to qualify for a loan together by making sure everyone had a feasible business growth plan. The borrowers were not required to work with each other or even communicate with one another outside of initial group meetings at the lending organization. These two lending organizations operated in separate cities to account for the bias that may come from the fact that people with a stronger disposition to work collectively may choose collective loans versus individual loans. The firms were selected from lists of all the clients provided by the Directors of each microfinance institution to help decide which firms would offer a sample that would vary in age, sales, product line, employment, location, and type to insure a proper industry representation of small start-up firms in Bulgaria (See table 1). Such precautions helped to minimize the possibility that social capital creation could be attributed to industry homogeneity or size (Portes & Sensebrenner, 1993).

The analysis focused on only the smallest of the formal, legal start-up firms in the major regions of Bulgaria. This was conveniently controlled for because part of the mission of the microfinance institutions is to lend only to the smallest legitimate entrepreneurial firms. The number of employees in the firms owned by those interviewed consisted on average of three employees. Number of employees is used to describe the size of the company in accordance with Eastern European standards. According to the most recent law on small and medium enterprises in Bulgaria, a micro-firm consists of all firms with 10 or fewer employees (Morris, 2000). The average age of the firms interviewed was three years old. However, the average age of the firms when they received their loans ranged from one to two years. Younger firms were not available for analysis because the lending institutions that offered the loans had to make sure that the new company had at least been able to get a footing in the industry. For this purpose, this research was able to look at firms that had a prior opportunity to create social relationships in the industry. It used their social relationships prior to receiving the loan as a benchmark from which to decipher how much the network improved or deteriorated.

The typical small business start-up in Central and Eastern Europe consists mainly of service, manufacturing, and retail companies. The advantages of being a small business entrepreneur, whether in a rural or urban setting, are that there is low entry and exit costs, and low overhead. For many of the entrepreneurs, it was not that expensive to start at a very small level. Often they started the businesses out of a rented stand or shop. The main strategy in business start-up in Central and Eastern European countries is to gather money from friends and family, rent a small stand in the open market, and purchase a few supplies to sell. The only problem with this method is that it almost never affords someone the opportunity to expand the

business. After paying taxes and paying overhead, almost nothing is left for expansion and growth.[1]

This study followed grounded theory building techniques (Glaser & Strauss, 1967; Miles & Huberman, 1984) in order deeper understand how social and economic factors affect start-up firms in transition economies. The in-depth field methods used help provide rich contextual data for theorizing and conducting a detailed analysis of interfirm relationships, how they are formed and how they function. Also, because very little academic research has been done at the microentrepreneur level, a more inductive exploratory approach to this study was necessary to understand what is actually taking place within and between these firms. The study was done in five steps.

First, semi-structured interviews were conducted with the microfinance institutions' directors and at least one loan officer. These interviews tried to get at what was going on and what types of questions should be asked in interviews with the entrepreneurial firms.

Second, loan officers were interviewed and questioned on what levels of firms they lend to, and what the variance between the firms is. This was done to get a picture of the homogeneity of the borrowing firms. A practitioner demographic study that had been done on a large representative sample of the entire small sized firms in Bulgaria was also reviewed. This sample allowed me to see which category the firms that were receiving loans fell into. From this information firms were selected that would offer a representation across the board of all the firms receiving loans from these lending companies. However, this method was not completely void of bias because of the fact that once categories were selected, many of the interviewed firms were selected by the loan officer—who may tend to offer only successful companies.

Third, demographic data was collected from the lending companies on the pre-selected firms for interviewing (e.g., firm age, size of loan, type of industry, etc.). Most of this data was used to control for the effects of social and financial capital on firm performance. Asking these same questions from the business owners themselves also validated this data.

Fourth, the first four interviews were used as more exploratory in order to look for valuable information than presented in the literature. The only difference between these interviews and the ones to follow is that double the normal time was taken to interview the entrepreneurs. These first interviews helped tease out some of the information that was not pertinent to the research objective. All interviews were semi-structured and on site of the start-up firm, so as to allow for field observation as well. The owners and founders of every organization except for two were interviewed. For these two organizations, the next person up in the organization was interviewed, which happened to be the most senior employee of a two- and three-employee firm.

The interview consisted of seven set questions or objectives in order to gather specific information on each firm. However, the questions were only asked at appropriate times in the

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[1] An example can be seen in the activities of one particular borrower under the alias name of Doncho. Doncho had a small cosmetics stand in the open market. He would often work 12-hour days, 6 days a week. He started his business in 1994. For three years Doncho tried to expand his business and move past the start-up phase of simply breaking even. After trying over and over to receive a loan for business expansion, Doncho met up with one of the microfinance institutions in Bulgaria. Within a month Doncho received his first business expansion loan. With this loan he expanded his business by increasing his product line in depth and breadth. Eight months later Doncho received a second, larger loan. With the second loan he rented another stand and hired two people. Within a year's time Doncho was able to almost double his monthly profit. Doncho is only one success story of many, but he demonstrates the difficulty of business growth without access to capital for expansion.

discussion. This was done in order to allow the interviewee to not feel constrained from being able to tell about the relations they had formed with other borrowers. For example, how the loan had affected the firm's growth, and how their social ties had improved or worsened after receiving the first loan was asked. It was directly asked if the interviewee felt he or she had financially benefited not only from the loan, but also from the extra support they had received. Interviewees were also asked how their performance improved—looking for specific examples such as facility expansion, new employees, improved life circumstances, etc.

They were also asked to provide examples of how their social networks had improved. If the interviewee only responded that they have more friends now because of the loan or if they weren't in depth, probing was done to understand what new ties had been created and what this has directly done to improve business. Non-directive questions were used to probe, for example, "Can you tell me more information about any possible relationships you have built after receiving your loan?", and "How have these new relationships affected you and your business?".

After having discussed how their ties had improved or not improved, the entrepreneur was asked to rate the network improvement from a 1 to 7 scale. 1 being no improvement, and 7 being very much improvement. The interviewees was also asked to rate their company's performance before the loan and after they had time to implement the growth strategy to their firm from the loan they had received. The difficulty in this question was to avoid self-reporting bias. Thus, caution was taken to get as many details about the actual improvement of the firm. The interviews also improved construct validity by asking the loan officers to verify on the self-reported improvements made by many of the firms. The results were consistent with what the loan officers said and what the entrepreneurs reported.

Financial statements of each firm were also requested, but only five reports were obtained due to the fact that the accounting that went on in many of the firms was not structured and that many of the firms did not feel comfortable releasing actual financial statements. Notes were taken during all interviews to ensure detail.

The final step came immediately after collecting all the data (so as to not loose the context). Notes were transcribed into a more narrative form. The study also consisted of Likert scales from the interviews and ran ordinal logit comparisons of the likert scores and the archival data. The statistical results are used only to offer support for the qualitative findings of this study. The paper's intent is not to validate the field research, but to offer a starting point for future research on microentrepreneurship in transition economies.

IV. Dependent Variable

A. Performance

A firms performance was determined by subtracting post-condition of company by pre-condition of company and creating a separate variable measuring improved firm performance from time one to time two (pre- and post-conditions are based on a 1-7 Likert Scale--1=poor financial condition, 4=moderate condition, 7=excellent condition). The creation of this variable, rather than regressing each variable in a separate model, is justified in Allison's (1996) notion that if a variable is the same across time, then it is possible to create one variable out of the two and run a single model testing for significance.

V. Predictor Variables

A. Loan Process

Because there are only two types of loans available to the small start-up entrepreneurial sector, the loan process that an entrepreneur had to go through to obtain a loan was put into a binary variable.

B. Social Relationships

The social relationships were determined by in-depth interviews and a self report of how much the entrepreneur's social relationships have improved since the implementation of the loan. A seven point likert scale was used to code the information (1=no effect, 4=moderate increase in business ties, 7=great increase in business ties).

VI. Control Variables

Variables entered into the models as controls included firm size, firm age, and loan size. Firm size was measured using a logarithm of the number of employees, and used because larger firms are more likely to outperform smaller firms. This variable was logged because the data was skewed to the right. The age of each firm was included to control for any advantages associated with increased time for growth and development of social networks or learning curve advantages in performance. Loan size was used to account for improved performance based on the size of the loan.

VII. Findings

A. Field Findings

Entrepreneurs interviewed perceive that the content and structure of ties between firms directly affected firm performance. The overwhelming feeling among those who received collective loans and those who received individual loans is that when a company is embedded in interfirm ties, then their business will do better. Embedded ties (or a strong social network) between firms was perceived as consisting of "you don't help another person with their business because it's good for you. You do business with a person because it's good for them and you have friendship ties." Another popular depicting statement was, "if I'm doing well, and my friend is hurting, I should help him [her] out."

While those who received individual loans felt the importance of social capital, they seemed to have a much more difficult time improving social capital than those who had received a collective loan. Often the entrepreneur who received the individual loan reported that while they have improved their social relationships since receiving the loan, the social relationships they've built have been close in proximity, which were usually people selling or making similar products. It also seemed that the loan had nothing to do with them building more and stronger interfirm ties.

The report from those who received a collective loan had all sorts of stories to relate on how the collective lending process allowed them to meet and work with people whom they never before would have worked. One entrepreneur mentioned "I now have contacts in different lines of business that I can refer my own clients to…in return, he tells his clients about me." One example is seen in a borrower whom I'll call Tonya. Tonya owns a souvenir shop and has a friend, Boris, who owns a sandwich shop. They have become friends from the borrowers meetings and refer their customers to each other about the other's shop. They also

find out from their customers what they think of the other's shop and then meet and give feedback.

B. Statistical Approach

An ordinal logit model was used to estimate the relationships of the independent and mediating variables with the categorical and ordered dependent variable. This means that the actual values taken by the dependent variable do not matter except that larger values are assumed to correspond to "higher" outcomes. And since the data is qualitative by nature, ordinal logit analysis is suitable.

In an ordinal logit model, an underlying score is estimated as a linear function of the independent variables and a set of cut points. The probability of observing a specific performance outcome corresponds to the probability that the estimated linear function, plus random error, is within range of the cut points estimated in the outcome. This equation is written out in (1):

$$P(\text{outcome}_j = i) = P\ (\kappa_{i-1} < \beta_1\chi_{1j} + \beta_2\chi_{2j} + \ldots + \beta_k\chi_{kj} + u_j \leq \kappa_i) \qquad (1)$$

In ordered logit, u_j is assumed to be logistically distributed. The coefficients $\beta_1, \beta_{2,\ldots}, \beta_k$ are estimated along with the cut points $\kappa_1, \kappa_{2,\ldots}, \kappa_{1-1}$, where i is the number of possible outcomes, κ_0 is taken as $-\infty$ and κ_1 is taken as $+\infty$. This is a direct generalization of the ordinary two-income logit model. The coefficients and cut points are estimated using maximum likelihood, and no constant appears because the effect is absorbed into the cut points (Long, 1997)

Table 2 presents descriptive statistics and variable interrelations. Results of the ordinal logit model analyses appear in Table 3. Because of the robustness of the ordinal logit model, assumptions of heteroskedasticity and normality were not violated. Also, ordinal logit models are particularly adept for analyzing data with small sample sizes.

From the statistical tests performed on the measurable data sets obtained from archival and interview sources, this study furthers support for the qualitative findings that the differences in firm performance are effected by whether or not a firm received a collective loan or individual loan, and mediated by how much this improved the firm's social capital.

Social scientists have long recognized the importance of mediating variables in understanding path dependence. Woodworth's (1928) Stimulus-Organism-Response model, which recognized that an active organism intervenes between stimulus and response, is probably the earliest formulation of a mediation hypothesis. The central idea in such a model is that the effects of stimuli (loan process) on behavior (how the firm performs) are mediated by various transformation processes internal to the organism (the formation of social capital). Many social science theorists have shared the belief in the importance of postulating structures and interactions that intervene between input and output (Baron & Kenny, 1986). Positing social capital as a mediator explains how external market events take on inter-firm social significance. Social capital speaks to the issue of why collective loans correlate with higher performance. Social capital is tested as a mediator using the three models in table 3. From the results, it is clear that social capital is a strong mediator between the type of loan a firm receives and firm performance.

Social capital was first regressed on the type of loan a firm received. Second, performance was regressed on type of loan. And in the last model, performance was regressed on social capital and type of loan. The correlations between the appropriate variables in order

to predict perfect mediation (Baron & Kenny, 1986) were all significant ($p < .05$). None of the control variables significantly correlated with performance, and none of them expressed multicollinearity to each other or the independent variables ($p < .05$).

None of the control variables offered significant coefficients to explain for differences due to company size, loan amount, and age. A commonality that was seen in the general sample of the small entrepreneurial firms is that the entrepreneurs were all young firms that only had enough time to get their footing. A strong argument in defense of the importance of social capital is that the average loan size for those receiving individual loans was slightly, but insignificantly higher than those receiving collective loans (see table 3). Financial economics would automatically assume that access to larger amounts of working and investment capital would create greater benefits for the firm, but the results show the opposite.

VIII. Discussion

Though difficult and forlorn with many disadvantages, entrepreneurship is one of the only strategies available for survival and opportunity in transition economies. This trend will continue as Central and Eastern Europe continues in its massive reform efforts. When microentrepreneurs were asked what their main constraints were, they almost always said it was the lack of money and access to credit—as was the case with Doncho, Tonya, and others. Microentrepreneurs not only lack access to credit, but also do not have many productive assets and too little amount of business knowledge. After having lived 45 years under communism, entrepreneurship is still in its infancy. Microentrepreneurs are just now beginning to understand the importance of access to capital as well as the importance of social networks in expanding their business opportunities. Because of the many small stands and companies selling or making the same products, the more successful entrepreneurs are those that can gain the loyalty of regular customers and associates. The social capital networks created among entrepreneurs are invaluable in that they share business tips and help one another to be more competitive.

Microlending companies that provide loans to small start-up entrepreneurial firms are usually able to alleviate these resource constraints. In most cases, however, the networking opportunities from receiving a collective loan helped many businesses obtain new ideas as to ways of improving their services.

In all the interviews conducted, people's gratitude for the loans they received and the social relationships they were able to build as a result was almost unanimous. While some people were not happy with every lending policy, every entrepreneur expressed appreciation for receiving access to working or investment capital. Most of the entrepreneurs had never had a loan before, and most had previously tried for a loan from the traditional sources. One individual who owns a small convenience store said that before receiving a loan, she was bitter at the world—she thought that no one would help the small businessperson struggling in Bulgaria. She only saw the government and foreign organizations helping the big firms. When she received her first loan she regained hope and found more colleagues with whom she could share ideas and receive help. She stated, "They [the lending organization] are the only people who are helping the small business owners here in Bulgaria." These micro-lending organizations are reaching a socio-economic level of people who have not received any type of opportunity to grow in the new free market. With the average repayment rate of 97%, the smallest businesses of Central and Eastern Europe are proving that they can be actual

competitors and contributors in the economy when given access to credit that allows them to create social capital.

These entrepreneurs face many disadvantages and challenges to their survival. They receive no government help or even protection. The one area that can and has shown to be effective in helping the microentrepreneurs is the disbursements of small loans for the businesses to use as working and investment capital in such a way that they are able to come together and help each others' growth and transition to larger firm status. With access to credit, the microentrepreneurs are not only given an opportunity to care better for their families; they are empowered to improve their lives in a manner they feel is most important.

In the 1997 conference on Entrepreneurship in Transition Economies of Central and Eastern Europe, sponsored by the Berkley Center for Entrepreneurship at New York University and the Institute for EastWest Studies, it was concluded that what entrepreneurs need most in transition economies is financing (Watchel, 1999). This paper argues that not only financing for entrepreneurs is important, but that the type of financing offered facilitates opportunities for social capital formation that can then lead to improved performance on top of the effects from financial capital. Those firms that are given networking opportunities are able to utilize this and create social capital, which will boost performance as well. These arrangements facilitate the formation of two implications:

Implication 1: *Collective lending strategies are more likely to improve a start-up firm's social capital than individual lending strategies.*

Implication 2: *Start-up firms with greater amounts of social capital are more likely to outperform firms with less social capital.*

XI. Conclusion

This study examines microentrepreneurial firms by virtue of their newness to the market as well as their creative exploitation of financial capital in regard to social capital formation. Access to financial capital is one source of opportunity for microentrepreneurial firms, but how this capital is accessed can be another source of opportunity for the firm. My intention was to increase understanding of how collective lending strategies facilitate social capital formation, which in turn impact firm performance in Central and Eastern European entrepreneurial start-up firms. I drew upon economic and sociological perspectives to support the research conducted in Bulgaria. The ethnographic data is where the story of social capital in microentrepreneurial firms lies…the statistical data is only a validation of what is taking place in these transition economies. Using a structural embeddedness approach, I proposed that when entrepreneurial firms receive collective loans, versus individual loans, they are more likely to increase their social capital. Thus, when trust and number of ties are increased the influence of financial capital on performance will be enhanced by the mediating effect of the increased social capital.

One limitation of this study is that the statistical analysis is drawing from a small sample size. Future research should focus on obtaining a larger sample so as to be able to make stronger validity claims in backing up the qualitative analysis. Another limitation to this study is that though the location for the research was deliberately chosen for generalizability purposes, a cross-country study would be helpful to make the propositions even more widely applicable.

Not only should research be conducted to further these propositions for smaller firms in transition economies, but they should also offer insight on how large firms in developed economies might benefit from the development of social capital through collective financing strategies found in joint ventures, partnerships, alliances, and so on. Future research should look at how collective finance strategies might offer competitive benefits to firms of all sizes and geographic locations willing to develop social capital with their competitors—thus expanding the important benefits that come from collective financing strategies that develop trust, goodwill, and reciprocity in a competitive open-market environment.

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TABLE I
Interviews with Microentrepreneurs

Business Focus	Business Sector
Travel agency	Tourism
Independent Taxi Driver	Service
Shoe store	Retail Sales
Clothing store	Retail Sales
Cosmetics store	Retail Sales
Auto parts distribution shop	Retail Sales
Aquarium store	Retail Sales
Produce Store	Retail Sales
Dental supply company	Retail Sales
Convenience store	Retail Sales
Shoe store	Retail Sales
Leather goods store	Retail Sales
Book store	Retail Sales
Women's clothing store	Retail Sales
Kitchenware store	Retail Sales
Novelty store	Retail Sales
Convenience store	Retail Sales
Sporting goods store	Retail Sales
Cosmetics shop	Retail Sales
Car parts machine Shop	Manufacturing
Wood product manufacturing plant	Manufacturing
Printing Press	Manufacturing
Furniture manufacturing company	Manufacturing
Window blind manufacturing company	Manufacturing
Furniture Manufacturing company	Manufacturing
Advertising firm	Management Services
Dental office	Health Services
Pharmacy	Health Services
Pharmacy	Health Services
Pharmacy	Health Services
Sweet shop	Food Services
Bread store	Food Services
Restaurant	Food Services
Restaurant	Food Services
Restaurant	Food Services
Sweet shop	Food Services
Sweet shop	Food Services
Fur hat manufacturing company	Apparel Production
Nightwear manufacturing company	Apparel Production
Clothes manufacturing company	Apparel Production
Seamstress	Apparel Production
Designer clothes manufacturing company	Apparel Production
Total	**42 Interviews**

TABLE II
Descriptive Statistics and Partial Correlations (N = 39)

Variable	Mean	S.D.	Min.	Max.	1	2	3	4	5
1. Firm size	2.58	5.09	0	25					
2. Firm age	3.09	2.31	0.5	9	0.48				
3. Loan amount	392.85	1133.82	500	7000	0.48	0.37			
4. Social Capital	4.76	1.84	0	7	-0.04	0.09	-0.27		
5. Loan Type	1.25	0.44	1	2	-0.25	-0.11	-0.54	0.69	
6. Firm Performance	1.45	1.10	0	4	-0.17	-0.19	-0.47	0.52	0.51

TABLE III
Results of Ordinal Logit Analyses (N = 39)[1]

	Social Capital	Performance	
Variable	Model 1	Model 2	Model 3
Firm size	-0.01	-0.00	-0.01
	(0.06)	(0.08)	(0.08)
Firm age	0.29	-0.04	-0.09
	(0.19)	(0.15)	(0.15)
Loan amount (USD)	0.00	-0.01	-0.00
	(0.01)	(0.01)	(0.01)
Loan type	5.19**	1.65*	0.28
	(1.17)	(0.81)	(1.03)
Social capital			0.48*
			(0.22)
Cut 1	-1.41	-2.49	-1.05
	(0.91)	(1.03)	(1.21)
Cut 2	-0.95	-0.77	0.89
	(0.81)	(0.95)	(1.23)
Cut 3	0.42	0.80	2.57
	(0.69)	(0.97)	(1.28)
Cut 4	1.94	3.39	5.16
	(0.75)	(1.36)	(1.59)
Cut 5	3.49		
	(0.97)		
Cut 6	4.31		
	(1.07)		
Degrees of Freedom	4	4	5
Log Likelihood	-54.34	-49.57	-47.16
LL χ^2 ratio test	32.03**	14.13**	18.94**
Pseudo R-squared	.23	.13	.17

[1] Standard errors are in parentheses.

* $p < .05$, ** $p < .001$; two-tailed test for variable coefficients.