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ADVICE TO NEW BUSINESS FOUNDERS: EFFECTS ON PERFORMANCE AND DIMINISHING MARGINAL RETURNS (SUMMARY)

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SUMMARY

ADVICE TO NEW BUSINESS FOUNDERS: EFFECTS ON PERFORMANCE AND DIMINISHING MARGINAL RETURNS

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Principal Topic

This paper investigates the association between the number of sources of advice entrepreneurs utilize and subsequent performance. Specifically, we explore diminishing returns to scale between the amount of advice received and performance.

The emerging theory of outsider assistance suggests that outsider assistance leads to creation of knowledge that positively influences performance. At some point in the learning process an entrepreneur will have obtained most of the relevant information, and obtaining advice beyond this point will have a detrimental effect on performance. Social network research present similar findings; a larger network is more likely to provide entrepreneurs with more information and more non-redundant information. An inverted U-shaped relationship between network size and performance has been suggested, resulting in an optimum level of resources that should be devoted to networking. The purpose of this research is to apply these propositions to a representative sample of new businesses in Norway.

Method

A random sample of 309 young business owners reported on advice received in 2002 and performance in 2004. Three dependent variables of business performance were applied; invested capital, sales turnover and employment. The independent variable is constructed by advice given by 12 different actors during the business gestation process.

Results and Implications

The advice variable is significantly positively associated with all three performance variables, while advice squared has a statistically significant negative effect. This suggests diminishing returns to scale. The optimum level of number of resources is between five and six for all three dependent variables. Thus, on average, there seems to be a positive effect of advice on performance up to approximately five different sources. The results indicate that utilizing more than six sources has a negative effect on performance.

Entrepreneurs should pay attention to the importance of advice and focus on the quality instead of quantity. Further information from more advisors may prove non-redundant and the cost of resources used to access this information may outweigh the benefits. Policymakers might consider changing the focus of advice services they initiate to better reflect the needs of entrepreneurs.

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