

HUMAN RESOURCE MANAGEMENT IN MICROENTERPRISES: GATEWAY FOR SUCCESS*

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ABSTRACT

Micro enterprises, businesses with five or fewer employees, represent about 75% of all small business, and are often the starting point for successful firms. Why then is there a paucity of research on human resource practices in small businesses? Micro businesses are almost ignored in studies regarding human resources in business. Researchers have assumed that all small firms have the same human resource practices; however, we know this is not the case. What impact does Human Resources Management have on small businesses? Human resource shortages can negatively impact business growth in the areas of high tech employees, sales staff, and professional workers. This study explored key human resource practices in micro businesses, especially on the relationship between sales, benefits, training opportunities and hiring expectations within micro enterprises. Our findings on human resources management showed that only 25% of responding micro entrepreneurs provided paid vacations, 12.9% offered health benefits, and 10% offered some type of retirement plan. Also, organizations with higher sales provided more benefits and training opportunities than other micro businesses.

Key words: small business, micro enterprise, human resources management

EXECUTIVE SUMMARY

Micro enterprises, with five or fewer employees, are the smallest units of business possible. From sole proprietorships up to five employees, these ventures often grow into medium- or large-sized operations. Micro enterprise accounts for approximately 20% of new jobs and comprises over 75% of small businesses (U.S. Census Statistics of U.S. Businesses and Nonemployer Statistics, 2006).

While there are several organizations which focus on small business, The SBA, NASE (National Association of the self-Employed), and SBIR (Small Business Innovation Research) more information is needed to assist these new job creators. They are often overlooked in research since many assume all small businesses have the same Human Resources (HR) practices (Kok & Uhlaner, 2001). Therefore, one unexplored area of entrepreneurship is how small businesses develop and manage HR. This study looks at the intersection of micro business and their key HR practices.

A survey was conducted using a 45 item questionnaire mailed to 9,184 micro businesses in the State of Maryland. A total of 959 usable responses were gathered and analyzed using SPSS. Many of the questions asked for multiple responses in areas such as anticipated trends in

hiring, types of human resource shortages, approaches to training, benefits, paid vacations, and retirement benefits. Questions were also asked about forecasting of expenditures over the next twelve months, assessments of success factors, and predictors of challenges.

Well over one-half of respondents had been in business for over ten years. Only 32.4% were sole proprietorships, a much lower percentage than the national average of 71%. The mean number of either part-time or full-time employees, other than the owner, was 2.7 workers. Investments in employee benefits and training were low overall, but rose as sales increased. Those owners with more education tended to provide more training and benefits. In fact, 75.9% of respondents expected their employment numbers to stay static over the next twelve months. The shortage of sales staff, high tech workers, and professional staff in micro enterprises limited their business growth. Also, a very low 2.7% of respondents used the Internet for recruiting and less than 1% outsourced the recruiting function, impacting their businesses.

To encourage micro business owners to compete with larger companies in recruiting and retaining employees, more training opportunities that are easy to implement and are affordable for the very small enterprise are needed. Coordinated avenues for shared, specialized business services would also support business growth in micro enterprises.

INTRODUCTION AND LITERATURE REVIEW

There is a real lack of information about HR practices in small firms (Dun and Bradstreet, 2001; Cardon & Stevens, 2004; Gilman & Edwards, 2008; Heneman, Tansky, & Camp, 2000; Hornsby & Kuratko, 1990, 2003; Howard, 2001; Mazzarol, 2003). For too long, assumptions have been made that considered small firm Human Resources Management (HRM), as an operationally scaled down version of large firm HRM (Gilbert & Jones, 2000; Katz, Aldrich, Welbourne, & Williams, 2000; Kerr & McDougall, 1999). In addition, it has also been assumed that small firms are homogeneous in terms of their HR practices, regardless of whether they have less than 4 employees or one hundred employees (Kok & Uhlaner, 2001). As small business practitioners, consultants, and researchers, we are aware this is not the case in a small business operation. In fact, research has shown that as a company grows, HR practices become more formal (Kok & Uhlaner, 2001). Furthermore, some early research has shown a big difference between very small firms - businesses with less than twenty-five employees - and large firms due to less formal HR policies (Wagar, 1998).

It is this lack of information on the HRM of small businesses that must be rectified. More recently, and because so often the prime focus on small business is on the financial aspects of the firm, there is more interest shown in looking at HR practices in the small enterprise as a path to better customer relations and firm success (Klaas, 2003; Rauch, Frese, & Utsch, 2005; Rogg, Schmidt, Shull, & Schmitt, 2001; Singh & Vohra, 2005; Tocher & Rutherford, 2009; Utsch & Rauch, 2000).

Management Control Systems (MCS), of which HRM is considered a key part, are shown as an important link to the growth of early stage startup companies (Davila & Foster, 2007). The

accumulation of human capital is considered the main engine of macro-economic growth (de Kok, 2003). In Ireland, it has been shown that employment models which adopt an integrated approach in the bundling of HR practices underpin the business strategies of emerging high-tech companies and are more apt to be successful (Olivares, 2004). Furthermore, many researchers and practitioners believe that HRM practices relating to selection, development, retention, and motivation of the small enterprise workforce are associated with firm performance. In addition, gaining access to a workforce that produces superior output is key to micro firm success (Hornsby & Kuratko, 1990; McEvoy, 1984; Way, 2002).

In a study by Hess (1987), discussed in Hornsby et. al (1999), small business owners rate HR practices as the second most important management activity next to general management work (Hornsby, Kuratko, LaFollette, Hodgetts, & Cox, 1999). Dun and Bradstreet (2001) found managerial incompetence, particularly in HR managers, is a main cause of failure for small businesses. Employees in small firms “are frequently the key factor distinguishing successful from unsuccessful ventures” (Hornsby & Kuratko, 2003, p. 73). It is difficult, however, for the small or even medium-sized enterprise to justify the added costs of a professional HR manager, despite the benefits of one. Therefore, most small company owners or managers perform the functions themselves – although sometimes poorly - or turn these responsibilities over to untrained staff members who perform many different of duties (Ghassemieh, Thach, & Gilinsky, 2005; Hornsby & Kuratko, 2003).

These early efforts to allocate HRM are critical to the ultimate HR blueprint developed by the venture and will live on sometimes long after the founder is gone (Katz & Welbourne, 2008). Edgar Schein has long held that organization culture and norms are established by the actions of the founder in the early stages of growth, thus causing the early HRM practices to have even greater impact over time (Schein, 1995).

Since microenterprises – with five or less employees - are the smallest unit possible for a small business, the HR blueprints of these companies are hardly developed and there are no professional HR managers on payroll. At the microenterprise unit level of business, the owner wears the HR manager hat, along with many other hats. What are the practices, issues, and needs of these very small enterprises? Due to the scarcity of research on HR practices in small businesses, no research exists that looks at these, the smallest of enterprises.

Our current study, based on responses of 959 microenterprises in Maryland, attempts to address what HR practices are in these very small businesses. The study, exploratory in nature, provides descriptive data on HR issues and practices, as well as their relationship with variables such as sales, years in business, gender, and education level.

Microenterprises are important to the economy, to job creation, and to innovation in business. They comprise more than one-half of all small businesses, many of them starting out or operating long-term from home (SBA, 2004, 2009). Despite the overwhelming number of micro businesses, however, there are very few studies on micro enterprises in general and, specifically, on the nature and role of HRM. This research focuses on the HR practices of micro firms and the relationship between sales, benefits, training opportunities and hiring expectations within micro

enterprises.

Until recently, the development of microenterprises focused on third world economies, despite the fact that microenterprise development was a successful pathway to financial independence in the United States (Guste, 2006). In the 1980s, microenterprise development programs, or MEDs, were formally initiated as an attempt to assist women, minorities, and disadvantaged individuals in starting businesses. At that time, it had been established that the traditional support network for small business startups was not working for these particular groups. MED programs were modeled after those developed for use in LDCs, less developed countries (Else, et al., 2001; Jurik, 2005). Since the start of these programs, more attention has been paid to microenterprise growth in the United States and the importance of its role in entrepreneurship. However, there has still not been as much research as there should be, considering that so many businesses in America are microenterprises (Anthony, 2006).

Even though the area of micro enterprise has not been a key area of research in entrepreneurship, it is clear from these studies that micro businesses are critical to entrepreneurship in general. All businesses begin as micro enterprises and many remain small over the life cycle.

Research Questions

In recognition of the lack of research on micro enterprises, particularly in HRM, the primary purpose of this paper was to obtain information about HR practices in micro businesses including various HR opportunities and challenges. The variables of sales, gender, years in operation and education are compared.

Research question #1:

What proportion of microenterprises employ more than the owner and how many of these employees work at home versus work at an office; work full time vs. part-time?

Research question #2:

Do microenterprises plan to hire more employees the longer they are in business?

Research question #3:

Do microenterprises tend to outsource HR functions? Which functions?

Research question #4:

Do sales impact the provision of employee benefits?

METHODS

This exploratory study looked at the intersection of two understudied areas of entrepreneurship: micro enterprise and HR practices in these small business operations. This study developed a survey from the literature and conversations with entrepreneurs. A questionnaire consisting of 45 questions was mailed to a list of 9,184 micro businesses obtained through a national list compiler. The mailing list used was compiled via telephone surveys and consisted of micro enterprises in the State of Maryland with 0-4 employees. A total of 959 usable responses were gathered for a response rate of 10.44%, well within the desired response to a

survey mailing (Fowler, 1998; 2002).

An offer was extended to participants as an option to receive a copy of the study if they provided their names and addresses. Alternatively, participants could opt out and return anonymous answers to the surveys if they did not wish to reveal their names. Survey questions were formulated based on extensive interviews with practicing micro enterprises. The interview data was analyzed and questions were designed based on the analyses. The survey consisted of questions which required nominal responses to hiring, benefits and other personnel issues. Responses were data entered and analyzed with Excel and SPSS. Descriptive and inferential statistics were conducted such as frequencies, means and Pearson's Correlations.

RESULTS and DISCUSSION

The demographic composition of the 959 usable responses is detailed in Table 1.

Table 1: Demographics

N=959		Education	
Gender	%	Not HS Diploma	%
Female	30	High School Diploma	1.1
Male	70	Some College	17.3
		2 year Community College	21.2
		4 yr Degree	5.9
		Graduate degree	29.8
Ethnicity	%		24.0
Caucasian	91.8	Marital Status	%
Hispanic	2.9	Married	81.0
Native American	1.1	Single, Divorced	10.2
African-American	0.7	Single, Never Married	5.3
Oriental	0.6	Widowed	2.9
Other	1.5	Sales	%
Age	%	< \$10 K	4.8
< 28	1.4	10-25K	2.9
29-43	14.5	25-50K	6.7
44-62	62.5	50-100K	12.4
> 63	20.6	100-500K	41.8
		500-1,000K	11.3
		> 1,000K	15.3
Ownership	%	Length of time in Operation	%
Sole Proprietorship	32.4	< 1 yr	0.8
Partnership	3.6	1-3 years	8.4
Limited Liability	20.0	4-6 yrs	12.6

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Corporation	16.9	7-10 yrs	14.2
S-Corporation	24.9	> 10 yrs	64.0
Other	1.1		

Despite the known data of small business failures, 64.0% of the respondents reported being in business for over 10 years.

Organization-wise, 34.4% were a sole proprietorship and nearly 62% were structured as a corporation. This is contrary to the 2009 national average where 71% were sole proprietorships and 25% were corporations (Shah, 2011, p. 69).

Annual revenue of over \$500,000 was achieved by 26.6% of the participants, while only 14.4% had annual sales of less than \$50,000. The demographics of Maryland's microenterprises are strikingly similar to those determined in Bailey et. al.'s (2008) survey of Nebraskan rural microenterprises. MD's self-employed (sole proprietors) micro entrepreneurs were 32.4% of the respondents, very similar to the 36% from NE. Likewise, 11% of MD's gross sales were over \$500,000 and 18% of NE's were as well. However, MD surpassed NE in sales over \$1 million with 15.3% of microenterprises as opposed to NE's 8%.

Table 2: Number of Full-time and Part-Time Employed

Number of Unique Micro Businesses with Employees other than Owner N=548	Part-time Mean	Full-time Mean	Total Employees Mean
	1.6	1.2	2.7

As Table 2 shows, of the 959 total respondents, 548 or 57.1% employed at least one full- or part-time employee. Out of those businesses, the mean of part-time employees was 1.6 and full-time at 1.2. The mean of total employees is 2.7, emphasizing the very small size of these enterprises. Of the full-time employees, 69.5% worked in the office, with the balance working from their own homes. Of the part-time employees, 56.5% worked in the office, while the remainder worked from their own homes.

Participants were asked what areas they planned to invest in over the next 12 months. Interestingly, only 16.7% stated they would invest in employee benefits and 23% that they would invest in employee training.

Table 3: Investment in Employee Benefits & Training over the next 12 months by Educational Level of the Owner

N=959

Numbers in %

No High School Diploma	High School Diploma	Some College	2 Yr Community College	4 yr Degree	Graduate Degree

Benefits	27	10	15	12	20	19
Training	18	14	24	28	27	23

Examining the results by educational level revealed those with no high school diploma were the most apt to provide benefits. However when it came to training, those with some college through graduate degrees were more likely to invest in training for employees (Table 3).

Table 4. Investment in Employee Benefits & Training over Next 12 Months by Sales of Enterprise
N=959

Numbers in %	< \$10 K	10-25K	25-50K	50-100K	100-500K	500-1,000K	> 1,000K
Benefits	6	4	2	6	17	26	32
Training	11	11	6	11	19	42	47

Not surprisingly, as Table 4 shows, those enterprises with higher sales were more inclined to invest in benefits and training. This is similar to findings in a study of high performing, fast growth firms and the importance of training and development (Carlson, Upton, & Seaman, 2006). In these high performing firms, more importance is placed on training and development of employees than in low performing firms (Carlson, et. al, 2006). This was reflected in our study, where we found that higher sales firms were more likely to invest in benefits and training than were lower sales firms. Additionally, enterprises with higher sales were more likely to employ more people, $r = .308, p < .001$.

Only 16.6% of the respondents expected the numbers of employees, whether part-time or full-time, to increase over the next 12 months; 7.2% expected a decrease in employment while 75.9% expected their employment numbers to stay the same.

Roughly one third of respondents considered having a trained workforce as one of three top factors critical to their future success and business growth. In addition, 20% of respondents considered finding and keeping qualified employees one of three top factors as a major challenge to future business growth. Furthermore, only 21% considered healthcare costs as one of their three top challenges. This finding relates to Williamson (2000) who found that successful recruiting of employees is consistently rated as one of the most important factors related to success. These findings also are supported by Bailey et. al (2008) who found in their Nebraska study that concerns were expressed by rural micro entrepreneurs about a shallow workforce pool for small business owners from which to draw employees. The greatest needs expressed were

those concerning attracting, recruiting, and retaining employees in this limited labor pool. Often, senior managers in small enterprises articulate main problems related to HRM as “attracting talent, motivating employees, and retaining key employees” (Singh & Vohra, 2005, p. 57). The HR areas where shortages limited the business growth are listed in Table 5.

Table 5: Human Resources Shortages Affecting Business Growth by Gender and Years in Business
N=959

Numbers in %

<u>Area/Skills</u>	<u>Total</u>	<u>Female</u>	<u>Male</u>	<u>1-3 yrs</u>	<u>4-6 yrs</u>	<u>7-10 yrs</u>	<u>> 10 yrs</u>
High tech	12	13	12	14	12	7	13
Machinists	2	1	2	7	2	1	1
Sales	22	21	22	27	26	15	22
Construction	5	2	7	5	5	7	5
Services	5	5	5	14	5	4	4
Managers	5	5	6	6	7	4	6
Clerical	9	10	8	5	12	10	9
Professional	10	8	10	11	10	7	10
Other	5	6	5	6	5	4	5

Note: Respondents checked more than one job area.

The respondents identified the need for sales staff, high technology workers and professional staff as areas which limited their business. It is possible that, due to the very small size of the firm, recruiting practices are inconsistent and it may be more difficult for a small firm to competitively hire than for a large business, as discussed in Williamson (2000). Unlike larger firms who have more consistent recruiting practices, only 2.7% of respondents used the Internet for recruiting. Also, less than 1% of the respondents outsourced the function of recruiting to a more qualified professional.

As Table 6 shows, taxes, legal matters, bookkeeping, and advertising were the largest areas of outsourcing. These functions require specialized skills that many micro businesses may not possess. The other functions may be divvied up among the employees, or not done at all.

Table 6: Outsourced Functions

N=959

Tax	29.6%
Legal	16.5%
Bookkeeping	12.1%
Advertising	10.4%
Website creation	9.1%
Technical	9.0%
Collections	2.1%
Recruiting	0.9%
Sales	0.7%
Management Consulting	0.7%

Market Research	0.6%
Other	0.5%
Business Strategy	0.4%
Customer Service	0.3%
Product Development	0.3%

Benefits offered by microenterprises were generally low. However, as firms grow and sales increase, more benefits may be added. Thus, viewing the assortment of provided benefits can be misleading as the benefits are skewed towards larger firms and not representative of smaller enterprises.

Overall, microenterprises provided benefits in low numbers (Table 7). Only 23% of those businesses with sales greater than \$1 million offered sick leave and only 31% had paid vacations. Approximately 25% offered health benefits while, 26% of these firms offered bonuses for performance. Vacations did not become consistent a benefit in micro enterprises except in businesses reaching revenues of \$100,000 or more. 21.9% of the respondents offered paid vacations, 12.9% offered health benefits, and 10% offered a retirement plan of some sort. Some prior research has shown that more than 60% of small businesses do not offer any retirement plan to employees (Girard (2006) in Wang, Trent, & Parsons, 2009). However, in Wang et. al's (2009) study, 57.9% of the surveyed businesses, with less than 20 employees, offered retirement plans. Businesses with less than 5 employees, however, were less likely to offer retirement plans (Wang, et al., 2009).

Table 7: Benefits Provided by Sales of Firm

N=959

Numbers in %

	<u>< \$10 K</u>	<u>10-25K</u>	<u>25-50K</u>	<u>50-100K</u>	<u>100-500K</u>	<u>500-1,000K</u>	<u>> 1,000K</u>
Vacation	4	4	2	13	25	31	31
Sick leave	0	4	2	8	17	24	23
Health benefits	2	4	2	5	13	23	24
Dental	0	0	0	1	5	9	07
Retirement Plan	2	0	0	4	10	19	18
Stock options	0	0	0	0	0	1	1
Profit sharing	0	0	0	1	3	7	7
Child/Eldercare	0	0	0	1	0	2	0
Flexitime	0	4	3	7	6	6	5
Bonuses	2	4	5	8	7	22	26
Life insurance	2	0	0	0	4	7	7
Tuition reimbursement	0	0	0	1	3	6	3
Other	4	0	6	5	1	0	1

It was not surprising to see benefits increase as sales went up. In his research, McEvoy

(1984) found the benefits most often offered by small businesses were; holidays, rest breaks, life and health insurance with pensions, and vacations. These benefits were only offered by about one-half the firms.

In another study of small firms, 45.6% of the respondents used financial rewards such as bonuses to motivate employees (Kuratko, Goodale, & Hornsby, 2001). In addition, Carlson (2006) found high-sales growth performing firms used more cash incentive compensation than smaller firms, at every level in the organization.

In reference to training, 18.7% of respondents depended on the Chamber of Commerce for workshops while 10% used the Internet for training. This may point to the need for governmental assistance, as these firms cannot afford private training.

IMPLICATIONS AND APPLICATIONS

This research study just begins to address HR practices in very small ventures or micro enterprises. Not only has there been a real lack of research about HRM in small businesses, micro businesses are entirely overlooked in larger studies of HRM of businesses. Micro business, however, represents about half of all small business, and is often the starting point for potentially large, high growth, very successful firms. In terms of the business organization, there were more corporations (62%) than sole proprietors (32%) in the State of Maryland, which is unusual when compared to the national average of 71%. This may be due to the tax and liability provisions in Maryland. Or, at play may also be the fact that because there is an excellent service provider network in the state and forming a corporate entity is most often the advice given to business startups.

Micro enterprises offer a distinct pathway to success for so many people; from those recently laid off, to women, minorities, disabled, and others who have more difficulty in the traditional workplace. Micro enterprises tend to offer stable employment for their workers. This finding is substantiated by the 76% of respondents who planned to maintain their workforce in the next twelve months. The majority of both full time employees (69.5%) and of part time employees (56.5%) tend to work at the business location, as opposed to the owner's home. This is a strong indicator of the firm's potential growth and sustainability. Having a trained workforce, finding and keeping qualified workers and concerns about healthcare costs were the top three challenges for micro businesses in our study. Even the smallest firms offered some benefits to employees. The top benefit offered was paid vacations. Other benefits included health care, retirement, dental and bonuses. Micro business owners with an education higher than a high school degree were more likely to provide training, an area that falls under HRM, than their counterparts who did not possess a diploma (14% vs. mid-high 20% for some college to graduate degrees). This may be due to the owners' appreciation of and their perceived value of having well trained employees. However, overall, it is good news for micro businesses as they are apt to be less competitive than large businesses so being able to offer training programs to employees will help level the playing field in recruiting and retention. Training is also a method by which

organizations motivate employees. With the micro business's focus on training, one of the greatest needs expressed in Williamson's (2000) Nebraska study that found successful recruiting is consistently rated as one of the most important factors related to success as well as the Bailey et. al (2008) Nebraska study concerned attracting, recruiting, and retaining employees is addressed.

A link was found concerning the level of sales and the number of employees. As the level of revenue increased, the business hired more employees ($r=.308$, $p<.001$). The most important skills that micro businesses were looking for in potential employees were: sales, high tech, and professional services. This finding points to the lack of or need for professional staff in many of these entrepreneurial ventures. Since employees in these small ventures wear many hats, an unsurprising finding is, overall, very few functions were outsourced. In fact, the top function, accounting and tax preparation, was only outsourced by 30% of the participants. Such a small percent infers that these micro business owners perform nearly every function in house and it also points out the need for more training in the myriad of skills needed to start and operate a business today.

Surprisingly, the majority of these Maryland businesses were in operation longer than ten years, no doubt serving as a major component of the economic engine for the State. A key finding of this study is the impact a micro entrepreneur's level of education has on the training and benefits offered by the business. It appears that micro entrepreneurs with more education place more value in continuous education and training, and therefore tend to invest more in employee training than owners with less education do. Those micro business owners without a high school degree may not have an appreciation for employee development, and therefore offer less training to employees, which can be detrimental to recruitment and retention.

Since having a trained workforce is a major success factor, small firms may wish to consider adding more training and development benefits for their workforce. Most workers are drawn to organizations where they have opportunities for personal development. In fact, larger corporations are often more attractive to quality workers for exactly this reason; their opportunities for development are much higher. Therefore, micro enterprises must understand that they compete with large firms for quality workers and that they need to provide at least some training opportunities in order to have a reasonable chance to recruit successfully. A limited approach to training and development will not meet the needs or desires of their workers. Furthermore, by not investing in worker training, micro businesses may be jeopardizing their firm's long-term success.

Even with the dismal state of the economy and a near double digit unemployment rate, 76% of micro businesses expected to maintain their level of workers and 16.6% anticipated adding workers. This supports the conventional thinking that these small businesses, poised to hire, are still the engine of economic growth. Since these firms are maintaining or planning to add employees, local, state and the federal government should be providing assistance via financing, training, or tax incentives to ensure these firms grow.

Micro businesses cannot hire specialists in every area. Given the small size of these firms,

there needs to be a coordinated avenue for accessing shared services provided by business incubators, Chambers of Commerce, SBDCs, and business cooperatives where specialized services can be obtained at discounted group rates. Referral lists for specific professional and IT services need to be offered to these businesses as well. The top three areas which limit micro enterprise growth were sales training, high technology (programming, IT), and professional skills (accounting, law, etc.). Sales, professional, and high tech training needs to be provided to enable these firms to prosper and grow. Interestingly, healthcare was not a key challenge for nearly 80% of the respondents. Given the passage of the Affordable Health Care Act, it appears the remaining 20% microenterprise concerns will hopefully be addressed as well.

FUTURE RESEARCH

Although, this study looked at some key HR areas in micro businesses in the State of Maryland, more research needs to be done. A qualitative study is under development that will include semi-structured interviews of micro enterprise owners. The new study will explore the early development stages of micro enterprises HRM blueprints that underpin and support organizational changes and growth.

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