SECTION 1. Macroeconomic processes and regional economies management

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Factors influencing performance of tourism and hospitality entrepreneurial businesses in West Virginia

Abstract

Entrepreneurship has been recognized as an important factor in the process of economic growth, development, creation, and poverty reduction. The paper examines the factors that influence the tourism and hospitality businesses of the Appalachian region of West Virginia. The findings suggest that factors such as the entrepreneur's age, efficiencies due to innovation, education, and training are responsible for increasing profitability in West Virginia's tourism and hospitality services. A lack of competition and a poor legal structure with inefficient fiscal policies are barriers to a firm's profitability and growth. The lessons learned are highlighted and provide insights concerning what it takes to be successful at setting up a new entrepreneurial business in West Virginia.

Keywords: tourism and hospitality entrepreneurial businesses, business performance, economic growth and poverty reduction.
JEL Classification: M20, M21.

Introduction

Entrepreneurship has been considered a driving force that generates new opportunities for wealth and job creation, economic growth, and poverty reduction (Sauser, 2005; Yago et al., 2007). The positive relationship between entrepreneurial development and economic growth has been documented in both underdeveloped and developed economies (Harris and Gobson, 2006; Monk, 2000). It is critical that the entrepreneurial firm's dynamics are well understood to better guide entrepreneurial decisions and policy formation in the areas that are economically underdeveloped or depressed.

The West Virginia economy once was dominated by mining and manufacturing. Today both industries are in decline while tourism and government services are developing and growing. With the relative proximity of Washington, D.C., and other eastern cities, West Virginia's mountains, forests, and rivers, provide opportunities for the growth of entrepreneurial businesses within the tourism and hospitality sector.

Several authors have identified the development of hospitality and tourism services as an important source of economic growth and job creation (Getz et al., 2004; Carlsen at al., 2001) and analyze the factors affecting the performance of entrepreneurial businesses within tourism and hospitality service (Haber and Reichel, 2005). This paper contributes to the existing literature by investigates various factors influencing the financial performance and success of small tourism and hospitality businesses that operate in West Virginia. The model presented addresses the effect of human capital factors, innovation, family business history, government regulation, industry grouping and competitive forces on the level of economic profit. Based on the empirical results some policy recommendations are provided.

1. Economic background on the Appalachian state of West Virginia

West Virginia, "The Mountain State", derives much of its identity from the Appalachian mountain range which covers most of its territory and is home to many national and state forest and wilderness areas. Downhill skiing, quiet Nordic paths, whitewater rafting, and biking and hiking paths can be found along high ridges and in the woods. Fishing, hunting, and rock climbing all provide the environment for tourist and outdoor recreation activities and have created an environment for the development of tourism and hospitality services (Witt and Leguizamon, 2007).

West Virginia traditionally has been in a poor economic position relative to other states. Numerous jobs in the coal industry were lost in the 1980s and 1990s which created high unemployment rates and poverty within the state. Employment also declined in the manufacturing, steel, and chemical-processing industries. These job losses resulted in a migration of young people to other regions with the older age groups remaining in the area (Witt and Fletcher, 2005).

In the 1980s the state government began responding to this situation by promoting greater economic diversity through the development of a larger service sector. The West Virginia Development Office created several initiatives that emphasized the comparative advantage of the state's natural resources, its relatively new interstate highway system, and its location. The state also benefitted from a new appreciation of Appalachian culture and art as artists and novelists helped awaken the nation to West Virginia's beauty while historians, sociologists, and anthropologists began to create a new body of scholarly interest and work about the region (Rasmussen, 1994; Rice and Brown, 1993). As a result many family businesses within tourism and hospitality industry have developed in Appalachian West Virginia. Today, tourism and hospitality is one of West Virginia's fastest growing industries and makes an important contribution to the development of the West Virginia's economy (Witt and Fletcher, 2005).

West Virginia still fails to embrace market capitalism despite the initiatives and programs of the 1980s and 1990s. The Pacific Research Institute's Economic Freedom Index that measures the regulatory and fiscal obstacles imposed by each state on its residents ranks all states according to the extent to which they embrace capitalism or free market policies (Public Policy Institute of New York State, INC. http://www.ppinys.org/reports/jtf2004/econfreedom.htm). In 2007, West Virginia ranked 32 indicating that the state does not fully embrace the principles of capitalism while organizing its economy; many resource allocation decisions are highly regulated by the state government.

West Virginia also ranked 34th in the 2007 Tax Foundation's State Business Tax Climate Index but moved up and ranked 23rd in 2012 (The Tax Foundation: http://www.taxfoundation.org/research/show/22658.html). This index compares states in five areas of taxation that affect business: corporate taxes, individual income taxes, sales taxes, unemployment insurance taxes, and taxes on property, including residential and commercial property (Atkins and Dubay, 2007). The State Business Tax Climate Index has improved, and the state moved from the 20th position in 2011 to 18th in 2012. The Unemployment Insurance Tax Component of the State Business Tax Climate Index has changed from a rank of 30th in 2010 to a rank 26th in 2012.

The 2007 ranking of the Beacon Hill Institute's State Competitiveness Index indicates that West Virginia ranked near the bottom (47th) but improved to 42nd in 2011 (BHI State Competitiveness Report: http://www.beaconhill.org/Compete11/Compete2011.pdf). This index measures the long-term competitiveness in each state, and since all states face similar macroeconomic conditions, such as national fiscal, monetary and trade policy, they differ from one another only in their microeconomic policies such as tax and regulatory regimes, provision and emphasis on education, and attractiveness to business. West Virginia exhibits both micro- and macroeconomic inefficiency in relation to the other states.

West Virginia ranks low (41st) in the Cost-of-Doing-Business Index which reflects the state's comparative disadvantages in attracting and retaining businesses (Milken Institute Publication: http://www.milkeninstitute.org/publications/publications.taf). West Virginia is a state with a high cost of doing business, and the fundamental business costs of labor, taxes, real estate, and electricity are relatively high. West Virginia appears to present a hostile environment for capital investment and business development. The indexes for nations in other parts of the world, such as Estonia, Latvia, and Slovenia, have a more capitalist-based policy environment than West Virginia.

Over the last several years, the state government of West Virginia has undertaken steps to promote growth of the entrepreneurial businesses in the region. Some of the most recent reforms include reductions in business tax rates and privatization of workers' compensation (Sobel, 2007). While these reforms are encouraging, there is much more that needs to be done as the current state policies resulting in higher costs of doing business, high financial barriers, poor infrastructure, and lack of competitive market structure discourage creation of small entrepreneurial businesses. State policies that promote the operation and dominance of large chain businesses at the same time prevent small entrepreneurial businesses from entering the market. Small businesses have a hard time surviving as they compete against large, well-established nation-wide franchises.

2. Literature review

In economic theory, Schumpeter (1942) emphasized the significant role that entrepreneur or small entrepreneurial businesses play in fueling a capitalistic and free market economy. Entrepreneurs are characterized by innovation and risk taking and are credited with expanding the frontier and scope of economic activity (Morrison, 2000). Innovation that addresses the generation, acceptance, and implementation of new ideas, processes, products, or services makes a significant contribution to economic growth in the developed and developing world (Jones, 2000). Therefore, for years studies have focused on characteristics of entrepreneurs (Monk, 2000) and evaluated their role as a driving force in economic growth, job creation, and rapid industrialization (Harris and Gibson, 2006; Sauser, 2005).

The study of entrepreneurship is multi-dimensional (Bliss and Garrat, 2001) and focuses on the sensitivity of entrepreneurial businesses to both internal and external factors that have impacted small entrepreneurial businesses survival and success (Maes et al., 2005; Sarasvathy, 2001). An approach gaining support explains entrepreneurs' success as a combination of personal characteristics (psychological and physical predisposition), personal environment (role models, family factors and personal goals), business environment, and business ideas that promote or hamper the creation and development of successful entrepreneurship (Aldrich and Fiol, 2001). Some of the internal factors affecting entrepreneurship include the size and age of entrepreneurial business, age of entrepreneur (Beaver, 2002; Harada, 2002), education, training, prior experience (Perren, 2000; Simpson et al., 2004), risk taking (Lee and Tsang, 2001), innovation (Hurley and Huit, 1998), and entrepreneurial ethics (Ackoff, 1987).

The firm's ability to generate profits, higher earnings, and employ greater number of individuals have been recognized as key measures of performance and important indicators of success (Haber and Reichel, 2005; Getz et al., 2005). Coleman (2007) explores the impact of both human and financial capital on small firm profitability and growth. Pena (2002) and Bosma et al. (2004) find that higher level of education and higher levels of financial capital increase the earnings of the firm. O'Gorman (2001) found that when measured over time personality, lack of managerial skills, and style can all be barriers to growth.

Existing theories demonstrate the inseparability of the external environment and the entrepreneurial process (Fogel, 2001). External environments hostile to entrepreneurial businesses include: a lack or low intensity of competition (Garcia and Velasco, 2002), a lack of capital and management practice (Christie and Crompton, 2002), scarcity of resources (Buick, 2003), government regulation (Perren, 2000), economic policies (Glancey and McQuiad, 2000), and the overall pace of market reforms or a slowdown in an economy can constraint entrepreneurial activity (Glancey and McQuaid, 2000). Fogel and Zapalska (2001) examined macro-economic policies and procedures in economies of Poland and Hungary and concluded that countries with minimum legal and institutional barriers are likely to have better functioning and developed private entrepreneurial businesses.

It has been recognized that tourism and hospitality services have the potential to help communities solve some of their socio-economic development challenges (Coviello et al., 2006). Tourism and hospitality is a growth sector at both the national and international level as is evidenced by the emergence of a large number of new destinations and an increasing tendency among domestic and international tourists to move away from traditional tourism destinations. There is an increasing creation of "new age tourism" with a more recreational and socially responsible approach to vacationing at home and abroad (Lerner and Haber, 2001).

Tourism development is facilitated by both multinational corporations and locally owned small enterprises, and there can be both positive and negative effects. Capital-rich multinational corporations are the key players in the international tourism sector and have been criticized for generating minimal direct benefits to the local communities (Glancey and McQuaid, 2000). In rural, underdeveloped, and indigenous communities, both small enterprises and self-employment have the potential to bring benefits directly back into the host communities.

Some authors indicate that the firm's profitability is sensitive to revenues, pricing policies, and the level of investments in fixed assets (Bosma et al., 2004; Coleman, 2007; Swinney et al., 2006). While policy and institutional framework is considered to be a mediating factor influencing performance, there is no clear indication how this affects the performance of small entrepreneurial tourism and hospitality businesses in depressed areas of the U.S. (Lerner and Haber, 2001). This study is an effort to improve the understanding of hospitality business dynamics in Appalachia.

3. Methodology

One hundred tourism and hospitality businesses were randomly selected from a list of 250 businesses that operated in the area. The criteria for the selection were that the businesses were small entrepreneurial family activities with no more than 50 workers in the tourism and hospitality sector. The surveys were conducted in 2011. The data was collected by telephone and in-person interviews.

West Virginia was ranked 47 in State Competitiveness Index, so it is important to receive and examine a feedback on the respondents' perceptions of competitiveness with their local markets. As a result, the questionnaire included questions related to *Government and fiscal policies*. It is understood that businesses are more likely to be attracted to areas with moderate tax rates and clear evidence of financial discipline. A high level of labor force participation, and skilled labor that is available and not too expensive, combined with a widespread commitment to education, training and health care, make a state attractive to business. Those factors are captured by *human resources*. The *innovation* factor reflects an ease of adopting a new technology and availability of programs that would allow entrepreneurs to get informed and advised on technology trends and its potential (Buick, 2003).

4. Hypotheses and the model

The conceptual framework for identifying the determinants of entrepreneurial success has been presented in many business and economic studies (Castillo et al., 2007; Maes et al., 2005). A study by Sandberg and Hofer (1997) proposed a framework for estimating the performance of new entrepreneurial businesses by adding further explanatory variables. The conceptual model incorporated in this paper examines four categories of factors that determine firm success.

The first category is *organizational factors* (age of entrepreneur) and e*ntrepreneurial disposition* (family business history, years of experience, and college education), or the degree to which the owner of the entrepreneurial business is inclined towards entrepreneurial behavior. The second category is *entrepreneurial orientation*, which is whether or not the firm's activities demonstrate an entrepreneurial focus (innovation). The influences of these factors are moderated by *environmental factors* (lack of competition, sound fiscal and other government policies) and *type of business* (hotel/bed and breakfast or other). A complete list of the factors included in this study is given in Table 1. According to several studies (Castillo, 2007; Brown, 1991; Bosma et al., 2004; Bartlik, 1992) overall firm success is a function of all of these factors.

A linear regression model is used to identify the factors affecting an enterprise's performance. Following Westhead et al. (2001) and Kalleberg and Leicht (1991), profit was used to evaluate firm's performance. The last month's profit (at the time that interviews were conducted) is used as the performance measure. Since there was a wide range in the relative sizes of the firms, the logprofit (equation (1)) was used to provide a more stable dependent variable.

$$Logprofit = \beta_0 + \beta_0 X_i + e. \quad (1)$$

The independent variables considered in the model to explain firm performance are: entrepreneur's age, years of business experience, family business history, presence of innovation, lack of competition and sound fiscal policies, type of business (hotels and bed and breakfast) and business and/or college degree). The following hypotheses are tested: (1) the age of entrepreneur, training and education, and innovation have a positive effect on performance of entrepreneurial firm; (2) years of experience and close family ties have no impact on the performance of entrepreneurial businesses; and (3) differences in business sectors (operating as a hotel and/or bed and breakfast), lack of competition and sound fiscal policies have negative effect on performance of entrepreneurial firms.

5. Results

The entrepreneurial tourism and hospitality businesses that operate in West Virginia covered a wide spectrum of small enterprises from lodging to bicycling to hunting services. There were antique, craft and specialty stores (20%), hotel/lodging (24%), bed and breakfast (15%), bicycling (15%), skiing/snow sports (15%), sport goods stores (10%), boating and whitewater rafting (10%), folkways and fine arts (16%), restaurant/catering (18%), horseback riding (5%), Fishing, hunting and wildlife (6%), rock climbing (4%), and other (14%).

Regression analysis that has been used determined the impact of various variables on the performance of entrepreneurial enterprises. The regression results (model coefficients along with corresponding P-values) are shown in Table 2.

Table 1. Determinants of firm performance

	Coefficient	t- statistics	p-value
Intercept	3.9887	42.84	0.0000**
Entrepreneur's age	0.0056	1.75	0.0838*
Years of experience	0.0076	1.07	0.2872
Family business history	-0.0564	-1.22	0.2256
Innovation	0.1320	2.65	0.0095**
Competition	0.1332	2.60	0.0110**
Fiscal policies	0.1806	3.00	0.0035**
Hotels	0.0999	1.75	0.0839*
College	0.2091	3.07	0.0029**

Notes: R^2 = 0.7265. ** Statistically significant at the 5% level. *Statistically significant at the 10% level.

The regression results indicate that the e*ntrepreneur's age* is positively related to the performance of enterprise, implying that businesses operated by older entrepreneurs performed better than those operated by younger ones. This result substantiates Jovanovic's (1982) learning theory that the age of an enterprise and its profit growth rate are positively related.

The majority of respondents stated that the introduction of a new product or service was critical and made their business very successful. The regression results strongly support the hypothesis that *innovation* is positively related to profit growth.

Both *entrepreneurial education* and *business training* were also two significant factors affecting entrepreneurial firms. This effect is captured by the variable "College" in the regression. Respondents expressed that the West Virginia Small Business and Development Center (WVSBDC) program had been very helpful by providing at no cost consulting on planning, starting, and keeping a business operating on a profitable basis. Respondents stated that confidential one-on-one counseling provided them with the information and paperwork needed to open a business, including information on licensing, taxes, insurance, recordkeeping, and the forms needed for hiring employees, such as Workers' Compensation and Unemployment Insurance. They also expressed that they would like to obtain further assistance on business plan development, financial statement preparation and analysis, cash flow preparation and analysis, and identifying sources of funding.

Despite the assistance provided by the WVSBDC, several respondents cited problems with finance and marketing as being some impediments and experience and innovative product were the factors that were of most assistance. It was not clear from the responses whether the financial and marketing impediments were a symptom of other problems (bad management leading to a cash-flow crisis) or the actual cause (inability to raise enough start-up capital for the business).

The regression analysis also indicated that there was no significant effect of *years of experience* and *family business history* on firm's profitability. Many entrepreneurs enter into their own business without the benefit of business experience and family business experience and training provided by the family owning the business. This could explain why the variable is insignificant.

By far the most common work experience among entrepreneurs was experience in the same field as the business that was started. This suggests that a large number of entrepreneurs did not spin off their businesses from the businesses in which they were formerly employed to establish new businesses or continue their family businesses.

Competition and presence of sound of *fiscal policies* had a negative effect on the profitability of the entrepreneurial firm[1]. This confirms the results of Carlock and Ward (2001) who found that higher marginal income and corporate taxes rates hurt economic growth. This study also supports Bartik's (1992) study which provides an excellent summary of research on state and local taxes and economic growth and concludes that state and local taxes have a consistently negative effect on state and city economic growth. Taxes are one part of the package that determines business location, including climate, local amenities, workforce quality, and public infrastructure.

This paper's results confirm that the tax system that has evolved in West Virginia places a heavy burden on capital investment through the business franchise tax and the personal property tax levied on inventory, machinery, and equipment. West Virginia's tax regime also creates an excessive burden on taxpayers through a high-rate profit tax on corporations and an inequitable allocation of the tax burden through the use of tax credits and a number of industry-specific taxes. The overall effect has been tax system that is not conducive to economic growth and job creation. It is not surprising that West Virginia ranks 23th nationally according to the 2012 State Business Tax Climate Index (The Tax Foundation's) and ranks 18th on the 2012 corporate tax component of the index. All the respondents stated that by lowering corporate, net income and business franchise tax rates the state would grow faster as entrepreneurs would find West Virginia as a good place to established and grow entrepreneurial business.

Excessive taxation, regulation, and strong power of the state provided a greater uncertainty that decreases the willingness to undertake capital investment and accumulation leading to declining labor productivity and eventually depressed wages. Respondents expressed that greater uncertainty curtailed transactions transferring property to new owners who discover more valuable uses that ultimately led to economic stagnation in West Virginia. They all expressed that the West Virginia's government intervention through taxation and regulation hindered capital investment and created a hostile business environment.

This study also provided the observations and opinions of respondents regarding needed improvements in services provided by government including the West Virginia Small Business Development Center network. As education and business training has a positive effect on entrepreneurial success, the WVSBDC could assist in training entrepreneurs in the skills they needed. The center could provide programs to ensure that entrepreneurs are either sufficiently skilled to manage the marketing and financial demands of business or have access to training in these skills. Respondents said that they would like to receive more extensive assistance with feasibility surveys, market identification and planning, business plan development, cash flow preparation and analysis, and identifying sources of funding.

The center also could improve its operations according to the direct feedback gained from the survey respondents. Respondents stated that the WVSBDC provides services that help increase a small business's access to capital through assistance in obtaining bank loans, guaranteed loans, micro-loans, angel capital investments, venture capital investments, various grants, and investment through sources made available by the West Virginia Economic De-

[1] In the survey, respondents were asked if lack of fiscal incentives affected their business decisions which yielded "Yes" and "No" as responses. The regression coefficient captures this response. Thus a positive coefficient implies that respondents attributed lack of fiscal incentives as hurting their business decisions.

velopment Authority, the lending arm of the state. However, they expressed that those services are limited and difficult to obtain.

Respondents stated that the West Virginia government should substantially redesign business tax system so that it would be less likely to distort and discourage economic and entrepreneurial activity. The state should repeal the business franchise tax and personnel property tax on inventory, machinery and equipment and if necessary replace them with a broad-based value added tax similar to the business enterprise tax in New Hampshire. The state should also replace the high-rate profits tax on corporations with a low-rate tax on all businesses as well as repeal the future use of all business tax credits.

Policy implications and conclusions

This study identified the extent of entrepreneurial activity in the region of Appalachian region of West Virginia. Contact was made with many individuals who established small business entrepreneurial firms within tourism and hospitality industry. The evidence showed that the Mountain State entrepreneurs have been highly entrepreneurial and they do not differ from a typical entrepreneur in personal characteristics, background that relate to successful entrepreneurial activity and innovative approach to become successful. If it becomes possible to capture the personality of the West Virginia entrepreneurs included in this study, all previous research on entrepreneurial personality can be applied to West Virginia entrepreneurs presented in this study.

The data collected also presents a picture of the success and problems experienced by the Allegheny entrepreneurs. The study revealed extensive information on a special group of people, not those who enter business firms in hopes of rising to managerial levels, but those who strike out on their own to create a business which is essentially an extension of their own personalities and to some degree of their family tradition. For entrepreneurs who have the desire and willingness to start their own businesses, it offers an opportunity for freedom, enjoyment, and the creation of a unique economic being. All of the entrepreneurs interviewed expressed that there is nothing better and nothing that brings more joy and satisfaction to an individual.

The West Virginia government needs to reform its policies to instill greater security of property rights. Government infringement through taxation, regulation, and strong eminent domain powers make private property rights less secure in West Virginia. With respect to attracting and retaining businesses into its region West Virginia should follow the example of other states that have recognized the need to eliminate burdensome regulations and have implemented regulatory reforms.

West Virginia's poor regulatory environment has contributed significantly to the state's low level of economic growth. The study also demonstrates that West Virginia government taxes and regulates too much. Businesses and entrepreneurs in West Virginia are burdened by numerous costly regulations that are generally unnecessary and too intrusive. In order to generate prosperity the regulatory burden must be lifted and replaced with an environment that encourages innovation and success.

In summary, this study was successful in discovering the extent of entrepreneurial activity in West Virginia. During the study contact was made with many entrepreneurs who established small business entrepreneurial firms. As hoped for, the evidence showed that West Virginia entrepreneurs differ slightly from a typical entrepreneur on personal characteristics and background that seem to relate to successful entrepreneurial activity. The data collected also presents an excellent picture of the success and problems faced and experienced by entrepreneurs in West Virginia.

The study revealed extensive information on a special group of entrepreneurs, not those who enter business firms in hopes of rising to managerial levels, but those who strike out on their own, to create a business which is essentially an extension of their own personalities and/or family tradition. Furthermore, the study provided the Small Business Development Center network managers with the observations and opinions of a group of their clients or potential clients regarding needed improvements in services.

This study was based on insights from diverse intellectual perspectives and took into account both the social context of entrepreneurship as well as characteristics of the entrepreneurs themselves. Similar studies need to be conducted in the other areas of the rural and underdeveloped areas of the nation. Only by such concentrated efforts there is a hope to develop a more complete understanding of the causes, correlates and consequences of entrepreneurship.

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