

THE ROLE OF PROPERTY IN THE PORTFOLIO OF SMALL AND MEDIUM ENTERPRISES

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ABSTRACT

Previous published academic property research has tended to focus on the optimal allocation of real estate from the perspective of large institutions. Little attention has been given to mixed business portfolios of small to medium enterprises. This study seeks to address this imbalance by examining the perceptions of entrepreneurs who own more than one distinct business at any given time. Using in-depth interviews, this paper explores the role of property within the portfolio of small and medium enterprises (SMEs) of 15 successful entrepreneurs. The results suggest that property or property-related businesses feature prominently in these portfolios. The importance and differing roles of property during the life cycle of the portfolio is also highlighted and further indicate that property plays a strategic role in business decisions and often dictates the direction of individual businesses and the portfolio as a whole.

Keywords: Portfolio entrepreneurship, property assets, SMEs (small to medium enterprises)

INTRODUCTION

A number of studies have been undertaken in the property finance and investment literature relating to the optimal allocation of real estate in institutional investment portfolios; however, less has been undertaken in understanding property allocations within mixed business portfolios of small and medium enterprises (SMEs). This is an important area of research as for example, in New Zealand 95% of all enterprises can be categorised as SMEs.¹ This research examines 15 portfolio entrepreneurs (entrepreneurs owning a number of businesses at the same time) to establish what they perceive as to the role of property within their portfolios. Each entrepreneur owns a portfolio consisting of between three and 51 businesses, each of which can be classified as an SME. The understanding of the role that property plays within portfolios will be helpful in determining the relevance of property in the development and management of individual businesses and/or a portfolio of businesses.

¹ / http://www.med.govt.nz/templates/MultipageDocumentPage_3118.aspx, downloaded 2 June 2009

To date, little academic work has been carried out and published relating to property and SMEs. In comparison, the role of property is well researched which may be explained by less quantitative information available in contrast with the institutional sector. By taking a qualitative approach, this study is designed to overcome this dearth in data, by collecting in-depth information directly from portfolio entrepreneurs.

The paper firstly looks at what is meant by entrepreneurship and the portfolio entrepreneur; it then investigates the results of extant studies relating to property allocations within portfolios. Other business strategy literature is then reviewed. The research approach and process is then described, together with the main findings. The paper concludes with a discussion and proposed implications.

BACKGROUND LITERATURE

Entrepreneurship

Entrepreneurship is a young and changing field of research (Sarasvathy, 2004). Existing literature shows that entrepreneurship is often linked to areas such as small business and firm-level management, innovation and new product development, strategic management, marketing developments in information technology and cognition and behavioural studies among others. This phenomenon has attracted researchers from various academic disciplines and has led to a tremendous growth in entrepreneurship research and education in recent times. Shane and Verkataraman (2000) argue that it is “*an important and relevant field of study*” and that the contribution of scholars from different disciplines and the use of different methodologies would hopefully create a “*systematic body of information about entrepreneurship*”. This paper is an attempt to add to this knowledge by investigating the behaviour of portfolio entrepreneurs with regard to their property holdings within a business portfolio.

Entrepreneurship and the habitual entrepreneur

Despite the multitude of entrepreneurship studies, there is no clear consensus on what constitutes entrepreneurship (Gartner, 1989; Shane and Verkataraman, 2000). Bygrave and Hofer (1991) suggest that entrepreneurship involves all the functions, activities and actions associated with perceiving opportunities and the creation of organizations. This definition captures many of the key issues that have been discussed by other scholars and is used in the context of this paper. A number of different types of entrepreneurs have been identified in the literature. This paper however focuses on the “habitual entrepreneur”, an individual that can and may engage in repeated entrepreneurial behaviour both within the context of an existing organisation or in creating and/or acquiring another. MacMillan (1986) observes that these entrepreneurs enjoy the excitement and challenge of start-ups so much that once successful, they become bored. Although they continue to own the business, they prefer to employ professional management and then turn and start other ventures. This process is then repeated many times throughout their entrepreneurial careers. This business model has not long been

recognised within academic literature, but has been found to be common behaviour in a number of countries (Carter, Tagg and Dimitratos, 2004).

Although habitual entrepreneurs are distinct from other types of entrepreneurs, there are also differences within this group. Two types of which have emerged; the serial entrepreneur, who own one business after another, but only one business at a time, and the portfolio entrepreneur who owns more than one business at a time (Hall, 1995). This paper focuses on the behaviour of 15 New Zealand portfolio entrepreneurs and examines the role that property plays in their strategic decision making.

Understanding the development of an entrepreneur's portfolio

In order to understand the role of property within an entrepreneur's portfolio, it is useful to understand why an entrepreneur acquires new businesses and develops business groups. Research shows that portfolio entrepreneurs start to acquire new businesses not solely for wealth generation or creation. Reasons tend to vary from one entrepreneur to another and according to location and may also change over time. For example, Westhead and Wright (1998) found that the reasons for starting up businesses for rural portfolio founders was more likely to be related to the instrumentality of wealth and to have influence in their local community compared to urban portfolio founders who cited reasons linked to the need for independence and taking advantage of an opportunity.

For example, Rosa (1998) reported that portfolio entrepreneurs quote the following reasons for the creation and development of business clusters: positive diversification into a new market; plan forced diversification into new markets to spread risk or to overcome potential adversity; unplanned (opportunistic) diversification into new markets; business creation as a challenge or a hobby, ownership of additional businesses to protect a new area or brand name; ring fence a geographical diversification; ring fence risk; add value to existing ventures owned by entrepreneur; assist a friend or relative; launder money, profits or family assets; avoid paying taxes and cut costs and enhance internal efficiencies.

Optimal allocation of real estate within institutional investment portfolios

In order to gain an understanding of the strategic role property plays within portfolios, a review of the literature within the property finance and investment literature was undertaken; specifically in relation to the optimal allocation of real estate within institutional investment portfolios. Roles pertinent to the study were identified and examined.

Collateral for loan purposes

Research has demonstrated that companies with a high level of tangible assets (such as property) are likely to borrow more than firms with a low level of tangible assets; thus a significant positive relationship exists between tangible assets and financial leverage

(Bradley, Jarrell and Kim, 1984; Titman and Wessel, 1988; Rajan and Zingales, 1995; Westgaard, Eidet, Grosas, and Frydenberg, 2008). A possible explanation of this is the ability of tangible assets to serve as collateral for secured loans.

Diversification and optimal asset allocation

The role of property in a mixed-asset portfolio has been studied for over two decades, leading to the conclusion that real estate is fundamental to portfolio diversification. The benefits of combining properties or property trusts with stocks and bonds in a portfolio have been well established, with studies demonstrating a negative correlation between the expected returns on property and the expected returns on stocks and bonds (Hartzell, Hekman and Miles, 1986; Webb, Curcio and Rubens, 1988; Goetzmann and Ibbotson, 1990; Kallberg, Liu and Greig, 1996; Seiler, Webb and Myer, 1999). Liu and Mei (1992) relax the constant risk premium assumption and find that a significant property factor does not exist when risk premiums are not constant. However, Mei and Lee (1994) show opposite evidence that a property factor that significantly explains stock returns exists. Although inconsistent results are presented about the significance of a property factor to explain stock returns, these studies underpin the new investigation about the existence of either distinct or common risk factors driving both returns on property and returns on stocks and bonds.

Other studies relating to the role of property in a mixed-asset portfolio deal with optimal asset allocation among properties, stocks and bonds. Researchers have found the optimal percentage on property investment for a portfolio tends to range from 9 percent to up to 66 percent, based on different datasets or different time period data (Cooperman, Einhorn and Melnikoff, 1984; Webb and Rubens, 1987; Firstenberg, Ross and Zisler, 1988; Webb, Curcio and Rubens, 1988; Giliberto, 1992; Ennis and Burik, 1991; Kallberg, Liu, Greig, 1996; Ziobrowski and Ziobrowski, 1997).

Research relating to the effective diversification of portfolios has also considered business categories. Mueller and Ziering (1992) examined the correlation of returns on properties in areas of different Dominant Economic Employment Categories (DECs). They found that the majority of returns on properties among the five categories of finance/service, manufacturing, government, energy and diversified employment are negatively correlated when the economy experiences a growth period. When the economy experiences a recovery or decline period, the correlation of returns on a few pairs of the categories is negative and the correlation of other pairs is low. Their results suggest that economic diversification works for properties belonging to different dominant economic activity areas.

Inflation hedging

Inflation-hedging has also emerged as a benefit for direct property investment (Ibbotson and Siegel, 1984; Hartzell, Hekman and Miles, 1986; and Gyourko and Linneman, 1988). Rubens, Bond and Webb (1989) however, show that direct property investment hedges

against unexpected inflation but not expected inflation. Wurtzbach, Mueller and Machi (1991) concluded that direct property investment provides inflation hedging benefits for properties with low to moderate vacancy rates, but not for properties with high vacancy rates. These findings are consistent with other inflation hedging studies, given that cash flows from operating activities contribute to revenue less for commercial properties with high vacancy rates than with low vacancy rates.

Resource management and competitive advantage

The property literature has also identified issues such as resource management and competitive advantage as affecting property-related decisions and strategy. Singer, Bossink and Putte (2007) and Heywood and Kenley (2008) illustrated how properties can be used to enhance cost efficiency and product differentiation to promote the competitiveness of a corporation. Rasila and Gersberg (2007) also investigated property as a business resource and concluded that the quality of service received by out-sourced property may be inferior due to the possibility of imperfect communication between end-users and service provider. Wills (2008) studied the performance of properties in corporations in Australia and found that the companies that are able to reap long-run returns on properties need to include properties as an asset class within the corporate portfolio. Wills' results may suggest that businesses may hold properties in their portfolios in order to make timely acquisition and disposal decisions relating to these properties.

The above presents an overview of literature relating to the performance of property within large commercial portfolios. This paper aims to ascertain whether these traditional roles and/or additional roles are considered by portfolio entrepreneurs when investing in property. In order to achieve this, information was collected directly from the portfolio entrepreneurs responsible for making property-related decisions and to gain in-depth insights into their motivations.

METHODOLOGY

Portfolio entrepreneurs are an important segment of the business community, but very little is known about their behaviour. This study is designed to understand how, if and why entrepreneurs use property assets within their portfolios. The research is part of a larger research study (Morrish, 2008), that investigated how and why entrepreneurs become portfolio owners and how they structure, develop and manage the many challenges of having a portfolio of ventures and the different outcomes, not only at the venture level but also for the entrepreneurs themselves.

The main aim of both studies is to capture entrepreneurship as experienced by portfolio entrepreneurs. This is difficult to do using mainly quantitative methods which do not go beyond merely describing the phenomenon and calls for alternative methods. Thus, this research employs a qualitative approach to better explain the phenomenon being studied

(Gartner and Birley, 2002). Alongside this however, it is also essential to establish the extent to which this phenomenon exists and in what context. This study therefore employs a two-phase design (Cresswell, 1994) approach, whereby a less dominant quantitative phase is conducted, followed by the dominant qualitative approach. This approach supports Low and MacMillan (1988) in their call for mixed approaches in entrepreneurship research. The use of multiple case studies was deemed appropriate for this study.

Research procedures

Prior to case selection, confirmatory evidence was sought relating to the prevalence of portfolio entrepreneurs in the research setting. This part of the study was conducted in the South Island of New Zealand. The preliminary data was based on the New Zealand's Business Who's Who database. This database lists actively trading businesses and contains information on board of directors, company addresses, description of the operations allowing the classification of the business into different sectors, staff numbers and the date when the businesses were first established. Two separate sample streams were extracted from this database.

Sample one initially contained all of the listed South Island businesses (N1 = 4530). From this data set, companies that have directors that also held other company directorships were extracted. This generated a working sub-sample of companies (n1 = 920) as the basis for this part of the study. These companies were then classified into industry sectors according to the Australia and New Zealand Standard Industrial Classification (ANZSIC) Code. The second sub-sample (n2 = 5266) consists of all company directors in the list. These directors held up to 22 company directorships. Using a series of data filtering, directors with single company directorships were eliminated from the list. The remaining list (n3 = 1600) contained directors who held a minimum of two company directorships. This sample formed the basis for the case selection for the qualitative investigation using in-depth interviews.

This initial part of the study provided good descriptive statistics that pointed to the incidence of multiple entrepreneurs within the South Island of New Zealand, as well as some insights into the age and location of businesses owned by portfolio entrepreneurs. Table 1 summarises the findings which illustrate the scale of multiple business activities in the research setting.

Table 1: Scale of multiple business activities within the South Island of New Zealand

Prevalence	20.3% (n1 = 920) companies have directors who held between two and eleven other directorships
Location	A large proportion of companies were located within the main cities
Staff	They employed 39.46 employees on average
Age	Companies 0-5 years old were more likely to have directors that held other directorships
Sectors	A majority of the companies belonged to traditional sectors (manufacturing, retail, property, business services, agriculture, forestry, fishing and the wholesale trade.)

Selection of purposive sampling in case research

Case study research enables the use of purposive sampling which is the sampling of a particular context, given implicit criteria set out by the researcher (Miles and Huberman, 1994). The phenomenon of the portfolio entrepreneur can only be fully understood by engaging and studying actual portfolio entrepreneurs. It is therefore vital to seek out experienced entrepreneurs of this specific category. Sekaran (1992) says that purposive sampling is appropriate because sometimes, it might be necessary *“to obtain information from specific targets – that is specific types of people who will be able to provide the desired information, or because they conform to some criteria set by the researcher”*.

Purposive sampling is a type of non-probability sampling that can be categorised into two major types; judgement and quota sampling. Quota sampling involves conveniently choosing from target groups according to some predetermined number of quota. In judgement sampling, subjects are selected on the basis of their expertise in the subject being investigated (Sekaran, 1992). Due to the requirement of this study for “specialised informed inputs” on portfolio entrepreneurs, a judgement sample selected from the database gathered in phase one of the study was utilised.

The use of multiple case studies follows Rosa and Scott (1999), Wright, Robbie and Ennew (1997) and Sarasvathy (2001), which entailed selecting samples from a cross section of industries and businesses.

Multiple case studies

Having generated a sample of multiple business owners, a selection of likely cases was then made by identifying individuals who held the most number of directorships. From the 2nd database, a list was drawn to find 15 cases to interview. The cases were selected with the aid of business publications and consultations with individuals knowledgeable of the South Island business community. In keeping with purposive sampling, certain entrepreneurs were targeted. In some cases, referrals and/or introductions were obtained from people known to the entrepreneur.

The final cases consisted of prominent business people from a range of business sectors. Each participant owned at least three businesses and 40% of the participants have appeared in the New Zealand Business Review Rich List. The selection of the final list of participants was largely based on their accessibility and willingness to participate and share their experiences and opinions. A description of each of the participants is contained in Table 2. It should be noted that all 15 participants were males and all based in the South Island of New Zealand, a majority being from the Canterbury region. Their business interests extend to the whole country and cover a variety of sectors including manufacturing, information and communication technology (ICT), tourism, and most importantly property.

Table 2: Description of participants

Participant	Age	Age started in business	Approximate % of property-related business or activity	Industry
1	42	15	10%*	Accountancy services. Immigration, education
2	40	22	10%*	Technology, small business services, photo services
3	40	18	10%*	Technology, software development
4	50	40+	50%	Technology, manufacturing angel investing, commercial property, etc.
5	50	25	100%	Property: hotels, subdivisions, other
6	64	28	50%	Farming, technology, nutraceuticals, equity investments, commercial property, etc.
7	52	40+	10%*	Technology, consulting
8	67	n/k	95%	Hotels, property, commercial premises, etc.
9	41	18	80%	Finance and insurance services, property, subdivisions etc.
10	58	30+	10%*	Manufacturing, retail
11	67	18	75%	Wholesale cars, farming, property, etc.
12	47	45	10%*	Technology, wholesale, retail, professional services
13	31	25+	10%*	Adventure tourism, corporate services etc.
14	64	19	25%	Transport, construction, fuel, farms, property, etc.
15	47	35	20%	Technology, commercial property, etc.

* Property component serves as premises for business operations

Data collection

The primary data collection method was face-to-face in-depth interviews with each of the selected participant. The interviews were semi-structured and audio-taped and then transcribed for coding. The transcribed data was complemented by note taking during the course of the interview, observation recorded in real time, use of secondary informants such as staff, family and friends, and document searches that included public records, company records, press archives and company websites.

The participants were interviewed using a semi-structured interview protocol. This technique allows the consistency that structured interviews offer, together with the flexibility of unstructured interviewing when the necessity arises (May, 1997). This flexibility allows questions to be specifically tailored to the respondent being interviewed and thus they can answer more on their own terms. This also encourages open-ended answers from the interviewee allowing the collection of data that richly describes an individual's beliefs or experiences. The interviews were audio taped with the consent of the respondents. These interviews were on average three hours long and conducted using the following procedure:

1. An invitation was sent to the prospective respondent inviting them to participate in the study together with an explanation as to the purpose and description of the study.
2. Two days later a telephone call was made to the prospective participant to answer any questions. For those who agreed to participate, a date, time and location were confirmed for the interview. Most interviews were held in the participant's business premises where they felt comfortable.
3. A list of issues was used to guide the interview and these were presented to the interviewees in the form of open-ended questions.
4. The interviews were then transcribed for analysis.
5. Participants were offered a copy of the interview transcript.

Data analysis and interpretation procedures

This study utilised the constant comparison method of data analysis, where the researcher simultaneously coded and analysed the data in order to develop concepts; track emerging patterns or themes and address any deficiency in the previous information collected (Taylor and Bogdan, 1998).

Although qualitative software packages (QSR6 and NVivo) were used in the initial stages of coding, the main analysis used visual text, hand coding and case matching. Rosa (1998) and Sarasvathy's (2001) approach to analysis were used as a guide in tracking down the emerging patterns in the data.

RESULTS AND DISCUSSION

For any entrepreneur, the motivation to go into business is often dictated by a combination of business and personal aspirations. Becoming an entrepreneur involves a series of processes that starts with the concept of opportunity. The pursuit of such opportunities comes with a myriad of challenges not least of which is financial in nature. As with most SMEs, their birth is often financed by what resources the founder/entrepreneur own or have access to. In a majority of cases, these resources are property-based.

While property is often used as security for financing, this study has found that property has a much wider and significant role in an entrepreneur's business and the portfolio as a whole. In particular, only two out of the 15 respondents indicated that they would not invest in property because returns were more lucrative from other forms of businesses. An assessment of the approximate proportion of property businesses within each portfolio as set out in Table 2 identifies a range of 10% to 100%. Even portfolios that do not have significant property holdings consider property necessary for their core operations; thus make property-related decisions such as owning or renting premises and location considerations.

Entrepreneurs with significant property holdings in their portfolios viewed property as a major component of their business and business decision-making processes. The role of property as perceived by the participants are summarised below:

1. Property as a source of capital gain and acquiring profit
2. Property as a source for gearing capital and as loan collateral
3. Using property as an individual company
4. To assist a family member (e.g. in starting a business)
5. As a core business where the entrepreneur has experience and interest
6. As real estate asset for business (e.g. hotel, farm)
7. Diversification resulting in risk reduction
8. For tax purposes
9. As the first step and source of growth for the overall business portfolio (e.g. small scale development or rental property)
10. Tangible asset to diversify a portfolio of "intellectual property"
11. Keeping property to provide an income but not as a significant part of the business.
12. Subdividing what was farm land for development.

These results illustrate that portfolio entrepreneurs consider property not only as an asset for financing and investment purposes, but they must also consider how specific properties relate to their other businesses; for example hotels and farms. The other interesting finding is the role that property plays in the personal life of the entrepreneur; for example, assisting other family members, the acquisition of the family home or as an

asset that can be kept to serve as an income during retirement. These results reflect an interesting combination of the results highlighted from previous research in both the property-related and entrepreneurial literature.

Further analysis of the above roles shows that these can be aggregated and classified into themes relating to three distinct purposes with references to finance and investment, operations or business-related and for personal reasons. An illustration of how these are manifested is presented in Table 3.

Table 3: Three significant roles of property

Finance and investment purposes	Business related purposes	Personal reasons
Raising capital	Real estate asset to run the business from	Assist family member to enter a business
Accumulating profit	As a core business	Acquiring the family home (family assets)
Diversification and risk reduction	Exit strategy	Keep property assets for retirement income
Taxation reasons	Providing space for other business activities	
Income production	Entry into business	

Another important finding is the different role property assets play during the life cycle of the entrepreneur’s business portfolio. An example of this is the way that property was used by a number of entrepreneurs when establishing their portfolio, either by creating an income through rental properties or providing a tangible asset that serves as collateral for loan purposes.

This type of investment may be a premeditated strategy on behalf of the entrepreneur, but may also be explained by the “corridor principle” (Ronstadt, 1988). This principle purports that entrepreneurs find other opportunities (i.e. corridors) not otherwise available or apparent to them had they not started in business at all. Novice entrepreneurs therefore may choose to pursue more of these opportunities while still keeping their original venture. This then becomes a continuous process in their entrepreneurial life and leads to them becoming portfolio entrepreneurs. To illustrate this, if the entrepreneur’s core business is in hospitality, he is constantly aware of the trends in the industry and is attuned to opportunities to purchase and/or develop properties that come into the market.

In a portfolio context, it may be reasonable to assume that as the portfolio grows and resources allow, the entrepreneur will tend to purchase property that complements the core business. For example, it makes sense to purchase commercial property as base for the core business from which it can conduct its business from. A distinct strategy that was evident in the cases was the separation of the commercial premises from its business

operations. It appears that where this is the case, when the business is sold, the property remains as a different business unit and is therefore a company on its own. In this situation, property constitutes another business entity within the entrepreneur's portfolio.

Another important finding of this study indicates that portfolio entrepreneurs may look for different characteristics of a property investment at different stages of their business. Property takes a different role at the start of the business, during its operational life and when the entrepreneur wants to exit the business. For example, when the entrepreneur wants to divest his business interests, property may be used as an exit strategy by providing the entrepreneur with an income during his retirement. These roles are set out in Table 4.

Table 4: Role of property in the portfolio life cycle

Entry strategy	Mid strategy	Exit strategy
Wealth creation	Complementary to core business	Retirement income
Collateral for loan purposes		Family inheritance

CONCLUSION AND IMPLICATIONS

Using a qualitative and holistic approach, this study has uncovered a variety of roles played by property in an entrepreneur's portfolio of businesses, all of which are SMEs. The two most striking outcomes were firstly the three key roles that property is perceived to play by the respondents, firstly from a pure property finance and investment perspective, secondly from an overall strategic business perspective and finally the importance of family and personal requirements. These results provide a deeper understanding of the role of property within the context of SMEs and portfolio entrepreneurs and a wider perspective than has been reported by extant property literature. In addition to this, the differing roles identified at different stages of a portfolio life cycle suggest that further research may be undertaken in large property portfolios to see if these different roles exist.

This study set out to investigate the strategic role that property ownership plays in a portfolio of SMEs and established that previous published academic property research has tended to concentrate on institutional portfolios, with little attention given to property allocations within mixed business portfolios of SMEs. This study has gone some way to address this.

Property is one of, if not the most valuable asset in a business operation. This becomes even more important in SME settings as they are often used as leverage to access finance

and for other purposes. Findings from the study will go some way towards better understanding how property contributes to the success or otherwise of SME operations.

SMEs are regarded as the engine of many economies. While big corporations are conspicuous in their ownership and management of commercial properties, SMEs are less visible. There is very scarce literature at the interface between property and SME research. This study is the first to bridge the gap in these areas of study. There is evidence from this exploratory study that portfolio entrepreneurs use property strategically throughout the different stages of their business operations. Further investigation into how and why they do this will enhance understanding of the value property brings to business.

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