

Chapter 2

How Did Growth Become So Interesting?

Everything begins with something in history and entrepreneurship and growth are no exceptions. Historically, it is widely thought that entrepreneurship, as a concept, was coined by Jean Bertrand Say (1803), although some find even deeper historical roots with the work of Cantillon in the seventeenth century. In fact, in “*The Early History of Entrepreneurial Theory*” (Hoselitz 1951; Landström 2005) the conceptual roots in terms of the use and meaning of “entrepreneur” are traced to a much earlier time in the history of civilization. Evidence points to the term being formed during the Middle-Ages. That is, long before Cantillon or Say. It was “*celui qui entreprend quelque*,” that is, a person who gets things done. Generally, whether an activity is recognized as entrepreneurial or not tends to be justified by the nature of the action a person (in this case, the entrepreneur) undertakes (Landström 2005; Brännback and Carsrud 2009).

Clearly humans have been “starting” ventures for several millennia, and we are not suggesting that this began with the oldest profession. The reality is we have firms that have been started, owned, and managed by a single family over a thousand years (Carsrud and Brännback 2014). An enterprising family that can build a firm that lasts a thousand years must certainly have learned how to be both profitable and sustainable as many are in competitive industries like hospitality, beverages, and food. Perhaps with digging into linguistics we will discover that it actually began with the Greeks or Romans, but that is beyond the primary focus of this book.

Many people, but certainly not all, like to perceive entrepreneurship as rational behavior. They like to see it as a phenomena occurring as a result of rational thought and decision-making process following a linear causal logic. In Say’s conceptualization, the entrepreneur was the individual who did something at a cost, sold it for more, and in the process made money. Growth at best was an assumed part of the definition, but certainly not rapid growth. At this point, it is perhaps appropriate to spend some time with members of the Austrian school of economic thinkers.

2.1 Schumpeter's View

One of the great economists of the twentieth century was the Austrian Joseph Schumpeter who in his 1934 book expanded on Say's views by specifying that the entrepreneur was someone who created something new and sold the new, making money in the process. Schumpeter gave several suggestions to what the "new" could be: a company, a process, or a gadget, anything that was new to somebody else. A little later on in his writings, Schumpeter (1942) became a bit more specific. First he introduced the concept of creative destruction as necessary for progress. But this was about creating new markets and growing firms that led to changes in entire industries by revolutionizing economic structures from *within* (Schumpeter 1942, p. 83).

To go back to our earlier example of airlines, you need only to think of how airplanes in the course of 40 years revolutionized the transportation industry. Passenger carrying airlines have nearly driven passenger train lines out of business, especially in the USA. This helps one to understand this creative destruction process although trains have certainly not been removed from the transportation equation in Europe. Some of this creative destruction was actually driven by deregulation of markets (Carsrud and Ellison 1990).

Schumpeter (1942) further explains (p. 132, italics added by authors): "We have seen that the function of entrepreneurs is to reform or revolutionize the pattern of production by *exploiting* an invention or, more generally, an untried technological possibility for producing a new commodity or producing an old one in a new way, by opening up a new source of supply of materials or a new outlet for products, by reorganizing an industry and so on." Clearly Schumpeter understood the role that markets played in the process as well as the role of innovations.

A few lines later on the same page Schumpeter makes one more important specification with respect to the entrepreneurial function (italics added by authors): "This function does not *essentially consist in either inventing anything or otherwise creating the conditions which the enterprise exploits. It consists in getting things done.*" Thus, Schumpeter appeals to those who want to study venture creation on one hand and those who are interested in innovation on the other. Yet, at least at this point, Schumpeter keeps innovation and entrepreneurship as separate concepts. However, he sees both as important for economic *progress*. Progress does carry the notion of growth, but progress alone does not inform us with respect to the rate (or speed) of that growth.

Interestingly, Schumpeter does not specifically point at new venture creation per se. But, he does discuss the process of creative destruction as something that occurs in established firms (which can be small or large) that emerges from within and is primarily organic (p. 83). If that is the case, the growth rate is not rapid nor is it very high (Churchill and Mullins 2001). However, Schumpeter does specifically state that the role of the entrepreneur appears in the form of (p. 133): "... individual leadership acting by virtue of personal force and personal responsibility for success." Clearly, growth for Schumpeter was not the most critical component of entrepreneurship, but one that did exist. How then did growth become such an obsession for so many, especially in academia? In the 1980s, the University of Texas at Austin under the direction

of Prof. George Kozmetsky, a millionaire academic, began its first entrepreneurship center. It was then named the “Institute for Constructive Capitalism” in a bow to the influence of Schumpeter.

2.2 Growth Begins Taking Center Stage

A few years after Schumpeter wrote, one of the ultimately most influential women academics, Edith Penrose (1959) further expanded the discussion of entrepreneurship by explicitly focusing on growth, asking the fundamental question: What makes some firms grow and not others? It is her work “*The Theory of the Growth of the Firm*” that has become one of the classic underpinnings of the growth entrepreneurship research literature, if not the field in general. Interestingly, in reading her work it becomes evident that she was not concerned with small firms alone. Interestingly, Penrose was largely ignored for decades before her book became the “Bible” for those studying growth of firms.

Her work subsequently has become particularly influential in building the resource-based theory (RBT) of the firm, outlined two decades later by Wernerfelt in 1984 and further developed by Barney (1991, 1997) and their various disciples. The RBT of the firm was presented as an alternative, or a complement to, the five forces framework for competitive strategy (Porter 1980). Porter’s views were based almost entirely on his understanding of strategy within existing large firms.

Common in these two theoretical approaches to management are proposed strategies for firms to become better competitors and to enable the creation of sustainable competitive advantage, regardless of firm size. An assumption in both theories is that strategy is not dependent on firm size and what works in a large firm should be true in a small one, or even a start-up. In reality, the strategic management field has studied large corporations and even those who claim to be studying strategy in entrepreneurial firms are often looking at samples of firms that are public, venture capital funded, or recent initial public offerings (IPOs). The various management writings of Porter are certainly among the most widely known by managers, yet his approach is relative naïve about growing an entrepreneurial firm, especially one at a pre-IPO stage (Brännback and Carsrud 2008). Frankly, for any of us who have worked with start-up firms know full well that a new firm is not a shrunk down version of a large firm any more than a human embryo looks or acts like the result 18 years later.

One of the great “myths” about capitalism was the belief that large firms were the real drivers of an economy. For a long time, it was assumed by both academics and public policy makers that large firms were the main engines of national economies, especially in terms of job creation, innovation, and growth. However, this belief was substantially challenged with the publication of an extensive study by David Birch (1987). His classic study, based on data from 1969 to 1976, showed that small firms were the actual job creators in the US economy.

His initially controversial work followed a few years later by Bruce Kirchhoff and Bruce Phillips (1987) supported his findings. They found in their study (using data from 1969 to 1984), similar results to that of Birch. They also pointed out that Birch's study included two recessions (1969–1970; 1973–1975) and their study one additional recession (1980–1982). Kirchhoff and Phillips discovered that during recessions the job creation effect by small firms was the highest: 82 %, 66 %, and 100 %, respectively. Clearly someone had found a *black swan*. Until this time no one seriously viewed small firms, much less start-ups as having any serious impact on economies.

Taken together, these two studies took on the old myth that large firms drove the economy. This is not the first time a myth met its match with a series of frame breaking work. The believers in a flat earth never quite forgave Columbus. What these studies did was to shift the attention to looking at growth in small firms by both academics and policy makers. These researchers finally found a *black swan* or at least a potentially good substitute for a *unicorn*, the surprising reality was value of the ubiquitous small firm in the American economy.

2.3 Small Firm Growth and Public Policy

In considering the findings of both Birch and later Kirchhoff and Philips, it is easy to see how these results caught the attentions of American politicians and legislators, and they still do. Strategies and policies to increase economic productivity and employment have since been designed in most countries. Every President since Ronald Reagan have made sure to endorse growth in major addresses (often in the State of the Union addresses to Congress) and many other leaders in the US House and Senate have made similar remarks (Haltiwanger et al. 2010, p. 1). The term entrepreneur has been so widely used in recent years in America that you begin to wonder who is *not* one.

But this interest in entrepreneurship by governments is not solely an American phenomenon. An entrepreneurship center actually exists today at the University of Havana in Cuba. An entrepreneurship course is today required by law for every university student in Chile. Also, Chile encourages immigrant entrepreneurs with grants to start firms. In another example, Singapore has spent billions of dollars to attract biotechnology entrepreneurs including building an enormous biotechnology incubator facility. The hunt was on for growth-oriented firms regardless of the cost or even if they could be sustained.

The European Union (EU) took up the entrepreneurial growth challenge some two decades after the USA when they signed the Lisbon treaty in December 2001. This treaty specifically states that the key to a sustainable prosperity in the EU lies in substantial support of entrepreneurship thus creating economic growth. This was the first 10-year strategy that set out to create conditions among European member states to place Europe in a leading position economically. Ten years later the runner-up 10-year strategy was presented, EU2020, which now focuses on innovation.

While Europe was a bit slow to catch on en masse it is fair to say that the dominating assumption since the 1980s has been that firms need to survive *and grow*. That is, neither “no growth” nor “slow growth” is seen as acceptable by politicians (Birley 1987; Brännback and Carsrud 2008). Growth became the mantra, however poorly defined. To many politicians growth meant jobs and jobs meant being re-elected. Clearly, the motivation for politicians often was keeping their jobs and political power. However, growth for entrepreneurs was usually measured somewhat differently, usually in terms of market share.

Entrepreneurs are not concerned typically with the number of employees, who while a potential asset, are also a cost center and thus may reduce profit margins. Clearly some firms like Costco, the wholesale giant in America, view employees as assets critical to sales in their retail stores. Often family firms see employees as both assets and family, but growth in employee numbers is still not a goal to these firms, notwithstanding the findings of Coopers et al. (1989). These kinds of firms are frankly quite rare. Most larger and established firms typically look at employees as liabilities or a cost center. But we digress here, so let us return to the story of entrepreneurs and how they view growth.

Entrepreneurs and investors often have assumed that if a new firm grew and captured market share the business would somehow, sooner or later, be “successful,” however success might be defined. The more and faster you grew the better. Certainly venture capitalist (VC) wanted the entrepreneurs they worked with to focus on market share growth prior to the VC cashing out in an IPO or other exit strategy as an investor. Success for the VC clearly is the price per share they obtained upon exiting the firm. Long-term viability simply is not a major goal of the VC, nor has it been for hedge fund managers or many merger and acquisition (M&A) funds who often load a firm with debt before exiting. Share price as measure of success only applies to a very small fraction of firms, as most firms never go through an IPO or are acquired by another firm in an M&A. This may be one reason why for many entrepreneurs VCs are really *vulture capitalists*.

This new emphasis on growth was also a major shift for academics in their assumptions about firm performance. That is, scholars within traditional economic theory had assumed that small firms are primarily profit-oriented (Birley 1987) and not growth oriented. But clearly things were changing in academia as there where in the public policy realm.

2.4 Academic Interest in Growth of Entrepreneurial Firms

In looking at the topic of growth, it has been a major research topic for a long time within strategy where scholars assume that growth is the key objective for any large firm. How growth was defined and measured, however, was not always precise (Kiviluoto 2014, 2011; Brännback et al. 2009). As is typical in most work looking at nonpublicly held large firms one is dependent on what a CEO or owner was willing to tell a researcher. That is, measures were often based on self-reported data. As with

all self-report data it is subject to a wide range of bias. When an entrepreneur talks to a tax collector, you would think their firm was on the brink of bankruptcy. Yet, at a cocktail party the same individual will tell you he is the next Steve Jobs with an Apple.

If one wanted more “accurate financial data” it required looking at large publically held firms listed on stock exchanges. Clearly even public firms can “fudge” the books and keep financial information hidden, as most Americans understand in the recent financial crisis involving banks, known as the “Great Recession” where derivatives often hid damaging if not toxic assets. That is, we all know that understanding how well a firm is doing is not a simple measurement issue regardless of firm size. We will discuss measurement issues later in this book, but now we turn to growth in entrepreneurship research.

Growth as a research topic by entrepreneurship scholars started to emerge around 1987–1988. In fact, it spurred the start of what is now one of the leading journals in the field, which looked at VCs and growth. The *Journal of Business Venturing* was founded in 1986 and shortly thereafter papers specifically focusing on firm growth started to appear in 1987 as Sue Birley noted in her article of the same year. Other journals followed suit in the pursuit of growth as a differentiating factor. For example, the *American Journal of Small Business*, which was founded in 1976, became *Entrepreneurship Theory and Practice* in 1988. In the editorial titled Winds of Change in the first issue of volume 13, Ray Bagby wrote (1988, p. 5):

While we have always had entrepreneurs, the study and teaching of entrepreneurship is a relatively new academic discipline. Constrained resources, global competition and tremendous technological advances create the need for more innovative management than has ever been required in the past. Although small firms have always outnumbered large ones in our economy, their contribution seems to have been undervalued in the past. The recent revelations that these firms are often best positioned to cope with the threats and take advantage of the opportunities associated with our increasingly dynamic environment have generated more interest in studying them.

This quote could very well have been part of an introduction to an article calling for the need to study growth entrepreneurship 25 years later in the twenty-first century. Clearly in 1988 Ray Bagby, the journal’s editor, was reflecting on the impact of David Birch’s work of a decade earlier on the increasing interest in entrepreneurial firms by a number of groups, including academics. The era of studying “boring” small firms was about to be eclipsed by studying “exciting” growth-oriented entrepreneurial firms. While what academics’ study may seem a bit boring at times, this discussion shows a fundamental shift in focus for thousands of academics worldwide. There was an explosion in journals as well from a mere hand-full to now over 100 in the English language alone, all focused on entrepreneurial firms. The oldest journal in the field, the *Journal of Small Business Management*, carries the by-line now of *Advancing Entrepreneurship Research Worldwide*. In addition, academic conferences on entrepreneurship have grown in numbers as well, the annual meeting of the US Association for Small Business and Entrepreneurship is one such example. At least 80 such meetings occur around the world annually operated by a number of organizations, universities, and governmental agencies.

In what many consider the premier research meeting in the academic field of entrepreneurship—The Babson College Entrepreneurship Research Conference (BCERC)—growth as a dedicated track did not occur until 1988. Prior to that year, a track labeled entrepreneurial strategies existed. In 1988, a track with the title “Strategy and Growth in Entrepreneurial Businesses” contained three papers and four summaries. Only one summary specifically dealt with growth (Hills and Welsh 1988).

Another paper of historical interest is an early paper presented at BCERC in 1982 by Bill Dunkelberg and Arnie Cooper, titled “Entrepreneurial Typologies.” Their study identified three typologies based on the orientation of the entrepreneurs: growth, independence, and craftsman. In a sample of 1805 founders, 74 % could be classified into one of these three typologies. Of these, 45 % were identified as growth oriented. Growth was measured as the compound annual growth in number of employees. Those identified as growth oriented indicated a desired growth rate over the next 5 years of more than 30 %. Moreover, the paper by Kirchhoff and Philips (1987), which initially was presented at BCERC, was in a track of papers labeled “economic development.” In these studies, growth was measured as employment growth as a percentage of something, i.e., a relative measure. As will be argued later, relative and absolute measures are problematic with respect to venture growth.

While “*growth*” was the buzz topic of the time (and in still is), research results that questioned growth also started to occur. For example, early on a study by Birley (1987) showed that *employment growth was not the primary goal of entrepreneurs*. Interestingly, no aggregate growth occurred in the sample of her study and there was not an age effect with respect to firm growth. Those few firms that did manage to “grow” did so by increasing sales *without* hiring more employees. One can ask any entrepreneur if one of their goals is to hire people and most will usually respond that it is not high on their list unless they have no other choice. Here is where the entrepreneur’s goal is very different from the goals politicians have for entrepreneurs (Brännback and Carsrud 2008). Clearly growth is in the eye of the beholder.

2.5 The Growth Challenge

With growth entrepreneurship being recognized as important for national wealth creation by politicians in the early 1980s it started to evolve as an interesting research topic for academics toward the end of the 1980s. In some ways, this was driven by research dollars to understand the “new” phenomena and by donor dollars for what now has become over 200 chaired professors in the field. Since then the interest continues to grow tremendously. Politicians and researchers have seen growth since then (almost without hesitation) as being good and something any entrepreneur should pursue. Growth has almost become synonymous with entrepreneurship. In fact, there are those in academia who will argue that growth is the same as entrepreneurship. That is, entrepreneurship without growth is not entrepreneurship, perhaps at best the uninteresting area of small business management.

However, growth is not the self-evident goal for most entrepreneurs (Cooper et al. 1989). It is also extremely challenging for almost anyone to achieve high levels of year upon year growth. Even the vaunted Steve Jobs at Apple realized that double-digit growth rates year over year takes its toll on the firm and its suppliers. That is, the primary goal for many entrepreneurs is not growth, but some other goal and growth just happens to be a consequence of achieving that other goal (Carsrud and Brännback 2011a). In fact, growth, and in particular high growth is a very rare phenomenon, but the way popular press and media deals with the topic one may think it is common, natural, and almost easy. Just because you found one black swan does not mean that now all swans are black.

Amazon, Facebook, Google, Apple, and even Microsoft are all outliers when it comes to entrepreneurial firms overall, yet these are the ones we see in the media constantly seen as “typical.” Research studies and publicly available statistics show a different reality when it comes to growth. High or rapid growth is sexy for media attention while sustainable growth is boring but in the end usually wins most races. Even at some point these darlings of the media have to undergo a process of renewal as has happened at Apple and is happening at Microsoft. We have forgotten that Digital Equipment and Nortel were the examples of growth firms before they ceased to exist in stunning bankruptcy and sales of assets.

2.6 The Reality of Growth: The Other 97 %

Most companies start small and remain that way (Cooper et al. 1989). Many entrepreneurs really have no desire to create a huge corporation, go public, or even hire lots of people. That is “growth” may not be the driving goal for many who start firms. We once worked with a Chilean biotechnology firm that had developed a treatment for a disease that threatened the vast Chilean salmon farming industry. The Government of Chile wanted the female scientists who started the firm to grow rapidly, which was not what they wanted. The government wanted a growth firm; the scientists wanted an R&D firm.

Despite these conflicts in goals, many of the resulting entrepreneurial firms manage to survive even succession crises and live on as a major part of most economies (Carsrud and Brännback 2014). This is why family firms exist and in some sectors dominate. However, most founding entrepreneurs wish to have a sustainable business that will afford them and their families a comfortable life and a modicum of wealth accumulation even if there is not an exit such as an IPO or M&A (Carsrud and Brännback 2014). Some entrepreneurs may have a goal of bringing some technology to the market place as Steve Jobs did or curing a disease as we see in those behind many biotechnology firms. Growth for these entrepreneurs is a fall-out from achieving other goals for their firms. The reality is that of all start-up firms only 3 % ever manage to add on more than 100 employees (Aldrich 1999). The rest, 97 % remain small or medium size firms with well under 250 employees in the USA and even smaller in Europe.

Why is so much attention given to this 3 % and what about the other 97 %? One answer noted earlier is that high growth firms are "sexier to study than small firms." Another is high growth firms make better stories for the mass media, which is obvious if you pick up any business newspaper or magazine anywhere in the world. Whole magazines, like *INC.* and *Entrepreneur*, are devoted to these firms. Those that do not grow are usually seen as dull and mundane, and seemingly quite boring to the outside observer even though they exist all around us. Being a small business owner is just not as sexy as being an entrepreneur in my circles.

A third reason—being somewhat cynical—is that those professors studying entrepreneurship did not want to be labeled as *small business management professors*. This area has traditionally been considered the bottom of the academic totem pole in business schools only slightly above sales management but below human resources. Therefore, growth entrepreneurship was seen a conduit to enter a new field (that was even considered important to society) and to hopefully become the new, spectacular star entering the limelight on the academic stage.

Faculty, deans, and college development offices also realized this was where both research dollars and endowments were more likely to appear. They perceived that entrepreneurs would donate chaired professorships and centers, while small businesses were perceived as rarely giving significant endowments to universities. The rush was on, from a mere 3 journals in the field 30 years ago, now over 100 exist in English alone. From a mere hand full of endowed chairs and professorship in entrepreneurship there are now over 400 in the USA alone.

Academic entrepreneurship has become its own growth business as represented in the rapid growth in size of the Entrepreneurship Division of the Academy of Management and the now over 100 meetings for those researching entrepreneurship. Clearly, the academic field of entrepreneurship is a growth business, but the level of sustainability has yet to be determined. Where there is money college deans see plunder to pick and used elsewhere. Even academics have their own forms of *culture capitalists*.

2.7 It is not Always Brand New

For three decades, the focus has been to develop, foster, and study a small part of all firms—the 3 % of all newly starting firms. The reality today is that we still do not know how to efficiently identify those companies that belong to this 3 % of growth firms. It is often very hard to tell a baby mouse on steroids from a baby gazelle although Cooper et al. (1989) did try to provide some evidence as to what the "steroid" was. Often when we claim to be studying entrepreneurial ventures in reality we are studying well established large corporations (that indeed were small at a time, but not studied then) such as Amazon, Amgen, Apple, Facebook, Google, Starbucks, Southwest Airlines, or Ryanair and then try to generalize backward. When Harvard Business School or Ivey in Canada writes a case study on your firm as a growth firm you clearly have become a part of a training program for some would-be entrepreneur somewhere.

As academics we seem to think that if we teach our students as would-be entrepreneurs to copy the models of these rare breeds we will have given our students the secret recipe for success. For example, both People Express and Ryanair are based on the Southwest Airlines model, but so far only one of the “clones” remains alive and clearly exists in a different context. If we really only foster copycats it is a fairly simple exercise to determine when the market is saturated and any other new firm is then left to live on the leftovers. This in some ways was what happened with People Express Airlines as noted in the introduction to this book. Some copycats will succeed and other will not. But how will we know which one will without waiting for years? Copying an existing model and expecting it to create high growth is more an example of Israel Kizner’s view of incremental entrepreneurship than it is of Schumpeter’s frame-breaking model. Neither approach is a guarantee to success or growth.

Moreover, we like to think that growth is linear—it is rarely the case. While, Amgen was created in the early 1980s it took them several years to launch their first product. In fact in Amgen’s business plan the drug that ultimately saved the firm and its investors was listed as an after-thought. The firm had spent millions on a drug that failed and its only fall back was the ultimate savior of the firm. Even Apple was a company in serious distress several times. It often looked like it was on a roll-a-coaster ride depending on Microsoft to bankroll it at one point. Only after shifts in leadership, product lines, and markets did it reach its current zenith, which is now under attack by Google and Samsung.

In another example, Google has bought Motorola Mobile and is now a serious contender for the pole position of the global mobile phone market. The once proud technology leader in cellular phones, Nokia, seems to be more worried about survival as an independent company than being a model of high growth. Rovio, the company behind Angry Birds created 51 computer games before they finally hit the box-office success. Should all start-up companies now enter the computer, or mobile game market? Hardly!

Google, Rovio, and Apple probably are examples of firms within the rare 3 %. It should be remembered that 3 % is one with a revolving door, many enter and most leave just as rapidly. Think of Digital Equipment, Compaq, and Nortel when you realize just how fast the door really revolves. All of the firms mentioned previously were at one point in their existence excellent role models inspiring many starting entrepreneurs. Certainly as academics we know our students see a start-up smartphone app company gets bought for millions and think the process is quick and simple.

But, if these are part of the 3 % we are still left with the fundamental question: what about the other 97 % that will not become high growth firms? The success stories are frequently retold in popular press, business periodicals, and academic research journals, as are the dramatic falls from the heights, like Blackberry (formerly known as Research in Motion). However, rarely do these texts describe how long it took for the firm to reach this level of success. Most forget the bad times at Apple, or the challenges of Rovio prior to Angry Birds came on the scene.

Understanding the Myth of High Growth Firms

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