

You never know ...



Wanted: Entrepreneurs

(Just don't ask for a job description)

*If entrepreneurship is so important,
why don't we know more about it?*

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All the world loves an entrepreneur. They are the business equivalent of the date you bring home to your mother, or the people you consider role models for your kids, because they are seen as honest, bright, hard-working and successful. Most of us want to be one ourselves. Indeed, most countries and their policymakers are busy trying to find, encourage and grow more entrepreneurs.

But despite their prized status, not to mention their ubiquitous presence in many economies, entrepreneurs are like Heffalumps, the exotic creatures hunted by Winnie-the-Pooh and his friends. Everyone “knows” what Heffalumps and entrepreneurs are. But ask for details, and you get a wide range of physical, behavioral and environmental descriptions.

Wesleyan University economist Peter Kilby first made the Heffalump analogy close to 40 years ago. Since then, research on entrepreneurship has multiplied considerably, especially in the past decade. Still, the Heffalump syndrome continues to plague the study of the topic. “Although entrepreneurship has become a buzzword in the public debate,” notes a 2008 article in the journal *Foundations and Trends in Entrepreneurship*, “a coherent definition of entrepreneurship has not yet emerged.”¹

Such irony is not lost on those who have spent careers trying to build a better mousetrap for measuring entrepreneurship. “It’s a wonderful word for

raising money, but terrible for conducting research. It’s too vague of a word. ... There are so many different ideas of entrepreneurship,” says Paul Reynolds, professor of management at Florida International University and principal investigator in three major efforts to gather data on entrepreneurs.

Some might pooh-pooh (so to speak) the semantic worries of researchers pursuing this elusive economic phenomenon and the person who brings it to life. But countries ignore the matter at their own peril, because entrepreneurship is increasingly seen as the wellspring of healthy, growing economies, and failure to understand the dynamics of the person and the process makes it unlikely that economies will get optimum levels of either.

Much has been accomplished in the research community in the past 10 years or so. As a result, certain traits and other descriptive matters regarding entrepreneurs are better understood. But large gaps remain, in part because researchers have generally avoided stating what they really mean by “entrepreneurship” or generating a convenient definition of their own. As a result, some of the most important insights regarding entrepreneurship’s role in state and national economies, and its behavior in different economic environments, remain beyond our grasp.

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A working definition

So let's start from the beginning—that comfortable spot where we talk about entrepreneurs with nodding agreement.

An entrepreneur is a person who conceives, develops and operates a new business venture, assuming both the risk and reward for his or her effort. Entrepreneurs are often celebrated for their vision, derring-do and conviction to do it their way. Those who succeed make society better off for the jobs created and new goods or services delivered that make life more productive, comfortable or convenient. Success typically leads to financial gain for the entrepreneur, and sometimes extreme personal wealth. Such traits make entrepreneurship the seed and roots of the American Dream.

And there are a lot of dreamers out there. In the United States, about 12 million people are undertaking some entrepreneurial endeavor, according to the U.S. Panel Study on Entrepreneurial Dynamics. It also estimates that “perhaps up to one-half of all adults are engaged in self-employment or the creation of a new business at some point during their work career.”² Worldwide, the Global Entrepreneurship Monitor estimates, a half-*billion* people are trying to create a new business every year.

Cultures differ in their regard for entrepreneurs. The pedestal is high in the United States. Robert Litan is vice president of research and policy at the

Kauffman Foundation, based in Kansas City, Mo., and believed to be the largest foundation with a focus on entrepreneurship. Litan says entrepreneurship has been noticeably on the rise, something he attributes to certain conspicuous successes of the 1980s, when garage-born, pioneering firms like Microsoft and Apple came into prominence. That momentum was further boosted in the 1990s when the Internet opened untold opportunities for new business ideas.

“America has seen a regeneration of its economy largely on the growth of entrepreneurs, and it has become part of the culture,” Litan says.

Not all cultures hold entrepreneurship in such high esteem. The German, French and Japanese economies, for instance, have historically placed high value on the security and stability of large, mature firms. But in Europe, too, the profile of entrepreneurship is rising. In a 2008 report, the Paris-based Organisation for Economic Co-operation and Development says that in recent years “entrepreneurship has become a buzzword that’s entered the mainstream. Politicians continuously cite its importance and the need to create more entrepreneurial societies, and newspapers and television programmes frequently create themes around successful entrepreneurs.”³ The OECD itself has a center devoted to the promotion of entrepreneurship.

Research has shown that economic growth is strongly associated with the creation of new firms because they generate jobs and improve productivity through adaptation and change. New firms tend to push out old ones, and this churn is believed to rejuvenate economies—a critical matter in a hyper-competitive global economy.

But we don’t know much about the entrepreneurial process itself—the conception, development and entry into economic life. We know about this stuff anecdotally, but we don’t know it systematically. Many perceive entrepreneurship to be similar to biological gestation, where all firms develop in similar, predictable stages. Reynolds says such a model “is really inappropriate” because surveying to date has shown “that there is no one thing people do first or last.” There are general patterns, he says, but enough variety to frustrate any paint-by-numbers model.

In Brief

Still hunting Heffalumps

- Entrepreneurship is the new buzzword, and policymakers in many nations and states are trying to develop more entrepreneurs because of their positive effect on jobs and productivity.
- But while the term is familiar, there is little agreement about what entrepreneurship is, what it does and how it happens. Recent research has improved understanding of some descriptive features of the entrepreneur, but we still don’t know much about the entrepreneurial process itself—conception, development and entry into economic life. As a result, some of the most important insights regarding entrepreneurship—and any ability to encourage more of it—remain beyond our grasp.

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Government statistics offices have only recently started paying the topic much formal attention. The topic of entrepreneurship “has been around for hundreds of years,” says Tim Davis, head of the new OECD Statistics Directorate program tracking entrepreneurship performance. “But it is true that only in the last 10 years or so that government and serious statistical offices have said there’s something there to measure.”

A bird’s-eye view shows a lot of research on this topic of late. For example, the Entrepreneurship Research & Policy Network (part of the Social Science Research Network) was started in March 2006 and already consists of more than 4,300 papers. Babson College’s most recent annual compendium of entrepreneurship research includes close to 200 papers in 26 categories. Universities are adding faculty and entire programs to study and teach entrepreneurship. In 1996, the Kauffman Foundation and the University of Maryland started what would later become the Global Consortium of Entrepreneurial Centers. Today, the network includes more than 200 universities.

Such activity and attention has improved our understanding of entrepreneurship, particularly here in the United States. For example, we have a much better idea of the socio-demographic characteristics of entrepreneurs: Men are more likely than women to start their own business; immigrants have higher entrepreneurial rates than native-born; people in their 30s and 40s have the highest rates by age. Reams of descriptive details about entrepreneurs exist on topics ranging from financing to household and educational background to human resource management and psychological makeup. Says Reynolds, “The increase in knowledge of basic features of entrepreneurship has grown dramatically in the last 15 years.”

You think you’re so smart

But that’s less progress than you might think. It seems that the more we study and the more we learn about entrepreneurship, the more vast and complex the subject becomes. We see how little a dent has been made. Most important, existing research does not address the dynamism of the entrepreneurial process that society is ultimately most interested in encouraging; it describes the sorcerer’s features without revealing how the magic occurs.

In a 2006 essay, New York University economist William Baumol writes that while the entrepreneur is often mentioned and his or her role emphasized, “the discussion of the subject is most frequently very brief, and consists generally of a listing of the tasks of the entrepreneur—organizing of the firm, risk bearing, etc., with little that aspires to the status of sophisticated theory.” Baumol says this gap in the literature “is not neglect of a peripheral matter, but a gaping hole in our understanding of the economic mechanism.”⁴

Getting at the enchantment of entrepreneurship might seem an impossible task. But doing so is fundamental if the hope is to somehow understand and channel that magic for society’s benefit. And this brings us back to Pooh’s hunting party and the elusive Heffalump. One of the few things the research community seems to agree on is that there is no agreement on what entrepreneurship is or does. Says Litan, from Kauffman, “That’s a very contentious issue.”

Worse yet, researchers haven’t really bothered to stop and argue it through. They each hunt their own particular Heffalump, which may or may not resemble others’. As a result, the challenge of studying and understanding entrepreneurship “is made all the more demanding because of the considerable confusion that exists in the way that people use the term entrepreneurship,” says a January OECD report. “Indeed, even the OECD itself has contributed to the confusion since virtually every study that has focused on entrepreneurship has presented a different definition of the term.”⁵

The problem can be traced in part to society’s casual agreement on what an entrepreneur is and does. The term itself is attributed to Irish economist Richard Cantillon, whose 1732 essay on commerce, written in French, devoted attention to those who *undertake* economic activities that involve both risk and potential gain. In English translation, that person is an “undertaker,” but in French, he or she is the far more elegant “entrepreneur,” from the same root as “enterprise.”

Austrian economist Joseph Schumpeter, who made popular the phrase “creative destruction,” is widely viewed as the father of modern entrepreneur theory for his extensive work on capitalism, business cycles and the role of innovation. But save for

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We all know that entrepreneurship sometimes comes out of necessity—after the loss of a job or the inability to find a job, for example. Other times, entrepreneurship springs from the recognition of a market opportunity. Purists believe that entrepreneurship—at least the kind with the most economic potential—comes from capitalizing on a new idea or product, not from bootstrap undertakings.

Entrepreneurs *from page 15*

his emphasis on innovation, Schumpeter never went much beyond fairly general notions of the entrepreneur.

Trying to define

But aside from creating a general identification and exaltation of the entrepreneur, analysis of the entrepreneurial process has remained primitive. The lack of something as basic as a definition of entrepreneurship—much less a sophisticated model of it—effectively crumbles research efforts into mini camps of decentralized thought, many of them inapplicable to each other because each uses a subtly different definition, whether about the entrepreneur or his or her endeavor.

Don't believe it? Here's a quick test: When does entrepreneurship start? With the idea? When the first dollar is spent developing the idea? When a tax identification number is issued? Or maybe when the first dollar of revenue is earned, or the first employee hired? And when does a firm discontinue being an entrepreneurial activity? How do we know? And what does it transition into, exactly? All of these are discrete stages of the entrepreneurial process, but research to date assigns no particular empirical significance to any of them.

There are many other distinctions to haggle over. For example, we all know that entrepreneurship sometimes comes out of necessity—after the loss of a job or the inability to find a job, for example. Other times, entrepreneurship springs from the recognition of a market opportunity. Purists believe that entrepreneurship—at least the kind with the most economic potential—comes from capitalizing on a new idea or product, not from bootstrap undertakings.

To go a step further, many believe that genuine entrepreneurship transcends the recognition of a market opportunity and must involve innovation as well; to Schumpeter, innovation was fundamental. Litan subscribes to the innovation theory, because the underlying social goal of entrepreneurship is growth.

"It's too easy to equate entrepreneurship with small businesses," he says. "Most small business is what we call replicative"—businesses that take existing services or products and bring them to new markets, or tweak existing services and products for

a new niche. "We're not dismissing those that do it. But innovative entrepreneurship provides substantially more benefits" to owners and society, Litan argues. "They are the engines of growth."

Maybe so, but our ability to measure innovative entrepreneurship is almost nil; U.S. data systems can't even distinguish between endeavors undertaken out of necessity and by market opportunity. Not everyone buys into the innovation-only model. Some argue that it undervalues the added competition brought by replicative businesses, which keeps a lid on prices.

Indeed, the definition of innovation itself is another argument waiting to happen. For example, is Starbucks considered innovative? Its signature product—coffee—certainly isn't new, or even particularly different from anything that came before it. The firm's corporate franchising model isn't particularly new or different either. But with stores worldwide, tens of thousands of employees and a market cap in the billions, the company undoubtedly qualifies as innovative in some capacity and as entrepreneurial at some point in its development.

And that's fundamentally the problem: We don't know—or agree on—when a firm has started, what qualifies it as entrepreneurial or when it stops being entrepreneurial. Though research is trying to fill in the gap, too often study populations are subjectively defined in terms of their entrepreneurial characteristics and qualifications. While such studies certainly offer some utility, a shifting study population undermines any attempt to build coherent theory or models.

The big dig

Getting at these complex empirical research matters is both a problem and an opportunity for the research community. Indeed, you might say the research community is confronted with its own entrepreneurial test.

Litan estimates that there are more than 50 journals dedicated to the topic of entrepreneurship; many of these journals occupy narrow intellectual niches and have few readers. Litan wants to see the topic tackled by mainstream academic journals. "Unless [entrepreneurship research] is mainstream, it will be marginalized," he says. But economists "can't work without the data."

In March, the foundation released the Kauffman Firm Survey, a panel survey that tracks about 4,900 businesses founded in 2004. The survey's origin, according to the report, stems from the disconnect that "entrepreneurial activity is an important part of a capitalist economy, [yet] only a small amount of data are available about U.S. businesses in their first years of operation."

By anyone's standard, however, gathering good data is a slow process. Part of the problem is institutional inertia. Governments have long been data warehouses, cranking out and storing vast troves of information on businesses. Today, little of that data-gathering is dedicated to entrepreneurship, or even small business, because it hasn't been part of the research agenda in the past.

That orientation is not accidental, or even necessarily ill-conceived. In 2007, the National Research Council (NRC) published a lengthy report on the nation's ability to track business dynamics—the formal name given to birth and death cycles of business. It points out that, historically speaking, government's "predominant focus" in data-gathering was to measure output and jobs, with a focus on large firms because they account for most of the economy's output and employment (and one of the reasons the somewhat ironically named Small Business Administration defines its core audience as any firm with fewer than 500 workers). As a result, the report states, "the U.S. business data system is inadequate for understanding many of the mechanisms leading to greater productivity and innovation or the dynamics of firm and job creation."⁶

Some matters that seem both simple and necessary for understanding today's economy, and entrepreneurs' role in it, are left to guesswork. For example, business data are disaggregated along numerous dimensions—employment, geography, industry sector—but virtually no published data exist on the age of firms. As a result, it's often assumed that small businesses are young and that large businesses are old, even though we know that's not the case.

The NRC report notes that available data have improved: Government agencies like the Census Bureau, Bureau of Labor Statistics and Internal Revenue Service have long had administrative records with data on key developments in the life of a firm, such as receipt of an employer identification number or when positive cash flow or profits are achieved. Agencies, as well as independent researchers, have been digging into these databases to construct better longitudinal data sets for young and small businesses. The Census Bureau, for example, is expected to release new data this year

on firm births and deaths, and employment changes attached to each, going back to the late 1970s. Currently, such data go back only to the 1990s.

Yet despite recent progress, according to the NRC report, "substantial data gaps remain." That's because shifting the government's data collection system to new objectives is not a quick or easy matter. "It changes paradigms and they are not comfortable with it. They know what they've got [regarding existing data collection] and they want to keep it," says Reynolds.

Brick by data brick

Without assertive buy-in from government statistics offices, the creation of good data sets will evolve slowly. But the needle is moving.

The Kauffman Foundation has been pushing hard for better data sets, funding academic pursuits and pushing the envelope with its own research. For example, the Kauffman Index of Entrepreneurial Activity resulted from mutual interests with economist Robert Fairlie, of the University of California-Santa Cruz, and is one of the few nationwide measures of entrepreneurship at the state level.

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Kauffman also supported two of the earliest—and to date, still most significant—efforts to build longitudinal data sets on entrepreneurs. The godfather of such efforts—going "way back" to 1998—is the U.S. Panel Study on Entrepreneurial Dynamics, a project that evolved out of earlier survey work by Reynolds and was later joined by Richard Curtin at the University of Michigan. PSED was groundbreaking because it captured early stages of entrepreneurship (what Reynolds and Curtin refer to as the "nascent" stage) before an endeavor was picked up on official government registries. It's the period we all know exists, but previously had only anecdotes to work from.

To date, over 60 countries have participated at least once, and GEM [Global Entrepreneurship Monitor] has more than 200 researchers worldwide participating in the project. It touts itself as “the largest single study of entrepreneurial activity in the world.”

PSED provided the first readings of this developmental stage by screening 62,000 households to find 830 active nascent entrepreneurs, which it defined as anyone admitting to startup activity in the past 12 months, who also had the expectation of owning all or part of the new firm, and having no positive cash flow covering all expenses and employees for six of last 12 months.

Study participants were initially interviewed for 60 minutes and then three additional times over a four-year period. They were asked almost 500 questions, providing a level of detail about entrepreneurs and the firm development process that is unmatched. That’s both a problem and an opportunity, according to Reynolds.

“It’s very hard to get nascent on the phone because they are very busy people. They’ve got full-time jobs and families and kids and everything else,” says Reynolds. But “once we get them on the phone, we can’t get them off, because it’s a very sophisticated interview. It’s like low-level consulting. [The nascent entrepreneurs] stop the interview to take notes.” A new and enhanced project—dubbed PSED II—started the process over again in 2005 with a new batch of about 1,200 nascent entrepreneurs.

The original PSED also sparked the first effort at comparing entrepreneurial activity among countries, ultimately developing into a separate project called the Global Entrepreneurship Monitor. GEM had to overcome enormous hurdles—shoestring budgets, translation of the survey into dozens of languages, lack of sophisticated survey firms in some countries—but has managed to conduct 2,000 interviews per year per country (with a few exceptions), starting with 10 countries in the first year (1999) and expecting to increase to 42 countries this year. To date, over 60 countries have participated at least once, and GEM has more than 200 researchers worldwide participating in the project. It touts itself as “the largest single study of entrepreneurial activity in the world.”

Among many findings from these ongoing surveys, GEM has found an inverse relationship between entrepreneurship and gross domestic product—in other words, poor countries tend to have very high rates of entrepreneurship, much of it based on necessity.

As coordinating principal investigator of the GEM project in its early years, Reynolds acknowledges that GEM is “not a perfect data set.” But he points out that it “is the only harmonized comparison of business creation across this wide range of countries in existence.” And with a half-billion nascent or operating entrepreneurs worldwide, “this [is] on the scale of a lot of other major social phenomena,” Reynolds says. “It’s that scale of activity that you begin to realize that entrepreneurial activity is really this phenomenal activity that we didn’t really understand before.”

And the rising profile of entrepreneurship is motivating more countries to take a closer look at the phenomenon. In most OECD countries, entrepreneurship is becoming a policy priority, says Davis, of the OECD’s Statistics Directorate. That might not seem surprising, he admits, but even recently “there was very limited involvement of official national statistics offices in anything that was called entrepreneurship. In fact, you could go to all of the national statistic offices, and never see the word ‘entrepreneurship.’”

In the fall of 2006, the OECD and Eurostat kicked off an “entrepreneurial performance” program to track employer firms and their growth over time among a voluntary group of 15 member countries, with the hope that all OECD countries would join eventually. The effort is not plowing new ground in terms of surveying and other data-gathering. Rather, the project has established fundamental definitions and a framework of performance indicators. National statistics offices are being asked to mine existing databases because these repositories have the highest quality data and attention to detail, factors that facilitate credibility and comparability of the data, which is the whole point.

“We want to make entrepreneurship data boring. We want to make it mainstream. We want to make it part of the statistical program of the member countries, and develop a common language,” Davis says.

It was bigger than I dreamed

In April, the OECD released its first set of findings on entrepreneurial performance indicators, like employment growth. But knowing performance “is

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only the first step,” says Davis. Over time, the project will cobble together many data that will eventually allow researchers to investigate the many determinants of successful entrepreneurship. “That’s the next step, and a harder step.”

Kauffman’s Litan talks about “new frontiers” of research that help identify the red and green lights that entrepreneurs encounter. For example, talk to any entrepreneur about obstacles, and “you’ll very quickly have a legal discussion,” whether it be about government regulations, intellectual property or other matters of law, he says.

PSED I and II also offer the first attempt to aggregate the time and money put into startups, the latter of which they estimate at between \$40 billion and \$50 billion annually. What it shows is “how much (investment) never leads to a business. This is the social cost of this Darwinian process,” says Reynolds. He adds that future research might help reduce those dead-weight costs to society. Only about one-third of serious nascent entrepreneurs end up with an operating business, says Reynolds. “If we could get that to 50 percent, that would be a hell of a payoff. It wouldn’t take much for a lower social cost.”

This is why the Heffalump hunt matters. Only a better understanding of entrepreneurship in its living environment will give policymakers a chance at encouraging its propagation, or ensuring a better survival rate. The January 2008 OECD report says the absence of clear definitions and performance indicators for entrepreneurship has left policymakers “somewhat rudderless when it comes to developing policies” to facilitate entrepreneurship, particularly in the sense of international best practices.⁷ Many countries, for example, actively seek high-growth firms to fuel job and wealth creation. But in the absence of empirical data, policymakers play a game of how-about-this.


And in the end, the goal of coming up with a single definition of entrepreneurship might be terribly nearsighted. Likely more useful would be a model that identifies the many moving parts, traits and stages of entrepreneurship.

“The challenge of the future,” Reynolds says, is getting all of the research “into a more conceptualized scheme” that starts at idea generation and moves through the various stages of becoming a business (or not) and finally through the matura-

tion period or termination. “It’s a fun challenge when you realize how complicated it is.”

But he also points out that we’re not chasing this Heffalump for the fun of it. As market economies spread worldwide, entrepreneurship and innovation are widely believed to be the comparative advantage for national economies; a better understanding of both likely holds an important key to future growth.

The nice part is that once researchers have decoded the DNA of entrepreneurship, and recognize the environment in which it thrives, a perfect title awaits the tell-all book that will unmask this phenomenon:

What color is your Heffalump? 

Endnotes

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