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Do serial entrepreneurs run successively better-performing businesses?

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ABSTRACT

This paper investigates whether – consistent with theories of entrepreneurial learning by doing and resource acquisition – serial entrepreneurs' performance follows a rising trajectory over successive venturing spells. Or whether – consistent with theories of selective learning from failure and hubris – serial entrepreneurs perform better after experiencing a bad spell (and worse after experiencing a good spell). We test competing hypotheses about serial entrepreneurs' performance trajectories using Panel Study of Income Dynamics (PSID) data, which track the dynamic performance of a sample of American serial entrepreneurs for up to one-quarter of a century. The findings show that serial entrepreneurs obtain temporary benefits from spells of venturing which eventually die away. This implies that venturing generates benefits which spill over from one venture into subsequent ones, and it can provide a rationale for public policies which encourage re-entries by entrepreneurs, even if those entrepreneurs performed poorly in their first ventures.

1. Executive summary

There are two popular but mutually inconsistent conjectures about the dynamic performance of serial entrepreneurs. According to the first conjecture, which is informed by theories of entrepreneurial learning by doing and resource acquisition, serial entrepreneurs run ever more successful businesses over time. The second conjecture, which is informed by theories of selective learning from failure and hubris, asserts in contrast that serial entrepreneurs tend to be galvanized by poor performance, but fall into complacency traps if they become accustomed to success. Whereas the first conjecture implies that the temporal profile (or trajectory) of serial entrepreneurs' performance rises steadily over successive ventures, the second conjecture implies a cyclical performance trajectory. To date, research has not revealed which, if any, of these conjectures most closely accords with reality. The contribution of this paper is to explore whether serial entrepreneurs benefit more from successful or unsuccessful prior venturing spells — and more generally to reveal the performance trajectories of serial entrepreneurs' over successive ventures.

Why do we know so little about the performance trajectories of serial entrepreneurs? One possible explanation is that previous research has tended to rely on cross-section data which contain detailed information about only one of a series of businesses. The present paper attempts to extend our knowledge on this topic by exploiting a detailed and extensive longitudinal dataset, the US Panel Study of Income Dynamics (PSID), which inter alia contains data on multiple sequential ventures operated by the same individuals. Our paper exploits these data to provide an empirical analysis of the performance trajectories of serial entrepreneurs. We frame the range of different possible trajectories as a set of competing hypotheses. These hypotheses include not only the two mentioned above, but also a third hypothesis predicting temporary positive benefits from learning (consistent with theories of human capital depreciation) and a fourth predicting a flat trajectory. The competing hypotheses are nested within a general econometric specification of a first-order linear (performance) difference equation, which is estimated using dynamic panel data methods in order to identify which trajectory is most consistent with the data. We find that serial entrepreneurs' performance trajectories exhibit mean reversion: although good performance in one venture appears to be associated with good performance in

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subsequent ventures, these positive effects are nearly completely exhausted by the end of the next spell. These findings are consistent with the notion that benefits from venturing are temporary, and depreciate over time.

Our analysis and research findings carry several implications for entrepreneurship research and practice. First, a range of stakeholders, including lenders, are interested in discovering the likely risks and returns from participating in a serial entrepreneur's new venture. Performance trajectories may contain valuable information in this regard. For example, if performance tends to improve over successive ventures, banks might anticipate a greater prospect of seeing a return on their investments, and so become more willing to lend to serial entrepreneurs. The opposite might apply if performance tends to deteriorate over successive ventures. Second, entrepreneurs are known to be prone to over-optimism and other cognitive biases, which can cause them to experience poor performance in their initial ventures. This has prompted some experts to advocate tough bankruptcy laws, to discourage entrepreneurial “over-investment”. However, this recommendation implicitly assumes that entrepreneurs would do no better in subsequent ventures were they to re-enter. If serial performance trajectories predict improvements in the performance of subsequent ventures, gentler bankruptcy laws may be warranted. Hence appropriate public policies towards serial entrepreneurship may depend in part on what serials' performance trajectories actually are. Third, the prospect of a rising performance trajectory could induce risk-averse entrepreneurs to brave the hazards of start-up and make entry more attractive than if performance outcomes in successive ventures are unrelated. That realization could have a profound effect on initial entry decisions. For all these reasons, it is desirable to understand more about performance trajectories of serial entrepreneurs.

2. Introduction

Ever since MacMillan (1986) highlighted the centrality of serial entrepreneurs for understanding entrepreneurship, researchers have directed increasing attention to this important group. Several major contributions by Ucbasaran et al. (2003, 2006, 2008), Westhead and Wright (1998), Westhead et al. (2003, 2005), and Wright et al. (1997) have improved our understanding of issues as diverse as behaviors and opportunity recognition by serial entrepreneurs, and characteristics that distinguish serial entrepreneurs from both one-time (“novice”) entrepreneurs, and “portfolio” entrepreneurs who run several businesses concurrently. Theoretical and empirical research has also analyzed the entry and re-entry decisions of serial entrepreneurs (Amaral et al., 2011; Plehn-Dujowich, 2010; Stam et al., 2008), as well as their performance (Alsos et al., 2006; Gompers et al., 2010; Westhead et al., 2003, 2005). While these studies have certainly enhanced our knowledge about these aspects of serial entrepreneurship, it remains the case that relatively little is known about how serial entrepreneurs' performance in one venture is related to their performance in a subsequent venture they found. The profile of a serial entrepreneur's performance over successive ventures is termed a “trajectory” in this paper.

Much of what we know about serial entrepreneurship comes from cross-section studies of entrepreneurs which often focus on the entrepreneur's current or most recent business (Ucbasaran et al., 2006). Analyses of the performance of serial entrepreneurs therefore embody something of a static character, which has nevertheless facilitated interesting comparisons with other types of entrepreneurs, including novice and portfolio entrepreneurs (Westhead and Wright, 1998; Wright et al., 1997). Yet it is becoming increasingly widely recognized that we need to move beyond simple snapshots of serial entrepreneurs and to look instead at the dynamics of their venturing spells in general and their venture performance trajectories in particular. This promises to bring new questions into the purview of the researcher, including whether entrepreneurs' performance tends to improve when they try venturing again, perhaps because they learn from experience (Minniti and Bygrave, 2001; Parker, 2006) or acquire valuable resources in the course of the venturing process (Davidsson and Honig, 2003). There are several popular, but incompatible, anecdotal conjectures about the trajectories of serial entrepreneurs' performance over successive ventures, including an ever-rising trajectory as entrepreneurs perform “learning by doing” (Argote, 1999; Audia et al., 2000) and a “cycling” trajectory whereby serial entrepreneurs learn from and improve after failure, but fall into complacency traps and under-perform after they succeed (Entrepreneurship Magazine, 2009; Hayward et al., 2006; March, 1991; Simon et al., 2000). At present, we lack hard evidence, based on a large representative sample, about which trajectory best describes reality. The aim of the present paper is to fill this gap in the literature.

The paper starts by formally characterizing different possible performance trajectories of serial entrepreneurs, including those corresponding to the two popular conjectures noted above. We draw on previous theoretical literature – relating to learning by doing and selective learning from failure; human capital accumulation and resource acquisition; and hubris – to formulate a set of competing hypotheses about performance trajectories. We adopt a competing hypotheses framework because this is deemed an appropriate approach when prior knowledge gives rise to multiple reasonable explanations of a phenomenon (Armstrong et al., 2001), as is the case here. These hypotheses are then tested against each other using a sample of data taken from the US Panel Study of Income Dynamics (PSID). The PSID is a large representative panel survey which allows the researcher to follow serial entrepreneurs over several ventures for up to one quarter of a century. We then go on to estimate a dynamic panel data model of the performance trajectories of serial entrepreneurs across distinct businesses, to identify which trajectory is most consistent with the data.

This paper adds to previous research on the performance of serial entrepreneurs by extending the empirical analysis of serial entrepreneurship into a dynamic domain (Gompers et al., 2010). It does so by characterizing different serial performance trajectories, before estimating them using a sample of longitudinal data. We then draw out several implications of our results, which might interest a range of stakeholders, including lenders. For instance, information about serial entrepreneurs' performance trajectories could enable lenders to make better predictions of the profitability of new ventures proposed by serial entrepreneurs (Gompers et al., 2010; Ucbasaran et al., 2008; Wright et al., 1997). Lenders would presumably be more willing to fund the next venture of a serial entrepreneur if they believe that serial performance trajectories tend to rise rather than fall over successive ventures.