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The entrepreneur's mode of entry: Business takeover or new venture start?

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ABSTRACT

We extend the well-known occupational choice model of entrepreneurship by analyzing the *mode* of entry. Individuals can become entrepreneurs by taking over established businesses or starting up new ventures from scratch. We argue that the new venture creation mode is associated with higher levels of schooling whereas managerial experience, new venture start-up capital requirements and industry level risk promote the takeover mode. A sample of data on entrepreneurs from The Netherlands provides broad support for these hypotheses, and also bears out a prediction that entrepreneurs whose parents run a family firm tend to invest the least in schooling. We go on to discuss the implications for researchers, entrepreneurs and public policy makers.

1. Executive summary

It is common for researchers to analyze entrepreneurship in terms of new venture creation. Despite this emphasis, starting a new firm from scratch is not the only way individuals can become entrepreneurs. They can also take over an existing firm, including a family business if they come from a business owning family. One can therefore distinguish the *mode of entry* from the entry decision itself. Yet we currently know very little about the factors which determine the mode of entry which individuals choose, despite its importance for entrepreneurship researchers and public policy makers.

The present article aims to fill this lacuna. It does so by analyzing the entrepreneurial entry decision from the perspective of individual choice. The mode of entry choice is generally influenced by both a prospective business owner's personal characteristics and the intrinsic nature of a new business opportunity (Shane, 2003). This article analyzes individual-level determinants of the mode of entry, in particular individual-specific human capital, and so focuses on just this aspect of the mode of entry decision rather than on business aspects of new venture opportunities.

To this end, we develop a framework based on human capital theory and estimate it using a sample of data on Dutch entrepreneurs. The results reveal that important differences exist between the characteristics of entrepreneurs who opt for different modes of entry. We believe this carries several important implications for scholarship and practice. Most entrepreneurship researchers have not yet realized that the determinants of entrepreneurship entry might be distinct for different modes of entry. For example, many researchers define entrepreneurs as business owners and analyze the determinants of choice or success for this combination of self-starters and entrepreneurs who have taken over an existing firm. However, our study demonstrates that these entry modes are distinct. In particular, we find that individuals who come from business owning families and thus have the option of taking over a family firm will make different investments in human capital than their counterparts from non-business owning families. Taking over and running a family firm requires different kinds of skills and knowledge than

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starting up and running a new venture. The required skills and knowledge for family firm takeover are more likely to be associated with informal human capital conveyed through familiarity with a (parent's) business whereas the skills and knowledge required for new venture start-up are more likely to be obtained through formal education. Thus, we propose that individuals from business owning families with an option to take over a family firm invest less in formal human capital obtained through education than individuals from non-business owning families for whom this family firm takeover mode of entry is unavailable. This, our first proposition, is supported by the data.

We further argue that formal human capital will be especially useful for starting brand new firms relative to taking over firms (inside or outside the family). Formal education improves a person's ability to search and process large amounts of information leading to a greater ability to identify potential business opportunities. This ability is more valuable for starting up a firm than for a takeover, given the abundance of possibilities in new venture start-up compared to the takeover mode. Moreover, formal education, which is of general usefulness in the labor market, may be more valuable as a hedge for the greater risk borne by entrepreneurs who start-up a new business than for those who take over an existing firm. Thus we propose that more educated entrepreneurs are more likely to start-up a new venture than to take over a firm from outside of the family. The data show strong support for this second proposition.

Our third proposition combines the logic of the first two with the insight that informal human capital obtained in a family firm will be more applicable to another existing firm (obtained through outside takeover) than to a new venture start-up. Thus individuals from business owning families who do not take over the family firm will be more likely than individuals from non-business owning families to take over an outside firm than to start-up a new venture. The data support this proposition as well.

Another important dimension of formal human capital, managerial experience, is likely to be most productive in existing firms where it is especially likely that established personnel have to be managed. Our fourth proposition states that greater managerial experience enhances the probability of becoming an entrepreneur by takeover relative to new venture start-up. This proposition is borne out by the data too. In contrast, other types of experience, such as general labor market experience, industry experience, and previous business experience might be more critical in new venture start-ups than in firms acquired through takeover where other personnel are already engaged and can substitute for any shortfalls in these types of an entrepreneur's generic experience. In line with this, our fifth proposition states that entrepreneurs with greater labor market experience, industry experience, and previous business experience are more likely to enter via a new venture start-up than an (outside) takeover, compared with otherwise identical entrepreneurs with less of these types of experience. This proposition is not supported empirically in our study.

A further consideration relevant to our final proposition is that established firms are less risky than brand new firms. Indeed, evidence shows that on average brand new ventures have more variable growth and profit rates and lower survival rates than established firms do. In addition, problems of asymmetric information are more acute in new ventures compared with established firms, owing to the lack of a track record. As a result, access to finance and hence entry via a new venture start-up relative to takeover is likely to be more difficult the greater are capital requirements in a specific industry. Thus entrepreneurs operating in industries with higher start-up capital requirements and risks are more likely to enter via an outside firm takeover than via a new venture start-up. This sixth proposition is empirically supported.

Thus, we identify several salient determinants of entry modes. The paper concludes with a discussion of implications of the findings, and suggestions about possible directions for future research.

2. Introduction

An extensive literature now treats the decision to become an entrepreneur as an occupational choice. Recent research emphasizes the importance of several variables that may affect this decision, including borrowing constraints (Hurst and Lusardi, 2004; Parker and van Praag, 2006); human capital (Lazear, 2005; Hartog et al., 2010); geographical location (Acs and Armington, 2006); cognitive biases (Puri and Robinson, 2007; Lowe and Ziedonis, 2006; Hayward et al., 2006); and ethnicity (Fairlie, 2004). Much of this literature defines entrepreneurship as a transition into independent business ownership, and usually frames entrepreneurship in terms of new venture creation. Despite this emphasis, starting a new firm from scratch is not the only way individuals can become entrepreneurs. They can also take over an existing firm, including a family business if they come from a business owning family. One can therefore distinguish the *mode of entry* from the entry decision itself.

The present article analyzes the individual-level determinants of the mode of entry. Like many previous scholars, we define entrepreneurship as the junction where venturesome individuals and valuable business opportunities meet (Shane, 2003). But the focus of this article will be less on particular aspects of business opportunities and more on individual characteristics. Hence we take entrepreneurs to be people who engage in business venturing at their own risk, regardless of whether their mode of entry is to start a brand new firm or to take over an existing one. However, although our primary focus is not on aspects of business ventures such as organizational structure or past trading history, we also try to say something about the industry-specific nature of the opportunities embodied in different types of businesses.

There are at least two reasons why policy makers may be concerned with the mode of entry. First, the population is aging, especially in Europe, thereby increasing the potential for business transfers. According to the European Commission, ‘one third of EU entrepreneurs, mainly those running family enterprises, will withdraw within the next ten years. According to estimates this could affect up to 690,000 small and medium sized enterprises and 2.8 million jobs every year’ (Commission of the European Communities, 2006, p.3). The importance of business takeovers is also underlined by national data. For example, based on the age distribution of business owners, 20,000 firms per year are expected to seek takeover candidates in the next five years in The Netherlands. In comparison, 70,000 firms are started every year in The Netherlands (data source: The Dutch Ministry of Economic