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Exploring the impact of different types of prior entrepreneurial experience on employer firm performance

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ABSTRACT

We investigate the impact of prior entrepreneurial experience on current performance of firms with employees (employer firms). We distinguish between external entrepreneurial experience obtained outside of the current firm and internal entrepreneurial experience obtained within the boundaries of the employer firm currently run. Regarding the latter we focus on a special type of prior internal experience, i.e. as an own-account worker before scaling up to employer firm. Theoretically, both types of prior entrepreneurial experience are associated with different processes of learning-by-doing. Empirically, we find that both external entrepreneurial experience and internal experience as an own-account worker enhance employer firm performance. Our results therefore imply that, for individuals without any prior entrepreneurial experience wishing to start a new firm, a lean start-up strategy (as an own-account worker) is to be preferred over a more resourceful strategy hiring employees from the start.

1. Introduction

The 'liability of newness' (Hannan & Freeman, 1989; Stinchcombe, 1965) which is manifested in the high risk of failure for new business start-ups is a major concern for entrepreneurs, financiers, employees hired in new ventures and policy makers seeking wealth and sustainable job creation. Although some authors report that there is an initial "honeymoon" period of a year or two in which business closures are relatively infrequent (Fichman & Levinthal, 1991; Frank, 1988; Jovanovic, 1982; Mahmood, 2000; Van Praag, 2003), more than half of business start-ups never survive to reach their 5th birthday (Bartelsman, Scarpetta, & Schivardi, 2005; Phillips & Kirchhoff, 1989) and in highly turbulent markets with a high foreign firm presence less than half survive to reach their 3rd birthday (Burke, Görg, & Hanley, 2008). Individual characteristics of the founder-manager have been extensively used to establish why some start-ups stop operating shortly after they started, while others survive (see, for example, Kalleberg & Leicht, 1991; Cooper, Gimeno-Gascon, & Woo, 1994; Boden & Nucci, 2000; Thornhill & Amit, 2003; Williams, 2004; Millán, Congregado, & Román, 2012, 2014a, 2014b).

In its most basic form, variations in firm performance across entrepreneurs are attributed to differences in entrepreneurial ability that entrepreneurs possess. This is the basis of the classic Lucas model of occupational choice (Lucas, 1978). However, this model is completely static in the sense that entrepreneurs are endowed with a certain level of entrepreneurial ability which does not change over the entrepreneur's lifetime. Although entrepreneurial talent is certainly an important determinant of firm performance (Bosma, Van Praag, Thurik, & De Wit, 2004), in everyday life there is also an important role of learning-by-doing (Jovanovic, 1982). Indeed, several studies show that entrepreneurial experience and business success are positively related (Bosma et al., 2004; Burke, FitzRoy, & Nolan, 2008; Millán et al., 2012; Shane, 2000; Staniewski, 2016). However, not many studies distinguish between different types of prior entrepreneurial experience (Ucbasaran, Westhead, Wright, & Flores, 2010). In the present paper we study employer firms (firms with employees) and distinguish between external entrepreneurial experience obtained outside of the current firm and (a special type of) internal entrepreneurial experience obtained within the boundaries of the employer firm currently run, i.e. as an own-account worker before scaling up to employer firm. In particular we investigate whether both types of entrepreneurial experience may enhance firm performance.

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It is important to distinguish between the two sorts of entrepreneurial experience because the specific relationship between prior internal entrepreneurial experience as an own-account worker and current firm performance as an employer firm, has important implications for those individuals without any prior entrepreneurial experience wishing to start a new firm (i.e., novice entrepreneurs). In particular, if internal experience as an own-account worker enhances firm performance later on in the firm life cycle when the firm has reached employer status, it would imply that for novice entrepreneurs, a lean start-up strategy (as an own-account worker) is to be preferred over a more resourceful strategy hiring employees from the start.

As far as new-firm start-ups by novice entrepreneurs are concerned, we are thus comparing the relative value for firm performance of a lean start-up strategy (starting small, i.e. as an own-account worker) versus a more resourceful strategy (hiring employees from the start). Elements of the latter strategy that may positively influence firm performance are a reduction of resource constraints (Corradin & Popov, 2015; Fairlie & Krashinsky, 2012; Schmalz, Sraer, & Thesmar, 2017; Stucki, 2014) and starting closer to the industry Minimum Efficient Scale (MES) (Johnson, 2007). The conundrum is that these strategies involve greater scale of operations and hence greater exposure to risk by business start-ups. The greater exposure to the negative consequences of risk-taking is only worth taking if the gains in success are sufficiently high. This typically occurs in the context of globalization and the ICT revolution (Kreiser & Davis, 2010) which have caused the economic value of new ideas to become far more uncertain in modern "entrepreneurial" economies compared to the old "managed" economies (Audretsch & Thurik, 2001, 2004).

So necessarily this paper examines the alternative "skinny" small pilot launch entry strategy which is also used in an attempt to enhance performance and manage risk. Thus, before making strong sunk cost investments, new firms might optimally start operations at a small scale and only exercise an expansion investment option if circumstances prove to be favourable (Cabral, 1995). Adopting a lean or frugal approach to business can often help engender an efficiency culture in the firm as well as limit the risk by only committing the minimal amount of resources to test a new innovation before deciding any combination of scaling-up, altering the innovation to better fit the market or realising that it is better to focus on an alternative business opportunity/innovation (Bhide, 2000; Burke, 2009; Radjou, Prabhu, & Ahuja, 2012; Ries, 2011). So when starting a new business, it may be beneficial for entrepreneurs not to commit all of their resources all at once, but instead to try out a scaled down version of the business first and await market feedback before committing more resources. In support of this theory, Geroski (1995) reported that most new firms start with output less than the industry MES. Otherwise stated, it indicates the importance of path dependence on new venture performance (Coad, Frankish, Roberts, & Storey, 2013; Gruber, 2010).

In order for the lean pilot launch entry strategy to work as an effective learning strategy, the firms that use a prior lean state to explore an opportunity and that survive the initial start-up stage (despite being poorly resourced) before subsequently having enough information in order to decide to embark or not on more resourceful start-up, must at least outperform entrepreneurs who skip this prior lean-learning phase and start-up resourced from the outset. We test this necessary condition by analyzing a sample of employer entrepreneurs and investigating whether those employer entrepreneurs who initially started out small (i.e. without employees) but later on hired personnel, can generate extra value added over and above that created by employers who employed other workers from the start onwards (thereby committing a higher amount of labour resources immediately at start-up). In addition, one must also acknowledge the possibility that the relevant skills and judgment ability which are learned in the lean start-up phase can also be acquired through external entrepreneurial experience obtained in a prior firm. Therefore we distinguish between resourceful start-ups (i.e. with employees) by novice entrepreneurs and by experienced entrepreneurs.

As performance indicators we use survival (both firm survival and survival as an employer) and earnings (net earnings of the employer entrepreneur). We use data from the European Community Household Panel (ECHP), a longitudinal panel on individuals in households in the EU-15 during the period 1994–2001. This panel data base tracks the labour market status of individuals over time, distinguishing between the statuses own-account worker (self-employed with no employees), employer, paid employment, unemployment and inactivity. This allows us to establish the "starting status" of the employer, i.e. the labour market status immediately before becoming an employer entrepreneur. In particular, when an individual switches from own-account worker to employer (in the same firm), it is implied that the employer entrepreneur initially started the business on her own, i.e., the entrepreneur used a skinny, lean or pilot launch strategy. We estimate survival and earnings equations for employers using the starting status as main explanatory variable.

The paper follows a conventional structure. We initially examine relevant theory and derive testable hypotheses relating the impact of different types of prior entrepreneurial experience on various measures of new venture performance. We then review the data and outline the methodology. This section is followed by an outline of the results and the conclusions of the paper.

2. Theory and hypotheses

In the present section we will discuss different types of prior entrepreneurial experience (internal versus external) and show how these relate to different learning processes and different types of human capital obtained. These diverse channels of human capital development, in turn, may differently influence employer firm performance. Although in this paper we focus on the importance of prior entrepreneurial experience, we also acknowledge the important role of formal education for obtaining human capital relevant for running a business (Unger, Rauch, Frese, & Rosenbusch, 2011).

2.1. Different types of human capital for different types of entrepreneurial experience

Table 1 distinguishes between five possible labour market statuses

Table 1
Linking internal and external prior entrepreneurial experience to different types of human capital.

Previous activity: $t-1$	General entrepreneurial human capital	Employer managerial skills	Venture-specific human capital
Internal entrepreneurial experience			
Pilot launch/own-account work in the same firm	+		+
External entrepreneurial experience			
Own-account work in a different firm	+		
Employer in a different firm	+	+	
No entrepreneurial experience			
Paid employment		(+)	
Non-employment			