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A little bit of knowledge is a dangerous thing: Entrepreneurial experience and new venture disengagement

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ABSTRACT

Existing research has offered conflicting narratives of how entrepreneurial experience influences whether founders will continue working on or disengage from their ventures. We theorize and test how entrepreneurs with varying levels of experience disengage from early-stage companies. Findings reveal a U-shaped relationship, such that novices and highly experienced entrepreneurs are more likely to quit their ventures, while moderately experienced entrepreneurs are more likely to persist in their pursuits. We offer both theoretical and empirical explanations for how the propensity to disengage from new ventures evolves with entrepreneurial experience.

1. Introduction

Entrepreneurs gain many skills as they launch their ventures. Scholars and practitioners alike expect that with more entrepreneurial attempts, founders will become better at creating profitable businesses (Gompers et al., 2010; Holland and Shepherd, 2013; Lévesque et al., 2009). Yet, most ventures do not develop as anticipated and eventually, founders must determine whether to persist or disengage from their ventures. By *disengage*, we mean a decision to withdraw from full-time work on the business due to unmet expectations and pursue other career opportunities. While practitioners have urged entrepreneurs to gain awareness of when to quit (Ries, 2011), we argue that disengagement-as-a-skill has been underemphasized by academics analyzing how experience influences venture performance (Sarasvathy et al., 2013; Wiltbank et al., 2006). Research on the experience-disengagement relationship has yet to reveal consistent patterns. One reason for this may be because experience is perceived to have a linear relationship on disengagement. We develop an alternate theory that portrays experience as having a non-linear relationship on disengagement, such that novice and expert entrepreneurs will disengage at different rates than those with moderate experience. Our longitudinal analysis offers evidence for this relationship and its corresponding implications for scholars and practitioners.

2. Entrepreneurial experience and venture disengagement

Conventional thinking suggests experience's influence is linear – additional experience will more strongly influence entrepreneurial outcomes. However, research on the experience-disengagement relationship has yielded inconsistent conclusions. A comprehensive review (Please see Appendix A) led us to a total of 22 papers on this topic, the majority of which were based on

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small, cross-sectional samples. Ten studies showed insignificant effects between experience and the likelihood of disengagement, seven showed a negative relationship, two had mixed findings, and three revealed a positive relationship. None of the studies presented or reported findings of curvilinear results. As such, we propose a framework that revisits the fundamental assumption about experience and its influence on entrepreneurial trajectories. We turned to research demonstrating the non-linear influence of experience. A closer examination of cognition, strategic management, and entrepreneurship studies reveals that novices, the moderately experienced, and experts all leverage their experience differently in their pursuits (Cormier and Hagman, 1987; Haleblian and Finkelstein, 1999; Toft-Kehler et al., 2014). This research reveals that "a little bit of experience can be a dangerous thing" – at low levels, actors inappropriately apply experience to seemingly similar, yet inherently different, tasks. We argue that the differential effects of experience may also produce a non-linear relationship on the decision to disengage.

3. Methods and data

To answer our research question we created a longitudinal dataset with information about founders and their ventures. We constructed our sample using two databases maintained by Statistics Sweden: RAMS (yearly data on all firms) and LISA (yearly data on all Swedish inhabitants from 1989). From RAMS we sampled three full cohorts of firms started 1994, 1995, and 1996, followed until 2002.[1] From LISA we created experience variables for all prior venturing activities from 1989 to 1993 and used National Tax Board data to gather financial information. To decrease industry heterogeneity, we limited our sample to firms in knowledge-intensive sectors based on OECD classifications (Götzfried, 2004).[2] As a result, our sample consists of the full population of 29,338 new knowledge-intensive ventures founded in Sweden between 1994–1996.

3.1. Dependent variable

The dependent variable, *likelihood of disengagement*, is based on a yearly indicator of whether an individual is still working full-time in their venture (1= disengaged, 0=working full-time). The founder disengages when they begin work on or at another firm. We highlight two other decisions related to this variable: We retained bankrupt firms in our sample, since this is a viable pathway for disengagement, and bankruptcy and liquidation are rare (Thorburn, 2000). However, we dropped firms that experienced a trade sale which is generally considered an exit-outcome which does not reflect disengagement due to unmet expectations (Arora and Nandkumar, 2011).[3]

3.2. Independent variable

Our independent variable is *entrepreneurial experience*, defined as years of full-time involvement as a founder or co-founder in a prior venture. To reduce the effect of individuals arbitrarily entering and exiting (e.g. tax speculation or engaging in "portfolio entrepreneurship" (Westhead and Wright, 1998)), we required a two-year gap between ventures in the same industry and location to be considered a separate venturing activity.

3.3. Control variables

To address alternative explanations, we included several control variables. We control for founders' basic demographic characteristics: *gender* (1=male), *age*, and *number of children* living at home (updated annually). To account for entrepreneurs' ability to support the firm, we included household *wealth* based on equity reported to tax authorities, which tracks wealth excess of 800,000 SEK (~100,000 USD). Firms in our data are either incorporated (limited liability) or unincorporated (partnerships and proprietorships with unlimited liability). Since financial liability may affect the likelihood of disengagement, we controlled for *legal form* (1= incorporations). To account for additional investments in underperforming firms, we included a *new investment*s variable based on yearly equity injections (Wennberg et al., 2010). We controlled for *entrepreneurial earnings* as a measure of performance. We used firm-level performance variables from RAMS and individual-level data from LISA to calculate earnings based on Hamilton's (2000) definition [revenues – expenses = money taken out + entrepreneurial earnings] and used its natural log value to correct for skewness. *Education* was measured in years. We also controlled for other types of experience: *Management experience* was based on a "personnel responsibility" categorical variable in the 1990 census (0=no experience, 1=some experience, and 2=extensive experience). *Industry experience* was a count of years within the focal industry. *Venture similarity experience* was based on Finkelstein and Haleblian's (1999) measure of comparing industry affiliations of prior ventures. Last, we controlled for industry (at the SIC-2 level) and time-varying effects (year dummies).

[1] To minimize right censoring and incorporate up to five years of data prior to the focal venture.

[2] In Sweden, 35% of all new firms belong to these sectors, including information technology, chemicals, medicine, telecom, finance, business services, education and research (Folta et al., 2010).

[3] We deleted 1102 trade sales (representing 1.2% of disengaged founders) from the dataset. One limitation of our sample is that we are unable to directly measure the number of bankruptcies. However, according to the Swedish census data, the recent average number of annual bankruptcies is 0.19% of all privately held firms (from 2010 to 2015).