Entrepreneurship in Established Firms

Bottom-up initiative positively influences entrepreneurial outcomes, but top management involvement is necessary to seize the benefits

by Nicolai J Foss

Interest in entrepreneurship has been booming over the last three to four decades. This is manifest in the attention that policy makers devote to it as an instrument of growth and dynamism at the level of the economy, and the interest of corporate decision-makers in entrepreneurship as an instrument of corporate renewal. Academic interest has increased in parallel, with numerous chairs, programs and research initiatives being dedicated to the subject.

The question, however, is what we mean by «entrepreneurship», where it is located, and what can be done to stimulate it. In thinking about entrepreneurship, we have focused too much on upstart companies, neglecting the entrepreneurial activities carried out by established players. In fact, entrepreneurship is often *defined* as starting up new companies. But this is surely too narrow, for entrepreneurship is fundamentally about deploying resources under uncertainty to meet future customer and consumer wants and in the hope of earning profits (1). Thus, entrepreneurship is a generic economic function that not just start-ups but also established companies carry out. How-

(1) N.J. Foss, P.G. Klein, *Entrepreneurial Judgment and the Theory of the Firm*, Cambridge, Cambridge University Press, 2012.

ever, arguably because of our fixation on start-ups, we do not have as good an understanding of entrepreneurship by established firms as we might wish to have. We have many somewhat insights – many of which actually concern why entrepreneurship initiatives tend to be suppressed by established players – on phenomena like intrapreneurship and corporate internal venturing, but not a more coherent theory.

One manifestation of this is that our understanding of the role of senior management in established companies with respect to furthering entrepreneurship is incomplete. In fact, conflicting views exist. The dominant view is that entrepreneurship thrives best inside established companies when senior management maintains a hands off-approach, leaving much to bottom-up decision-making. Senior management of course defines procedures, budgets and criteria that surround the entrepreneurial process, but does not engage with the entrepreneurial process itself. However, this view is at variance with, for example, well-known examples of CEOs being involved very directly in the entrepreneurial process, notably Thomas Watson and his involve in IBM's development of the 360 system, or the very direct involvement of Steve Jobs in many of Apple's entrepreneurial initiatives. This already suggests that there may be a need to reconsider the dominant view. In the following, I will do this, drawing on some recent research with Jay Barney and Jacob Lyngsie (2). I begin by setting the stage in terms of the surge in interest in entrepreneurship that has characterized the last few decades.

The Increasing Importance of Entrepreneurship

Around the mid-1970s observers suggested that «churn» was increasing in the US economy; for example, firms were increasingly moving in and out of industries. Churn has different components, but one of them is the founding of new companies – that is, what many would take to be the essence of entrepreneurship. At about the same time the share of employment shifted dramatically from large companies to smaller ones. For example, in 1970, the Fortune 500 companies accounted for 20 per cent of US employment, but only 8.5 per cent in 1996 (3). Firms were getting smaller. Policy makers quickly took an interest in these developments, particularly when important work began to show that much productivity advance (up to 50 per cent in some estimates!) is caused by reshuffling of assets when firms collapsed, merged, started up, and so on in response to new entrepreneurial and innovative initiatives (4).

It is not surprising, therefore, that there have been numerous calls from policy makers for somehow stimulating entrepreneurship – both the supply of it and its quality – by designing policies and institutions that are conducive to entrepreneurship, particularly in a Europe plagued for a very long time now with sluggish productivity growth and relatively poor growth performance. Given the current performance of the Italian economy, which includes very low levels of financing by venture capitalists, high enterprise death rate, and difficulties attaching to contract enforcement and general ease of doing business, is not surprising that entrepreneurship has also been debated in this country as a way to reinvigorate the economy.

However, most such interest and debate have centered on start-ups in a lopsided way. The problems with an over-emphasis on start-ups as the hallmark of entrepreneurship are many, including the low productivity, low rate of job creation and high mortality of start-ups. While indeed start-ups may create to dynamism in the economy, it is too often the kind of dynamism that wastes resources (5). In fact, the alleged «small-firm effect» when it comes to innovations (which implies that start-ups are likely to be more innovative on average) is highly questionable (6). Luckily, there has recently been an increase in interest in how entrepreneurship manifests in more established companies (7).

There has of course long been interest in internal corporate venturing (8). But, as I shall explain below, much of this interest has taken an essentially passive view of senior management. Senior management, however, often isn't passive. They initiate, monitor, orchestrate and often participate in a quite hands-on way in business development. For example, facility services giant,

(2) J.B. Barney, N.J. Foss, J. Lyngsie, «The Role of Senior Management in Opportunity Formation: Direct Involvement or Reactive Selection?», *Strategic Management Journal*, 39(5), 2018, pp. 1325-49.

(3) B. Carlsson, «Small Business, Entrepreneurship, and Industrial Dynamics», in Z.J. Acs (ed.), *Are Small Firms Important? Their Role and Impact*, Boston-London-Dordrecht, Kluwer Academic Publishers, 1999, pp. 99-110.

(4) E.g. L. Foster, J. Haltiwanger, C.J. Krizan, «Market Selection, Reallocation, and Restructuring in the U.S. Retail Trade Sector in the 1990s», *Review of Economics and Statistics*, 88(4), 2006, pp. 748-58.

(5) See S. Shane, *A General Theory of Entrepreneurship: The Individual-opportunity Nexus*, Cheltenham, Edward Elgar Publishing Limited, 2003.

(6) N.J. Foss, *The Established Company in Entrepreneurship Research*, Working Paper, 2018.

(7) R.D. Ireland, J.G. Covin, D. Kuratko, «Conceptualizing Corporate Entrepreneurship Strategy», *Entrepreneurship Theory and Practice*, 33(1), 2009, pp. 19-46; N.J. Foss, J. Lyngsie, «The Strategic Organization of the Entrepreneurial Established Firm», *Strategic Organization*, 12(3), 2014, pp. 208-15.

(8) E.g. R.A. Burgelman, «A Process Model of Internal Corporate Venturing in the Diversified Major Firm», *Administrative Science Quarterly*, 28(2), 1983, pp. 223-44; R.A. Burgelman, «Corporate Entrepreneurship and Strategic Management: Insights from a Process Study», *Management Science*, 29(12), 1983, pp. 1349-64.

Danish ISS has often been criticized for its lack of entrepreneurialism. Partially as a response to such criticism, ISS has started a number of diversity initiatives that are explicitly meant to improve productivity and innovation (9). Much research suggests that employee diversity can be productive of creativity (and therefore innovation and entrepreneurship) in established firms. Thus, opportunities for innovative entrepreneurship may emerge from knowledge combinations within a firm (10), such as when employees who are heterogeneous in terms of their education, age, gender, tenure, and experience work together on problem-solving. ISS is already highly diverse (in terms of demographics such as gender, age and country of origin) and the company simply seeks to leverage on such diversity to make the company more entrepreneurial overall. While many of the resulting initiatives are quite incremental, the analytics carried out by the company indicates substantial productivity and earnings gains (11). However, much of our current thinking about entrepreneurship basically excludes this kind of senior-management directed entrepreneurship in established companies.

Two Views of Senior Management in the Process*

Top-down and Bottom-up Processes

Since the research of Robert Burgelman (12), scholars have made a distinction between two processes through which entrepreneurial initiatives emerge within companies, namely intended, top-down planned processes and bottom-up autonomous processes.

However, most scholars today emphasize the autonomous, bottom-up process as the most important driver of such opportunities (13). Such scholars also often argue that direct senior management involvement in this process is likely counterproductive. Thus, senior management should not directly engage with the process of opportunity formation, and mainly assume the role of approving or rejecting opportunities generated through the autonomous process.

Such reasoning can be found in Foss (14) which is an account of the adoption by leading Danish hearing-aid producer Oticon in 1991 of the «Spaghetti Organization», an extreme (for that time) example of radically decentralizing a company to stimulate bottom-up initiative in the service of innovation. This organizational form was based on radically empowering employees in the hope that this would motivate and enable them to come up with new project ideas. Such ideas would then be proposed to a board of senior managers who would evaluate projects based on simple financial criteria. Project leaders were free to hire project members, manage projects, make decisions on the pay of colleagues, etc. In other words, this organizational design unleashed bottom-up initiative. In fact, it did so very successfully, leading to many major innovation projects, saving the company from an impending bankruptcy, and founding a trajectory of successful innovation that has continued to this day.

However, the Spaghetti Organization was abandoned in 1996, partly because it resulted in too many uncoordinated initiatives (e.g., duplicative R&D and marketing efforts), and partly because its ethos of free initiative clashed with frequent intervention on the part of senior managers. Per implication, had senior management been able to control its temptations to intervene in projects, and been much more passive, the Spaghetti Organization might have been in existence for much longer. More generally, with respect to actual decision-making, senior managers should keep a distance to processes of idea generation and opportunity formation, and seek to restrict their involvement in the bottom-up process to approving or rejecting opportunities generated through this process (15).

Reactive Selective and Proactive Involvement

Barney, Foss and Lyngsie (16) acknowledge that autonomous processes of entrepreneurial initiative do take place in companies. However, they criticize the view that senior management's role in the entrepreneurial process is mainly one of reacting to the opportunities that are generated in the bottom-up process (the «reactive selection view»).

(9) ISS, *Diversity Adds Millions to ISS Bottom Line*, 2017, accessed 5 July 2017, available online at: https://www.dk.issworld.com/-/media/issworld/dk/Files/PDF%20filer/Corporate%20Social%20Responsibility/4355_UK_Mangfoldigheds_Engelsk%20final.pdf?la=da-DK.
(10) A. Leiponen, C.E. Helfat, «Innovation objectives, knowledge sources, and the benefits of breadth», *Strategic Management Journal*, 31(2), 2010, pp. 224-36.
(11) ISS, *op. cit.*
(*) This and the following section borrow from Barney, Foss, Lyngsie, *op. cit.*
(12) Burgelman, «A Process Model of Internal Corporate Venturing», cit.; in the diversified major firm; Burgelman, «Corporate Entrepreneurship and Strategic Management», cit.
(13) R.A. Burgelman, «Intraorganizational Ecology of Strategy Making and Organizational Adaptation: Theory and Field Research», *Organization Science*, 2(3), 1991, pp. 239-62; B. Lovas, S. Ghoshal, «Strategy as guided evolution», *Strategic Management Journal*, 21(9), 2000, pp. 875-96; C.R. Østergaard, B. Timmermans, K. Kristinsson, «Does a Different View Create Something New? The Effect of Employee Diversity on Innovation», *Research Policy*, 40(3), 2011, pp. 500–09.
(14) N.J. Foss, «Selective Intervention and Internal Hybrids: Interpreting and Learning from the Rise and Decline of the Oticon Spaghetti Organization», *Organization Science*, 14(3), 2003, pp. 331-49.
(15) Lovas, Ghoshal, «Strategy as Guided Evolution», cit.
(16) Barney, Foss and Lyngsie, *op. cit.*

First, if senior managers were merely reactive, the autonomous process may generate initiatives that have little chance of ultimately being exploited, because they are too costly or inconsistent with a firm's strategy. The employees who developed such rejected projects may be discouraged and demotivated by this experience, and may therefore have little incentive to engage in bottom-up entrepreneurial activity again. Second, the reactive selection view fails to acknowledge organizational costs associated with generating opportunities through the autonomous process in the context of a diverse workforce. These processes can be wasteful, because of «the wheel invented more than once». Additionally, when much initiative is left to bottom-up processes, it may be difficult to coordinate (interdependent) activities. For example, demographic diversity can make it difficult for individuals within the firm to understand and coordinate their different entrepreneurial activities. Barney, Foss and Lyngsie therefore argue that bottom-up initiative (in particular in the context of diversity) presents distinct challenges in the entrepreneurial process that call for senior management involvement – what they define the «direct involvement view».

Moreover, senior management often has better information of how a given entrepreneurial initiative fits into the company's core activities. Such information may lead to different kinds of senior management involvement in the entrepreneurial process. Thus, senior managers can work with protagonists of entrepreneurial initiatives at lower levels, and, for example, help projects to pivot if they encounter critical resource constraints, or if certain aspects do not make commercial sense. Senior manager involvement in the entrepreneurial process can also be of a more corrective kind. Thus, bottom-up entrepreneurial processes can become too untrammeled. While the uncertainty and complexity of the entrepreneurial processes can make it difficult for senior management to get closely involved, such involvement may be necessary to coordination and cooperation problems that can emerge when employees are highly empowered to make decisions.

So, What Do the Data Say?

To test the above ideas (i.e., the reactive selective and the proactive views) against each other, Barney, Foss and Lyngsie analyze two matched data sources from Denmark (17). The first data source was a paired-respondent questionnaire that was sent to all Danish companies with more than 40 employees in 2009. The second data source, the Danish Integrated Database for Labor Market Research (IDA), contains detailed information on all members of the Danish labor force. Approximately 170,000 individual employees were matched with their employing firm in the final sample.

Entrepreneurial outcomes in (or by) companies were measured as the CEO's self-reported counts of new opportunities, in terms of new products, services, and markets that the firm had identified. This was regressed against a measure of employee diversity (specifically, educational diversity), and a measure of bottom-up initiative, and a measure of the company's level of centralization. Thus, respondents were presented with four different entrepreneurial decisions and asked to indicate the hierarchical level at which the authority to make decisions in relation to the activity was vested. The four activities, which were chosen to closely reflect key decisions related to the entrepreneurial process, were: (i) developing new products or services, (ii) introducing major changes in marketing activities, (iii) making significant changes in products and services, and (iv) discontinuing a major product or service. High values of the centralization measure reflected a high level of senior manager involvement in the entrepreneurial process. We added a long list of control variables, including industry controls, company size, location, the size of the top-management teams, the number of hierarchical levels in the company, its level of formalization, the age and tenure of employees and other variables.

Barney, Foss and Lyngsie find the following. First, diversity and bottom-up processes are positively associated with entrepreneurial outcomes, while centralization is negatively associated with these. This is in line with established research. Second, however, we *also* find that companies where senior management is not directly involved in the entrepreneurial process do not

(17) *Ibidem.*

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benefit from relying on a bottom-up opportunity-formation process and they don't benefit from diversity either. Thus, we find «positive interactions» between centralization and diversity and bottom-up initiative and centralization. It furthermore appears that some, perhaps considerable senior manager involvement is necessary to benefit from bottom-up initiative, given high levels of diversity. A number of robustness tests support the findings.

In sum, the empirical results support a positive contingent relevance of senior management direct involvement in the entrepreneurial process in terms of both bottom-up initiative and employee diversity (i.e. the direct involvement view). In addition, we find support for a configurational association among the use of bottom-up initiative, employee diversity, and centralization. Thus, to fully benefit from a diverse workforce, firms may rely on bottom-up initiative while controlling the entrepreneurial process through more direct involvement by senior management.

Conclusions

In spite of increasing interest in the entrepreneurial activities of established firms, significant research gaps remain and the entrepreneurship of such firms is still comparatively neglected. To the extent that it is addressed, it is often put under labels such as «corporate renewal», «innovation» and «exploration». Perhaps for these reasons our understanding is highly incomplete when it comes to the proper role of senior managers in the entrepreneurial process in established firms, in spite of important work decades ago. The dominant line of thinking posits that senior management should take a hands-off approach to the bottom-up entrepreneurial process, and that their main role is to select among the opportunities that emerge from this process.

In contrast, the recent findings of Barney, Foss and Lyngsie indicate that senior management may have a more direct role to play than is commonly held in the research literature. Both diversity and bottom-up initiative are positively associated with entrepreneurial outcomes, as established literature has long suggested, but senior management involvement in the entrepreneurial process is necessary to seize the benefits of diversity and bottom-up initiative. ■

In sintesi

- Negli ultimi quarant'anni, **il tema dell'imprenditorialità si è sempre più imposto all'attenzione degli studiosi di management.** A dispetto della tendenza a focalizzare il dibattito sull'avvio di nuove imprese e start-up, il tema assume una rilevanza fondamentale anche per le organizzazioni consolidate, nella misura in cui l'imprenditorialità può essere intesa come la decisione di impiegare risorse in condizioni di incertezza per andare incontro a desideri futuri di clienti e consumatori nell'ottica di generare profitto.
- In questo senso, una delle questioni centrali riguarda **il livello organizzativo a cui è possibile collocare l'imprenditorialità**, e conseguentemente i modi in cui è possibile stimolarla. In particolare, numerosi studi si sono concentrati sulla rilevanza dei processi top-down o piuttosto dei processi bottom-up nel favorire la generazione di nuove idee. Da questo punto di vista, la maggior parte delle ricerche ha enfatizzato l'impatto maggiormente positivo dei processi autonomi, dal basso, di individuazione di nuove opportunità; come aspetto complementare, si è affermata l'idea che il ruolo del senior management dovrebbe essere meramente «reattivo» rispetto alle opportunità scaturite dal basso.
- Un recente studio ha invece evidenziato **l'importanza di un ruolo proattivo del senior management rispetto all'imprenditorialità bottom-up**: ciò può garantire una migliore integrazione delle nuove iniziative nella strategia aziendale, un loro più efficace coordinamento e una riduzione dei costi organizzativi a esse associati, prevenendo lo spreco di risorse (per esempio, causa la duplicazione di progetti). Un ruolo proattivo del senior management sembra essere correlato positivamente anche ai processi imprenditoriali che nascono in aziende con elevati livelli di diversità della forza lavoro.
- In conclusione, per mettere pienamente a frutto le opportunità imprenditoriali sviluppate all'interno, **le imprese consolidate devono trovare un giusto equilibrio tra promozione di processi bottom-up, diversità della forza lavoro e ruolo proattivo di supervisione** da parte del senior management.