
New Firm Creation in the United States

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New Firm Creation in the United States A PSED I Overview

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Abstract

The first US Panel Study of Entrepreneurial Dynamics [PSED I] is the most comprehensive assessment of the firm creation process yet completed. Based on a representative sample of those actively involved in business creation, analysis begins with the consideration of 75 factors that may affect the decision of adults to get involved in the creation of a new business, followed by a detailed exploration of over 130 factors that may be associated with completing the start-up process with a new firm. The results indicate, first, that over ten million persons are involved in the firm start-up phase as nascent entrepreneurs. Second, the major factors associated with entry into the start-up process have little impact on completion of the process with an operating business. Third, activities pursued in the start-up process – not the characteristics of the entrepreneur, the start-up, or the location – have a major impacts on the transition from start-up to a successful new firm. There is little impact associated with being male; being White, Black or Hispanic; having more education; being wealthy; having experience with other start-ups; having an “entrepreneurial personality”; or being in a

supportive environment. This project demonstrates the value of tracking a representative sample of nascent entrepreneurs with a longitudinal study. Implications for future research, entrepreneurs, and public policy are substantial.

Contents

1. Introduction	1
1.1. How Do New Businesses Come About?	1
1.2. An Author's Personal View	2
2. New Firm Creation: Importance and Need for More Details	7
2.1. What Does the Start-Up Process Look Like?	9
3. Conceptualization of the Process	13
3.1. Socio-Cultural Characteristics	15
3.2. Stable Personal Traits and Orientations	17
3.3. Immediate Personal, Social Context	21
3.4. Work Related Experiences	23
3.5. Procedures, Strategies, and Resources Associated with Firm Implementation	25
3.6. Ambient Social, Cultural Community Context	29
3.7. Industry and Competitive Context	31
3.8. Regional Characteristics and Change	32
3.9. Overview	32

4. Becoming a Nascent Entrepreneur: Conception to the Start-Up Process	35
4.1. How Many People are Trying to Start New Firms?	35
4.2. What Kind of People are Trying to Start New Firms?	36
4.3. Life Context and Start-Ups	42
4.4. Comparison Group Data	48
4.5. Overview	53
5. Creating a New Business: Results from the Start-Up	55
5.1. What Kinds of People Create and Types of Start-Ups Become New Firms?	58
5.2. Start-Up Activity	68
5.3. Interactions: Who They are and What They are Doing?	76
5.4. Overview	84
6. Overview and Implications	87
6.1. Implications: Research	90
6.2. Implications: Entry Into the Start-Up Process	92
6.3. Implications: New Firm Creation	93
6.4. Implications: Public Policy	93
References	97
PSED I Scholarly Works	99
Acknowledgements	109
A. Methodological Appendices	111
Appendix.4Ax.1. Notes on Assessment of the Screening Data	111
Appendix.4Ax.2. Comparison of Nascent Entrepreneurs and Typical Adults	112
Appendix.5Ax.1. Constructing Start-Up Time Lines Data Set	118

Appendix.5Ax.2. Disposition of All Cases and 72 Month Outcome Status	122
Appendix.5Ax.3. Detailed Comparison of Start-Ups Outcomes: New Firms and Others	134
Appendix.5Ax.4. Constructing Start-Up Activity Indices	153

1

Introduction

1.1 How Do New Businesses Come About?

The most comprehensive and detailed assessment of this question is the first US Panel Study of Entrepreneurial Dynamics [PSED I]. This project started with the screening of 64,000 US adults followed by four extensive two-phase interviews spread over a five year period. Analysis began with the consideration of 75 factors that may affect the decision of adults to get involved in the creation of a new business – to become nascent entrepreneurs. General comparisons were made of those active in start-ups with others interviewed in the screening and detailed comparisons were possible with a small comparison group. The assessment continued with a detailed exploration of over 130 factors that may be associated with completing the start-up process. This study focuses on understanding how the 200 nascent entrepreneurs that reported a new firm within seven years of entering the start-up process were different from the 468 who quit or continued to work on the start-up.

There are a number of significant findings from this research program. First is the large number of individuals involved as nascent

2 *Introduction*

entrepreneurs – 10 million in 1998–1999 when the PSED research project began; as many as 16 million in 2005.

Second is the finding that the major factors associated with entering the start-up process and becoming a nascent entrepreneur, such as age, gender, educational attainment, household income or net worth, and residence in a community with recent population growth are unrelated to completion of the start-up process with a successful new firm.

The third major finding is that the activities pursued in the start-up process – not the characteristics of the entrepreneur, the start-up, or the location – have an impact on the transition from start-up to a successful new firm. Actions associated with implementing a productive process, developing a presence for the new firm, creating an organizational and financial structure for the firm, during an intense investment of time and money – facilitated by same industry work experience – seems to be particularly important in the birth of a new firm.

Most important – and encouraging – anybody can do this. There is no magic associated with being male; being White, Black or Hispanic; having more education; being wealthy; having experience with other start-ups; having an “entrepreneurial personality”; or being in a supportive environment. None of these individual attributes, perceptions or attitudes seem to make much difference once an individual is involved in the start-up process. Any person with the knowledge, skill, ideas, drive, and the ability to mobilize resources and organize a business can create a new firm.

This project, though expensive, very labor intensive, and requiring considerable patience, has demonstrated the value of tracking a representative sample of nascent entrepreneurs with a longitudinal study. Implications for public policy are substantial. Efforts to increase the firm birth rate to improve economic growth may not have the same focus as those designed to help disadvantaged groups develop a role in the economy through participation in entrepreneurship.

1.2 An Author’s Personal View

This brief text – brief in terms of the scope and importance of the topic – has been written for two reasons. The first is to provide an overview of

the nature of the business creation process as it existed in the United States at the end of the 20th century. The second is to make clear the nature and significance of the contribution of the Entrepreneurial Research Consortium, the organization responsible for the implementation of the first Panel Study of Entrepreneurial Dynamics.

The Panel Study of Entrepreneurial Dynamics [PSED], as it is now called, was the result of the collective efforts of the Entrepreneurial Research Consortium, led by Nancy Carter, Bill Gartner and me, Paul Reynolds. It eventually involved over 120 individuals and 34 member units and raised \$620,000 to implement this research program. These funds were supplemented by two NSF grants, one provided to Nancy Carter (NSF Grant SBR-9809841) for an over-sample of women nascent entrepreneurs and the other to Patricia Green (NSF grant SBR-9905255) for an over-sample of minority nascent entrepreneurs. The design was an initial screening to locate nascent entrepreneurs followed by a detailed initial and three follow-up interviews. The project was completed with substantial support from the Ewing Marion Kauffman Foundation after data collection responsibilities were shifted from the University of Wisconsin Survey Research Laboratory, following its closure, to the University of Michigan Institute for Social Research. The final versions of all data sets and descriptions on the public domain website [psed.isr.umich.edu] have been well developed and maintained by Richard Curtin.¹ A replication, PSED II, was initiated in 2005 with primary support from the Ewing Marion Kauffman Foundation and supplement funding from the US Small Business Administration.²

There are now dozens of peer reviewed journal articles, working papers, dissertations, scholarly monographs and the like that describe the rationale, research procedures, and analysis of data from PSED I.³ These documents make clear the relevance of the data to a wide range of theories, hypotheses, and hunches regarding various aspects of the

¹ A comprehensive overview of the project design is provided by Gartner *et al.* (2004).

² This is in the form of two grants, one to University of Michigan Institute for Social Research (Richard Curtin, Principal Investigator) to collect data and the other to Florida International University (Paul Reynolds, Principal Investigator) to assist in the design of the project and assessment of results, and to supervise an Advisory Committee.

³ A recent overview of scholarly work reflecting this research paradigm is provided by Davidsson (2006).

4 *Introduction*

entrepreneurial or firm creation process. There has not, however, yet been a summary of the major focus of the project, a description of what happens when one or more individuals develop and implement a new firm. That is the focus of this book.

It is of some interest why no overview has been completed. There are two procedural reasons and one, which predominates, related to the dysfunctional nature of the scholarly reward system that has developed in the social science research community. The first procedural reason is straightforward, reflecting the complexity of the full PSED I data set. Collecting the data involved screening 64,000 US adults, detailed phone interviews and questionnaires collected four times following the screening interview. The final data file has over 5,000 variables on 1,281 individuals. While many researchers are familiar with parts of the data set, very few are comfortable with the entire mass of items, variables, skip patterns and the like. My role, as the coordinating principal investigator throughout the entire project, has given me a unique perspective and understanding of all major – and many minor – aspects of the project design. It seems useful to provide this description – and a review of the solutions to the many technical issues – before this knowledge is lost.

The second procedural reason is time; it took over six years from the inception of the screening interview to the completion of the fourth round of data collection and creation of the final data sets for analysis. As the ERC was organized two years before the screening began, the gap from initial commitment to the capacity for complete analysis was almost a full decade. Many of the original ERC participants have been pursuing other research options since the program began and many of the most recent analyses and publications have been completed by scholars who had hardly entered higher education when the project was initially proposed. There has been no effort to provide an overview of the entire project; some of the technical problems that required solution, described in the appendices, indicate why this is a complicated challenge.

The third problem is perhaps the most significant. The current scholarly reward system places an almost pathological emphasis on peer reviewed journal publications, and these collective products place

great emphasis on “theory testing.” In most cases, this is generally in the form of testing isolated hypotheses, hunches, or informed guesses, rather than theorems or propositions derived from an explicit, formalized theory.⁴ It encourages researchers to pretend they are contributing to a research agenda that has emerged within the scholarly community – reflected in extensive literature reviews – and explicate specific research objectives that can be “tested” with data. This leads to, as in the case of the PSED I data, to a number of unrelated analyses, each dealing with one or more specific processes or hypotheses: Does ethnic status affect entry into the start-up process? Does household wealth affect success at completing the process with a new firm? Does a strong internal locus of control influence firm growth aspirations? The result is a great deal of detail regarding a large number of pieces of the puzzle, but no effort to describe the overall puzzle itself.

In the philosophy of science this is referred to as “normal science,” the process of adding bricks to a wall that composes “scientific consensus.” It tends to distract individuals from the larger, more critical, issue of just what the wall is for and why it is being built in a particular location. This is, of course, the underlying issue in the development of new paradigms, as so eloquently explicated by Kuhn.⁵ PSED I, as the test bed for the Global Entrepreneurship Monitor research program,⁶ has clearly led to a new paradigm for the study and understanding of firm creation and the entrepreneurial processes; it would not have occurred were the principals solely focused on “normal science.”

This text is designed to provide an overview of the business creation process. This summary has required the resolution of a number of technical and substantive issues in order to provide a comprehensive description of the process itself. The details are provided in the footnotes, endnotes, and appendices. As all of the interview schedules, research procedures and data are in the public domain and available at no charge, other scholars who would like to suggest other solutions

⁴ An introduction to forms of theories and basic issues in the creation of scientific knowledge is provided in Reynolds (1971b).

⁵ Kuhn (1962).

⁶ The data collection procedures are summarized in Reynolds *et al.* (2005). Major findings in the first five years are presented in annual reports, available at ‘www.gemconsortium.org’: Reynolds *et al.* (1999, 2000, 2001, 2002, 2004a).

6 *Introduction*

to these issues are welcome to plunge into the pool, but it may take a while to learn how to swim in this data set.

While the total number of individuals that have contributed to the creation of the PSED I project and the final version of the data set is close to two hundred, the author takes full responsibility for the presentation that follows. There are, as in most significant human endeavors, many mistakes and oversights, but the design developed collectively by the ERC in implementing PSED I seems to have avoided any mistakes that would undermine the value of the basic contribution – provision of the first empirically based description of the creation of a representative sample of new firms. The results can be extrapolated to all new firms begun in the United States in 1998–2000. The impact and repercussions of this project have been enormous and, in most cases, positive.

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