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Global heroes

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Despite the downturn, entrepreneurs are enjoying a renaissance the world over, says Adrian Wooldridge (interviewed here)

Illustration by Nick Dewar

IN DECEMBER last year, three weeks after the terrorist attacks in Mumbai and in the midst of the worst global recession since the 1930s, 1,700 bright-eyed Indians gathered in a hotel in Bangalore for a conference on entrepreneurship. They mobbed business heroes such as Azim Premji, who transformed Wipro from a vegetable-oil company into a software giant, and Nandan Nilekani, one of the founders of Infosys, another software giant. They also engaged in a frenzy of networking. The conference was so popular that the organisers had to erect a huge tent to take the overflow. The aspiring entrepreneurs did not just want to strike it rich; they wanted to play their part in forging a new India. Speaker after speaker praised entrepreneurship as a powerful force for doing good as well as doing well.

Back in 1942 Joseph Schumpeter gave warning that the bureaucratisation of capitalism was killing the spirit of entrepreneurship. Instead of risking the turmoil of “creative destruction”, Keynesian economists, working hand in glove with big business and big government, claimed to be able to provide orderly prosperity. But perspectives have changed in the intervening decades, and Schumpeter’s entrepreneurs are once again roaming the globe.

Since the Reagan-Thatcher revolution of the 1980s, governments of almost every ideological stripe have embraced entrepreneurship. The European Union, the United Nations and the World Bank have also become evangelists. Indeed, the trend is now so well established that it has become the object of satire. Listen to me, says the leading character in one of the best novels of 2008, Aravind Adiga's "The White Tiger", and "you will know everything there is to know about how entrepreneurship is born, nurtured, and developed in this, the glorious 21st century of man."

This special report will argue that the entrepreneurial idea has gone mainstream, supported by political leaders on the left as well as on the right, championed by powerful pressure groups, reinforced by a growing infrastructure of universities and venture capitalists and embodied by wildly popular business heroes such as Oprah Winfrey, Richard Branson and India's software kings. The report will also contend that entrepreneurialism needs to be rethought: in almost all instances it involves not creative destruction but creative creation.

The world's greatest producer of entrepreneurs continues to be America. The lights may have gone out on Wall Street, but Silicon Valley continues to burn bright. High-flyers from around the world still flock to America's universities and clamour to work for Google and Microsoft. And many of them then return home and spread the gospel.

The company that arranged the oversubscribed conference in Bangalore, The Indus Entrepreneurs (TiE), is an example of America's pervasive influence abroad. TiE was founded in Silicon Valley in 1992 by a group of Indian transplants who wanted to promote entrepreneurship through mentoring, networking and education. Today the network has 12,000 members and operates in 53 cities in 12 countries, but it continues to be anchored in the Valley. Two of the leading lights at the meeting, Gururaj Deshpande and Suren Dutia, live, respectively, in Massachusetts and California. The star speaker, Wipro's Mr Premji, was educated at Stanford; one of the most popular gurus, Raj Jaswa, is the president of TiE's Silicon Valley chapter.

The globalisation of entrepreneurship is raising the competitive stakes for everyone, particularly in the rich world. Entrepreneurs can now come from almost anywhere, including once-closed economies such as India and China. And many of them can reach global markets from the day they open their doors, thanks to the falling cost of communications.

For most people the term "entrepreneur" simply means anybody who starts a business, be it a corner shop or a high-tech start up. This special report will use the word in a narrower sense to mean somebody who offers an innovative solution to a (frequently unrecognised) problem. The defining characteristic of entrepreneurship, then, is not the size of the company but the act of innovation.

A disproportionate number of entrepreneurial companies are, indeed, small start-ups. The best way to break into a business is to offer new products or processes. But by no means all start-ups are innovative: most new corner shops do much the same as old corner shops. And not all entrepreneurial companies are either new or small. Google is constantly innovating despite being, in Silicon Valley terms, something of a long-beard.

This narrower definition of entrepreneurship has an impressive intellectual pedigree going right back to Schumpeter. Peter Drucker, a distinguished management guru, defined the entrepreneur as somebody who "upsets and disorganises". "Entrepreneurs innovate," he said. "Innovation is the specific instrument of entrepreneurship." William Baumol, one of the leading economists in this field, describes the entrepreneur as "the bold and imaginative deviator from established business patterns and practices". Howard Stevenson, the man who did more than anybody else to champion the study of entrepreneurship at the Harvard Business School, defined entrepreneurship as "the pursuit of opportunity beyond the resources you currently control". The Ewing Marion Kauffman Foundation, arguably the world's leading think-tank on entrepreneurship, makes a fundamental distinction between "replicative" and "innovative" entrepreneurship.

Five myths

Innovative entrepreneurs are not only more interesting than the replicative sort, they also carry more economic weight because they generate many more jobs. A small number of innovative start-ups account for a disproportionately large number of new jobs. But entrepreneurs can be found anywhere, not just in small businesses. There are plenty of misconceptions about entrepreneurship, five of which are particularly persistent. The first is that entrepreneurs are "orphans and outcasts", to borrow the phrase of George Gilder, an American intellectual: lonely Atlases battling a hostile world or anti-social geeks inventing world-changing gizmos in their garrets. In fact, entrepreneurship, like all business, is a social activity. Entrepreneurs may be more independent than the usual suits who merely follow the rules, but they almost always need business partners and social networks to succeed.

The history of high-tech start-ups reads like a roll-call of business partnerships: Steve Jobs and Steve Wozniak (Apple), Bill Gates and Paul Allen (Microsoft), Sergey Brin and Larry Page (Google), Mark Zuckerberg, Dustin Moskovitz and Chris Hughes (Facebook). Ben and Jerry's was formed when two childhood friends, Ben Cohen and Jerry Greenfield, got together to start an ice-cream business (they wanted to go into the bagel business but could not raise the cash). Richard Branson (Virgin) relied heavily on his cousin, Simon Draper, as well as other partners. Ramana Nanda, of Harvard Business School (HBS), and Jesper Sorensen, of Stanford Business School, have demonstrated that rates of entrepreneurship are significantly higher in organisations where a large number of employees are former entrepreneurs.

Entrepreneurship also flourishes in clusters. A third of American venture capital flows into two places, Silicon Valley and Boston, and two-thirds into just six places, New York, Los Angeles, San Diego and Austin as well as the Valley and Boston. This is partly because entrepreneurship in such places is a way of life—coffee houses in Silicon Valley are full of young people loudly talking about their business plans—and partly because the infrastructure is already in place, which radically reduces the cost of starting a business.

Illustration by Nick Dewar

The second myth is that most entrepreneurs are just out of short trousers. Some of today's most celebrated figures were indeed astonishingly young when they got going: Bill Gates, Steve Jobs and Michael Dell all dropped out of college to start their businesses, and the founders of Google and Facebook were still students when they launched theirs. Ben Casnocha started his first company when he was 12, was named entrepreneur of the year by *Inc* magazine at 17 and published a guide to running start-ups at 19.

But not all successful entrepreneurs are kids. Harland Sanders started franchising Kentucky Fried Chicken when he was 65. Gary Burrell was 52 when he left Allied Signal to help start Garmin, a GPS giant. Herb Kelleher was 40 when he founded Southwest Airlines, a business that pioneered no-frills discount flying in America. The Kauffman Foundation examined 652 American-born bosses of technology companies set up in 1995-2005 and found that the average boss was 39 when he or she started. The number of founders over 50 was twice as large as that under 25.

The third myth is that entrepreneurship is driven mainly by venture capital. This certainly matters in capital-intensive industries such as high-tech and biotechnology; it can also help start-ups to grow very rapidly. And venture capitalists provide entrepreneurs with advice, contacts and management skills as well as money.

But most venture capital goes into just a narrow sliver of business: computer hardware and software, semiconductors, telecommunications and biotechnology. Venture capitalists fund only a small fraction of start-ups. The money for the vast majority comes from personal debt or from the "three fs"—friends, fools and families. Google is often quoted as a triumph of the venture-capital industry, but Messrs Brin and Page founded the company without any money at all and launched it with about $1m raised from friends and connections.

Monitor, a management consultancy that has recently conducted an extensive survey of entrepreneurs, emphasises the importance of "angel" investors, who operate somewhere in the middle ground between venture capitalists and family and friends. They usually have some personal connection with their chosen entrepreneur and are more likely than venture capitalists to invest in a business when it is little more than a budding idea.

The fourth myth is that to succeed, entrepreneurs must produce some world-changing new product. Sir Ronald Cohen, the founder of Apax Partners, one of Europe's most successful venture-capital companies, points out that some of the most successful entrepreneurs concentrate on processes rather than products. Richard Branson made flying less tedious by providing his customers with entertainment. Fred Smith built a billion-dollar business by improving the delivery of packages. Oprah Winfrey has become America's richest self-made woman through successful brand management.

The fifth myth is that entrepreneurship cannot flourish in big companies. Many entrepreneurs are sworn enemies of large corporations, and many policymakers measure entrepreneurship by the number of small-business start-ups. This makes some sense. Start-ups are often more innovative than established companies because their incentives are sharper: they need to break into the market, and owner-entrepreneurs can do much better than even the most innovative company man.

Big can be beautiful too

But many big companies work hard to keep their people on their entrepreneurial toes. Johnson & Johnson operates like a holding company that provides financial muscle and marketing skills to internal entrepreneurs. Jack Welch tried to transform General Electric from a Goliath into a collection of entrepreneurial Davids. Jorma Ollila transformed Nokia, a long-established Finnish firm, from a maker of rubber boots and cables into a mobile-phone giant; his successor as boss of the company, Olli-Pekka Kallasvuo, is now talking about turning it into an internet company. Such men belong firmly in the pantheon of entrepreneurs.

Just as importantly, big firms often provide start-ups with their bread and butter. In many industries, especially pharmaceuticals and telecoms, the giants contract out innovation to smaller companies. Procter & Gamble tries to get half of its innovations from outside its own labs. Microsoft works closely with a network of 750,000 small companies around the world. Some 3,500 companies have grown up in Nokia's shadow.

But how is the new enthusiasm for entrepreneurship standing up to the worldwide economic downturn? Entrepreneurs are being presented with huge practical problems. Customers are harder to find. Suppliers are becoming less accommodating. Capital is harder to raise. In America venture-capital investment in the fourth quarter of 2008 was down to $5.4 billion, 33% lower than a year earlier. Risk, the lifeblood of the entrepreneurial economy, is becoming something to be avoided.

Misfortune and fortune

The downturn is also confronting supporters of entrepreneurial capitalism with some awkward questions. Why have so many once-celebrated entrepreneurs turned out to be crooks? And why has the free-wheeling culture of Wall Street produced such disastrous results?

For many the change in public mood is equally worrying. Back in 2002, in the wake of the scandal over Enron, a dubious energy-trading company, Congress made life more difficult for start-ups with the Sarbanes-Oxley legislation on corporate governance. Now it is busy propping up failed companies such as General Motors and throwing huge sums of money at the public sector. Newt Gingrich, a Republican former speaker of America's House of Representatives, worries that potential entrepreneurs may now be asking themselves: "Why not get a nice, safe government job instead?"

Yet the threat to entrepreneurship, both practical and ideological, can be exaggerated. The downturn has advantages as well as drawbacks. Talented staff are easier to find and office space is cheaper to rent. Harder times will eliminate the also-rans and, in the long run, could make it easier for the survivors to grow. As Schumpeter pointed out, downturns can act as a "good cold shower for the economic system", releasing capital and labour from dying sectors and allowing newcomers to recombine in imaginative new ways.

Schumpeter also said that all established businesses are "standing on ground that is crumbling beneath their feet". Today the ground is far less solid than it was in his day, so the opportunities for entrepreneurs are correspondingly more numerous. The information age is making it ever easier for ordinary people to start businesses and harder for incumbents to defend their territory. Back in 1960 the composition of the *Fortune* 500 was so stable that it took 20 years for a third of the constitutent companies to change. Now it takes only four years.

There are many reasons for this. First, the information revolution has helped to unbundle existing companies. In 1937 Ronald Coase argued, in his path-breaking article on "The Nature of the Firm", that companies make economic sense when the bureaucratic cost of performing transactions under one roof is less than the cost of doing the same thing through the market. Second, economic growth is being driven by industries such as computing and telecommunications where innovation is particularly important. Third, advanced economies are characterised by a shift from manufacturing to services. Service firms are usually smaller than manufacturing firms and there are fewer barriers to entry.

Microsoft, Genentech, Gap and The Limited were all founded during recessions. Hewlett-Packard, Geophysical Service (now Texas Instruments), United Technologies, Polaroid and Revlon started in the Depression. Opinion polls suggest that entrepreneurs see a good as well as a bad side to the recession. In a survey carried out in eight emerging markets last November for Endeavor, a pressure group, 85% of the entrepreneurs questioned said they had already felt the impact of the crisis and 88% thought that worse was yet to come. But they also predicted, on average, that their businesses would grow by 31% and their workforces by 12% this year. Half of them thought they would be able to hire better people and 39% said there would be less competition.