

# Small-Business Group Formation as an Entrepreneurial Development Model

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**Why do small-business groups in developed countries exist?** Research has shown the strong economic impact of business groups throughout the world but remains heavily focused on large-business groups and on emerging economies. Theoretical approaches to explain the existence of highly diversified business groups range from market power to the resource-based view and include market failure, transaction costs, agency theory, and cultural embeddedness. These approaches, however, are not very appropriate to explain the existence of small to medium-size firms in developed countries. What we know is that these smaller groups exist and that they are largely the outcome of related diversification.

We investigate relatively small and young-business groups organized in a holding structure. What are the perceived benefits of this kind of group for entrepreneurs and how can we explain the phenomenon theoretically?

Based on case study research, we argue that the small-business group is both the outcome and the antecedent of growth. It enables, and helps to realize and manage the growth of entrepreneurial firms. The enabling function consists in increasing reputation, attracting complementary resources that facilitate the exploitation of new opportunities, overcoming overembeddedness, and dealing with coopetition (concurrent cooperative and competitive relationships with another company). The group is also the outcome of realized internationalization and related diversification. Interestingly, for the emergence of the small-business group, just as important as diversification is the integration of activities as well as the separation of closely linked activities. Finally, the small-business group corresponds to an entrepreneurial management style. The main contribution of this article is to link organizational structure to the management and growth of entrepreneurial firms.

## Introduction

Business groups, understood as groups of companies under common ownership, where personal and operational ties exist among the member firms (Strachan, 1976), are an important feature of the global economy. Research has shown the strong economic impact of business groups throughout the world irrespective of context (Granovetter, 2005). However, three general assumptions recur in the dominant literature on business groups. First, business groups are highly diversified (Guillén, 2000). Second, business

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groups are large firms (Iacobucci & Rosa, 2005). Third, business historians consider any organizational form other than the divisional M-form as a transitional phenomenon of inefficient organization (Chandler, 1962).

Several theoretical approaches such as market failure (Granovetter, 1995) and transaction cost theory (Coase, 1937; Williamson, 1985) have been used to explain the existence of highly diversified business groups especially in emerging economies (Chung, 2005). These theoretical approaches cannot adequately explain the existence and proliferation of small, young, and growing business groups in developed countries, groups that are characterized by related activities rather than by unrelated diversification (Iacobucci & Rosa, 2005; Wiklund, 1998). The question of group formation is especially important, as the strong economic impact of small-business groups in Europe has been demonstrated (Iacobucci, 2002; Loiseau, 2001; Rosa & Scott, 1999). Khanna and Yafeh's (2005) conclusion is apt: "Other reasons [than risk sharing] are more likely to explain the ubiquity of business groups around the world." One missing link to better understand business groups is the role of entrepreneurial processes (Iacobucci & Rosa), but, except for the confirmed empirical fact that business groups are the outcome of diversification, it is still not understood: first, "why [...] entrepreneurs prefer to run a group of companies rather than organizing them within the same legal boundaries," and, second, how the small-business group develops over time (Iacobucci & Rosa).

When an entrepreneur is simultaneously involved in multiple activities ("portfolio entrepreneurship") in order to exploit new opportunities, an important question arises: What is the link between these activities and why does the entrepreneur create a new company? The literature on portfolio entrepreneurs has focused on entrepreneurs' superior human capital in detecting and exploiting opportunities (Ucbasaran, Westhead, & Wright, 2006). In summary, research on business groups has largely neglected small-business groups and research on portfolio entrepreneurship the organizational structure. We focus on the facilitating effects of the small-business group organizational structure from an entrepreneurial perspective. We investigate business groups that are relatively small, young, and growing organized as a holding, in which a dominant entrepreneur has effective control.

Entrepreneurship is growth (Sexton & Bowman-Upton, 1991). Literature on growth can be summarized in terms of antecedents and consequences of growth (Wiklund, 1998). Therefore, we can speak of three elements: enabling, realizing, and managing growth. According to the model developed by Covin and Slevin (1998), growth increases management complexity and leads to various problems both within the firm and between the firm and its external environment, problems that need to be resolved in order to enable new growth. In other words, growth needs to be managed (Covin & Slevin).

Two main dimensions are subject to growth-induced change: the organization and the entrepreneur. The organization needs to change in order to adapt to growth (increasing sales, employees, complexity, etc.); the entrepreneur needs to develop stronger management competences and to adopt a different management style in order to manage the growing firm more efficiently and effectively through different stages (Kazanjian, 1988; Stanworth & Curran, 1976): from birth to growth, maturity, and decline (Greiner, 1972; Hofer & Charan, 1984). Common to these stage models is the assumption that firms go through crises leading to organizational change. As a consequence, growing firms will become organized in the same way through the creation of organizational subsystems in the form of departments and the development of a formal organizational structure (Hambrick & Crozier, 1985): integrated, with functional departments or divisions. Empirical research on stage models of the firm seems to partially confirm the inevitability of moving finally to the form of mature firms, involving personal and organizational changes (Kazanjian; Stanworth & Curran; Terpstra & Olson, 1993). Interestingly, these

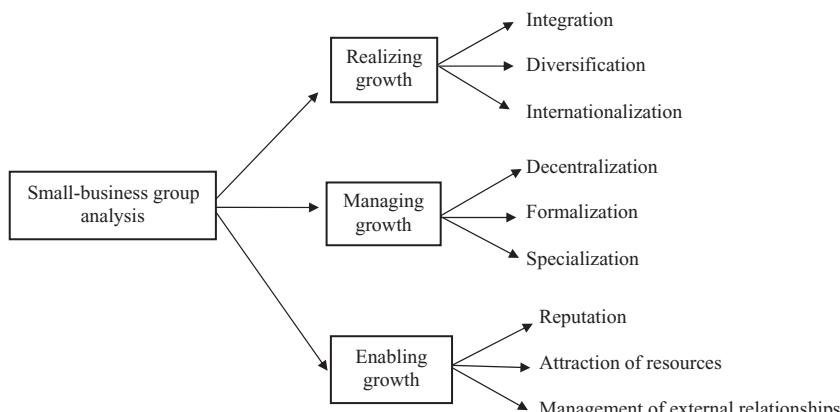
studies have never taken into account the actual organization structure. It seems that a functional or divisional structure is simply taken for granted. In general, the entrepreneurial literature has largely neglected the impact of the choice of different organization modes on growth (Venkataraman & MacMillan, 1996).

From the existing research on growth emerge distinct problem areas for enabling and managing growth. The main areas mentioned in the literature for enabling growth are increasing reputation in the firm environment; attracting highly qualified people; attracting financial resources; and increasing the number of relationships with customers, suppliers, and all other forms of interfirm relationships (Barringer & Greening, 1998; Kazanjian, 1988; Terpstra & Olson, 1993; Venkataraman & Van de Ven, 1998). Few theoretical approaches lend themselves to explaining these activities. For the management of external relationships, empirical research has shown an association among social capital, networking activity, and growth (Chell & Baines, 2000; Delmar, Davidsson, & Gartner, 2003; Huggins, 2000; Jarillo, 1989), but we lack any knowledge as to what extent this plays a role in business groups. The main areas for managing growth are linked to coping with increasing size: how to manage an increasing number of employees, how to define roles and responsibilities, and how to coordinate the work; they concern issues of decentralization, formalization, and specialization (Olson & Terpstra, 1992). In addition, the current research on stage models poses a growth paradox. Research has shown that firms increase planning, control, and formalized structures as a consequence of growth; that is, they move from an entrepreneurial type of organization to a nonentrepreneurial type of organization (Sadler-Smith, Hampson, & Cbaston, 2003). However, other streams of research have shown that an entrepreneurial management style is associated with firm growth (Covin & Slevin, 1988; Sadler-Smith et al.). In this sense, entrepreneurial management would both enable and hinder further growth.

From the above discussion emerges the idea that an analysis of business groups from an entrepreneurial growth perspective needs to take into account factors for enabling, realizing, and managing growth. These three aspects will guide our research, as shown in Figure 1. We take a qualitative theory-building approach, as entrepreneurship research has hardly established a link between organization modes and growth (Venkataraman & MacMillan, 1996).

Figure 1

### The Research Model



We proceed in the following fashion. First, we analyze the entrepreneurial process of small-business group formation. We identify the reasons for the setting up of new companies over time as well as the establishment of a holding structure. This longitudinal view provides insights into possible development patterns and clarifies whether diversification is the sole reason for setting up business groups. Then, we analyze in depth the reasons for setting up a small-business group: We try to understand whether and how it enables growth on the one hand and whether and how it facilitates the management of the growing firm on the other hand.

## Definitions

A business group is a set of companies under common effective control; that is, the entrepreneurs are directly involved in the strategic decision making (Iacobucci & Rosa, 2005; Strachan, 1976). The business group can be considered a firm (Iacobucci, 2002). A company is a legal entity mostly in the form of a partnership or limited company (Iacobucci & Rosa). In this sense, a business group is a firm made up of multiple companies. We focus on small-business groups that are relatively young and growing. By adopting the current European definition of small and medium enterprises (SME), small-business groups have less than 250 employees (Loiseau, 2001). Our groups are less than 15 years old, growing as an ensemble, and controlled by a dominant entrepreneur reflecting research in entrepreneurship that often considers age, size, and growth as discriminating variables for entrepreneurial firms (Begley, 1995; Vanderwerf & Brush, 1989).

## Research Design

### Case Study Research as the Appropriate Research Methodology

The complex phenomenon of entrepreneurial growth and the limitations of the existing research, as well as the need to gain an in-depth understanding of the effects of the business group organizational form on firm development, led us to pursue a qualitative methodology, as recommended by other researchers (Blackburn, Curran, & Jarvis, 1991; Huggins, 2000; Pihkala, Varamäki, & Vesalainen, 1999).

Given the exploratory nature of this study and our interest in finding out more about how and why entrepreneurs developed their companies into the organizational form of the small-business group, we decided that a case study design would be most appropriate (Eisenhardt, 1989). Dealing with a contemporary event and exploring a phenomenon that has hardly been studied, this research is inductive and theory building in nature, drawing conclusions from cases to the theory (Eisenhardt). Formal hypotheses were not developed since hypothesis testing is not generally feasible, as there is little from which hypotheses can be developed (Kelley, 1991). Our objective is to compare and enrich the theoretical approaches through case studies in order to generate new propositions. We present the findings as a dialog between theory and field work, following the example of case material presentation adopted by Maurer and Ebers (2006), in which citations are used to illustrate the analyses.

We chose three extreme cases (Eisenhardt, 1989). Data were collected through a series of interviews (organized between September 2003 and November 2005) with the CEOs of the companies. We conducted four interviews with each entrepreneur and, in

order to obtain a more unbiased picture of the small-business group, also did at least one interview with each partner within the different companies that made up the small-business group. Overall, we conducted 41 interviews. To enhance validity and reliability, we used triangulation of data sources and data collection (Eisenhardt; Yin, 1984): secondary information, company press releases, and other company information. Research faces bias from inevitable human judgments about research design and interpretation (Meyer & Tucker, 1993). To reduce possible bias, we proceeded in the following way: All interviews were transcribed. While the first author collected the data, the second author made initial evaluations. The first author independently made his evaluation before the evaluations were combined. If the two authors did not share the same opinion, extra data were obtained to avoid divergences in interpretation.

The data were analyzed in the following way: We organized themes into emerging categories (Ropo & Hunt, 1995). We named the categories by moving interactively back and forth between the data and the literature (Strauss & Corbin, 1990). These categories are realizing, enabling, and managing growth. The main result of our case study is the drawing of conclusions from cases to theory; that is, we generalize from data to theory. Therefore, the outcome of our research is the formulation of propositions.

### **Short Description of the Three Cases**

At the outset, the three cases seemed to be very different from each other: a very small international consulting firm versus a small diversified service firm versus a medium-size integrated consumer goods firm. All three groups are organized as holdings.

Group A was founded in 1994; it is a service firm based in Paris with companies owned by the firm located throughout France. In its first year of existence, the firm made about \$100,000 in sales and was already profitable in year 1. Since its foundation, the firm has had an average annual growth rate of about 16% in sales and 10% in profits. The growth rates during the last 5 years averaged 18 and 28%, respectively. Sales in 2005 were about €7.15 million, with pretax profits of about €2.2 million. In the first year, the group had two employees. It had 25 in 2005. The majority of the capital is held by the founding entrepreneur/CEO. In 2005, the firm had eight subsidiaries.

Group B was founded in 1995 in southwest France and operates in the food sector. The company produces and commercializes a variety of food products. It had sales of about \$200,000 in its first year and reached break-even in its second year of existence. Its rate of growth has averaged about 25%. During the 5-year period from 2000 to 2005, the group increased its sales from \$25 million to \$130 million. It currently employs about 250 people in its seven subsidiaries. The founding family holds the majority of the capital.

Group C is a consulting firm and was founded in 1997 in southwest France. It specializes in consulting for high-tech industries. At its founding, the company had two employees. In 2005, it had seven subsidiaries and 18 employees who worked directly for the group. Sales in 2005 were about \$3.9 million (see Table 1).

### **Small-Business Groups: Realizing, Managing, Enabling Growth**

#### **The Entrepreneurial Process and Realizing Growth: The Development of the Small-Business Groups**

First, we wanted to understand how the group evolved over time and how this impacted both the organizational configuration and the growth of the firm. As we generally

Table 1

## Case Description

	Case A	Case B	Case C
Start-up date	1994	1995	1997
Numbers of employees (2005)	25	250	18
Average number of employees per company	3.13	35.71	2.57
Sales (2005)	\$7.15 million	\$130 million	\$3.9 million
Type of activity	Service	Food business	Consulting company
Evolution of activities	General advertising and communication agency ↓ Sports sponsoring ↓ Career management for athletes	Packaging and branding of food products ↓ Production activities ↓ Marketing company for international sales	Communication agency for high-tech firms ↓ Public relations ↓ Lobbying
Numbers of subsidiaries in 2005	8	7	7
Geographic focus	National	National	International
Capital	Majority founding entrepreneur	Majority family	Majority founding entrepreneur
Effective control	Dominant entrepreneur	Dominant entrepreneur	Dominant entrepreneur

lack understanding of this entrepreneurial process, “it is important to focus attention not only on the latest ventures developed but on the overall pattern of growth, as the ventures successively established are strictly connected” (Iacobucci & Rosa, 2005).

We use the categories proposed by Iacobucci and Rosa (2005) to analyze the entrepreneurial process of small-business groups. They suggest that one distinguish between different activities for realizing growth: market penetration (increase market share with existing products in existing markets), internationalization as the most important form of geographic diversification, expansion into new market segments within the same sector, diversification understood as the move into new sectors, and, finally, integration of activities of the value chain. While it can be argued that the latter is not necessarily the outcome of a growth strategy (the total sales of final products and services might remain unchanged), we believe it an important phenomenon of group formation. We extend these categories by adding a category that emerged from the case studies: the separation of activities previously performed within one unit.

**Group Emergence and Development Into a Holding Company.** Business group formation was the result of the emergence of new opportunities. All cases are characterized by humble beginnings and, most interestingly, by the fact that—without exception—sooner or later, the initial activity was abandoned. The entrepreneurs diversified into new fields before knowing what would become the core activity of the business. The group was not planned but emerged over time.

Group A, founded by its current CEO, started as a general advertising and communication agency. The firm subsequently moved into the field of sports sponsoring and, finally, into the area of career management for athletes, focusing almost exclusively on the French market. The firm became the main competitor in France to the global market leader in this sector. The company as it is today was born out of a merger in 1997. The merger of activities (sports sponsoring and management of athletes’ careers), however, led to an image problem and a conflict of interest: “Clients were asking me: Who are you working

for? For the athletes who are looking for a sponsor or the firms which want to sponsor a testimonial?" (CEO of A). So the activities were separated again, and a holding structure was established. Another important factor in the separation of the activities was the competences of the CEO's main partner. While the original founder had competences in both activities, the partner only had competences in one.

Group B is a small-business family group with most of the family members working in the group. When the company started in 1995, it commercialized only one type of product to large supermarket chains. This activity was later abandoned. The diversification into a different product category led to the creation of the second company.

Group C was founded by the present CEO in 1997. The firm started as a communication agency for high-tech firms in southern France. Having gained a sufficient client portfolio, Group C diversified into the field of public relations in 1998. Finally, the group entered the field of lobbying, which was considered close to the PR business. The CEO of Group C was at the time convinced that he could successfully bring in his personal networks. When the lobbying activities became more sizeable than the communication unit, the CEO entered the consulting business. The company, therefore, specialized in consulting services for a particular high-tech industry in the region. In 1999, Group C already comprised four companies that stood for the four activities of the firm. When the consulting business became the major activity, the consulting company was transformed into the central company of this small-firm holding in 2000.

### **Unplanned Emergence of the Group**

Case A: "I was faced with two problems: how to manage diverse clients and how to deal with the competences of my-cofounder. Finally, we ended up with a group of companies."

Case B: "At the beginning we developed without any specific reason into a group structure; only later did we realize the benefits of this structure."

Case C: "We were moving from activity to activity. When we launched the consulting business, I felt this was what we should be and that we needed to organize the activities."

The establishment of a legal holding structure in France can be partly explained by certain favorable economic conditions (taxation, transfer of ownership, leveraged-buy-out legislation, and legal thresholds such as employing over 50 people and, therefore, being required to have employee representative bodies), but—at least in our cases—reasons of sense making were more important than the specific French context. There is a general feeling for defining the center of activities, to give guidance to all partners and employees of the firm as well as to outside parties such as clients and suppliers. The entrepreneurs became aware of the group when external events forced them to think about organizational issues. While the first three ventures correspond to accumulating new activities, the creation of the holding, which took place through the creation of the fourth company for case B and the fifth for cases A and C, was somehow linked to the previous or subsequent separation of activities into different companies, activities that were previously performed within the same company.

### **The Creation of the Holding**

Case A: "With diversified activities, I wanted a reference point internally and for our customers. The holding was born."

Case B: "With three or four companies under ownership, you feel the need to officially define a center."

Case C: "I had the vision to build a portfolio of strong sub-brands in consulting under the heading of our main brand that was the holding company."

It seems that the existence of a central company, seen as a reference point not only for third parties but also for the entrepreneur, gives some sense of stability to an otherwise fluid configuration of companies. We can conclude that nobody started out to form a group and that the emergence of the group was initially unplanned. The setting up of a holding involves different issues: fiscal and legal reasons and ease of separating activities as well as issues of sense-making internally and signaling effects externally. The holding structure follows the initial formation of a business group once the core business of the group had been defined. The establishment of a holding structure leads to a tightly coupled group of companies favoring strategic control. The holding is the legal form of the organization; in this sense, not all business groups need to be holdings, but all our case firms adopted over time the legal form of a holding as it happened to be often the case in France (Loiseau, 2001; Vergeau, 1997).

**Group Development Over Time.** Over the years, the founder of Group A had developed a vision that consisted of developing new activities, becoming a majority shareholder in these new companies, helping others to develop the activity further, and developing partnerships. The entrepreneur believes that the number of companies within the group will grow as new diversification opportunities appear. Once a new activity develops good potential, it is spun off. "Cycling will be the next spin-off, we are simply waiting for the right moment" (CEO of Group A).

Firm B's rapid development is directly associated with the development of the group's structure. For the first 5 years, the firm only commercialized food products. That is, the activities were limited to the packaging and branding of food products; there were no production units. In the mid-1990s, the firm had to make a decision when problems arose with its main supplier, which was located in northern France. The management thought that changing to another supplier would be difficult and would not change the situation in the long run. As a consequence, the firm developed into a holding company. The commercialization of one of the side products was spun out into a 100% subsidiary, and the production of the main product line was integrated into a newly founded company.

"We started with a very small production line: at the beginning, we produced only one product type while buying the rest from our main supplier, then we added another product type, another product, and finally phased out the relationship with our supplier." (CEO of Group B)

Shortly afterward, the firm abandoned its original founding product line by closing down the marketing company and by transferring the employees into other companies of the firm. In 1998, the firm added another major product line by creating a dedicated marketing and production company. In 2003, the firm, which had been concentrating its sales efforts on France, created a marketing company for international sales. In 2004, another product line was added, targeting a new market segment. A dedicated marketing company was created, while the production has been initially outsourced. In 2005, the firm consisted of the holding company, four marketing companies, and two production companies.

The logic of the group's organization is based on the horizontal and vertical configurations of the firm. Each product category gives rise to a category of companies: each

activity within the value chain (such as marketing and production) leads to the creation of a separate company. Therefore, for product category X, there is a marketing company  $X_1$  and a production company  $X_2$ . The CEO is convinced that tensions between the companies specializing in one activity are not greater than in a single firm:

“There are natural tensions between different functions and product lines. This situation would not change in a single firm but capital allocation would be much more difficult to handle.” (CEO of Group B)

Once Group C had defined its core activities, it started to internationalize. In 1999, it created its first fully owned subsidiary in Germany. In 2002, another industry considered close to the initial industry was added to the consulting portfolio. Subsidiaries were created in Japan and Canada in 2003, followed by Spain in 2004 and Italy in 2005. The British subsidiary, which had been created in 2002 was closed down in 2004, and the Italian one at the end of 2005. In 2005, Group C had only 18 direct employees but consisted of seven companies: a central holding company, plus one company for each activity, and one company for each country. In the same year, the CEO sold 30% of his shares to a large global consulting firm. This strategic alliance allowed the group to offer its clients reinsurance services as well as consulting services.

“When we started something new, we created a new legal entity. We have a sort of a strange matrix organizational form. The managing director for Spain, for example, is a senior consultant in the consulting company.” (CEO of Group C)

One of the perceived advantages of this structure is the great ease with which it is possible to enter and exit activities without risking the survival of other activities. Once activities had developed a sufficient sales volume or a sufficient client base, the group diversified into new fields. The new activities were financed separately and did not hurt the ongoing activities in other fields. Additionally, a side aspect of separating activities into different companies was performance control measures.

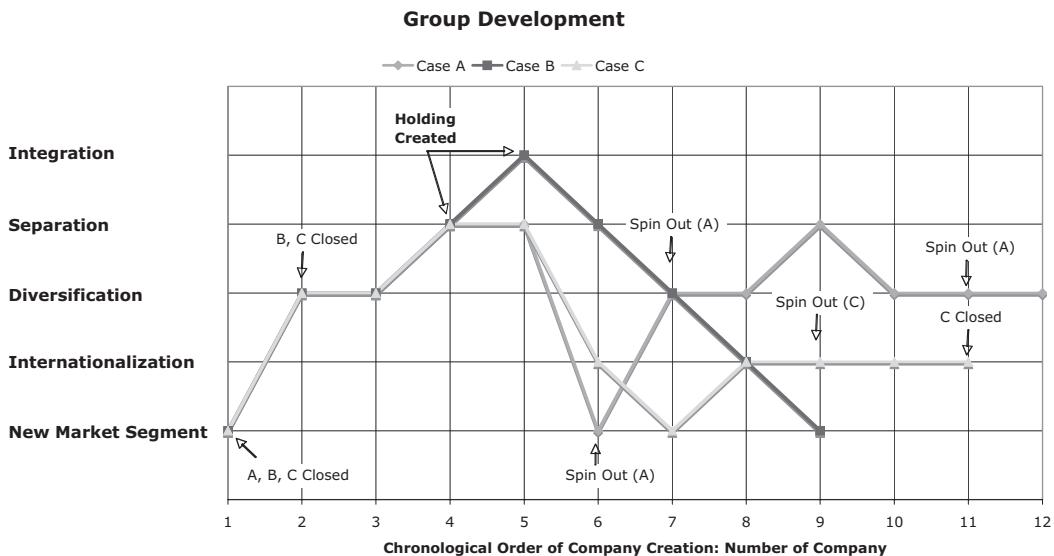
“You do not expect immediate results from a new firm. Therefore, the performance criteria are different. Sometimes within units, there are little incentives to add new activities because they will hurt the unit’s results over the short term.” (CEO of Group C)

Third, as a consequence, motivation to enter into new activities is supposed to be higher in a new company than within an existing company. Figure 2, summarizes the development of the groups over time.

***The Growth Drivers.*** The question of where the growth comes from in business groups is an important one. In our cases, we see two common patterns: first, a trial-and-error process in which the entrepreneurs jump onto different activities until they find one or two core activities; these core activities allow for significant growth through further market penetration. The two main businesses of Group A are responsible for 70% of sales. Group B’s main marketing activity captures 70% of sales. Group C’s initial consulting business accounts still for about 50% of sales. The groups realized substantial growth through their core businesses, which are still contributing in absolute terms to the overall growth of the firm. However, the most recent diversification or new market segment activities are those that show the highest relative growth rates and are perceived as the future growth drivers of the firm. At the current stage, growth is driven both by growth in the core business and the creation of new businesses.

Figure 2

### The Development of the Small Business Groups



In all cases, diversification of the activities can be characterized as related diversification. This finding contrasts hypotheses about large-business groups where the group is understood as a result of unrelated diversification and confirms findings about small-business groups, suggesting that the logic of these two types are different (Iacobucci & Rosa, 2005). The small-business group develops around certain core competences: These core competences are the basis for related diversification (opportunity) but also limit the effective control of companies in the periphery of the group, if those companies have important new competences relative to the existing ones within the group (constraint). As the CEO of Group A explained: “When the resources and competences that the rest of the group can contribute to a particular company are minimal, we need to think about spinning out the activity. It’s a flexible structure.”

The group also facilitates the divestment of activities, which increases the flexibility of the company and reduces risk.

“When you are small, and your brand declines, for whatever reason, the firm is dead. Having different companies and different brands, lowers our mortality risk. ‘Different’ also means ‘different identities.’ ” (CEO of B)

The history of the groups shows strong dynamics in which change happens frequently. Change involves not only the creation of new companies but also the closing down and spinning off of existing companies.

Complementary to existing empirical research, the small-business group is the outcome not only of diversification but also of separation and integration of activities. In particular, the separation of activities seems to be very important in structuring the business group around a holding company. This result needs further investigation since, once again, the main question emerges: “Why do entrepreneurs prefer to run a group of companies rather than organizing them within the same legal boundaries?” (Iacobucci &

Rosa, 2005). While this question is already puzzling for the case of related diversification, it is still more puzzling for activities that have been previously handled within one unit and that subsequently were separated into different companies. Overall, the group facilitates the diversification and integration of activities without having to change the organization of the existing structure.

## Managing Growth

According to stage models, the first crisis the entrepreneur has to face is a management crisis (Greiner, 1972) if the firm wants to grow and prosper (Hofer & Charan, 1984). This means that entrepreneurial firms need to abandon the entrepreneurial management style, which is to be perceived as different from the management style of established companies (Miller, 1983). The way a company is managed influences the way work is performed (Covin & Slevin, 1988). One of the key differences between entrepreneurial management style and established firm management is that entrepreneurial management is driven by opportunities and not by the resources currently controlled, by flat organizational structures, by informal planning systems, by loose job descriptions, by little formalization, by uncertain reward systems, by unsophisticated control systems, and by multitasking employees who are not particularly specialized in a specific area (Birley & Norburn, 1985; Covin & Slevin; Flamholtz & Randle, 2000; Stevenson, Roberts, & Grousbeck, 1985). Employees in small firms have a certain versatility because they must be able to handle very different tasks (Flamholtz & Randle).

Our cases have not (yet) been subject to transition crises. The impression emerges from our cases that the group structure helps to delay transitions and to prolong the maintenance of an entrepreneurial management style. The small-business group seems to be a means of replicating a known structure and, therefore, a means of facilitating the management of the growing firm, which helps to overcome the problem of managing a larger structure (Lorenzoni, 1990) without having to formalize and specify the tasks. The case entrepreneurs who were unfamiliar with managing larger structures prefer to replicate known structures to pursue both diversification and integration strategies.

## Management Style

Case A: “The whole structure can be managed like a start-up and the structure is very transparent. There is clear direction within the firm: one company—one project.”

“Personally, I prefer to head a few companies and not one large unit.”

Case B: “I am an entrepreneur. I had been working for two years in a large firm before starting my first firm. I do not like working in large firms.”

“From my first (failed) venture, I learned how to manage a small firm. I feel more comfortable managing eight small companies instead of one larger company.”

Case C: “When I talk about company x with an employee, we talk about their consulting activities, when we talk about company y, we talk about their business development activities. I think it is more transparent than if I had to handle this within one company.”

The group structure facilitates management and control of the firm. Lack of management and industry experience can be overcome by the organization structure. The entrepreneurs can replicate a structure that they know how to manage. Their role is not in question, and they are hardly subject to change, contrary to the assumptions of

entrepreneurial growth models (Kazanjian, 1988; Stanworth & Curran, 1976). The small-business group seems to be the small firm's alternative to the large firms' divisional structure. Another factor linked to the replication of known structures is competence building. The small-business group allows for the specialization of individual companies, especially through the competences of the respective CEOs or cofounders. It facilitates the development of broad competences in its employees, in contrast to the specialization promoted by the task division of large firms. In this sense, the firms remain more entrepreneurial, less formalized, less centralized, etc. The small-business group allows the entrepreneur to keep their entrepreneurial management style without sacrificing the growth of the firm. The firms will, therefore, differ in their management system.

**Proposition 1a:** Small-business groups are associated with high degrees of decentralization, low degrees of formalization with little precise job descriptions.

**Proposition 1b:** Low management or industry experience is positively associated with business group formation.

## Enabling Growth

**Reputation.** Entrepreneurial firms are characterized by liability of newness (Stinchcombe, 1965) and smallness (Baum, Calabrese, & Silverman, 2000). One form these liabilities take is the lack of credibility and legitimacy and the uncertainty of third parties about the quality of products and services, which we can summarize as lack of reputation (Aldrich & Fiol, 1994; Stuart, Hoang, & Hybels, 1999). According to Larson (1992), reputation is a precondition for economic exchange. Reputation leads to social and economic trust in capabilities (Larson). Increased reputation should facilitate access to other stakeholders, such as suppliers and clients who are willing to engage with the young firm, since the perceived risk of an exchange relationship is lower. Gaining reputation is an effective means of overcoming liability of newness and increasing firm performance (Gulati & Higgins, 2003; Larson; Roberts & Dowling, 2002). Research has shown that certain forms of endorsement have positive effects on venture development (Stuart et al.). In addition, it has been suggested that mimicry, acting as if a company were bigger or older than it in fact is, could be a means to overcome problems linked to missing reputation (Bhide, 2000).

### Reputation

Case A: "Being the head of a division in a company with a small number of people is not very credible. And furthermore, to manage everyone together in one entity would lead to confusion."

Case B: "Distribution channels think that we are bigger than we are: for them, we are a house of brands with different companies for each brand."

Case C: "When you have a holding company with a specialized company for a particular service, people think that you are a real champion in the field and they do not immediately ask how many people are working in the firm. If we had only one company offering different services, people would think that we were not capable of delivering these services."

The existence of a group structure seems to signal reputation. The group structure gives an impression of bigger size, specialized competences, and stability. Clients and

suppliers seem to have greater trust in a small firm that is composed of many companies instead of only one. The group appears as a sort of second-best alternative for reputation, which is effectively gained through relationships with clients and suppliers. The group structure seems to influence the perception of clients and suppliers. The signaling effects should positively influence firm development (Stuart et al., 1999). In this sense, the mimicry effect should be even stronger for very small firms.

**Proposition 2a:** Small-business groups will have positive signaling effects on reputation thus positively influencing firm growth.

**Proposition 2b:** The smaller the size of the group, the greater the signaling effect of group structure on reputation.

**Attraction of Firm Resources.** Entrepreneurship is also understood as seizing opportunities independent of the resources currently controlled (Timmons, 1994). This understanding of entrepreneurship implies that the entrepreneur does not yet control all the resources necessary to run, maintain, and develop the business. We make a distinction between the acquisition of resources and the attraction of resources. Acquisition of resources means that an entrepreneur can exchange existing resources for other resources; attraction of resources means that entrepreneurs can control resources without having to acquire any. It has been argued that the difference between large-firm management and entrepreneurship is the capacity to attract resources rather than acquire them (Hamel, 1999). Attraction of financial, human, and other productive resources is seen as a primary factor for enabling growth (Barringer & Greening, 1998; Kazanjian, 1988; Scott & Bruce, 1987; Stanworth & Curran, 1976). In our case studies, the small-business group facilitated, through the creation of new companies, the attraction of complementary competences via the hiring of specialists and the attraction of financial resources.

### Attraction and Control of Resources

Case A: “When I had an idea but not all the competences, I was looking for partners inside or outside the firm to develop the activity. So I decided to give them the activity upfront, invest in the company and take a stake in it.”

“You cannot compete with X, the largest global competitor, in terms of attracting top talent, even if we have a strong position in France. You only can attract top people if you give them real responsibility, a stake in the project, and a buy-out option for the future.”

Case B: “We partially financed production through the holding company and partially through banks. Bankers like the concept, one activity, one company, dedicated results. And finally, you add another money stream and can partially guarantee the sales for the new firm. It is much more difficult to attract financing for the development of a single company.”

Case C: “It’s better to be managing director and a major shareholder of C-Japan than being an employee of a large consulting firm.”

“Consulting is our basic business for which employees receive a salary; business development is a result-based activity.”

Entrepreneurial firms cannot compete using the same means as large firms; they have to offer a different package to attract resources. To be the managing director with a significant stake in a company, to participate directly in its development, and to be one’s

own boss can be a worthwhile package. The creation of a new company makes hiring top talent possible, which is an attraction of superior human capital. Third-party equity resources, other financial resources (bank financing), and superior human resources enable firms to diversify or to integrate activities. The small-business group and the creation of new companies are considered a means to attract complementary competences by hiring specialists.

While some research investigated reasons for entry and exit of the initial founder team and showed that increasing task diversity after the start-up phase was linked to member entry (Ucbasearan, Lockett, Wright, & Westhead, 2003), we show how the creation of new companies within the small-business group kept the initial founder team unchanged and effectively enabled the attraction of new, key personnel and facilitated financing. In this sense, business group development can be seen as a process of resource allocation, as argued by Rosa (1998), as well as a process of resource attraction leading to entrepreneurial opportunities. The organizational form facilitates the exploitation of entrepreneurial opportunities and addresses problems associated with resource attraction, as mentioned in the entrepreneurial growth literature (Barringer & Greening, 1998; Kazanjian, 1988; Scott & Bruce, 1987; Stanworth & Curran, 1976). It seems that the business group facilitates the access to external financing (time to convince the bankers and possible amount raised through collaterals) as well as the attraction of diverse resources.

**Proposition 3:** Small-business group organization has a positive influence on the attraction of resources in terms of time, scale, and scope.

**Management of External Relationships.** Engaging and managing relations with other people, groups, or entities are based on social capital, i.e., on the capacity of people to connect (Burt, 2000). “Social capital is the sum of the resources, actual or virtual, that accrue to an individual or group by virtue of possessing a durable network of more or less institutionalized relationships of mutual acquaintance and recognition” (Bourdieu & Wacquant, 1992). For many entrepreneurial research questions, it is interesting to understand the ability of a person or a firm to manage external relations. Firms are constrained by their relational capability, i.e., the capability to establish, maintain, and develop relationships (Dyer & Singh, 1998; Lechner & Dowling, 2003; Lorenzoni & Lipparini, 1999; Pihkala et al., 1999). Two areas of investigation emerged from our case studies: network overembeddedness and managing relationships with competitors (co-opetition).

**Embeddedness.** The theory of structural embeddedness considers network structure and a firm’s network position as both opportunities and constraints. Favorable positions are regarded as network resources (Burt, 1992; Easton, 1992; Granovetter, 1974; Gulati, 1999; McEvily & Zaheer, 1999); over-embeddedness, however, (“trapped-in-one’s-own-net”) can lead to inability to act (Gargiulo & Benassi, 2000; Uzzi, 1997). Social overembeddedness can, at a certain point, become a development barrier for firms. Often, young companies have to offer customized products for clients in order to win first contracts, which can lead to almost exclusive relationships (Bhide, 2000).

The literature has proposed various models to deal with overembeddedness and the limits of relational capability. One is network restructuring, i.e., the cutting of redundant ties and the adding of new nonredundant ones, leading to a network in which the core is stable but, as a whole, evolves (Dore, 1986; Lechner & Dowling, 2003). Another model is network hierarchy, i.e., the structuring of networks into different layers (first-tier, second-tier suppliers), thereby reducing the direct relationships a firm has to deal with (Dyer & Singh, 1998; Lechner & Dowling). A third model is the integration of activities: Once firms organized as networks have reached a medium size, they tend to hire over-proportionally

(compared to the firm's growth) (Jarillo, 1989) and increasingly integrate activities previously performed externally (Delmar & Davidsson, 1998). These are the three established models. In our cases emerged a fourth alternative model: the small-business group that facilitates relationship building through setting up new companies.

### Overembeddedness

Case A: "We work for C (a client) and manage their sponsoring program but we are also the manager of P (an athlete). Now the folks at C will tell us that they will not work with us because we also manage P. By having different companies with different CEOs, we could convince them that this is another business, another company, with different people responsible for managing the business and the relationships."

Case B: "It was clear to us that we had to integrate production activities: we created the production company. Our main supplier had already begun to sell us lower quality while he sold a superior quality to our clients in the south in order to take over our market share."

"Private labeling is a similar issue: we produce for the same clients their private labels and sell them our brand."

"The relationship would be almost impossible to handle within a single company. It reduces tensions between units."

Case C: "We created the Italian consulting company, mainly because one of our Spanish clients did not want us to work with a particular company in Italy. I did consider the Italian market attractive, but the impetus for setting up the company came from the problems we experienced in handling a particular client."

The small-business group can be understood as a strategic network with multiple centers (the subsidiaries) that can engage independently in interfirm relations. Old relationships sometimes hinder the formation of new ones. People will not work with the firm because the firm works with certain other companies. Dividing up the firm into separate companies by creating a small-business group thus enables the firm to address this problem and thereby to position itself to create new relationships. By adding new companies to the firm, the small-business group overcomes overembeddedness, and, by hiring top talent as CEOs for the new company, the firm can acquire superior human resources and additional social capital that extends the relational capability of the firm. In this sense, it is the separation of activities that facilitates the management of external relationships—a key issue for growing firms (Barringer & Greening, 1998; Kazanjian, 1988). The group structure is therefore partially an outcome of external pressure.

**Proposition 4:** Small-business group organization has a positive influence on the development of new relationships and, therefore, for the building of interfirm networks.

*Co-opetition.* Co-opetition is a situation in which a company has at the same time both cooperative and competitive relationships with another company. The management literature generally considers industries to be collections of firms bound together by rivalry, therefore questioning the value of relationships with competitors (Dollinger, 1985). However, it has been shown that co-opetition is a common phenomenon both for large and small firms (Dowling, Lechner, & Bau, 1998) even if the management of these complex relationships has only been studied for large companies.

### ***Co-opetition***

Case A: "At the moment, we cooperate in the cycling business with a big group who is our competitor in the football business. Without separate companies, we could not deal with this kind of situation."

Case B: "Occasionally, we produce some special lines for competitors. If we had integrated all activities into one firm, it would not work. Our sales team would really lose their motivation."

Case C: "We have partners in the space sector who are competitors in aeronautics. Separation helps."

Two of the main strategies employed by large firms to deal with co-opetition are dissolution and decentralization. Dissolution of the relationship means avoiding co-opetition. Decentralization of the management means that each division treats its relationships independently (Dowling et al., 1998). The cases suggest that divisionalization is not an option for small firms but that the group structure and the existence of different companies are an effective means of handling situations of co-opetition. The cases also suggest that co-opetition is seen by the firms as a necessity. In Case A, co-opetition seems to help overcome size or competence constraints; in Case B, to stabilize sales by occasionally producing for other firms as well as gaining entry into distribution channels. In Case C, it is a means to increase the number of clients. Overall, relationships with competitors can give access to temporarily needed resources or lead to the temporary pooling of resources; this should positively influence firm performance, especially in the years after foundation, when sales tend to grow discontinuously (Lechner & Dowling, 2003). Entrepreneurial firms that view competitors not only as pure rivals but also as a potential resource should therefore be more successful (Lechner & Dowling). However, the major problem of how to manage these relationships has not been addressed in the current literature. The creation of new companies and the separation of activities seem to be an effective means to deal with co-opetition. Similarly, we can also argue that the group structure is partially a result of co-opetition.

**Proposition 5:** Co-opetition is positively associated with small-business group formation.

### **Limits of the Small-Business Group Model**

An interesting phenomenon concerns the activities within the small-business group that the firm decides to spin out. Why do entrepreneurs spin out companies? Entrepreneur A explained the decision between taking a majority stake in the new company and linking it to the rest of the group or simply spinning out the activity by maintaining a minority stake in the following way: The most desirable process is to bring in a partner who will become the CEO of the new company and then to develop the new activity. The entrepreneur and/or the holding company takes a majority stake in this new company and finances the development activities; this is especially the case if important competences are held by the existing structure and if the activity is close to the core businesses. A second possibility is that the firm develops an activity and takes a significant stake in the company (between 30 and 50%), while the partner brings in new and decisive competences. A last possibility is that the firm takes only a minority stake (up to 30%, usually around 10–15%), but the partner, who benefits from the image and infrastructure of the holding company, has chief responsibility for developing the activity.

Therefore, if the competences of a specific company happen to become more important than the core competences of the group, the management of the group might have to reconsider the legal and financial relationships. One of the main advantages of the group, i.e., the capacity to attract considerable complementary resources, might actually decrease the control function of the group since the CEOs in the companies could, in time, acquire sufficient experience, competences, and reputation and financial resources to be able to start a company on their own, outside the group, especially if the corporate added value is considered negligible. In this case, the financial relationships might not be sufficient to maintain and control the whole group structure.

Unlike in large corporations, it would seem that the control potential of the small-business group depends on financial relationships on the one hand and on the division of competences within the group on the other hand, or more specifically between the competences of one individual company and the rest of the group, i.e., on the value added of other parts of the group to a specific company within the group. Effective control (Iacobucci & Rosa, 2005; Strachan, 1976) of the companies forming the small-business group is, therefore, also a function of the ability to make a relevant contribution to the companies.

Limited competences within the group will lead—in the case of a further increase of activities within the small-business group (diversification and/or integration)—to an externalization of activities and the transition from a pure small-business group toward a network model of organization. We could consider the small-business group as an elastic organizational form, a loosely coupled system (Aldrich, 1979; Glassman, 1973; Orton & Weick, 1990). The small-business group might be characterized as a process of constitution and reconstitution around certain core businesses through the entry and exit of activities. The small-business group seems to constitute an organizational and strategic paradox, insofar as it is a possible growth strategy for an entrepreneurial firm through structural replication (multiplication of small companies) and through a process of resource attraction, but, at the same time, it leads almost naturally to a mechanism that limits its replication, i.e., the number of its subsidiaries.

## Conclusion

The empirical evidence of the small-business group in developed countries (Iacobucci, 2002; Iacobucci & Rosa, 2005; Rosa & Scott, 1999) opens a new field for analyzing growth strategies and the structural development of entrepreneurial firms. Our research question was “why does the small-business group exist?” in developed countries. Given that the theories used to explain large-business groups in emerging and transitional economies were ill suited to answer this question, we took an entrepreneurial perspective. The small-business group helps to realize, enable, and manage growth. It seems that the organizational form plays an important role in the exploitation of new opportunities through the attraction of superior complementary resources. Entrepreneurship research has highlighted the importance of identifying and acquiring resources at the early stage of a company’s life (Lichtenstein & Brush, 2001). We found that the small-business group is able to call upon and mobilize resources, especially superior human and social resources, without having to acquire them or without having to possess them right from the beginning.

Entrepreneurship is about growth (Sexton & Bowman-Upton, 1991), and our case studies are growing firms with an organizational model that facilitates realizing, enabling, and managing growth. Where does the entrepreneurial behavior come from? In our cases, there was a dominant entrepreneur that used the benefits of the business group structure

not only to seize new opportunities for growth but also to grow the existing activities. We cannot answer the question of whether the business group form is particularly suited to the growth intentions of individual or dominant entrepreneurs, since we did not have a case with a founding team. We could also consider that the partners brought in the newly formed companies as entrepreneurs, but this consideration would be beyond the scope of this article, even if our cases strongly suggest that the small-business group promotes an entrepreneurial orientation throughout the firm.

Entrepreneurs are obsessed with opportunities (Timmons, 1994), and our cases suggest that they create new companies because they see new opportunities. These new opportunities are linked to their existing competences and those developed in previous companies (Ucbasaran et al., 2006), but the emergence of the group structure is unplanned. Only after the creation of several companies did the entrepreneurs try to make sense of what they had carried out, which, in our cases, led to the creation of a holding structure. Other companies emerge because of the necessity to separate activities. Over time, entrepreneurs started to use the business group structure consciously as a tool to enable, realize, and manage growth.

While it has been argued that the small-business group is a model for diversification strategies (Iacobucci, 2002; Iacobucci & Rosa, 2005), we found that it is an effective structure for implementing the vertical and horizontal configuration of the firm. The small-business group is a means for diversification, integration, and separation of activities.

The small-business group seems at least to delay, if not avoid, the typical management crises that entrepreneurs face as outlined in the stage development models of entrepreneurial firms (Greiner, 1972). By replicating known structures, entrepreneurs are able to manage a larger aggregated structure without having to radically change their management style. In this sense, the organizational structure partially compensates for lack of management and/or industry experience and helps to at least temporarily delay growth transitions, maintaining an entrepreneurial management style (Covin & Slevin, 1998). The cases suggest that the small-business group as an organizational form is a means of overcoming overembedding and dealing with co-opetition. This is a very interesting finding since it means that the organizational form helps to overcome growth barriers, in our cases, the ability to develop new relationships with other firms or clients.

The small-business group, however, poses an important question: Does it, at some point, limit the development of the firm? Our cases seem to suggest that the small-business group evolves around certain core competences and spin-out activities (the dilution of the group's stake in other companies). Therefore, the firm periodically reduces the scope of its current activities while adding new ones subsequently, leading to continuous entrepreneurship and evolution toward a network model. In this sense, the small-business group is a truly competence-driven firm model that stimulates entrepreneurship through the exploitation of new opportunities within the group or within the evolving network.

The relationships between the different companies, i.e., the structure of the small-business group, should be analyzed in a dynamic perspective rather than a static one. The case studies suggest that entrepreneurs have a limited capacity to control the periphery of the group. The development of the group depends heavily on the development of the individual companies: The potential for action on the periphery of the group is dependent on the strengthening of the competences of the core. The latter might pose definitional problems: To what extend do we need to take into account the spin-out businesses that were once controlled financially and effectively by a dominant entrepreneur but that still might benefit from the small-business group in terms of reputation, possible utilization of brand names, and other group resources?

In this article, we have developed a series of unique propositions that should stimulate further research. Our study, of course, has its limits. It is based on only a few cases, and the main goal is to extend existing theory (Yin, 1984). We need more in-depth case studies on the development of the small-business group as well as quantitative and hypothesis-testing research endeavors. A replication of our study in other settings would be very useful for advancing theory. While there are no particular incentives, e.g., from a legal or tax point of view, to set up such an organizational form in France, in other countries, the specific context might favor this particular organizational form. Lazerson (1995) found, for example, that the frequent occurrence of the network model in Italy was favored by legal and tax incentives that limited the size of the firm in terms of number of direct employees. In these cases, it would be interesting to see if the propositions we developed apply.

Many questions for future research arise: Does the organizational form actually limit the size of the firm? Does structural instability finally mark the difference between entrepreneurial and established firms' development? What competences are most appropriate for preventing the departure of individual companies toward the periphery? We also believe that the linkage to the resource and dynamic capabilities debates needs to be explored further. What resource hurdles do holding companies have to address? What learning is required and exhibited? What is the linkage between resources/capabilities and opportunity recognition, pursuit, and exploitation? The main impulses for further research arising out of our study would be to consider the outcome of habitual entrepreneurship and to direct more attention to an organizational perspective.

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