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A Job Creation Roadmap: How America's Entrepreneurs Can Lead Our Economic Recovery

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A Job Creation Roadmap

How America's Entrepreneurs Can Lead Our Economic Recovery

Good afternoon, Chairman Graves, Ranking Member Velazquez, and Members of the Committee. My name is Andrew J. Razeghi, and I am a Lecturer at the Kellogg School of Management at Northwestern University. I am pleased to provide testimony for today's hearing. The opinions provided in this testimony are my own and not necessarily those of the Kellogg School of Management.

As you know, small businesses are instrumental to the U.S. economy. They employ 50% of all private-sector workers and are responsible for creating over 60% of new jobs.[1] In order to determine how best to support entrepreneurs in leading economic recovery, it is important to do so within the context of the following three principles:

1. First, **not all entrepreneurs become entrepreneurs for the same reasons**. These reasons differ significantly and have implications for how best to support entrepreneurs in leading economic recovery and growth.

2. Second, **self-employed small business owners have different goals than those of high-potential entrepreneurs**. Whereas self-employed business owners create businesses to employ themselves and provide income for their families, high-potential entrepreneurs create businesses for themselves and others (investors, employees, suppliers, and customers). Ray Kroc, the visionary entrepreneur who grew McDonald's Restaurants and its global supplier and franchise system, was a high-potential entrepreneur. The McDonald brothers, on the other hand, who started the business that Ray discovered and grew, were self-employed small business owners. While they share many traits, these two groups differ most significantly in their ***aspirations and challenges***.

3. Third, these differences must be taken into account as they have implications for the types of **skills, funding, and social infrastructure** required to succeed.

There is no better time to support entrepreneurs in leading our economic recovery than now, not only because we need them but also because they want to start. Like the 1990s, we are witnessing a similar draw to entrepreneurship. Never before had we experienced as much enthusiasm for entrepreneurship as we did in the 1990s with a record 885,000 businesses started each year since 1997 (or more than 2,400/day). This was 4 times the number of new firms created in the 1960s and more than 16 times as many created in the 1950s.[2] This growth was evidenced across all industries, including manufacturing, retail, real estate, and technology. We have a similar opportunity now.

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[1] The Kauffman Firm Survey data collected in 2005 on businesses that started in 2004.
[2] Rogers, Steven. Entrepreneurial Finance: Finance and Business Strategies for the Serious Entrepreneur. Second Edition. McGraw Hill. p. 1

Motivation: Not All Entrepreneurs Become Entrepreneurs for the Same Reasons

Ask people from other countries to describe the typical American businessperson and they will portray the entrepreneur: a creative visionary who deems nothing impossible. As my colleague Lloyd Shefsky has observed: "entrepreneurs are the Sinatras of business."[3] They do it *their* way. They are rebels, misfits, and mavericks.[4]

This is the romantic vision of the entrepreneur however it does not necessarily apply to all small business owners. Simply, there is no single path to entrepreneurship nor is there a single type of entrepreneur. Understanding how people become entrepreneurs is vital in creating the most-effective environment, policies and programs for them to succeed. Why? Their motives differ. There are "in it" for different reasons. And to make decisions in the absence of understanding these underlying motivations will be sub-optimal in helping entrepreneurs lead our recovery and growth.

In this testimony, I describe three types of entrepreneurs:

- **Dreamers**: those who choose entrepreneurship
- **Accidental Entrepreneurs**: those for whom entrepreneurship is a necessity
- **Stewards**: those for whom entrepreneurship is destiny

While these groups and the paths they travel are not necessarily mutually exclusive (the roads do intersect at times), the distinctions between them are significant enough to warrant careful examination.

These three types of entrepreneurs ultimately become either **self-employed small business owners** or **high-potential entrepreneurs**. Just as their motivations differ so too do their aspirations. I also explore differences between these groups and their implications for **skills, funding,** and **social infrastructure**.

[3] Shefsky, Lloyd. Entrepreneurs Are Made Not Born: secrets from 200 successful entrepreneurs. McGraw-Hill. p. 2.
[4] An homage to Apple's famous television advertisement, "The Crazy Ones."

1) The Dreamers: Those Who Choose Entrepreneurship

First, there are those for whom entrepreneurship is a ***choice***. I refer to them as Dreamers.

Dreamers are drawn to entrepreneurship by one of two factors: either a desire to work for themselves or by inspiration to solve a problem they feel ideally suited to tackle. These entrepreneurs often start their businesses *despite* their skills (or lack thereof) and despite having the necessary resources available to them at the start. In other words, they don't wait to create. Most notable among this group of entrepreneurs are so-called 'user entrepreneurs' (those who create businesses to solve their own problems).

Anecdotally, this group of entrepreneurs includes people such as Jessica Kim, the founder of baby and children's products company BabbaCo (http://www.babbaco.com/)[5]. As a working parent, Jessica saw a need that required a better solution than what was available at the time. She didn't have enough time to create entertaining, engaging, and educational activities for her young children as they passed through critical developmental stages. Her response? She invented a solution to solve her own problem. Notably, Jessica created a monthly subscription service for new parents whereby she delivers developmental and learning activities "in a box", aptly named BabbaBox, by mail to her customers' homes. She solved her own problem and then offered the solution to others in her same situation. Jessica is a user entrepreneur.

Likewise, Brad Flora, the founder of advertising technology start-up NowSpots (http://www.nowspots.com)[6] is the publisher of the Chicago-focused online newspaper The Windy Citizen. His problem was the ineffectiveness of existing advertising technology (notably, banner advertising) as a viable economic engine to pay for the overhead associated with his journalistic activities. And thus, Brad invented his way out of his problem. With the increasing popularity of social media (Twitter, Facebook, etc.), Brad created unique social media advertising units (called NowSpots) to effectively replace ineffective banner advertising. Rather than offering marketers "impressions and click-throughs" as is typically the case with online banner advertising, Brad created ad units that allowed marketers to package and promote their content in order to acquire "Facebook Likes and Twitter Followers" via other publishers' websites. Having succeeded, Brad then began selling the technology as a platform to other online publishers and NowSpots.com was born.

While user entrepreneurs such as Jessica and Brad represent only 10.7% of start-ups, they account for 46% of businesses that last longer than 5 years.[7] This can be explained,

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[5] The author is an investor in BabbaCo through a seed fund called Excelerate Labs II (www.exceleratelabs.com).
[6] The author is a direct angel investor in NowSpots (www.nowspots.com).
[7] Kauffman Foundation Study. March 7, 2012. These findings draw on data from the Kauffman Firm Survey longitudinal study tracking nearly 5,000 firms started in 2004. http://www.kauffman.org/newsroom/nearly-half-of-innovative-startups-are-founded-by-user-entrepreneurs.aspx

in part, by their depth of knowledge of the problem for which they are solving and their personal motivation to solve it. Particular attention should be given to this group as they over-index in terms of success versus others. Given these types of entrepreneurs exhibit very high levels of intrinsic motivation, they are best-supported by having access to risk capital and mentors that can help them bridge the gap between their aspirations, skills, capital, and customers.

2) Accidental Entrepreneurs: Entrepreneurship Chooses Them

Second, unlike those for whom entrepreneurship is a choice are those for whom entrepreneurship is a ***necessity***. These are often the victims of job loss and those whose skills are no longer relevant in the marketplace as well as those whose former employers' products are no longer in demand. I refer to these business founders as **Accidental Entrepreneurs**. While they had no intention to start their businesses, they also had no choice. Entrepreneurship is a decision made for them, not by them. Their underlying motivation is to survive.

Such was the case of Tom Hodge, a toolmaker for General Motors who was laid-off two days before Christmas on December 23, 2008. With his buyout as seed capital, a 39-page business plan, and a 1,500 square foot shop in Germantown, Ohio, Tom started Absolute CNC Machining to supply energy, medical, and aerospace companies in the region.[8] Entrepreneurship chose Tom. Since losing his job, Tom has not only started his business, he now employs 3 full-time additional employees, is earning a profit and reinvesting in his business, and he has the ambition to grow to 15-20 employees within the next 10 years.[9]

Like Tom, entrepreneurship also chose Sara Clemence, a magazine publishing executive laid-off on New Year's Eve 2008 from Conde Nast's *Portfolio* publication. Two months after losing her job, she created *Recessionwire* (www.recessionwire.com), a website chronicling "the upside of the downturn".[10] As she puts it, "All of the sudden, my opportunity cost was really low." Just as Tom and Sara, many accidental entrepreneurs are part of the swelling group of companies responsible for new business creation during economic downturns.[11]

In terms of entrepreneurial traits, this feeling of having "nothing to lose" is common to successful entrepreneurs. They think not only in terms of the *financial costs* associated with their ideas, but also in terms of the *opportunity costs* of not pursuing their ideas. Thus, it is not uncommon for many successful entrepreneurs to credit "being fired" or

[8] Bloomberg BusinessWeek. The Rebounders. http://images.businessweek.com/ss/09/03/0313_rebounders/3.htm
[9] From email communication with Tom Hodge on March 14, 12. tomhodge@absolutecnc.us.
[10] Bloomberg BusinessWeek. The Rebounders. http://images.businessweek.com/ss/09/03/0313_rebounders/2.htm
[11] Razeghi, Andrew. "Innovating through Recession: When the Going Gets Tough, the Tough Get Creative." http://www.scribd.com/doc/7439356/Innovating-Through-Recession-by-Andrew-Razeghi-of-Kellog-School-of-Management

"losing their jobs" as motivation for striking out on their own. Creativity loves constraints. Humans have an innate ability to figure things out when we have no other choice. As Matt McCall, Partner at Chicago-based New World Ventures observes, "Darwin plays a role in innovation."[12] And it is important that Darwin be allowed to continue to play that role. The three-year survival rate for new firms is 78.5%[13] with only 45%[14] surviving longer than five years. Not all ideas and entrepreneurs should succeed. Survival of the fittest is healthy for the economy. At the same time, we must work diligently to identify, support, and make it easier for companies to grow that have the greatest potential to succeed.

3) The Stewards: Entrepreneurship As Destiny

Third, beyond Dreamers and Accidental Entrepreneurs are those for whom entrepreneurship is their ***destiny***. These types of entrepreneurs, **Stewards**, are the ***beneficiaries of chance***. Stewards include those who inherit businesses and/or have assets transferred to them (including sole proprietorships, partnerships, farms, and the descendants of multi-generation family businesses).

Stewards are motivated not only by legacy but also by the family's values and their role as ensuring continuity of the enterprise for the next generation. Beyond legacy, they are also motivated by their own opportunity to make a positive contribution to the family business and to their communities.

The empirical research on the contributions of family businesses to our economy varies largely based on the definition of "family business" (i.e., whether only multi-generation family businesses, or also sole proprietorships, partnerships, and farms). Conservatively, if one only considers multi-generation, family businesses with multiple family members working in the business and with the intention to pass the business along to succeeding generations, these businesses account for 27% of the workforce or 36 million people and contribute 29% of U.S. GDP.[15]

Unlike first generation entrepreneurs who focus on creating new wealth from the introduction of new ventures, Stewards generally focus on preserving and protecting wealth generated by legacy assets. Their goal is to ensure the sustainability of the family firm. Certainly there are family business leaders who also share the ambitions of first-generation founders and are "entrepreneurial" in their talents. However, generally speaking, their focus is preservation.

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[12] Matt McCall, Partner, New World Ventures (Chicago). www.newworldvc.com.
[13] The Kauffman Firm Survey data.
[14] Shane, S. (2008). The illusions of entrepreneurship: The costly myths that entrepreneurs, investors, and policy makers live by. New Haven, Conn.: Yale University Press.
[15] Astrachan, Joe. Shanker, Melissa. "Family Businesses' Contribution to the U.S. Economy: A Closer Look." Family Business Review, vol. XVI, No. 3, September 2003. Family Firm Institute, Inc., p. 217.

Understanding these differences in **motivation** and how people become entrepreneurs - by choice, chance, or destiny - is vital to creating good policy to support economic recovery and growth. While Dreamers are motivated to create and grow companies based on a desire to work for themselves and/or solve a unique problem, Accidental Entrepreneurs are motivated by a lack of opportunity while Stewards are motivated by a sense of duty, pride, and responsibility. Certainly the traits of these three groups overlap; however it is important to be mindful of these differences as they pose significant implications for skills/talent development, funding and capital needs, and the social infrastructures required to help entrepreneurs succeed. I will discuss each of these shortly.

Independent of their motives and origins, it is equally important to distinguish between **the self-employed small business owner** and **high-potential entrepreneurs.**

This distinction will help to inform the appropriate programs and infrastructure required to support these groups and is perhaps the greatest area of opportunity for the United States to improve its efforts in encouraging recovery and growth.

Let’s consider these distinctions now and their implications.

All High-Potential Entrepreneurs Are Self-Employed, But Not All Self-Employed Are High-Potential Entrepreneurs

Although they comprise a large majority of small businesses, the self-employed are not the same as high-potential entrepreneurs. While people may become entrepreneurs under any one of the three scenarios described above, self-employed small business owners and high-potential entrepreneurs differ in their ***aspirations***. Notably, they have different ***visions***.

According to the U.S. Census, 75% of U.S. businesses have no payroll (sole proprietorships and partnerships). In Kauffman's research, nearly 60% have no employees and 82% have two or fewer employees.[16] These typically represent self-employed small business owners who, by definition, are not "employers" (other than employers of themselves).[17] They generally work in services occupations, retail, and trades whereby they apply their own skills, knowledge, and assets in order to generate cash to pay for their respective lifestyles.

High-potential entrepreneurs, on the other hand, tend to work in high-growth categories such as science and technology and are focused on enrolling others in their visions. While they may not have the requisite skills or knowledge of a particular industry or category, high-potential entrepreneurs are adept at connecting ideas, capital, and people in the pursuit of their dream. Unlike many small business owners focused on leveraging their unique capabilities, high-potential entrepreneurs are not hindered by their own capabilities rather they are driven by opportunity and will find people who can execute and provide subject-matter expertise as needed.

While both types of businesses – self-employed small businesses and high-potential entrepreneurs - share many traits in common, these differences in aspiration and control, require different policies, programs, and infrastructure to help them succeed and ultimately to help the U.S. on the road to recovery and growth.

[16] The Kauffman Foundation firm survey data.
[17] Astrachan, Joe. Shanker, Melissa. "Family Businesses' Contribution to the U.S. Economy: A Closer Look." Family Business Review, vol. XVI, No. 3, September 2003. Family Firm Institute, Inc., p. 215.

Small Is Beautiful (For Some, but Not for Others)

Daniel Isenberg of Babson College notes, "In the 1970s, the economist E.F. Schumacher set the scene for environmental sustainability with Small is Beautiful. But small is not beautiful for entrepreneurs: small is a stigma. Small connotes self-employment and stagnation which is not only different from entrepreneurship, it is fundamentally opposite." [18] Not all entrepreneurs share the same growth ambitions.

High-potential entrepreneurs aspire to grow. As Troy Henikoff, serial entrepreneur and Chief Executive Officer of the Chicago-based new venture accelerator Excelerate Labs focused on high-potential entrepreneurship puts it: "We look for entrepreneurs who have a penchant for problem-solving and a bias towards action. We are interested in high-impact, high-growth, and highly-scalable businesses."[19] High-potential entrepreneurs are drawn to large and growing problems where existing solutions are ineffective and/or unacceptable given what they deem possible. This practice results in ideas (typically new ventures) that are at least 10x beyond what most consider feasible and/or even required to satisfy their customers. While everyone has the capacity to think big, driven by higher aspirations high-potential entrepreneurs simply choose to think big all the time. They are not satisfied to remain a small business. Quite the contrary, their vision is to grow.

Beyond their choice to "think big" however, high-potential entrepreneurs are also endlessly curious, observant, unsatisfied with the status quo, and opportunistic in the pursuit of profits. For them, entrepreneurship is as much a capability in and of itself as it is a job. In fact, 10% of entrepreneurial leaders are responsible for starting nearly 30% of all new businesses, while 20% start almost half of all new businesses. In other words a minority of entrepreneurs create the majority of businesses.[20] Creating and building companies is their strength. *These* are the high-potential entrepreneurs.

Self-employed small business owners, on the other hand, are certainly creative, action-oriented, and solve problems daily, but most often they have different aspirations. Anecdotally, many small businesses live by the mantra "stay small, keep it all." Their intent is to provide products and services that generate enough income for themselves and their families whereas high-potential entrepreneurs have the intention to create products and services with massive scale and global reach thereby creating value not only for themselves, but for their investors, employees, suppliers, and customers. And thus, high-potential entrepreneurs focus on growth and new wealth creation (to the extent that they will often cannibalize their own businesses as technologies change in order to remain competitive). Small business owners, on the other hand, generally focus

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[18] Isenberg, Daniel. Babson College. Babson College Entrepreneurial Ecosystem Project. "Entrepreneurship (does not equal) Self-Employment. April 1, 2011. http://ideas.economist.com/blog/entrepreneurship-≠-self-employment
[19] Troy Henikoff. Co-founder and CEO of Excelerate Labs (Chicago). www.exceleratelabs.com.
[20] Ernst & Young: Nature or Nurture, Decoding the DNA of the Entrepreneur. The survey studied 685 entrepreneurs. p. 3

on defending their positions in market and seek regulation that will promote self-preservation. Both groups are instrumental to our economy however both have different **challenges,** and **require different skills, financing, and social networks.** Let's consider each of these now.

1) Different Challenges

Self-employed small business owners and high-potential entrepreneurs have distinct business **challenges**. Self-employed small business owner typically struggle most with cash flow, scaling to meeting customers' changing needs, fending off lower-cost competition (typically larger competitors), gaining distribution, marketing, and financial constraints such as health insurance, workman's compensation and employee head taxes. As a result, they are most interested in protecting their markets, increasing awareness among their customers of the uniqueness of their products and services, lowering costs, and decreasing their tax burden.

High-potential entrepreneurs, on the other hand, share many of these challenges, however they are often willing to trade profits for top line growth. And as growth is their primary goal, their greatest challenge – in addition to these – is attracting and retaining the best talent (thus the discussion of and interest in immigration reform) and acquiring enough capital to fund growth. So, whereas the self-employed seek to protect, high-potential entrepreneurs seek to grow (even if that means cannibalizing their own products and services in order to do so).

That said: a similar challenge they have is that a small business of 500 employees is nothing like a small business of 5 employees. They have completely different needs. Companies don't start with 500 employees just as humans are not born teenagers.

2) Different Skills

From a **skills** perspective, self-employed small business owners are often focused on exploiting their own skills and knowledge, whereas high-potential entrepreneurs focus on making connections between disparate talents of many people to build an entity whose skills and assets are well-beyond the scope of any single individual. While skills training programs are instrumental to helping self-employed small business owners learn how best to manage their businesses, identifying and attracting highly-skilled workers is the most-important need of high-potential entrepreneurs.

3) Different Financing Needs

The average cost to start a new business varies widely depending upon the type business. Average start-up expenses can range between $20k-$30k. In addition, these forms of financing differ dramatically between self-employed small business owners and high-potential entrepreneurs.

Self-employed small business owners rely on retail and commercial banking products, lines of credit, and micro-loans (less than $100,000) in order to procure equipment and other assets and to fund working capital. Most notably, 92% of small business loans in the United States are micro-loans, most of which came in the form of business credit cards.[21]

Why do small business founders use high-interest credit cards?

First, they are easier to get than bank loans and government grants (e.g., they do not require business plans to get approved). Second, they are accepted ubiquitously. Third, credit cards are anonymous funding sources. Unlike friends and family, you need never have Thanksgiving dinner with your credit card company. The problem with credit cards, of course, is that they are very expensive forms of financing (between 15-30%). Small businesses carry between $3,500-$11,000 balances. This poses a problem. Credit card debt reduces the likelihood that a new business will survive more than 3 years. Every $1,000 increase in credit card debt increases the probability a firm will close by 2.2%. That said: due to the ease of acquisition and anonymity, credit cards are the most popular form of small business financing. This is an area of opportunity for improvement.

Crowdsourced funding such as the programs promoted by the JOBS (Jumpstart Our Business Startups) Act and facilitated by private companies such as AngelList, Indie Go Go, Kickstarter, Peerbackers, Quirky, and other crowdfunding vehicles is movement in the right direction. The role of companies such as SecondMarket also provides alternative liquidity options for start-ups unable or unwilling to go public and/or be acquired. While crowdfunding will help provide a more cost-effective alternative to credit card financing, start-ups will need to be mindful of the number and types of investors they accept as venture capitalists (those who will likely fund subsequent rounds) generally frown upon too many angel investors.

Unlike self-employed small business owners, high-potential entrepreneurs, on the other hand, are implicitly focused on growth and thus require financing in the form of risk capital at varying stages of development (e.g., angel/seed capital, bridge financing, venture capital, and private equity). The fundamental difference between these financing vehicles is in the underlying collateral required. Whereas the self-employed trade on their assets by personally guaranteeing loans, high-potential entrepreneurs trade on the growth potential of their idea (i.e., a capital gain for investors). High-potential entrepreneurs therefore are unlikely to find value in bank loans (much less to qualify) given the structure and requirements of those financing vehicles. Also, high-potential entrepreneurs often seek "smart money" (i.e., investors who also provide

[21] The Kauffman Foundation firm survey data. The Use of Credit Card Debt by New Firms. Pop culture is filled with examples of entrepreneurs using credit cards to fund their dreams. Most notable perhaps was the blockbuster hit movied The Blair Witch Project, funded almost exclusively with credit card debt totally $35,000. The film went on to gross $250 million.

industry connections and category expertise in a given area along with the capital infusion). This combination results in a healthy return for venture funds.

Most high-potential entrepreneurs are venture-backed (i.e. funded by venture capital). And venture-backed companies outperform the total U.S. Economy. Notably, for every $1 of venture capital invested (1970 to 2010) $6.27 of revenue was generated in 2010. And while annual venture investment equals less than 0.2% of U.S. GDP, VC-backed companies have generated revenue equal to 21% of U.S. GDP. Venture-backed revenue in 2010 was 10% of U.S. sales (or $3.1 trillion in venture-backed revenue).[22]

Venture-backed companies are also more resilient in bad times. While U.S. sales dropped 1.5% between 2008-2010, VC-backed revenue increased 1.6%.

Venture-backed high-potential entrepreneurs also outperform in employment growth. In 2010, 11% of the U.S. private sector jobs were in venture-backed companies and (even during the downturn between 2008-2010, while U.S. private employment dropped 3.1%, VC-backed companies dropped by 2.1%).

So, while VC-backed companies only equate to 0.2% of U.S. GDP each year, these companies employed 11% of the total U.S. private sector workforce and generated revenue equal to 21% of U.S. GDP.

Furthermore, once they go public, 92% of job growth for young companies starts. Thus underscoring the need for a robust and effective IPO market to ensure high-potential entrepreneurs the access to capital they need to grow.

So, the question is: why do high-potential venture-backed entrepreneurs outperform the overall economy – during both good times and bad?

For one, venture capitalists make high-potential entrepreneurship their focus. They screen for, develop, promote, and fund those entrepreneurs and their businesses. This deliberate focus on high-potential entrepreneurs and on emerging, high-growth categories ultimately create the best conditions to yield the highest financial returns. In essence, venture capitalists control for success through patient and consistent capital infusions (multiple series), hands-on coaching and guidance, and the willingness to take calculated risks (and even fail).

Most importantly, venture capitalists maintain a portfolio approach to investing. Rather than placing few big bets, they place many small bets. Start small and scale. That said: as Paul Lee, Partner at Chicago-based venture capital firm Lightbank, has observed: "A good venture capitalist fails 80% of the time. A great one fails 70% of the time."[23] As

[22] "Venture Impact: The Economic Importance of Venture Capital-Backed Companies to the U.S. Economy. National Venture Capital Association. HIS Global Insight, Edition 6.0.
[23] Observation made by Paul Lee. Paul is Managing Partner at Lightbank (Chicago). www.lightbank.com

much as one can control for success, life often has other plans. Regulations change, new, more cost-effective competition emerges, technologies are disrupted, founders leave, and so on. Venture capitalists win by placing many small bets across a wide-array of businesses and continue to fund them as they hit key milestones.

Beyond supporting individual high-potential entrepreneurs, perhaps the venture capital industry's most-notable contributions to the U.S. economy is the role they play in creating new industries: biotechnology, medical devices, computer software, semiconductors, clean technology, alternative energy, pollution control, communications, and the internet. These industries would not exist were it not for venture capitalists' willingness to invest in, mentor, and support high-potential entrepreneurs.

4) Different Social Networks

From a **social perspective**, whereas small businesses and the self-employed often network locally with other small business owners, high-potential entrepreneurs network globally with other high-potential entrepreneurs.

Global social capital is as valuable to high-potential entrepreneurs as collateral is to small business owners.

Small business owners and high-potential entrepreneurs also differ in the nature of their social circles. Whereas the self-employed may be active with their local chambers of commerce, high potential entrepreneurs are actively involved on a global basis and by virtue of involvement in incubator and accelerator programs.

For example, whereas small businesses benefit from working with organizations such as SCORE (Service Corps of Retired Executives), high potential entrepreneurs prefer to work with mentors and coaches from high-growth-focused organizations such as YCombinator in San Francisco, TechStars with offices in several U.S. cities, and Excelerate Labs in Chicago (the top 3 ranking venture accelerators in the U.S.).[24]

These entrepreneurial ecosystems are instrumental in helping support high-potential entrepreneurs. They are modeled after the organic economic ecosystems responsible for regional growth throughout the country. What happens is this: a venture-backed anchor company is successful, has a liquidity event in the form of an IPO or acquisition. This, in turn, generates a lot of cash for the company and its founders. The anchor company and its founders and employees, in turn, spin out other high-growth businesses that create more jobs and new wealth thereby repeating the cycle. Such was the case of Fairchild Semiconductor (the company that gave birth to the Silicon Valley), as well as Dell (Austin, Texas), Medtronic (Minneapolis), and Groupon (Chicago).

[24] The author is a Limited Partner and mentor in Excelerate Labs II. The ranking was done by FORBES.

Given these vast differences in challenges, skills, financing requirements, and social networks, **it would behoove the United States to create distinct programs: one focused on self-employed small business owners and the other focused on high-potential entrepreneurs.** Many countries have programs to support high-potential entrepreneurs, including Canada, Chile, Ireland, Israel, and others. In the U.S., one program of note in the private sector is The Start-up America Partnership (founded by The Case Foundation and The Kauffman Foundation). While their underlying mechanics differ, these programs generally provide the following services:

- **Know-How**: enabling start-ups with tools, knowledge, and mentors (typically other successful high-potential entrepreneurs, academics, and experts)

- **Reduced Cost Services & Facilities**: business accounting, legal services, office space, infrastructure, and other assets offered at reduced rates

- **Talent Scouting & Recruiting**: connecting the right people (both founders and start-up employees) with the right opportunities (co-founders and talent)

- **Proof of Concept Opportunities (i.e., in vitro testing environments)**: helping start-ups get access to customers willing to test hypotheses, prove/disprove their assumptions, and improve their products and services

- **Distribution/Customers**: helping introduce start-ups to potential customers and assist start-ups in reducing their overall customer acquisition costs

- **Capital**: promoting and connecting start-ups to appropriate capital sources (namely, angel investors, angel networks, and venture capitalists).

These programs work because that they address the underlying motivation and aspirations of high-potential entrepreneurs. They allow start-ups to iterate quickly, fail cheaply, and scale fast once their business models are proven. As a result, these programs accelerate the speed at which start-ups ultimately create jobs. For example, Excelerate Labs (Chicago) has funded and developed 20 companies since its inaugural class of start-ups (2010). These 20 companies have raised over $15 million in VC and created over 100 jobs in less than 18 months. As of the writing of this testimony, only one company has discontinued operations while two have had successful exits. The question is: why do accelerators work? They work because they provide high-potential entrepreneurs the most-effective ecosystem for quickly and cheaply testing their ideas, getting access to capital, and “discounted” infrastructure needed to support product development. They also work because they are competitive programs. Acceptance rates into accelerators (less than 3%) rival most Ivy League universities. Those who manage the programs maintain very high standards to control for entrepreneurial talent, the ideas themselves, and the capacity of the given accelerator to make a difference given its unique network and skills.

Nature or Nurture: Are the Qualities of High-Potential Entrepreneurs Innate (Can they Be Learned?)

So, the question is how can we identify and develop these high-potential entrepreneurs? Ask any successful entrepreneur where he or she learned to be an entrepreneur and you will likely hear stories of paper routes, babysitting jobs, and science fairs turned into sidewalk sales. [25]According to Ernst & Young, 55% of successful entrepreneurs started their first company before age 30. Entrepreneurship is learned, but it is also mimicked. Children of entrepreneurs have the advantage of learning about esoteric concepts such as revenue and costs and income very early in their development. To them, entrepreneurship is not a mystery rather it is almost an expectation. In addition, 58% of successful entrepreneurs describe themselves as "transitioned" (meaning they had experience outside of the world of entrepreneurship before launching their ventures).[26] When asked which forms of education or sources of learning provided them with the skills needed to be successful businesses, experience as an employee ranked #1, followed by higher education, mentors, family, co-founders.

Similar to athletic ability and musical aptitude, while these skills are innate to some, they can be learned by all those who have the motivation to learn. Entrepreneurial skills fall into three categories: cognitive, behavioral, and social skills.

1) COGNITIVE SKILLS: Thinking Differently

First, they think differently. Notably, high-potential entrepreneurs are what we refer to as lateral thinkers. This is the ability to make connections across disparate industries, categories, and markets. They are able to find solutions elsewhere and apply those to the problems they are trying to solve. Such was the case of Henry Ford who borrowed ideas from the fire arms, meatpacking, and tobacco industries in "inventing" modern automobile manufacturing (aka "the assembly line"). Other cognitive skills include the ability to identify and challenge conventions and industry norms (e.g., how Steve Jobs reinvented the music industry, retail industry, telecommunications, and consumer electronics' industries); the ability to create demand for products and services where customers don't know they have needs (e.g., how Howard Schultz created Starbucks and Charles Schwab created discount brokerage); and the ability to distill complex problems into practical solutions (e.g., how Herb Kelleher created Southwest Airlines). High-potential entrepreneurs are also able to identify gaps between existing products and market discontinuities. By exploiting emerging and disruptive trends, they are able to create the future instead of responding to it. These cognitive skills, while they come natural to some, are certainly "teach-able" and can be learned.

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[25] Ernst & Young: Nature or Nurture, Decoding the DNA of the Entrepreneur. The survey studied 685 entrepreneurs. p. 1

[26] Ernst & Young: Nature or Nurture, Decoding the DNA of the Entrepreneur. The survey studied 685 entrepreneurs. p. 1

2) BEHAVIORAL SKILLS: Acting Differently

Beyond these cognitive skills, high-potential entrepreneurs also exhibit unique behavioral differences. They are self-motivated, driven, disciplined, risk arbitrageurs whom manage time and resources as precious commodities. They are persuaders, salespeople, sellers of their own dreams and ambitions. Mostly, they are motivated by more than money and have a bias towards trial and error versus research and development. They act on their instincts even when the data may suggest otherwise. Their mantra is "fire, ready, aim." They are able to act this way due to a high tolerance for failure and the ability to try, try again even when their initial efforts fail. Research has shown, in fact, that while first-time entrepreneurs have only an 18% chance of success, those who have previously failed have a 20% chance of success in their next venture.[27] They learn from mistakes and thus are able to avoid them the next time around. It is worth noting that entrepreneurs who are successful with their first ventures are more successful with subsequent ventures than those who fail. Simply, while failure may lead to success, success begets greater success.

3) SOCIAL SKILLS: Connecting Ideas + Capital + Talent + Customers

Beyond thinking and acting differently, they also interact differently. Whereas inventors create, innovators connect. Thomas Edison was more than an inventor. He connected talent, ideas, and capital. He was socially masterful. If you simply think differently, but are unable to persuade others to join you, you end up with nothing more than frustration. Likewise, if you are good salesperson but your ideas are not unique, you're nothing more than a good salesperson. So, the question is: must you be socially-connected to be successful? The answer is yes but you do not necessarily have to be the one who has the connections, rather you have to be able to take advantage of the connections once they are made for you. This is one of the significant benefits of venture accelerators: they make introductions.

All of these skills – cognitive, behavioral, and social - can be taught and all can be learned.

[27] Paul Gompers, Anna Kovner, Josh Lerner, and David Scharfstein. Harvard University. Skill vs. Luck in Enterpreneurship and Venture Capital: Evidence from Serial Entrepreneurs. July 2006.

Are Entrepreneurs Job Creators?

The short answer is yes and no. According to Kauffman Foundation research, new firms (those less than 5 years old) create a majority of net new jobs (approximately 3 million new jobs each year). If all others keep their jobs, that's the number we need to remain at full employment.[28] Another way of saying it is that new jobs created in the United States each year are created by and in firms less than 5 years old. This has been the trend for the past 30+ years. Thus more entrepreneurs equates to healthy recovery.

While entrepreneurs certainly contribute to job creation, they only do so in the context of the economy. The logic is simple: as companies create products and services that consumers and businesses demand, revenues and profits increase, new businesses hire new employees who, in turn, earn income to consume products and services and hopefully save for retirement. Without a healthy economy, people do not have the means to consume (assuming they don't use credit for consumption). Thus, beyond entrepreneurs themselves, the system and environment must be conducive to entrepreneur*ship*. This includes having the right talent, regulation, tax policy, and so on to support high-potential entrepreneurship.

It's Not Size Alone, but Also Age of Firm that Matters

What is important to note here however is not necessarily the size of these firms, rather it is their age. Researchers at the University of Maryland in partnership with the U.S. Census Bureau have found that young firms, most of which happen to be small, account for much of America's job growth. However, mature small firms often destroy jobs, as do small start-ups that do not survive.[29] *Youth* trumps size.

This is perhaps most evident by studying other economies, notably Greece, an outlier among European Union countries for its number of small firms. Approximately one-third of Greek manufacturers are "micro firms" (fewer than 10 employees) compared with, for example, Europe's strongest economy, Germany, where only 4.3% are considered micro firms. Other troubled economies in Europe including Spain, Portugal, and Italy suffer the same fate.

The downside of small businesses (not including high-potential entrepreneurial growth businesses) is their relative inability to compete. They aren't as productive as larger firms. For example, the productivity of European firms with fewer than 20 workers is on average little more than half that of firms with 250 or more workers. So, it's important to note that size alone is an insufficient measure. Age matters. Like small

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[28] The Kauffman Foundation, "The Case for the Start-up Act," http://www.kauffman.org/research-and-policy/startup-act.aspx

[29] "Who Creates Jobs? Small vs. Large vs. Young", by John C. Haltiwanger, Ron S. Jarmin, and Javier Miranda, NBER working paper No. 16300, August 2010.

firms, of course, larger firms have drawbacks including the inability to respond to disruptive technologies, customers' changing needs, and new business models. What is the implication? Government should focus not only on supporting small (and new) firms, it should also focus on reducing friction as those companies grow. We should encourage companies to have higher aspirations. We should encourage and make it easy for companies to grow and remove incentives for companies to stay small.

Beyond the differences in size and age, the strongest predictor of a country's growth rate is the number of new businesses started in each country each year. While most job loss in recession is attributed to large companies downsizing and to self-employed small businesses (who in recent years account for 79% of all jobs losses), high-potential entrepreneurs continue to hire in good times and bad.

Why does this happen? In part, it can be explained by the nature of the categories in which high-potential entrepreneurs compete. By definition, they are focused and active in growing industries whereas many large companies compete in mature and declining industries. Thus, job creation is as much a function of the categories in which entrepreneurs compete as it is the size and age of their companies.

Innovation Cuts Both Ways: Start-ups Create New Wealth, but Are Also Becoming Less Job-Intensive

While the number of new businesses started remains at 500,000-600,000/year, starting in 2009, these businesses have been creating *fewer* jobs. Whereas new businesses would historically create 7 jobs per firm/year, they now create less than 5 jobs per firm/year. As a result, given the current trajectory, between 2009-2019, we will witness 7.5 million fewer jobs. Without those jobs, the United States risks a lack of growth and chronic unemployment rate of 9-10%.

So why is this happening? In brief, innovation cuts both ways. While innovation has reduced barriers to entry for entrepreneurs, it has also reduced the need for employees. For example, if you can rent space on Amazon.com's servers, why build and maintain your own? If you can contract out design services, why hire and train your own? And if you can distribute your products virtually (digitally) why maintain a sales staff to do it for you? In effect, start-ups have embraced the same efficiencies that large companies have mastered.

In short, while entrepreneurs are net new job creators, much can be done to ease friction and promote the creation of more high-potential entrepreneurs. And, as they grow more and more efficient at operating their companies, we will need more high-potential entrepreneurs starting more companies now and in the future.

Closing & Recommendation

In closing, I recommend that the Committee consider the following principles as you determine the best ways in which to help entrepreneurs lead our recovery and growth:

1. **Not all entrepreneurs become entrepreneurs for the same reasons.** They differ by motivation and aspiration. While some seek to preserve and protect, others are focused on growth and will even cannibalize their own businesses in order to grow. These differences must be taken into account to create good policy, incentives, and programs to support entrepreneurship and job creation.

2. **Self-employed small business owners have different needs and challenges than those of high-potential entrepreneurs.** The skills, funding, and social networks required to help both self-employed small business owners and high-potential entrepreneurs are different. We need more focus on high-potential entrepreneurship in the United States, including a focus on the skills, funding sources, and social networks to facilitate coaching, mentoring, rapid experimentation, and customer development.

3. **High-potential entrepreneurial skills can be taught and can be learned and must be done so holistically** by focusing on cognitive, behavioral, and social skills. These skills must not only be taught, but also developed as early as possible in Americans' educational and professional lives.

4. **Entrepreneurs do create jobs**, but only in the context of an environment that can connect know-how, capital, and talent and make it easy for small business owners and high-potential entrepreneurs to do business.

There are many tools we can use to create the appropriate environment for high-potential entrepreneurs to succeed. In order to understand how best to use these tools, I highly-encourage the Committee to consider exploring efforts, activities, and programs that promote high-potential entrepreneurship independent, but related to, our programs to support small business owners. This deliberate and focused effort on high-potential entrepreneurs would help the United States remain competitive, economically-stable, and growth-oriented in a world where success if measured not by speed, but by velocity. We must not only move quickly, but in the right direction. Thank you.[30]

- Andrew Razeghi

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[30] Special thanks to Lloyd Shefsky (Kellogg School of Management), Matt McCall, Rishi Roongta, and Jeff Maters (all of New World Ventures), Tom Hodge (Absolute CNC Machining), Troy Henikoff (Excelerate Labs), Paul Lee (Lightbank), Keith Bandolik (Switchcraft), Dr. Arlyn Rubash (Bradley University), Marge Rubash (Eureka College), Cindy Razeghi, Tom Warden, Chudi Amu, Tom Stat, and Andrew Stein.