The growth of business groups by habitual entrepreneurs: the role of entrepreneurial teams

Donato Iacobucci
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ABSTRACT

Previous research demonstrates that entrepreneurial processes underpin the growth of business groups. A business group is a set of companies controlled by the same entrepreneur. Case studies of portfolio entrepreneurs suggest that one of the main reasons for business group formation is the need to create an entrepreneurial team, which is achieved by giving minority shares in the new ventures to others, mainly former employees. This enhances the portfolio entrepreneur’s ability to grow and diversify the businesses under their control. The paper identifies and discusses the different types of entrepreneurial teams developed by portfolio entrepreneurs, and their dynamics.

Keywords: Business groups, entrepreneurship, entrepreneurial teams.
JEL: L25, L26

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Introduction

Since the 1990s entrepreneurship researchers have become increasingly interested in ‘habitual entrepreneurs’, i.e. entrepreneurs who repeatedly set up businesses. In this study we focus on ‘portfolio entrepreneurs’, who are habitual entrepreneurs who retain ownership and control of previously established businesses, leading to the formation of business groups. A business group is a set of businesses which are legally distinct, but belong to the same person or people. The two concepts – portfolio entrepreneur and business group – refer to the same phenomenon but from different perspectives: the business group refers to the set of companies owned by the same entrepreneur; the portfolio entrepreneur refers to the person owning a set of companies or a business group.

The interest in portfolio entrepreneurs and business groups has been motivated by several factors: a) the phenomenon is more widespread than generally recognized and has been somewhat overlooked in the entrepreneurship literature (Wright et al., 1998; Carter and Ram, 2003); b) the development of new ventures by previously established entrepreneurs is as important for job creation and innovation as the entry of ‘novice’ entrepreneurs (Storey, 1994; Zahra et al., 2000); c) the need to focus on entrepreneurs’ careers to understand entrepreneurial processes (Scott and Rosa, 1996; Westhead and Wright, 1998b).

Business groups traditionally have been associated with large firms, and there is a significant body of literature on the nature, management and performance of large business groups (Goto, 1982; Khanna and Palepu, 2000; Morck and Yeung, 2003; Chang, 2006). However, owning more than one business is also relatively common in the small business sector (Birley and Westhead, 1993; Rosa, 1998). Research shows that there is a steady increase in the incidence of multiple business ownership as firm size increases (Rosa and Scott, 1997; Loiseau, 2001; Iacobucci, 2002). This suggests that the formation and expansion of a business group might be a normal and common way to grow a small firm. Business group formation is associated with successful entrepreneurs who have been in business for some time. This implies that the roles and functions of business groups may differ, being associated especially (but not
exclusively) with entrepreneurial processes in small firms, and management governance related processes in large firms.

Theoretical and empirical studies of habitual entrepreneurs fall into two broad categories. The first is mainly concerned with exploring the differences between novice and habitual entrepreneurs in terms of their personal characteristics, the gestation process, the features of the new ventures, etc. (Wright et al., 1997b, 1997a; Alsos and Kolvereid, 1998; Westhead and Wright, 1998a, 1998b; Ucbasaran et al., 2003). The second focuses on the characteristics of business groups brought about by the activity of habitual entrepreneurs. These studies examine the nature and processes underlying the setting up of new companies by established entrepreneurs and the characteristics of the resulting groups (Rosa, 1998; Rosa and Scott, 1999). The approach in this paper is within this latter category.

Despite the wealth of empirical and theoretical insights offered by this literature, analysis of the entrepreneurial processes involved in the formation of business groups by habitual entrepreneurs is still at an early stage (Carter and Ram, 2003). Two issues seem specifically relevant. The first is the direction of growth followed by habitual entrepreneurs in creating new ventures and the reasons for developing a new company rather than incorporating expansion within an established firm. For example, there are significant administrative costs involved in establishing a separate, new company - why not just grow within an already existing unit? The second is related to the entrepreneurial team dynamics, since the development of business groups often involves a presence of other people playing an entrepreneurial role. The tendency to focus on the ‘habitual entrepreneur’ tends to mask the role potentially played by other actors in the business group.

This paper focuses on the role of entrepreneurial teams in the formation and dynamics of business groups. This issue seems relevant since the more a group grows, the more a habitual entrepreneur will be forced to delegate or seek help through partnerships. The entrepreneurship and small firms literature has long observed that the inability of the entrepreneur to delegate is a major barrier to the growth of small firms. This, however, is usually only conceptualised within the context of a single firm. The onus is often negative (why delegation does not take place), rather than understanding evolved good practice where the entrepreneur has clearly succeeded in delegating. It could be argued that the best examples of delegation practice are to be found amongst portfolio entrepreneurs who have had to cope with the need for team building as new
firms are added to the business group. The literature on entrepreneurial teams also focuses on the dynamics of multiple ownership and control within single firms. The potential intricacies of team building over a range of firms has not been explored yet.

Given the small number of empirical and theoretical studies on these issues, this paper is exploratory in its design and aims. It relies on in-depth interviews with established entrepreneurs to provide some insights into these issues and develop theoretical propositions that can be applied in future studies.

The paper is organized as follows. Section 2 introduces the main issues addressed in the empirical part of the paper. Section 3 presents the research methodology; Section 4 analyses the case studies and develops some general propositions related to the observed phenomena. Section 5 discusses the main results and propose a theoretical framework to explain the presence of groups in the small business sector. Section 6 presents the main conclusions and suggests some implications from this study.

**Business groups as entrepreneurial systems**

A business group is a set of companies that are legally distinct, but belong to the same person or persons. In the small business sector business groups emerge as a result of the actions of portfolio entrepreneurs, i.e. habitual entrepreneurs who start new businesses while retaining the ownership and control of previous ones. Ownership may be in the hands of one person (the entrepreneur), but, in most cases, it involves others, often members of the entrepreneur’s family.

On the basis of how ownership of the companies is structured, we can distinguish between ‘horizontal’ and ‘vertical groups’ (Figure 1). In the first type, all the businesses are owned directly by the same person(s); in the second type the person(s) own and control a company which controls other companies (and so on) – referred to also as a ‘pyramid’ (Morck and Poterba, 2005; Almeida and Wolfenzon, 2006).

Business groups (and portfolio entrepreneurs) are widespread in all countries, industries and firm size classes (Rosa and Scott, 1997; Loiseau, 2001; Almeida and Wolfenzon, 2006; Cainelli and Iacobucci, 2007). Despite this, little empirical and theoretical work exists on small groups; most of the literature on business groups relates to large firms, particularly conglomerates with highly diversified portfolios of businesses (Shiba and Shimotani, 1997). Business groups are supposed to occur most frequently and most profitably in emerging
economies with significant market information asymmetries (Khanna and Rivkin, 2001; Yiu et al., 2005; Silva et al., 2006). They are often associated with economic inefficiency and poor performance, but there is a growing recognition of the advantages of the business group as an organizational form in terms of the advantages they offer in facilitating mutual insurance amongst the affiliated firms, and in enabling risk to be shared. Empirical research, however, has failed to fully substantiate these theories and “other reasons are more likely to explain the ubiquity of business groups round the world” (Khanna and Yafeh, 2005, p. 301).

Figure 1 – Types of business groups

The justification for the presence of pyramidal groups generally is that they are a device for separating control rights, which remain in the hands of the controlling family, from cash flow rights, which are shared with the non-controlling owners (Morck and Yeung, 2003; Morck et al., 2005). This separation is achieved better when companies are listed on the stock exchange, and the non-controlling owners are represented by a large number of minority shareholders. However, this explanation is valid for only a tiny minority of large companies and cannot account for the spread of family-owned, small groups where there is little or no separation between ownership and control.
Almeida and Wolfenzon (2006) develop a model to explain the presence of business groups in small, family-owned firms. The starting point of their work is their dissatisfaction with the argument related to separating ownership and control. As they point out: ‘Despite the ubiquity of pyramidal business groups, no formal theory explains their existence. A traditional informal explanation argues that pyramids are formed to allow a family to achieve control of a firm using only a small cash flow stake’ (Almeida and Wolfenzon, 2006, p. 2638). The basic idea behind Almeida and Wolfenzon’s (2006) model is that business groups are used by entrepreneurs to manipulate the ownership structures of new businesses to maximize their financial wealth. The legal autonomy of the new business gives the entrepreneur the opportunity to raise outside equity from minority shareholders.1 Entrepreneurs exploit this by privately appropriating part of the cash flow of the controlled companies to the detriment of minority shareholders (cash flow advantage), or by using the cash flow of the controlled companies to finance new businesses (financing advantage). It is taken for granted that the ‘entrepreneur’ will retain control and management of the new business and that the minority shareholders will be purely investors with no involvement in management. We suggest that this is a major limitation of the model; in the case of small groups (and small firms in general) the inclusion of minority shareholders is unlikely to be for purely financial reasons because of the high level of agency costs related to outside equity in privately held companies (Jensen and Meckling, 1976; Chrisman et al., 2004). Ownership of small firms commonly involves relatives or partners, who are also directly involved in their management.

The Almeida and Wolfenzon (2006) paper is a theoretical study and the authors make no attempt to verify their conclusions empirically. Little empirical research exists on how business groups form, and how they form in the small business sector (Lechner and Leyronas, 2009). Are the processes the same for large and small firms, or there are radical differences in the nature of business groups in the large and small firm sectors? How far can business groups be considered the result of entrepreneurial processes rather than a device to efficiently manage a portfolio of businesses?

1 We use the term ‘outside equity’ to refer to equity raised from people other than the entrepreneur’s family. The term is commonly used in the finance literature to refer to equity capital supplied by investors who are not directly involved in the management of the business, i.e. who are purely financial investors (Fama and Jensen, 1985; Myers, 2000).
Assessing the role of entrepreneurship in business group formation entails analysis of the relationship between the setting up of new companies by habitual entrepreneurs and the processes of opportunity identification and new venture creation. In a recent review of the literature on small firm growth, Macpherson and Holt (2007, p. 184) note that there are research gaps in the factors that explain the adoption and/or usefulness of specific systems of organizing, and the impact of these systems on firm growth. We know very little on why portfolio entrepreneurs decide to pursue growth through founding new companies rather than accommodating growth and diversification in the existing firm (Wiklund and Shepherd, 2008). Given that the new businesses set up by portfolio entrepreneurs are often closely related to the established ones (Iacobucci and Rosa, 2005), conventional management theory would suggest related diversification to be more likely incorporated within the established firm, rather than used to spawn a new one.

Also important is the relationship between business group formation and the development of entrepreneurial teams. It is being acknowledged increasingly that the entrepreneurial activity is normally a team responsibility rather than being down to a single person (Gartner et al., 1994; Cooper and Daily, 1997). By an entrepreneurial team we mean a group of people who share the ownership and management of a new venture (Kamm and Nurick, 1993; Watson et al., 1995; Cooney, 2005). Although there are more general definitions of teams in business activities, we think that ownership and management are essential aspects for defining entrepreneurial teams and it is in this sense that we apply it in this paper.

The relationships between team dynamics and business group formation has received little attention at either a theoretical or an empirical level. The entrepreneurship literature treats entrepreneurial activity mostly as being initiated by the owner-manager(s), either individuals or, in the case of family firms, by family owners. Employees are treated as agents of implementation. In the corporate entrepreneurship literature, however, it is the employees (the intrapreneurs) who play a major role in initiating new ventures, often in the face of opposition from their employers (Zahra et al., 1999). The groups examined in the present study are medium sized groups, in which both types of phenomena could be expected to be operating.

In reality all these dimensions (entrepreneur, family members, employees, external partners in joint ventures), can form complex team interactions. A major issue is whether entrepreneurial teams confer advantages or disadvantages in helping to grow a business group. There may be
circumstances where the need to delegate and acquire new managerial capacity can be greatly enhanced with the right entrepreneurial team in place; or where the right partnership may be vital to enable the exploitation of an opportunity requiring a blend of skills and resources (Forbes et al., 2006). In the long term this can lead to an efficient constellation of companies run semi-autonomously so that the entrepreneur can concentrate on new ventures (Rosa, 1998).

This paper, based on a study of Italian small business groups, explores the role of entrepreneurial processes and team dynamics in the formation and evolution of business groups. No specific hypotheses or propositions are suggested at this stage of the paper, but they emerge as evidence is analysed and discussed. It is thus an inductive approach to a little studied phenomenon.

**Data and methods**

Unless a great deal is known about the theory of a particular phenomenon, or the measures are straightforward and capable of rigorous measurement, applying a theory driven deductive approach can be counterproductive and premature (Creswell, 2009). In the case of growth through business group formation in small firms, it is a subject that has received little attention (Rosa, 1998; Iacobucci, 2002; Lechner and Leyronas, 2009). Hence a more exploratory approach is preferable, in which insights are sought rather than invoking straight away an approach based on the rigorous falsification of hypotheses. Business group formation is also a process that evolves over time, sometimes a long period of time. Cross-sectional quantitative surveys and questionnaires are thus not the most appropriate approach. Ideally such research would require a longitudinal research design in which a series of portfolio entrepreneurs are monitored over a period of years. In the absence of such a dimension in the research, insights can still be gained from interviews of retrospective events. In depth interviews was carried out with portfolio entrepreneurs that developed a business group. The aim of the interviews was that of collecting data and information that were not publicly available. We were interested in particular, in information about group origins, the circumstances surrounding the growth process, the reasons for starting up new companies, etc. Our interviews were based on a semi-structured questionnaire that included questions on five main topics: the beginning of the entrepreneurial activity; the growth strategy followed after establishment of the original activity; the reasons for developing new businesses and setting up new companies; whether other members of the
entrepreneurial team played a role in these processes; the present structure of the group. The interview guide is provided in the Appendix. We chose a semi-structured interview because of its flexibility and our desire not to impose a predefined pattern of analysis on the interview results. We also wanted the entrepreneur to give her/his account of how the group was formed, rather than choosing among suggested explanations.

Interviews were held at one of the company locations of the entrepreneur being interviewed. In a few cases a follow up interview was conducted to clarify certain points or to collect additional data. The interviews were recorded (in digital format) and transcribed into word-processed documents for analysis. The transcripts were transferred to QRS NVivo to facilitate the process of coding. First, we coded the text according to pre-defined topics that we considered relevant in terms of the issues we wanted to analyse. Other topics that emerged in the interviews, were added. Finally, we rationalized the topics by merging ones that expressed similar concepts and relating groups of topics under general categories.

As is common in qualitative analysis, purposive sampling rather than statistical sampling was used (Silverman, 2000, p. 104; Bryman, 2001, p. 324), in order to discover and identify new variables, or relationships between variables, that previously were either unknown or poorly understood. Our sampling method was designed to cope with heterogeneity rather than what is typical. Interviewees (entrepreneurs) were chosen from the population of small and medium sized manufacturing groups located the Marche region (Italy). We selected cases that were relevant for the aims of the study and which showed some diversity in terms of industry sector. The selection criteria we applied were: a) group founded and still controlled by the entrepreneur interviewed; b) the group comprises more than two manufacturing companies (to provide a sufficiently rich context for analysing the development process); c) group companies are new ventures not acquired businesses; d) the group is small or medium sized, i.e. less than 500 employees overall. These selection criteria identified some 30 groups. The results reported here refer to 14 groups whose entrepreneurs agreed to be interviewed. The small number of case studies analysed is not a limitation in terms of the objectives of our analysis, and, as our interview programme progressed, we became confident that we had identified all the main issues and that the information value of further interviews would have been very small. The groups that we selected for our case study, although located in a single region, show similar characteristics to those observed at the national level (Cainelli and Iacobucci, 2007). Moreover, comparison
between the groups examined in this study and cases in other countries (Rosa, 1998; Loiseau, 2001; Lechner and Leyronas, 2009) shows that there are noticeable similarities in their structure and dynamics. This suggests that most of the empirical findings from this research, and the theoretical hypotheses developed to synthesize the main results are not sector or country-specific. Table 1 presents some general characteristics for the groups interviewed.

<table>
<thead>
<tr>
<th>Case</th>
<th>Original activity</th>
<th>Main direction of expansion</th>
<th>Companies in the group</th>
<th>Domestic Production Companies (a)</th>
<th>Overall Employees (2004)</th>
<th>Year of foundation of the original company</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Paper rolls for printers and calculators</td>
<td>Several segments of paper roll market Design and production of cash registers and other small electric household appliances</td>
<td>7</td>
<td>3</td>
<td>222</td>
<td>1972</td>
</tr>
<tr>
<td>2</td>
<td>Batteries for motor vehicles</td>
<td>Several segments of the battery market Electric vehicles (scooter, cars, etc.)</td>
<td>9</td>
<td>2</td>
<td>154</td>
<td>1975</td>
</tr>
<tr>
<td>3</td>
<td>Footwear soles</td>
<td>Several segments of footwear soles (leather and synthetic) Vertical integration in compound production for synthetic soles</td>
<td>3</td>
<td>3</td>
<td>293</td>
<td>1964</td>
</tr>
<tr>
<td>4</td>
<td>Chemical treatment of metals</td>
<td>Printed circuits Assembly of electronic components Systems for car safety</td>
<td>4</td>
<td>2</td>
<td>142</td>
<td>1972</td>
</tr>
<tr>
<td>5</td>
<td>Paper sacks (for industrial use)</td>
<td>Several types of paper sacks (for industrial use) and paper bags</td>
<td>8</td>
<td>3</td>
<td>210</td>
<td>1965</td>
</tr>
<tr>
<td>6</td>
<td>Industrial electric systems</td>
<td>Industrial automation systems for household appliances, automotive and aerospace industries</td>
<td>3</td>
<td>2</td>
<td>205</td>
<td>1975</td>
</tr>
<tr>
<td>7</td>
<td>Publishing</td>
<td>Printing industry Cartoon industry Products and services for the printing industry</td>
<td>7</td>
<td>5</td>
<td>216</td>
<td>1972</td>
</tr>
<tr>
<td>8</td>
<td>Industrial Automation for metal working</td>
<td>Complete range of activities for the design of automation systems in manufacturing plants</td>
<td>5</td>
<td>2</td>
<td>244</td>
<td>1976</td>
</tr>
<tr>
<td>9</td>
<td>Printed circuits</td>
<td>Several types of multilayer printed circuits Other products and activities related to the main business (rapid prototyping, membrane keyboards, etc.)</td>
<td>6</td>
<td>3</td>
<td>223</td>
<td>1972</td>
</tr>
<tr>
<td>10</td>
<td>Heating systems</td>
<td>Wide spectrum of products and services for air conditioning Heating systems for both industrial and domestic sectors</td>
<td>6</td>
<td>1</td>
<td>105</td>
<td>1985</td>
</tr>
<tr>
<td>11</td>
<td>Mould production</td>
<td>Product development and engineering. Mould design and construction. Try outs and moulding.</td>
<td>4</td>
<td>1</td>
<td>187</td>
<td>1971</td>
</tr>
<tr>
<td>12</td>
<td>Frames for metal chairs</td>
<td>Office furniture Home furniture</td>
<td>2</td>
<td>1</td>
<td>71</td>
<td>1963</td>
</tr>
<tr>
<td>13</td>
<td>Furnishings for bars</td>
<td>Display cabinets for ice-cream</td>
<td>6</td>
<td>3</td>
<td>307</td>
<td>1963</td>
</tr>
<tr>
<td>14</td>
<td>Foam</td>
<td>Several plastic products for packaging. Plastic products for the construction industry</td>
<td>4</td>
<td>4</td>
<td>148</td>
<td>1972</td>
</tr>
</tbody>
</table>

(a) Excluding the original company and the acquired companies
In most cases the entrepreneur established the first company during the 1970s, and new companies were added during the 1980s and 1990s. The relatively slow growth rates observed can be related to the fact that they all are family-owned groups, whose expansion was mainly self financed.

Companies belonging to business groups fall into three broad categories (Iacobucci and Rosa, 2005): foreign companies (if present); financial companies (e.g. holding companies, property companies, etc.); and production domestic companies, operating in the manufacturing or the service sector. The category of foreign companies is not relevant for this study given that, by law, they must be managed as independent legal units. Financial companies are normally set up for fiscal or other financial reasons and are not directly involved in production or services. Thus, our analysis includes only production domestic companies. Apart from being the main companies in terms of employees and sales, domestic companies are especially interesting in terms of understanding the reasons why habitual entrepreneurs set up new legal units rather than developing new ventures within established companies. Our sample includes groups with at least two domestic companies; in most cases these are manufacturing companies.

Results

This section synthesizes the results of our interviews with entrepreneurs on the development of the businesses under her/his control from the start date of the original venture, the reasons for establishing a group of companies and the circumstances surrounding their establishment.

The setting up of a new company by a portfolio entrepreneur is associated with the start-up of a venture that has some degree of diversity from the established business(es). Several studies demonstrate that firms tend to diversify in activities with high degrees of relatedness or coherence with existing activities (Teece et al., 1994; Breschi et al., 2003). This applies especially to small firms, although there is little empirical evidence on diversification strategies in the small firm sector (Lynn and Reinsch, 1990; Robson et al., 1993; Sandvig and Coakley, 1998; Macpherson and Holt, 2007). Although diversification is a common motivation for the establishment of a business group by a portfolio entrepreneur, it is mostly related diversification,
through which the habitual entrepreneur expands control in activities closely connected to his or her original idea (Rosa, 1998; Iacobucci, 2002).

Diversification can be seen as a necessary but not sufficient condition for the creation of a new legal unit, since diversification can be managed through alternative forms of organizations within the same legal unit. The most important justification in the literature on the creation of new companies is that legal autonomy allows the entrepreneur to change the ownership structure of the new business (Almeida and Wolfenzon, 2006). This appears to be confirmed by our case studies: entrepreneurs normally retain a majority share in the new companies, selling or allocating minority shareholdings to other people. According to the ‘financial’ explanation (Almeida and Wolfenzon, 2006), this is done to maximize the financial wealth of the controlling entrepreneur. Our findings, however, show that there are other reasons for involving other people in the ownership of new ventures: other people may be given stakes in the new business not in order to raise outside equity, but as a way to involve them in the management of the new business, thereby establishing or enlarging an entrepreneurial team.

Three different patterns of ownership sharing emerge from our analysis. In the first, a joint venture is established with another entrepreneur, which we term ‘entrepreneur involvement’. In the second, the venture is started by the portfolio entrepreneur who then gives a stake in the new company to a vital employee to secure his/her involvement in the development of the new business. We refer to this as ‘employee involvement’, in which the employee’s status changes to part-owner in the new venture. In the third pattern, the new business is established as a result of the inspiration of an intrapreneurial employee, who succeeds in involving the entrepreneur; we refer to this as ‘intrapreneur involvement’. Table 2 shows that 22 of the 35 new companies set up by portfolio entrepreneurs involve some form of ownership sharing, and that all three patterns of ownership sharing described above are frequent. We report some excerpts from our entrepreneur interviews that are illustrative of these patterns.

**Pattern 1: when a new company emerges as a joint venture with another established entrepreneur.**

This case is rather widespread across the groups:

“…we had [at the beginning of the seventies] an important customer in Rome to whom we sold paper rolls for telex. The demand was expanding and we decided to buy a new automatic
machine. I talked about the idea to this customer. We went to Germany together to see the machine and we then decided to make a joint venture for this new production”. (Case 1).

“I had always the idea that the future of printing was on rotary press. Then there was an opportunity with an Italian newspaper that wanted to print in the Marche region. We set up a new company in which the newspaper company took the one third and we took the remaining two thirds” (Case 7).

In these and other cases, the involvement of other entrepreneurs was for two main reasons: to raise capital for the initial investment (thus spreading the risk) and to secure demand for the new product. The setting up of a new company was aimed at keeping the new partner separate from the rest of the entrepreneur’s assets and companies.

**Table 2 – Production domestic companies set-up by entrepreneurs and employee up-grading**

<table>
<thead>
<tr>
<th>Case</th>
<th>‘entrepreneur involvement’</th>
<th>‘Employee involvement’</th>
<th>‘Intrapreneur involvement’</th>
<th>Total (a)</th>
<th>Production domestic companies (b)</th>
<th>(a) / (b) %</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>1</td>
<td>1</td>
<td></td>
<td>2</td>
<td>3</td>
<td>66.7</td>
</tr>
<tr>
<td>2</td>
<td>1</td>
<td></td>
<td></td>
<td>1</td>
<td>2</td>
<td>50.0</td>
</tr>
<tr>
<td>3</td>
<td></td>
<td>2</td>
<td>1</td>
<td>3</td>
<td>3</td>
<td>100</td>
</tr>
<tr>
<td>4</td>
<td>1</td>
<td></td>
<td>1</td>
<td>2</td>
<td>2</td>
<td>100</td>
</tr>
<tr>
<td>5</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>3</td>
<td></td>
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<tr>
<td>6</td>
<td>1</td>
<td></td>
<td></td>
<td>1</td>
<td>2</td>
<td>100</td>
</tr>
<tr>
<td>7</td>
<td>2</td>
<td>2</td>
<td>1</td>
<td>5</td>
<td>5</td>
<td>100</td>
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<tr>
<td>8</td>
<td></td>
<td>1</td>
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<td>1</td>
<td>2</td>
<td>50.0</td>
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<tr>
<td>9</td>
<td>1</td>
<td></td>
<td>1</td>
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<td>66.7</td>
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<td>100</td>
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<td>11</td>
<td></td>
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<td></td>
<td>1</td>
<td>1</td>
<td>100</td>
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<td>12</td>
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<td>1</td>
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<tr>
<td>13</td>
<td></td>
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<td></td>
<td></td>
<td>1</td>
<td>33.3</td>
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<tr>
<td>14</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>2</td>
<td>50.0</td>
</tr>
<tr>
<td>Total</td>
<td>9</td>
<td>8</td>
<td>5</td>
<td>22</td>
<td>35</td>
<td>62.9</td>
</tr>
</tbody>
</table>

(a) (b) Excluding the original company and the acquired companies

**Pattern 2: ‘Employee involvement’, following the need to develop a venture initiated by the portfolio entrepreneur.**

This is the most interesting pattern in terms of its quantitative importance (see Table 2) and its significance for our study. The former employee does not participate in the opportunity
discovery phase, but only in the development of the new venture. The following examples belong to this pattern.

“The new company was set up as a rib of the original company. At the beginning the original company made both moulds and production lines. The two activities could not coexist for technical reasons. Moreover the new company could also work for other customers. The new company was set up in 1990 associating an employee I trusted and who is now the production supervisor of the new company. I gave autonomy and trust to this employee”. (Case 8).

“Together with printed circuits we began to produce membrane keyboards. It was low technology by our standards. The product was initially developed within the original company at the end of the eighties but never reached large volumes. It was a languishing department because no one was really interested in it. I found an employee who took 10 per cent in the new company and who was interested in developing it… It was an activity which already existed in the original company. But if it had remained there it would have died.” (Case 9).

“During the following years the groups continuously enlarged its product range to be ready to cover all the needs of its actual and potential customers. In 1975 another company was created... Also in this company minority shares were given to a few technicians who were directly involved in the management of the company. We needed someone we could trust to manage the specialized factories. We thought that involving these people in the ownership of the companies was the best way to get them involved in the management of the companies....” (Case 3)

“In the [now closed] business of professional training there were a group of 5 people employed in printing. When the business was closed there were two possibilities; selling the printing activity or starting a company to work for external [to the group] customers. The employees started looking for new customers… We then decided to start a new company. I gave 40% of the ownership to 2 former employees (20% each) who are responsible for the management of the company. At present it is one of the largest printing company in central Italy” (Case 7)

The involvement of former employees in the new companies responds to several - sometimes overlapping - needs. The most important is to overcome the entrepreneur’s limitations to develop the new business while controlling the existing ones. Because the new business is similar to the established ones these limitations does not refer to expertise or capabilities, but to the time and attention that is required to set up a new business, while retaining the control and management of established ones. When questioned about this the entrepreneurs interviewed responded that just installing a manager to be in charge was not good enough; a new venture requires particularly high levels of motivation, interest and dedication. This was combined with a
shrewd appreciation of the need to prevent employees establishing the same business in competition and stealing customers. Direct ownership not only made them partners, but ultimately also helped spread risk.

Pattern 3: where the new venture arises from the activities of an intrapreneurial employee.

In this pattern, the intrapreneurial employee participates actively in the new business from the opportunity discovery phase and the portfolio entrepreneur plays a supporting role (in terms of providing financial resources, market credibility, network relationships, etc.) in the development of the new venture.

“In the same years [end of the Seventies] a young man who was also a friend, employed in one of our companies, suggested we started a commercial activity that he would supervise. At the beginning, my brother and I took 60% and the former employee 40%. For some years this company developed the commercial activity but then this employee champed at the bit and started a production activity for one of our companies … This new company grew rapidly driven on by this former employee helped, financially and commercially, by the group” (Case 4).

“There was a designer who was employed for some time in a company of the group. He had a difficult character. After some time he resigned and went to France to work for a cartoon firm. I had always wanted to enter the cartoon industry. After a few years he resigned from the French firm and came back to Italy and proposed some ideas to me. I proposed setting up a company together. I gave him 30% of the new company although he did not pay anything in cash” (Case 7).

“A former employee of our main supplier of plastic material (compound) suggested to us starting a company for producing the plastic material. As we were not satisfied by our suppliers of raw materials (both in terms of quality and price) we set up a new company producing plastic granules for soles. We gave a minority share (25%) to the technician who suggested this new activity (he was a chemist) and who took the main responsibility in running the company” (Case 3)

In all the above cases the portfolio entrepreneur retained control of the new company, although giving a significant stake to the associate entrepreneur. The latter played the key role both in structuring the new business and in developing it; moreover, the new activity is fully supported by the portfolio entrepreneur and is part of his or her business group.

Overall, the interviews show that whatever the nature of the associated entrepreneur - established entrepreneurs or former employees - the development of an entrepreneurial team to
exploit a new business opportunity is one of the most important reasons for organizing the new venture as a separate legal entity, thus forming or enlarging a business group.

The setting up of a legal independent company is especially important in the new venture creation phase. This was expressed very clearly by one entrepreneur:

“The logic behind these new companies is as such: [the original company] experiments on new activities and new products. As soon as it sees that the latter are promising business a new company is set up with the aim of developing the new activity. This is done because it is possible to create a healthy competition between the different activities, motivating people responsible for them to produce more and better. At the same time the relative performance of the different activities are more easily measurable and comparable. For a new business you need a new, focused, organization”. (Case 2)

The development of a group of companies, and the associated enlargement of the entrepreneurial team, is carried out by portfolio entrepreneurs to support new venture creation. Once the ventures have been developed, the focus is on rationalizing the management of the established activities. In some cases this may mean a merger of part or all of the companies in the group. In two of the cases we examined (cases 3 8), following the establishment of a group of companies, the portfolio entrepreneurs decided to merge most of the production companies and to transform their groups into multidivisional companies. This was motivated by achievement of greater managerial efficiency.

“In 1989 we decided to rationalize the group … and decided to merge the different companies. Notwithstanding the merger, from an operative point of view the factories remained autonomous. Specialization was retained at the level of production units.” (Case 3)

“In 2003 we decided to merge all these companies [those production units operating in the same sector: i.e. industrial automation]. Within the new company we created four divisions that reproduce the specialization of the merged companies.” (Case 8)

The collapse to a divisionalized organization is less likely when the group has been developed through the enlargement of the entrepreneurial team, given the reduced autonomy and motivation of the associated entrepreneur who is now managing a division rather than an independent company. Also, the existence of minority shareholders (associate entrepreneurs) in the companies forming the group would also create problems in determining the values of shares of the merged companies.
Although the portfolio entrepreneur may play a variety of roles in the individual companies of the group, in terms of the group as a whole, he or she retains a ‘dominant’ position. His or her majority share in all the group companies allows the portfolio entrepreneur potentially to intervene at any time in the control of the business - in the case of conflicts of interest with associated entrepreneurs. Case 3 provides an example of such a situation. The group was formed through entry into different segments of the same market (footwear soles) and by integrating activities along the production chain (production of a plastic compound). In each of these companies there were different minority shareholders that helped the entrepreneur in the start-up of the new companies. Once the companies were operating successfully, the entrepreneur decided to merge most of them although not all the minority shareholders were in agreement with this strategy. The minority shares in the individual companies were transformed into minority shares in the merged company, but one of the original minority shareholders decided to exit from ownership of the group.

Other difficulties within the entrepreneurial team occurred in other cases where the original business was founded by more than one entrepreneur. In cases 5 and 13 the founders were two brothers; in case 12 they were two close friends. This resulted in the presence of two dominant entrepreneurs within the same group. In all the three cases the group was eventually broken up, and the two entrepreneurs involved took control of the different parts. The problems that can arise if there are two dominant entrepreneurs in the same group is further evidence that a business group in the small business sector should be considered as a whole, subject to a unique vision and strategy, rather than a portfolio of different businesses.

**Discussion of results**

The empirical analysis based on direct interviews with portfolio entrepreneurs highlighted several aspects (e.g. the importance of entrepreneurial team development) that have been underestimated by the literature on business groups, or provide an alternative explanation for an already observed phenomenon (such as the presence of external shareholders in new companies).

Figure 2 synthesizes the main results of the empirical analysis by highlighting the role of entrepreneurial team development in business group formation. The Figure shows that building an entrepreneurial team is not the only reason why a portfolio entrepreneur may decide to organize a new venture as a separate legal entity. However, empirical evidence demonstrates that
it is an important phenomenon that must be given adequate theoretical explanation. This section develops some theoretical propositions to explain the phenomenon of entrepreneurial team development by portfolio entrepreneurs and discusses the implications of our findings for the actual debate on firm growth and entrepreneurial team dynamics.

Figure 2 - Entrepreneurial team development by portfolio entrepreneurs

The fundamental process in business group formation in the small business sector is new venture creation by established entrepreneurs. It is a process of growing the entrepreneur’s assets, capital and profits, which is different from the more frequently studied process of growth of individual firms. Whether the former results in the setting up of new companies as opposed to divisions within an established firm, depends on two main features: a) the degree of diversification from already established businesses; b) the need to involve other people in the ownership of the new venture. This latter aspect is stressed in financial explanations of business group formation (Almeida and Wolfenzon, 2006). However, the results of our interviews show that the presence of minority shareholders is motivate by the need to involve other people in the management of the new business.

This would seem to contradict the hypothesis that habitual entrepreneurs have an advantage based on recognizing and exploiting new business opportunities based on the learning and human capital accumulated through their entrepreneurial activity (Ucbasaran et al., 2003;
Macpherson and Holt, 2007; Ucbasaran et al., 2007). We suggest that other theoretical models of habitual entrepreneurs may help to explain the evidence observed. These alternative models rely on the idea of individual specialization and the problems arising from the limited time and attention that entrepreneurs can dedicate to the setting up of a new business while running the established ones (Kihlstrom and Laffont, 1979; Holmes and Schmitz, 1990; Gifford, 1998). Some studies refer to this problem (Rosa, 1998), but it has been substantially overlooked by much of the literature on portfolio entrepreneurship. When a new business opportunity arises portfolio entrepreneurs must decide how to share their time between managing the established businesses and exploiting this new business. This is not a trivial problem since start-up of a new business requires a high level of commitment from the people involved, in order to maximize the probability of success.

The critical element in exploiting a new business opportunity is not so much its recognition, but its initial development. This is effectively synthesized by Ardichvili et al. (2003, p. 113) according to whom: ‘While elements of opportunities may be ‘recognized’, opportunities are made, not found’. Identifying an opportunity is of little value unless there is the possibility to put the entrepreneurial idea into practice and test its validity (Harper, 2003); this is not a ‘one shot’ game, but a process that requires dedication and attention in order to adjust the idea to market conditions and maximize its success possibility (Bruyat and Julien, 2001).

For these reasons, when a portfolio entrepreneur is considering the development of a new business opportunity he/she has to choose between two alternatives: i) dedicating the required amount of his/her time to the start-up of the new venture; or ii) involving other people in the start-up of the new venture and giving them an entrepreneurial role. In the first case the opportunity cost is represented by the potential problems related to diverting time and attention from the established businesses. In the second case, the main problem lies in choosing the right person to delegate to and persuading him or her to take on an entrepreneurial role in the new venture.

Persons entrusted with entrepreneurial roles need entrepreneurial attitudes and capabilities and must be trusted by the entrepreneur. It is not by chance that among our interviewees, almost all of the people who had been entrusted with such a role were former employees. The employee relationship allows the entrepreneur to evaluate the competences and entrepreneurial attitude of the person and develop the trust required to make him or her a member of the entrepreneurial
When enlarging the entrepreneurial team involves a former employee, the portfolio entrepreneur draws on two strengths. In the first pattern (employee involvement) the entrepreneur must be able to identify and leverage an employee’s entrepreneurial capabilities to manage the start-up phase. In the second pattern (intrapreneurship) the portfolio entrepreneur must be able to accommodate the proposed project within the group. The employee relation allows the entrepreneur to evaluate the entrepreneurial attitude of the employee and develop the trust relationship needed to make him or her part of the entrepreneurial team.

Being part of an entrepreneurial team means involvement in ownership and control of the new venture. The future contingencies associated with the start up of a new business are both innumerable and unpredictable making it very expensive, if not impossible, to write incentive contracts for salaried managers to induce them to perform in an entrepreneurial role. The way used by portfolio entrepreneurs to create an entrepreneurial team is that of giving to people minority shares in the new business. This has several consequences: i) it makes the person responsible for the outcome of the business; ii) it enhances his or her authority over resource allocation and coordination; iii) it is an incentive for business-specific human capital investment (expertise, contacts, etc.); iv) reduces the risk of associated entrepreneurs ‘resigning’ their responsibility for managing the business, in the case that results do not match expectations.3

The portfolio entrepreneur supports the new business with capital and experience while dedicating to it only a fraction of his/her time. The associated entrepreneur, on the other hand, is completely dedicated to the new business and assumes the main role in its start-up. The existence of a business group, therefore, helps us to understand the dynamics of entrepreneurial teams in

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2 It is interesting that in our study there were no new companies set up to involve members of the entrepreneur’s family. This suggests that the resource-seeking aspect is pre-eminent, transcending interpersonal trust and attraction.

3 This is done not only to prevent potential loss of specific human capital, but also to reduce the risk that a salaried manager would start a business of his/her own to exploit the new business opportunity once he/she knows enough about it.
situations where there is a ‘dominant’ or ‘lead’ entrepreneur and one or more ‘associate’ or ‘sub’ entrepreneurs. The few existing theoretical and empirical studies that acknowledge these dynamics refer to individual businesses and do not consider the functioning of teams in a multi-business situation (Ensley et al., 2000; Harper, 2008).

The portfolio entrepreneur remains the ‘dominant’ figure in the group; he/she retains a leading position in the original company of the group and majority ownership of all the other companies. However, the portfolio entrepreneur does not necessarily play a ‘leading’ role in all the new ventures: if there is an associate entrepreneur, then he/she plays the major entrepreneurial role. This division of the entrepreneurial responsibility is often realized under dyadic relations between the dominant and one associate entrepreneur. This makes it possible to differentiate team interactions within the same group based on the circumstances surrounding the start-up of each new business and the role of the dominant and associate entrepreneur in each of them. In this regard, the business group is a flexible organizational structure that accommodates a wide range of team patterns: from the ‘hierarchical’ model between a lead and a sub-entrepreneur that is observed in ‘employee involvement’, to the ‘tutoring’ model that is observed in the case of ‘intrapreneurship involvement’.

Although the portfolio entrepreneur may play various roles in the individual companies of the group, and can vary the extent to which ‘hands on’ management is applied, he or she still retains the dominant position in the group as a whole (Rosa, 1998). Case studies highlight the difficulties that arise when there is more than one ‘dominant’ entrepreneur within the same group, a situation that happened when the original business was set up as a partnership between family members or friends. In all these cases, the group broke up because of divergent visions and strategies over time, and enlargement of the group. This is evidence that team dynamics can also be detrimental. Selecting the wrong partners to manage individual companies can result in time consuming feuds and conflicts which can sap away any advantages of intended delegation, or in the extremes can lead to the group splitting and the formation of rival companies by partners who have left with much essential knowledge and set up competing firms of their own, having seduced away key clients and customers.

This discussion suggests the following propositions about business groups formation and growth in the small business sector.
Proposition 1: Business groups are the result of the development of new business by established entrepreneurs, mainly inspired by related diversification opportunities.

Proposition 2: The setting up of a new company is especially advantageous in the start-up phase, as it helps to focus resources on the development of the new product, process or service. When the activities reach their mature stage, companies are more likely to be merged as a result of a rationalization process.

Propositions 3: The setting up of a new company is more likely when portfolio entrepreneurs need to enlarge the entrepreneurial team, both to exploit opportunities he/she already discovered or to accommodate and support business opportunities discovered by novice entrepreneurs.

Proposition 4: The accommodation of outsiders can be crucial in maximising the growth potential of the new venture, through providing energy, knowledge and commitment to the success of the new venture, which the portfolio entrepreneur cannot do him/herself owing to other commitments.

Proposition 5: The entrepreneurial teams developed by habitual entrepreneurs are predominantly formed by former employees.

Conclusions and implications

The main aim of this paper was to further the knowledge on the growth processes involved in setting up new companies by portfolio entrepreneurs, leading to the formation of business groups. The results of this study suggest that the process of new venture creation by habitual entrepreneurs is an important justification for the presence of business groups in the small firm sector. The setting up of new companies comes about for two main reasons:

a) the need to specialize (focus) the new organizational unit to enhance the probability of success of the new venture;

b) the need to give shares in the ownership of the new business, thus enlarging the entrepreneurial team to exploit new business opportunities.

The latter reason seems specifically important for analysing the role of entrepreneurial processes in explaining business group formation. Besides joint ventures involving established
entrepreneurs, it is the phenomena of ‘employee involvement’ and ‘intrapreneur involvement’ that are the most interesting.

In the first case the established entrepreneur leverages the capabilities of one of his/her employees to enhance the capacity to create a new venture. Entrepreneurial attitudes are exploited in choosing employees to become part of an entrepreneurial team; recognizing the initial opportunity remains the prerogative of the portfolio entrepreneur. In the second case the entrepreneur is able to accommodate an employee who wants to develop a business. The portfolio entrepreneur must reconcile the new project within the group activities and accommodate the emerging entrepreneur within a coherent team.

Compared with alternative ways of organizing the new business, the legal autonomy granted to the new venture helps to focus resources and monitor results. In addition, and most important, legal autonomy allows the portfolio entrepreneur to modify the ownership structure of the new business and give minority shares to people involved in the start-up of new ventures. The formation and enlargement of the business group coincides with the enlargement of the entrepreneurial team; i.e. additional people playing entrepreneurial roles within the group. By involving other people in the start-up of new ventures, portfolio entrepreneurs overcome the problem of allocating time and attention among established and new activities, thus enhancing their ability to enter new businesses while retaining ownership and control of the ones already established.

Whatever the reason for setting up a new company the benefits of legal autonomy are especially important in the start-up phase; once the new venture has been consolidated the need for legal autonomy diminishes and the group may collapse to a divisionalized organization. This suggests the existence of an evolutionary pattern of business groups with expansion of production companies when new businesses are added, and contraction when the new businesses are consolidated. In some cases the number of companies may stay the same, but the structure of the group may be rationalized through the creation of holding companies and a better definition of centralized and autonomous activities.

While the relationships between business group formation and diversification strategies has received attention in the literature, this paper highlights the importance of entrepreneurial team dynamics in explaining business group formation by habitual entrepreneurs. Most of the empirical literature on entrepreneurial teams refers to owner managers of the same business
(Watson et al., 1995; Ensley et al., 2000). The analysis of team development in business groups provides interesting insights into types of entrepreneurial teams, their internal organization and their dynamics.

The interviews demonstrate that the group form allows entrepreneurs to design and form a wide range of team patterns: from the hierarchical model observed in the case of ‘employee involvement’ to the ‘tutoring’ model observed in ‘intrapreneurship involvement’; these patterns can be identified within the same group, according to the characteristics of the new venture, the circumstances that led to its start-up and the people involved. Though the ‘dominant’ entrepreneur in the group as a whole does not change, he/she is not expected to play a ‘lead’ role in all the new ventures. This is evidence of the importance of distinguishing among different types of teams (Harper, 2008).

This study demonstrates that growth (in terms of assets, capital, employees, profits) is closely associated in the case of many small firm entrepreneurs by establishing business groups rather than growing a single firm. By shedding insights into the evolutionary and dynamic nature of this process we have contributed to the understanding of the complexity of growth dynamics in the small firm sector. We have shown that consideration of entrepreneurial processes contributes to an understanding of business group formation by habitual entrepreneurs. We would suggest that the study of business groups shed light on important aspects of entrepreneurship. Specifically, the analysis of the companies successively set up by habitual entrepreneurs can further understanding about how previously established businesses influence the process of opportunity discovery and new venture creation. Although much work has been done on this area, the existing literature does not take account of the overall process and dynamics of business group formation and the existence, as suggested by our study, of a pattern of development of business groups accompanying the development of the entrepreneur’s career.

The empirical and theoretical findings from our study have some implications for practitioners. One is the importance of recognizing the group structure as the organizational form suited to facilitating growth through the start up of new businesses. Though mimicking an M-form in some respects, the business group has its own specificities, the most important of which is the possibility to change the ownership structure of a new business and set it to maximize the probability of success. This is not trivial since in the new economic conditions the ability to motivate people and to induce them to make the specific investments needed for the exploitation
of new business opportunities has become critical (Rajan and Zingales, 2000). The business group appears to be a flexible form that helps entrepreneurs to exploit new business opportunities while retaining some of the advantages of centralized control. Instead of considering the group as a peculiarity of emerging economies or as an ‘anomalous’ structure resulting from capital market imperfections, it should be seen as an organizational form specifically suited to accommodate growth and, thus, should be given adequate space in the entrepreneurship and management literature.

References


