Entrepreneurs really do matter as study shows 60 percent sales drop after founders die

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(Phys.org)—The death of a founding entrepreneur wipes out on average 60 per cent of a firm's sales and cuts jobs by around 17 per cent, according to a new study.

The research, by Professor Sascha O. Becker at the University of Warwick and Professor Hans K. Hvide at the University of Bergen, sheds light on exactly how much a founder-entrepreneur 'matters' in terms of influencing the performance of privately-owned businesses.

The authors analysed firms' performance up to four years after the death of the founder-entrepreneur and found a long-lasting and significant negative impact.

As well as the striking effect on sales (down 60 per cent on average after four years) companies where the entrepreneur dies have 20 per cent lower survival rates two years after the death, compared to similar firms where the entrepreneur remains alive.

Professor Becker, Deputy Director of the Centre for Competitive Advantage in the Global Economy (CAGE) in the Department of Economics at the University of Warwick said: "It seems founder-entrepreneurs are the 'glue' that helps to hold a business together.

"We expected businesses that experienced the death of a founder-entrepreneur to have some kind of a dip in performance immediately after the death owing to the upheaval, but we anticipated there would be a bounce-back.

"However the results were quite surprising. Even four years after the death, most firms show no sign of recovering and the negative effect on performance appears to continue even further beyond that."

The researchers analysed Norwegian data on privately owned firms up to 10 years old. In the year of foundation, those firms have, on average, two employees, but the largest startups might have up to 20 employees.

They chose Norway as the country is unique in the level of detail collected by public authorities on companies and their founders.

They followed 341 firms where the majority-owning founder-entrepreneur had died, and compared them to the same number of 'twin' companies which shared similar characteristics but where the entrepreneur remained alive.

The difference between the effect on sales (down 60 per cent) and on employment (down 17 per cent) is something of a puzzle.

Professor Becker said: "Sales drop by much more than the employment rates after the entrepreneur dies.

"This shows what a vital role these people play in maintaining productivity levels within a firm – but we don't know exactly why that is.

"It could simply be that the founder was a fantastic sales-person who generated a disproportionately high level of sales.

"On the other hand it could be down to a leadership effect, where the founder-entrepreneur inspires the employees to perform as best they can and without this presence that drive slips away."

The study looked at various different types of firms to see how they were affected by founder-entrepreneur death.

They found no difference between results for family or non-family firms, urban or rural businesses, and no significant variation across sectors.

Among the businesses analysed, all ages of firm were affected by founder-entrepreneur death.

It was the very youngest (between one and two years) that saw the strongest negative effect – however there was still a significant effect on more mature firms (about five and six years old).

The level of education of the founder-entrepreneur also played a role in determining how badly the firms were affected – those with the most highly educated founders experienced a bigger drop in performance after the death.

The study also looked at whether ownership shares matter. The researchers found that the effect of the death of a 50-per-cent owner was roughly half that of the death of a majority owner.

Perhaps the most prominent example of entrepreneur death in recent years is Steve Jobs.

But Professor Becker cautioned against applying these findings to Apple as it is today – instead one should look back to Apple's early history in the 1980s.

"Apple today is a mature, publicly listed company whereas the firms in our study are privately owned and much younger than Apple was when Steve Jobs died," he said.

"Perhaps a better illustration of the phenomenon we have identified is when Jobs left Apple during the 1980s when it was less than 10 years old.

"Apple struggled without him and didn't really regain its momentum until Jobs came back to the helm in the 1990s.

"During this time Jobs was lost to the firm, creating a similar dynamic to what happens in companies in which the founder-entrepreneur dies."

The research is published as CAGE Working Paper No. 109/2013 under the title "Do Entrepreneurs Matter?" authored by Sascha O. Becker and Hans K. Hvide.

More information: www2.warwick.ac.uk/fac/soc/eco … /109.2013_becker.pdf

Provided by University of Warwick