
**Competencies and
Institutions Fostering
High-growth Firms**

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Competencies and Institutions Fostering High-growth Firms*

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Abstract

High-growth firms (HGFs) are critical for net job creation and economic growth. We analyze HGFs using the theory of competence blocs, linking firm growth to property rights and the interaction of complementary expertise. Specifically, we discuss how the institutional framework affects the prevalence and performance of HGFs. Firm growth is viewed as resulting from the perpetual discovery and use of productive knowledge. A key element in this process is the competence bloc, a nexus of economic actors with complementary competencies that are vital in order to generate and commercialize novel ideas. The institutional framework determines the incentives for these individuals to acquire and utilize knowledge. We identify a number of institutions that foster

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the emergence of competence blocs and the creation of HGFs. In particular, our analysis points to the pivotal roles played by tax structures, labor market regulation, and the contestability of currently closed service markets. Finally, we characterize institutions beneficial for sclerotic or dynamic capitalism, respectively, depending on whether they provide a favorable environment for the emergence of competence blocs and the creation of HGFs.

Keywords: Competence bloc; Dynamic capitalism; Entrepreneurship; Flyers; Gazelles; High-growth firms; Industrial policy; Innovation; Institutions; Labor security; Product market regulations; Property rights; Sclerotic capitalism; Self-employment; Tax policy.

JEL codes: H32; L5; L25; M13; O31; P14

At the microeconomic level, restructuring is characterized by countless decisions to create and destroy production arrangements. These decisions are often complex, *involving multiple parties* as well as strategic and technological considerations. The efficiency of these decisions depends not only on managerial talent but also on the existence of *sound institutions* that provide a proper transactional framework.

Ricardo Caballero (2007, p. 3, *italics added*)

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1

Introduction

Most productive activities take place in profit-driven enterprises. These organizations also carry out a major share of all research and development and function as the main vehicles for economic renewal — in short, they are the engine of long-run economic growth. The success of an individual enterprise hinges on its ability to combine diverse factors of production and to satisfy consumers in an efficient way. At the aggregate level, economic growth in contemporary market economies presupposes continuous and massive microeconomic restructuring and factor reallocation.

Enterprises exhibit large heterogeneity in age, size, industry affiliation, growth ambitions, and realized growth performance. It is well documented that young and small firms contribute disproportionately to net employment and productivity growth.¹ Meanwhile, most firms grow very slowly, or not at all. Zook and Allen (1999) report that only one in seven companies achieves sustained growth while remaining profitable. Accordingly, some observers point to a small number of rapidly growing firms — which may be neither small nor young — that contribute a

¹For a survey of the empirical evidence, see van Praag and Versloot (2008).

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disproportionately large share of net job creation and economic growth (see, e.g., Birch and Medoff (1994), Storey (1994), Schreyer (2000), and Acs et al. (2008)). To the extent that this is true, it is of crucial importance to understand under what institutional conditions talented entrepreneurs are motivated to establish firms with the ambition and ability to expand rapidly, as well as what conditions are conducive to the expansion of existing firms with growth potential.

Our main aim in this paper is to characterize the institutional setup that is likely to be most conducive to the fostering of high-growth firms (HGFs).² By institutions we mean “the rules of the game in society” (North, 1990, p. 3).

It should be noted that there is a large literature studying the effect of so-called micro-level factors on firm growth. In a wide-ranging survey of the literature on firm growth, Storey (1994) identified 35 such factors, which he classified into three categories (p. 122): (i) The starting resources of the entrepreneur(s), e.g., motivation and education; (ii) the firm, e.g., age and size; and (iii) strategy, e.g., management training and market positioning.³ A related strand of literature addresses the effects of micro-level factors on HGFs; see, e.g., Delmar and Davidsson (1998), and Barringer et al. (2005) for surveys. Barringer et al. (2005) identify founder characteristics, firm attributes, business practices, and human resource management as the four most influential categories of variables explaining rapid firm growth.

Turning to macro-level factors, there is a literature studying the effects of public policy, like tax policy and financial assistance, aimed at stimulating the growth of small and medium-sized firms (see, e.g., Storey (1994, 2006)).⁴ The literature on the effects of institutions on

²Gerschenkron (1962) introduces the felicitous concept “appropriate institutions,” which nicely captures what we set out to identify in this essay. Gerschenkron’s term has recently received renewed attention, see, e.g., Acemoglu et al. (2003). They focus on differences in what constitutes good policy depending on a country’s “distance to the technological frontier.” More generally, the role of institutions has moved to the fore of mainstream explanations for economic performance, especially over the longer term. See, for example, North and Weingast (1989), Rodrik et al. (2004), and Acemoglu et al. (2005).

³See, e.g., Delmar (1997), Davidsson (2006), and Reynolds (2007) for recent surveys and discussions.

⁴There is a larger literature on the institutional effects on firm entry and firm exit; see, e.g., Djankov et al. (2002), Fan and White (2003), and Brandt (2004).

firm growth in a broader sense — the business climate — is still limited (examples include Demirgüç-Kunt and Maksimovic (1998), Henrekson (2005), Klapper et al. (2006), and Powell (2008)). The literature specifically addressing the effects of institutions on HGFs is scarce, focusing almost exclusively on the provision of capital to HGFs; see e.g., Buss (2001).⁵ Two exceptions are Davidsson and Henrekson (2002), who analyze the effects of institutions on the incentives for entrepreneurs to establish and rapidly expand enterprises, and Stam et al. (2007) who discuss the policy implications of the fact that entrepreneurs with high growth ambitions contribute relatively more to economic growth than the average entrepreneur.

Over the past decades endogenous growth theory has also developed models that come closer to making explicit what drives long-term economic development. Explicit incentives for innovation have been included so as to explain why individuals would engage in creating new technologies and better ways of producing goods and services (Barro and Sala-i-Martin, 1995; Aghion and Howitt, 1998). However, the actual agents of change, the entrepreneurs, are still defined rather narrowly and theory does not capture the wide-ranging and complex functions suggested outside mainstream economics (see, e.g., Baumol (1968), Glancey and McQuaid (2000), Swedberg (2000), Johansson (2004), Bianchi and Henrekson (2005), and Phelps (2007)). To a great extent enterprises are still modeled as “representative firms” which are treated as “black boxes” (Rosenberg, 1982, 1994) even though research scholars have started to open it up; see, e.g., Aghion and Tirole (1994) and Acemoglu et al. (2007).

We argue that these approaches need to be supplemented by a micro-oriented analysis of how institutions affect the behavior of the individual actors involved in the process. In order to make such an analysis manageable, the actors are divided into a limited number of functionally defined categories. The theory of competence blocs (Eliasson and Eliasson, 1996) offers such a categorization. A competence bloc contains a set of actors with the different and complementary competencies

⁵We do not count studies with general conclusions such as “since HGFs are important, growth obstacles need to be removed.” The analysis needs to be more precise to be considered.

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required to generate and exploit new knowledge. This process, in turn, eventually results in large-scale economic development and economic growth. This requires “breadth” (all categories of actors of the competence bloc have to be in place) as well as “depth” (a critical mass of actors are needed to fulfill each function efficiently). Hence, this analysis may be seen as an extension of Davidsson and Henrekson (2002) where we expand the analysis to include other actors than entrepreneurs.⁶ Our broader approach aims to deepen our understanding of the effects of institutions on HGFs, since institutions may affect different actors differently. Due to the complementarity of competencies, institutions may have a larger effect on firm growth than suggested by an analysis that focuses on a single actor.

An underlying assumption is that rapid economic growth and employment creation are obtained if individual actors form competitive competence blocs and establish new firms with high growth potential and aspirations. This requires appropriate institutions that harmonize the incentives of the different types of actors with complementary competencies (Pelikan, 1993; Henrekson and Johansson, 1999).

The study is organized as follows. In Section 2, we define the competence bloc and its key actors and competencies. In Section 3, we briefly review the literature on HGFs. In Section 4, we discuss more generally the HGFs-institutions nexus, as a preamble to the in-depth institutional analyses that follow. Section 5 deals with the effects of taxation, and Section 6 discusses the organization of the labor market. Section 7 deals with product market regulations that disturb the link between the entrepreneur and the customer, by restricting market entry by private entrepreneurs and by restricting private customers’ ability to choose a (private) provider. We classify institutions into either of two categories, depending on whether they support what we call “sclerotic” or “dynamic” capitalism, respectively. Section 8 concludes.

⁶The surveys by, for instance, Storey (1994) and Barringer et al. (2005) show that studies investigating micro-level factors mainly focus on the entrepreneur/founder (including discussions of his/her management team and his/her social and professional networks) and strategies for human resource management of employees, notably workforce training and incentive programs. The financial resources and provision of capital to growing firms are also discussed.

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