

Growing Pains: A Study of SME Growth

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“All the evidence we have indicates that the growth of a firm is connected with attempts of a particular group of human beings to do something; nothing is gained and much is lost if this fact is not explicitly recognized.”

Edith T. Penrose

The Theory of the Growth of the Firm (1959)

Abstract

Growth in small- and medium sized business (SMEs) is often seen as a sign of entrepreneurial success, and is important for employment and national economies. However, it is acknowledged that growth also leads to challenges for the SMEs, and many small business owners decide to intentionally keep their companies small in order to avoid the turmoil.

Current literature and theoretical development in the academic field has emphasized the preconditions, or the *antecedents*, leading to growth, rather than addressing *how* the firms grow and the *effects* of growth in terms of challenges for the SMEs. This gap in research has led to the prevalence of unsatisfactory conceptualizations of the growth phenomenon. Further, the linear and deterministic growth trajectories often portrayed in the disputed theories that exist are argued to be of little value to practitioners. The problem statement for the thesis is thus: “*Given the current research on SME growth, contrasted against how the phenomenon is experienced by practitioners, how can we better conceptualize the process of growth and the challenges that SMEs face as they grow?*”

This thesis reviews existing theoretical perspectives on SME growth and addresses some key limitations. Further, it contains the case study of growth in a small Norwegian company. By combining the insight gained from existing literature and empirical data from the case study, the thesis presents a new and novel conceptualization of the *process* of SME growth and the *effects* of growth, which is argued to better portray the idiosyncratic and path-dependent growth of SMEs than any one theoretical perspective by itself.

The thesis makes a contribution to the academic field by providing an alternative conceptual framework for reasoning on the growth process of SMEs. The framework consists of four categories of internal and external forces, changing through the growth of the SME, and putting pressure on the existing organizational configurations and practices. Further, the framework suggests seven categories of challenges that may arise due to misalignment of the forces, based on findings from existing literature and the case study. Together, this new conceptualization is argued to potentially help practitioners better understand and address the challenges that arise from the growth process.

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1 Introduction

Without continual growth and progress, such words as improvement, achievement, and success have no meaning.

Benjamin Franklin

1.1 The topic of the thesis

What happens when a small company grows? This question was the starting point for the thesis you are about to read. Most people would agree that growth is a good thing for any company, and especially a small one. In fact, entrepreneurship research and practice often emphasize growth as the measure of success of a firm, celebrated through ratings such as Fortune's "Fastest-Growing Companies"¹ and Deloitte's "Technology Fast 500™"². Furthermore, companies are termed *unicorns* and *gazelles* based on their high growth rates.

The context of this thesis is small- and medium-sized enterprises (hereafter **SMEs**). These companies are shown to play an important role in the modern economy, and are well recognized as vital and significant contributors to job creation, economic development, innovation, and the welfare of economies. However, there is no universal definition of what an SME actually is:

- In Norway, the Confederation of Norwegian Enterprise (NHO) defines SMEs as companies with less than 100 employees³
- In the European Union, an SME is defined as a company with less than 250 employees and less than €50 million in turnover or €43 million in balance sheet total⁴
- In the United States, the Small Business Administration (www.sba.gov) sets SME size criteria by industry, but a typical definition is businesses with less than 500 employees.

¹ See <http://fortune.com/100-fastest-growing-companies/> (Accessed 2015/12/26)

² See www.deloitte.com/fast500 (Accessed 2015/12/26)

³ See <https://www.nho.no/Politikk-og-analyse/SMB/> (Accessed 2015/10/24)

⁴ See http://ec.europa.eu/growth/smes/business-friendly-environment/sme-definition/index_en.htm (Accessed 2015/10/24)

Following the Norwegian standard, 99.5% of Norwegian companies were defined as SMEs in 2015. If we were to apply the European or American standard, even more would be within the definition. There is no wonder that small firm growth has attracted significant attention from both researchers and policy-makers recent years.

For the business owners, growth should be a good thing for their business as it may increase the revenue, and hopefully the profitability. Growing the business can also be an exciting adventure, and a much-welcomed validation of the ideas and “sweat equity” put into the company.

However, growth may also be a double-edged sword for the SME. In addition to being a measurement of (positive) changes in employment, sales, or market share, growth is also a *process* that leads to issues in the organization. From the business practice, you can often hear statements such as “*things must change when the company exceeds twenty employees*” or “*we are not ready to take the company to the next stage*”. What are those “things” that change, and why do we portray growth in “stages”?

The topic of this thesis is the growth process of SMEs and the challenges that may come from growth. By improving our understanding of these concepts, I hope to contribute both to future research in the field, and to practitioners in small businesses who are worried or curious about the potential hazards of growth.

1.2 Problem statement and research questions

According to Davidsson et al. (2007), new research on SME growth may have several alternative foci, as presented in Figure 1.1.

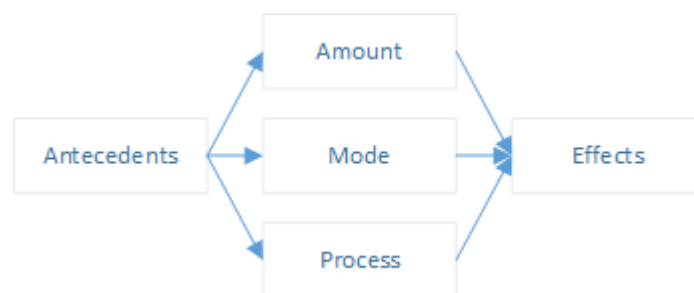


Figure 1.1: Alternative foci for studies of small firm growth
Source: (Davidsson, Achtenhagen, & Naldi, 2007)

The dimensions of the figure (the foci) are described as follows:

- The *antecedents* of growth: the preconditions or factors that facilitate, predict, or hinder growth.
- The *amount* of growth: the various measurements that can be applied to measure *how much* one or more companies grow, either individually or as a group.
- The *mode* of growth: the different ways SMEs grow, e.g. in terms of internationalization, mergers and acquisitions, or organic growth.
- The *process* of growth: the internal changes in the SME as the company grows.
- The *effects* of growth: the organizational and managerial challenges that come from different forms of growth.

Even though the amount of research on SME growth has increased since the late 1980s, reviewers complain that a coherent picture still does not exist (Davidsson, Achtenhagen, & Naldi, 2007). Further, conceptual development has been limited and the literature is highly fragmented into several theoretical perspectives, with studies covering only a fraction of the variables considered important in other studies (Wiklund, Patzelt, & Shepherd, 2009). Dobbs and Hamilton (2007) reviewed the empirical contributions since mid-1990s, and concluded that our current knowledge base “still lacks a body of theory capable of explaining the growth of small businesses” (p. 296).

The focus of this thesis is the *process* of growth, and the *effects* that come from this process in terms of challenges. Rather than asking *why* a firm grows, the thesis will look into *how* they grow and examine what goes on within the firms as they are growing.

Based on this, the problem statement for this thesis is:

Problem statement:

Given the current research on SME growth, contrasted against how the phenomenon is experienced by practitioners, how can we better conceptualize the process of growth and the challenges that SMEs face as they grow?

In addition to the problem statement, which serves as the main research question of the thesis, I will address the following research questions:

Research Question 1: How is the phenomenon of SME growth explained in the literature?

Research Question 2: How is growth experienced by practitioners in an SME?

Research Question 3: How can different theoretical perspectives be integrated to present a holistic and integrative view of the challenges SMEs face during growth?

To answer the research questions, I will conduct a thorough review and critique of the literature on SME growth. Further, I will seek to find propositions that may be utilized in constructing a new conceptualization of the SME growth process and challenges. The understanding built from conducting the literature review will also serve as a theoretical platform for a case study, where I will seek to gain insight into how practitioners experience growth and the accompanying challenges. Finally, I will attempt to view the literature available on SME growth through the findings and insight gained from the case study, in order to address the problem statement in the discussion and conclusion of the thesis.

1.3 Purpose of the study

The purpose of this study can be summarized in the following way, given the problem statement and approach:

- To develop a comprehensive understanding of the concepts and theories related to growth in SMEs
- To understand how the literature on SME growth relates to how growth is experienced in practice, with a special focus on how the process and challenges are perceived by practitioners
- To propose an integrative conceptual framework that derives from available theories and perspectives found in the literature, as well as empirical data from the case study, and aims to better conceptualize the process of growth and the challenges faced by SMEs as they grow.

My intention for contributions through this thesis is thus twofold: to present previous research in a way that makes it more easily accessible to new researchers and practitioners; and to present a new or derived conceptual framework that allows stakeholders of small- and medium sized enterprises to better understand the challenges they experience as they grow.

1.4 Configuration of the thesis

The remainder of this thesis consists of the following chapters:

Chapter 2: Research method describes the strategy applied to answer the research questions and reach the goals of this thesis.

Chapter 3: Literature review provides an extensive review of available research on SME growth. Throughout the chapter, several propositions will be presented that are of specific relevance to my research. New researchers and practitioners may also utilize the information in this chapter as a theoretical foundation towards understanding the existing theoretical perspectives on SME growth.

Chapter 4: Case study presents the empirical part of the thesis, based on an in-depth case study of a small Norwegian software company. The chapter starts with a narrative of how the company has grown during the past 20 years, before presenting an analysis of the growth process and the challenges the company has experienced.

Chapter 5: Discussion gives a discourse on the propositions and findings from the literature review alongside the findings from the case study. The chapter thus cumulates the findings from the two preceding chapters in order to derive new theory. Further, the chapter will present and discuss a new conceptual framework that draws on the findings from this thesis.

Chapter 6: Conclusion presents the conclusion of the thesis, and a description of how the problem statement and research questions have been addressed. Further, the chapter presents the limitations of the thesis, and suggestions for future research.

2 Research method

Research is the process of going up alleys to see if they are blind.

Marston Bates

2.1 Introduction

While conducting preliminary inquiries on the topic of SME growth during the summer of 2015, I soon found indications of a highly fragmented field where several authors called for future studies to consolidate the available research. As described in the previous chapter, one goal of this thesis is to propose an improved conceptualization of the SME growth process and the managerial challenges that come from the process.

In order to contribute to the research field, I have employed a somewhat non-standard approach. Instead of deriving ideas from one specific theory or school-of-thought, I have used input from multiple theoretical perspectives as well as empirical data from an in-depth case study. This approach has helped me make sense of the interplay between the growth process and the variety of challenges that arise.

2.2 Research philosophy

The philosophical stance of this thesis is **interpretivism**, as described by Saunders et al. (2015, p. 140), where the purpose has been to create a new and richer understanding of SME growth by emphasizing how participants experience the phenomenon. In line with this philosophy, it has been essential to capture different perspectives from different groups of people within an organization experiencing growth. An important implication of the research philosophy is that my interpretation of the research data, as well as my own values and beliefs, played an important role in the research process.

2.3 Research strategy

Based on the preliminary findings and the need for an integrative theory, the choice was made of an **inductive** theory development approach. This implied that data was collected to explore the phenomenon and identify themes and patterns, rather than to test a previously defined theory.

An illustration of the research strategy is presented in Figure 2.1. In line with the philosophical stance and the approach to theory development, this thesis applies a **qualitative research method**. According to Saunders et al. (2015), this research method is often associated with an interpretive philosophy where the researcher need to “*make sense of the subjective and socially constructed meanings expressed about the phenomenon being studied*” (p. 168).

In order to get a complete overview of the academic field, the research strategy incorporated a thorough literature review. This review would then provide the theoretical platform necessary to further specify the goals of the case study. The literature review would also answer the first research question of the thesis: *How is the phenomenon of SME growth explained in the literature?*

The case study was designed to give an in-depth inquiry into how SMEs may experience growth. A single case study was chosen, as the goal was to get information from individuals with different perspectives in the SME (e.g. owners, managers, and employees). In addition to providing a rich understanding of how the participants had experienced growth, the case study would also provide a thorough narrative of the historical events that had shaped the growth process. The case study thus answers the second research question: *How is growth experienced by practitioners in an SME?*

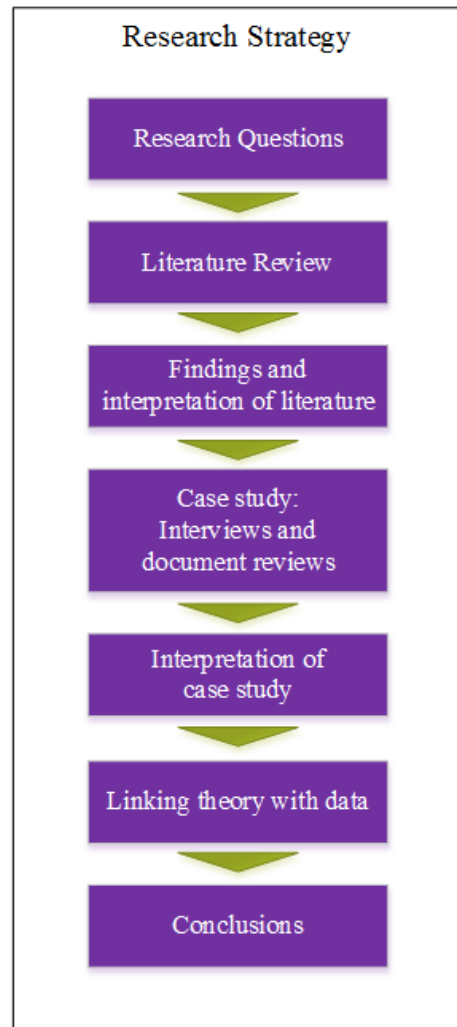


Figure 2.1: Research strategy

The final research question was: *How can different theoretical perspectives be integrated to present a holistic and integrative view of the challenges SMEs face during growth?* By linking the findings from the literature review and the case study, I have aimed to construct a new conceptual framework of SME growth and the accompanying challenges.

2.3.1 Literature review

The literature review was conducted with an integrative approach. An **integrative review**, as thoroughly described in Torraco (2005), aims to synthesize and critique representative literature on the topic in an integrative way, to generate new knowledge about the topic. The reason for choosing this approach was my goal of developing new theory, and a thorough understanding of studies addressing related research problems was necessary in order to advance the field. More specifically, the literature review aimed to find and evaluate previous research presenting several perspectives of how to understand the SME growth phenomenon. The goal was to connect these perspectives in order to use the literature review as a platform for the case study and the subsequent discussion. As the current research has not yet converged on a dominant paradigm, it was important to critically evaluate all of the most prominent perspectives.

One problem with this broad strategy was to evaluate which theories were more relevant than others were. The literature selection was initially guided by previous reviews of SME growth research. These reviews were the starting point of the thesis, and an important part of my preparation and scoping of the problem statement. Most notably, the literature reviews by Davidsson et al. (2007), Dobbs and Hamilton (2007), and McKelvie and Wiklund (2010) provided important guidance both towards the most prominent research papers and authors, towards deficiencies and gaps in current research, and towards research opportunities.

Further, I searched Google Scholar for highly cited works using “SME Growth”, “Small business growth” and terms related to specific aspects or perspectives of SME Growth. This literature then led to new theoretical perspectives, further evaluated and explored through backward and forward *snowballing*, as described by Jalali and Wohlin (2012). One method applied to evaluate the relevance was to look at how often the literature had been cited by other researchers, as suggested by Torraco (2005). The number of citations was thus used as a primary proxy of the relative importance of the research.

However, this approach had flaws in terms of favoring research streams with a long history. As new theoretical developments emerge, it takes time before the number of citations catch up with the established schools of thought. Since there has been a sharp rise in SME research the past decades, it was important to evaluate *newer* research as well. Without the proxy of citations, it became even more important to assess the quality and value of *recently published* research through evaluation of methodological rigor, theory robustness and quality of reasoning (Saunders, Lewis, & Thornhill, 2015).

I argue that the approach has provided a representative sample of the research domain, and that it has sufficiently covered the most important works. The literature review will present what was considered the most salient works in terms of theories and research perspectives.

2.3.2 Case study

In order to understand how practitioners experience the growth process and the accompanying challenges, a single in-depth case study was chosen as sufficient. The case study was based on an interpretive approach, and I sought to find more aspects of the growth phenomenon by selecting interviewees with various backgrounds in the company. While the founders would provide the majority of information, as they knew the entire history of the company, information and perspectives from additional employees would provide even more depth, breadth, and richness on both the process and the challenges.

The Norwegian software company Genus AS was selected for my case study. As I had been employed in the subsidiary of this company for seven years, this allowed me to adopt the role of an *internal researcher*, as described by Saunders et al. (2015, p. 208). There were several advantages with this approach. First, it reduced the complications in negotiating access to interviewees and documentation. Second, I had former knowledge of the organization and an understanding of the complexities, thus reducing the time necessary to understand the contextual settings. Third, it allowed me to *continuously verify* my findings with stakeholders in the organization. Thus, while the interviews were formally recorded, verification of the information could be provided in a more informal fashion.

Tietze (2012) provides advice to researchers conducting research in their employing organization. As she describes, my role as an internal researcher also had disadvantages that I had to address. First, I had to put away, or at least be aware of, my assumptions and preconceptions about the company. When interpreting the information, I was conscious of my

role and had to verify all my interpretations. Further, only information coming from the interviewees was included in the case study. While I would have been able to provide parts of the information based on my experience in the company, I found it useful to ask even “basic” questions in order to present the information as the interviewees perceived it.

According to Saunders et al. (2015, p. 397), another challenge with the approach is the response bias, where the interviewees may have provided only a partial picture of the situation. The reason for such bias may be the wishes of respondents to cast themselves in a socially desirable role, or the organization in a positive or negative fashion. To overcome these challenges, the employees interviewed were allowed anonymity in the reporting of the findings to assure their answers were not linked to them specifically. Further, the quality of the data was improved by asking several participants about the same situations and thus allowing for interpretation through several perspectives and *triangulation* of information, as suggested by Saunders et al. (2015, p. 207).

The interviews were carried out as either one to one interviews, group interviews, or focus groups. Further, they were conducted in a semi-structured fashion, partially based on a set of pre-defined open questions. In addition, all interviewees were asked to give a personal narrative of how the company had grown while they had been employed, and to highlight the most important challenges or changes they had experienced. Probing questions were used to explore responses of specific interest to my research topic, or to triangulate information received from other interviewees.

Data from the interviews were recorded by making notes. While audio-recording may have been beneficial, the “formality” of an audio-recorded interview could have resulted in a reduced willingness to provide information. Immediately after the interviews, the notes were transcribed, translated, and summarized on a computer. To anonymize the data, the names of the participants were replaced by codes, while background information such as employment year and role in the company was maintained. Each transcript was stored as a separate word document.

When all interviews were conducted, the transcripts were analyzed through “Thematic Analysis”, as described by Braun and Clarke (2006), to explore different interpretations of the growth phenomenon. By working through the transcripts, I searched for themes and categories of responses. I used coding in two dimensions: the first dimension was a categorization of

challenges and process descriptions, the second dimension was a time-stamp that specified the time in the company history that specific events had occurred. The coding of challenges and process descriptions derived from a combination of labels I developed to describe the data and terms found in existing literature.

In addition to the interviews, the company provided access to documentation such as news articles, presentations, and internal documents ranging back to the founding in 1995. This documentation gave complementary insight into how the company was organized, what the foci of the founders and employees were at specific times, and how they had presented themselves to the employees and their surroundings.

Based on the interviews and the documentation, I synthesized the information into a narrative of the company history and an analysis of the information. A draft of the case study was then sent to interviewees for respondent validations. Based on the responses, I made some corrections, additions, and deletions before finalizing the case study.

2.4 Evaluation of case study research method

While the criteria of *reliability* and *validity* are central to judgements about research quality in quantitative research, they are not easily transferred to qualitative research such as in this thesis. In order to evaluate the research method used for the case study, a qualitative approach based on interpretivism, I have applied the criteria of *dependability*, *credibility*, and *transferability* as formulated by Lincoln and Guba (1985), cited in Saunders et al. (2015, p. 206).

Dependability

In an interpretivist context, dependability means recording all changes to produce a reliable account of the emerging research focus, and is thus the parallel criterion to reliability. During my research, I made transcripts of all interviews as described previously, and tracked the changes made to the transcripts. The transcripts were further translated into a narrative that is presented in Chapter 4, which was sent to the participants for validation. The transcripts themselves are not attached to this document for several reasons, including sensitive information and the promise of anonymity. To increase the dependability, I also used my supervisor as an auditor by reporting on progress and findings related to the interviews.

Credibility

Credibility is a parallel criterion to internal validity, with an emphasis on ensuring that representation of the research participants' socially constructed realities match what the participants intended by providing the information. As with dependability, the credibility was improved through participant validation of the narrative. Furthermore, as I had easy access to the participants, I could continuously validate my interpretations with the participants. Finally, discussions with my supervisor improved my reflections and interpretations. I thus believe that a degree of credibility is ensured.

Transferability

Transferability is a parallel criterion to external validity, concerned with the question of whether the findings can be generalized to other relevant settings or groups. The transferability is improved by providing a narrative of the case, allowing future researchers to evaluate the context. Further, the thesis is presented in a way that should enable the reader to follow the logical steps taken in developing the conceptual framework. However, transferability could have been improved by adding additional case studies, and I recognize the limits of what can be generalized from a single case study.

2 Research method

3 Literature review

We learn more by looking for the answer to a question and not finding it than we do from learning the answer itself.

Lloyd Alexander

3.1 Introduction and structure of literature review

To answer the first research question of this thesis, I have conducted an extensive review of available research on SME growth. The goal is not to provide an exhaustive review of all the literature on SME growth, since this would be impractical and infeasible for a master's thesis. Instead, I will elaborate on insights from the different streams of research focused on the growth phenomenon, as this will highlight the differences and similarities in the research.

The chapter will provide a thorough insight into what is already known about the growth phenomenon, as well as research gaps and areas for further exploration in the case study. It may also serve as a theoretical foundation that can be utilized by new researchers and practitioners, and thus help more people understand the field of SME growth.

The structure of the literature review is arranged as follows:

- Section 3.2 introduces the concept of growth, and why growth is important to SMEs.
- Section 3.3 presents perspectives on how SMEs grow, categorized by the theoretical lenses used to understand the concept.
- Section 3.4 summarizes the findings from the literature review.
- Section 3.5 presents a critique of the literature in the context of my problem statement.

3.2 Growth and the SME

To be able to study the growth of SMEs, we must first establish how *growth* is to be defined and studied in this thesis. According to Penrose (1959), the concept of growth can be defined in at least two ways: as an increase in size or amount; and as a process of development.

Growth as an *increase in size or amount* has been the dominant definition used in the literature (Davidsson, Achtenhagen, & Naldi, 2007). By using this definition, growth is measured through increase in e.g. sales, employees, profitability, market share, valuation, assets, or physical output. The diversity of measures brings some challenges for researchers who are trying to accumulate and compare the results (Delmar, Davidsson, & Garther, 2003), impeding further theory development. Weinzimmer et al. (1998) concluded that the inconsistencies in measurement approaches have contributed to a lack of consensus in research of organizational growth. In addition to the unit of measure, the research also differ in formulas used, e.g. average percentage change vs. first and last year observations (Weinzimmer, Nystrom, & Freeman, 1998). Most of the current research on *determinants* of growth are quantitative studies where growth is measured between two points in time and determinants are considered static.

However, as Davidsson et al. (2007) explains, a number of the determinants affecting growth change over time. Growth may therefore be better understood as a change process, and this affects how it should be studied. The focus of this thesis is the study of the *process* and *effects* of SME growth. The process is defined here as the organizational process of moving from one position to a more preferable and competitive one. This leads to an understanding of growth as a process of *change* and *development*. This thesis will ask neither whether there is an “optimum” size of the firm, nor which factors determine whether growth will actually occur or not (the *antecedents* of growth). Rather, it will focus on the internal nature of growth and the managerial challenges (the *effects*) that comes accompanies this process.

3.2.1 Motivation for growth

Another important aspect when studying the process of growth is whether growth is actually *preferable* for the SME. The managers of SMEs are often aware that growth may lead to both desirable and undesirable effects (Davidsson, Achtenhagen, & Naldi, 2007). Growth involves change, and not all SMEs are willing to make the changes necessary to grow (McKelvie & Wiklund, 2010). One study showed that noneconomic concerns, such as adverse effects on

employee well-being, might be more important to SMEs attitude towards growth than prospects of financial benefits (Wiklund, Davidsson, & Delmar, 2003). Further, research has shown that SME owners often believe that increased size will make their firms more vulnerable when facing a crisis (Wiklund, Davidsson, & Delmar, 2003; Davidsson, 1989; Davidsson, Achtenhagen, & Naldi, 2007), even though evidence suggest that a *small* firm size makes long-term survival problematic (Aldrich & Auster, 1986).

Indeed, there are several advantages of staying small. Fewer employees often means a simpler organizational structure and higher degree of flexibility, allowing the firm to bring innovations to the market faster and at a lower cost (Steffens, Davidsson, & Fitzsimmons, 2009). A small organization may also make it easier for the owner-manager(s) to maintain control over the operations, and keeps them closer to the customers and the market. Fewer customers may make it easier to please each individual customer and maintain a high degree of quality in products or services. A range of other arguments for the advantages of staying small can be found in the literature, and it must be acknowledged that a high proportion of SMEs are more interested in maintaining their current level of operations than expanding (O'Farrell & Hitchens, 1988).

However, there are also rational arguments for growing the business. In terms of employee well-being, a larger organization may introduce new career opportunities for the employees. There are also important learning opportunities coming from working in a growing organization, which may help attract even more talent from the environment.

As the SME grows, it will be able to spread fixed costs over more units of output and have better opportunities to use the existing resources more efficiently. This cost advantage of size is called *Economies of Scale*⁵. Economies of scale are also related to the *managerial* resources of the SME. Increased size enables justification of specialized managers (i.e. sales-, financial-, and production managers), which in turn leads to each function being performed more efficiently than if all of them are performed by one or a few persons.

Albeit closely related to Economies of Scale, the *Experience Curve Effects* are also important to mention. Developed by Bruce D. Henderson and the Boston Consulting Group, this theory is applicable for the production of both services and goods to describe how the time used to

⁵ Software is a special example with extreme economies of scale: once software has been produced, there are virtually no further production costs – leading to marginal costs of zero. This is by itself a reason for scaling up a software business.

perform a task will be reduced the more times the task is performed. This will in turn lead to lower unit costs, as productivity will rise – giving a strategic advantage to those firms producing in large scale. This requires a standardization of processes and a specialization of resources that smaller firms are often unable to achieve.

Profitability is also seen as an important motivator for SME growth, but there are mixed evidence as to whether SMEs are able to convert growth into a more profitable business. The process of growing may lead to challenges when the growth is not aligned with the resources and competences of the firm. In particular, the managerial challenges that come with growth may reduce or reverse the profitability of the firm (Penrose, 1959). Studies have shown that firms starting from an above-average profitability *before* pursuing growth are more likely to achieve a sustained above-average performance (Steffens, Davidsson, & Fitzsimmons, 2009). Further, growth appears to play an important role on improving the *sustainability* of the firm (Orser, Hogarth-Scott, & Riding, 2000).

3.3 Theoretical perspectives on growth

The current body of research on SME growth is a large and fragmented field of theoretical perspectives, each capturing limited aspects of the phenomena. As mentioned previously, an obvious challenge is the inconsistencies in approaches to measuring growth. In addition, the focus of the studies vary from causal analysis to taxonomic classifications. McKelvie and Wiklund (2010) proposed that the lack of development in the field is due to the urge for addressing “how much” companies grow before adequately answering “how”.

This section describes some of the most prominent research streams related to SME growth, based on the classifications in the literature reviews of Dobbs and Hamilton (2007), O’Farrell and Hitchens (1988), and Davidsson et al. (2007). However, the approaches for studying SME growth are vast, and it is virtually impossible to classify all the literature in a meaningful way (McKelvie & Wiklund, 2010).

Even though the focus of this thesis is the process and effects of SME growth, the section includes additional research streams that are focused on the determinants (or *antecedents*) of growth. The reason for including these perspectives is to present a holistic overview of the research on SME growth, as well as to examine the relationship between such determinants and their effect on the growth *process*.

The following sections will present seven research streams, or *perspectives*, that relate to SME growth. Throughout the perspectives, **16 propositions** will be presented that summarize the most important findings for this thesis.

3.3.1 Stochastic models

One of the most posited hypotheses regarding firm growth is that it is a result of chance, irrespective of management and strategies (Robson & Bennet, 2000). This approach to firm growth started with Robert Gibrat's *Inégalités Économiques*, published in Paris in 1931 (Gibrat, 1931). His book is cited as the first formal model of the dynamics of firm size and industry structure (Sutton, 1997), and announced what is known as "The Law of Proportional Effect" or "Gibrat's Law".

The rationale for this view can be found when you inspect data on firm sizes and market concentration over time. As expected, you will likely find a size distribution with a few large firms and a long tail of small firms – a kind of skew distribution often approximated by a lognormal distribution. A key characteristic of such distributions is that they can be generated by a stochastic process where the variate (in this case the size of the firm) is subjected to cumulative random shocks over time (O'Farrell & Hitchens, 1988). The underlying reasoning is that (Robson & Bennet, 2000):

- i) There are many causes of size changes
- ii) None of these are believed to exert a major influence on size change, and
- iii) Their effects are independent of the size of firms.

According to "The Law of Proportional Effect", the growth rate of a business is independent of its current size. Put differently, "*the probability of a given proportionate change in size during a specific period is the same for all firms in a given industry – regardless of their size at the beginning of the period*" (Mansfield, 1962, p. 1030). Growth will depend on a range of forces or variables, some making for growth, others causing decline, but each variable will only account for a very small portion (Dobbs & Hamilton, 2007). Taken together, a firm's growth can be viewed as a random walk (Robson & Bennet, 2000), and since so many factors are affecting the growth there is no dominant theory (O'Farrell & Hitchens, 1988).

A number of studies have incorporated Gibrat's hypothesis, and Gibrat's Law has played a prominent role in economic models designed to explain the size distribution of firms

(Mansfield, 1962). However, as pointed out by Mansfield (1962), “*Although Gibrat’s law is very convenient from an analytical point of view, it does not seem to hold up very well empirically*” (p. 1035).

This thesis will not be based on the hypotheses coming from the stochastic models research stream. Even though these models are still used for modeling firm size distributions, the focus of the thesis is the internal process of growth. However, any model trying to portray SME growth should acknowledge that a range of factors exist that may affect the growth of the firm, and including all such factors would make the model impractical.

For a comprehensive summary of theoretical development of stochastic models based on Gibrat’s Law, see Sutton (1997).

3.3.2 Stage models

The line of theory referred to as “stage models” is a collective term for the large number of “stages of development” models that first appeared in the literature between 1969 and 1972. Stage models are used both metaphorically (to package concepts), descriptively (to represent clusters of correlated characteristics), and causally/normatively (as latent mechanisms governing growth) (Stubbart & Smalley, 1999).

Rather than explaining the *causes* of growth, these models are mainly concerned with the *process* of growth – and how SMEs can adapt to this growth internally. This perspective is thus highly related to the focus of this thesis. The models further assume that all companies go through a sequence of similar phases, or stages of development, where each stage ends in a crisis that needs to be resolved for the company to continue growing. The number of stages in the different models vary from three to as many as ten (O’Farrell & Hitchens, 1988).

An extensive amount of literature exist that contains explanations of SME growth based on stages. McMahon (1998) gives a summary of the published reviews of this literature. As evidenced by these reviews, “*the growth and life-cycle stages framework has a substantial history in the literature of economics and business generally, and in the literature focused specifically on SME development*” (McMahon, 1998, p. 24).

The utility of these models has been in their ability to predict the challenges of growing firms (Phelps, Adams, & Bessant, 2007). Consequently, stage models are often used normatively, as a source of advice to managers on how to plan for future growth. The popularity of these

models, as well as the similarity to the problem statement of this thesis, makes them highly relevant. The following sections will describe three of the more renowned stage models developed by Greiner (1972), Scott and Bruce (1987), and Hanks et al. (1993), before giving a general summary of key findings and a special critique of the research stream.

Greiner: Evolution and Revolution as Organizations Grow

One of the first, and most known, of the stage models is that of Greiner (1972). In this theory, companies pass through a series of developmental stages as they grow. Each phase begins with a period of evolution, where the company experience steady growth and stability. As the company continues to grow, it will eventually face a revolutionary period of “substantial organizational turmoil and change”

(Greiner, 1972). The dimensions affecting growth are: the company size (number of employees and sales volume), the age of the organization, its stage of evolution and revolution, and the growth rate of the industry. Greiner further defines the five phases of “evolution and revolution”: Creativity, Direction, Delegation, Coordination, and Collaboration – as shown in Figure 3.1. The growth rate of the industry will affect the length of the phases.

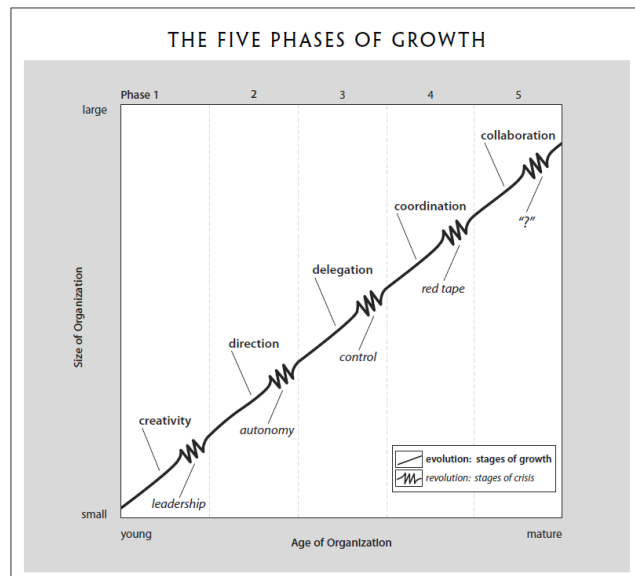


Figure 3.1: The Five Phases of Growth
Source: (Greiner, 1972)

Each evolutionary period is characterized by a dominant management style and organizational configuration adopted to achieve growth. At the end of an evolutionary period, this same management style becomes a problem that must be solved through a “revolution” before growth can continue. This makes each phase both a result of the previous phase and a cause for the next phase. The key differences in organizational and managerial practices between the phases are summarized in Table 3.1.

Table 3.1: *Organizational Practices in the Five Phases of Growth (Greiner, 1972)*

Category	Phase 1	Phase 2	Phase 3	Phase 4	Phase 5
Management Focus	Make and sell	Efficiency of operations	Expansion of market	Consolidation of organization	Problem solving and innovation
Organizational Structure	Informal	Centralized and functional	Decentralized and geographical	Line staff and product groups	Matrix of teams
Top-Management Style	Individualistic and entrepreneurial	Directive	Delegative	Watchdog	Participative
Control System	Market results	Standards and cost centers	Reports and profit centers	Plans and investment centers	Mutual goal setting
Management Reward Emphasis	Ownership	Salary and merit increases	Individual bonus	Profit sharing and stock options	Team bonus

Greiner later added a sixth phase, where further growth “*depends on the design of extra-organizational solutions, such as creating a holding company or a network organization composed of alliances and cross-ownership*” (Greiner, 1998, p. 9).

Scott and Bruce: Five Stages of Growth in Small Business

Building on Greiner (1972), Mel Scott and Richard Bruce introduced a model of “Five Stages of Growth in Small Business” (Scott & Bruce, 1987). Similar to Greiner, the authors propose that a business follows certain stages of development, each preceded by a crisis. However, unlike Greiner (1972), this model deals exclusively with small businesses – making the crises somewhat different.

The crises described in this model may be either internal or external to the firm, and each crisis is resolved through a relatively major change in the company. The model was developed to help managers of small businesses to plan for future growth by using the model as a diagnostic tool to analyze the present situation.

Where Greiner (1972) used the number of employees and sales volume as an indicator of size and growth, Scott and Bruce (1987) accepts that no single measure can precipitate change: size may be measured by e.g. sales, total assets, or number of employees. Size is therefore dealt with as something unique to each business.

The model consists of five stages, as depicted in Figure 3.2. The model incorporates possible failure at each of the crisis points, and as the authors explain: “*although the business may fail at any time it is most likely to happen at one of the crisis points*” (Scott & Bruce, 1987, p. 47).

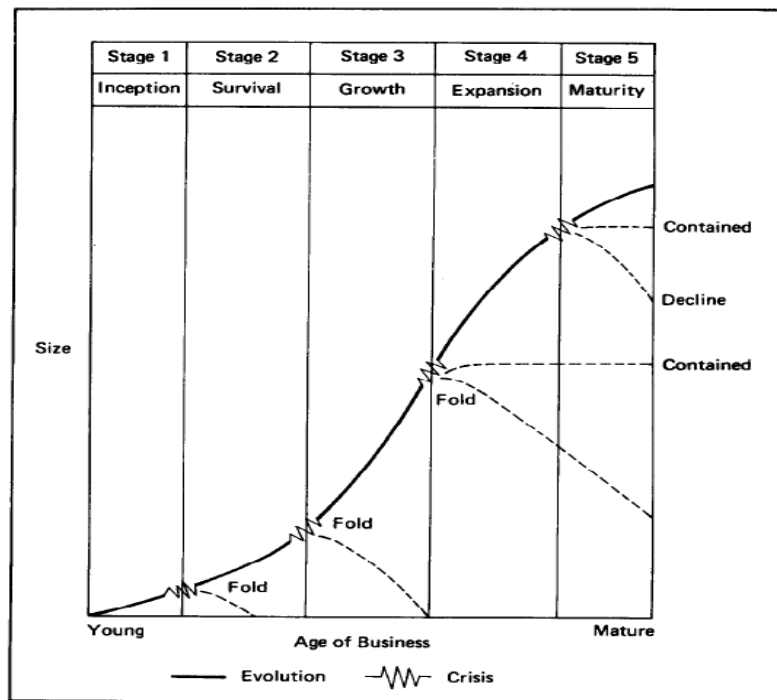


Figure 3.2: Five Stages of Growth in Small Business
Source: (Scott & Bruce, 1987)

Similar to Greiner, the figure is accompanied by a table describing the details of each phase – reproduced in Table 3.2. As seen, there are several similarities in the dimensions of the business that change during the transitions (i.e. management role- and style, organization structure, and focus). However, Scott and Bruce also connected the stages to the industry life cycle (“Stage of industry”).

Table 3.2: A model for small business growth (Scott & Bruce, 1987)

	Stage 1. Inception	Stage 2. Survival	Stage 3. Growth	Stage 4. Expansion	Stage 5. Maturity
Stage of industry	Emerging, fragmented	Emerging, fragmented	Growth, some larger competitors, new entries	Growth, shakeout	Growth/shakeout or mature/declining
Key issues	Obtaining customers, economic production	Revenues and expenses	Managed growth, ensuring resources	Financing growth, maintaining control	Expense control, productivity, niche marketing if industry declining
Top management role	Direct supervision	Supervised supervision	Delegation, co-ordination	Decentralization	Decentralization
Management style	Entrepreneurial, individualistic	Entrepreneurial, administrative	Entrepreneurial, co-ordinate	Professional, administrative	Watchdog
Organization structure	Unstructured	Simple	Functional, centralized	Functional, decentralized	Decentralized functional / product
Product and market research	None	Little	Some new product development	New product innovation, market research	Production innovation
Systems and control	Simple bookkeeping, eyeball control	Simple bookkeeping, personal control	Accounting systems, simple control reports	Budgeting systems, monthly sales and production reports, delegated control	Formal control systems, management by objectives
Major source of finance	Owners, friends and relatives, suppliers leasing	Owners, suppliers, banks	Banks, new partners, retained earnings	Retained earnings, new partners, secured long-term debt	Retained earnings, long-term debt
Cash generation	Negative	Negative/breakeven	Positive but reinvested	Positive with small dividend	Cash generator, higher dividend
Major investments	Plant and equipment	Working capital	Working capital, extended plant	New operating units	Maintenance of plant and market position
Product-market	Single line and limited channels and market	Single line and market but increasing scale and channels	Broadened but limited line, single market, multiple channels	Extended range, increased markets and channels	Contained lines, multiple markets and channels

Hanks et al.: A Taxonomic Study of Growth Stage Configurations

Of the more recent theory, the works of Steven H. Hanks and his co-authors (Hanks, 1990a; Hanks, 1990b; Hanks, Watson, Jansen, & Chandler, 1993; Hanks & Chandler, 1994) represent an advancement of knowledge in the area of stage models (McMahon, 1998).

Before describing their taxonomic study of growth stage configurations, Hanks et al. (1993) compare and contrast 10 previous models from the literature, among these Greiner (1972) and Scott and Bruce (1987). They find that although there are many commonalities, there are wide differences in the specifics. Instead of defining growth stages a priori as in previous research,

leading to a typological approach, they used a multivariate analysis of empirical data from 126 high-tech organizations in Utah to reveal common patterns and relationships (a taxonomic approach). The result of this analysis is a life-cycle model with four development stages and two disengagement stages as presented in Figure 3.3.

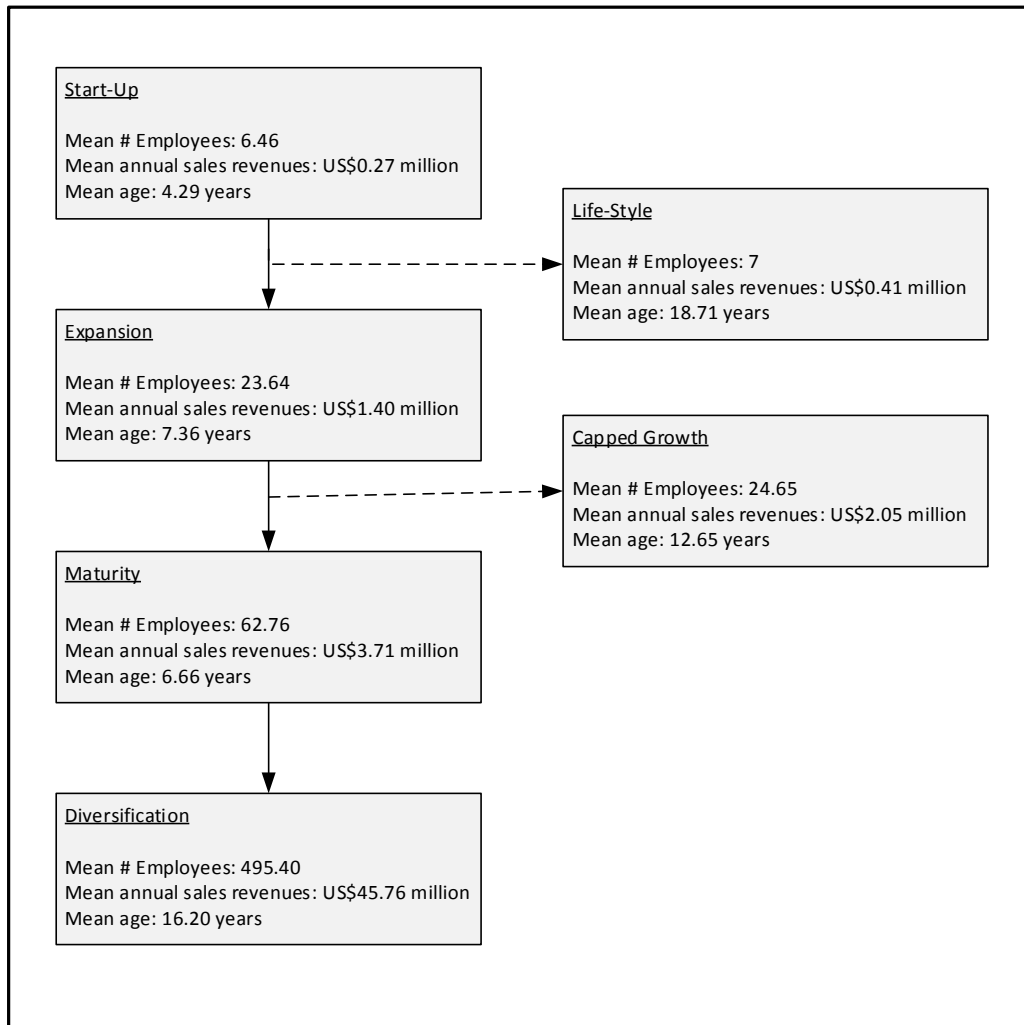


Figure 3.3: Hanks et al. (1993) Enterprise Life-Cycle Model
 Source: (McMahon, 1998)

The stages in the model, defined as “a unique configuration of variables related to organization context or structure” (Hanks, Watson, Jansen, & Chandler, 1993, p. 7), have the following characteristics regarding organizational configuration:

Start-Up: Simple structures, highly centralized organization, informal, little functional specialization, primary focus and priority is product development.

Expansion: More complex structures, very centralized organization, more formal than start-up, functional specialization is adopted, primary focus and priority is product commercialization.

Maturity: More complex structures, declining centralization, increasing formalization.

Diversification: Tendency towards divisionalized structures, low centralization, high formality.

In addition to the “natural” sequential progression through these stages as they evolve, some firms may disengage from the model.

Some companies become “Life-Style” companies, where the owner decides that there is too big a trade-off between his or her quality of life and further growth. With the lack of motivation for further growth, and a viable business at a relatively small size, the entrepreneur decides to disengage from the growth process and consciously choose to keep the firm small.

Other companies disengage from the growth process at a later stage and are slightly larger than the “Life-Style” companies are. These companies have expanded to a modest size with a viable scale of operation, and the owner-manager has made a choice to stop growing. This disengagement is termed “Capped Growth” or “Arrested Development”.

Criticism of stage models

The types of models described here have received much criticism, mainly because they portray growth as a sequence of stages or crises without offering any supporting evidence (Dobbs & Hamilton, 2007; Davidsson, Achtenhagen, & Naldi, 2007; Gibb & Davies, 1990). They further assume that a company must pass through all the stages sequentially or fail in the attempt, although empirical evidence does not justify such an assumption (O'Farrell & Hitchens, 1988). The model by Hanks et al. (1993) fares better in both regards, but is criticized for its limitations from being based on one particular industry (Davidsson, Achtenhagen, & Naldi, 2007).

Further, the models may be seen as *“little more than heuristic classification schemes rather than a conceptualization of the processes underlying growth”* (O'Farrell & Hitchens, 1988, p. 1371). The body of literature is also *“primarily discursive and wisdom based”* (O'Farrell & Hitchens, 1988, p. 1372).

The models also assume that there will be an optimal organizational configuration for each phase or stage. This does not account for new organizing principles that young ventures might experience with (Davidsson, Achtenhagen, & Naldi, 2007). Further, the models focus mainly

on the formal structures, while informal structures and processes may be of great importance (Davidsson, Achtenhagen, & Naldi, 2007).

Finally, the models tend to focus on the internal dynamics of growing concerns, paying insufficient attention to external factors in the social, economic, and business environment (O'Farrell & Hitchens, 1988).

Although these models are highly criticized, Davidsson et al. (2007) present a somewhat more positive view by claiming that “*research-based knowledge on growth processes and transitions would have high practical relevance alongside research findings on growth facilitators and obstacles*” (p. 381). They continue by stating that further research in this genre could present better alternatives to the “*universally applicable snake oil cures that one finds in the nonresearch-based management literature*”.

Key Findings from Stage Models

As stated previously, there are several other “stages-of-growth” models than the three described here. Other well-known theoretical models include those developed by Adizes (1979) and Churchill and Lewis (1983). Although there are differences in the number of stages and the specifics of the models, they all describe the phenomena of growing as a sequence of phases ending with challenges that need to be solved through changes in the organizational design and managerial practices.

The main theme in the models are thus the challenges faced by the management or the owner-manager of the firms. The popularity of such models may come from the familiarity of such challenges to business managers, when the models are used as a diagnostic tool – as suggested by Scott and Bruce (1987).

Based on these findings from the stage-models literature, I provide the following proposition:

Proposition 1: As the SME grows, the complexity of the company increases, forcing the company and the founder(s) to adapt through managerial practices and organizational design.

Another important finding is the choice not to grow, as described in Hanks et al. (1993) in his “Life-Style” and “Capped Growth” stages. This important phenomenon is also the main theme

of Davidsson (1989), where he found that fear of reduced employee well-being and loss of supervisory control were important growth deterrents. This brings the following proposition:

Proposition 2: The founders' and managers' perceptions of the advantages and disadvantages of growth will influence the growth of the SME.

3.3.3 Evolutionary models

Evolutionary models address the *idiosyncratic* nature of firm growth, where “*the growth of a firm over a period of time is contingent on the interaction of a number of internal and external forces*” (Dobbs & Hamilton, 2007, p. 298). These models propose a dynamic view rooted on learning, uncertainty, and path-dependency, creating *variations* in the population. They also incorporate a selection process that eliminates certain types of variation, while preserving others. Units of selection (variations) may be found in for example technologies, organizational policies, behavioral patterns, and cultural traits (Dosi & Nelson, 1994).

Aldrich (1999) describes evolution as the result of four generic processes: variation, selection, retention and diffusion, and the struggle over scarce resources.

Variation

Variations are firm-specific configurations of routines, competencies, or organizational forms. Such variations are sometimes a result of an intentional attempt to generate alternatives and seek solutions to problems. Other times variations are unintentional, or *blind*, resulting from luck, accidents or other events independent of environmental or selection pressures.

Variations are subject to a selection process, where those most suitable given the selection criteria are rewarded. However, it is the consequences of the variations, and not the intentions from those generating them, that form the basis of selection.

An important part of variation is the actors' capability of experimentation and discovery (Dosi & Nelson, 1994; Aldrich H. E., 1999). Company policies may encourage or discourage innovation - leading to organizational heterogeneity rather than differentiation.

Selection

A range of forces will determine which variations are more helpful than others in acquiring resources and legitimacy. Such forces are e.g. market forces, competitive pressures, the logic

of internal organizational structuring, and conformity to institutionalized norms (Aldrich H. E., 1999). A company's "fitness" to the environment is likely to be judged on different and possibly conflicting criteria (Dosi & Nelson, 1994). Variations at the organizational level that differ from the industry norm in, for instance, managerial capabilities or normative orders, are likely to have a negative impact on the firm's ability to draw resources from the environment (Aldrich H. E., 1999).

Further, selection processes also exist *within* organizations. These processes preserve organizational diversity, leading to a risk of decay if these selection processes show a suboptimal fit with the environment. Three important internal selectors are (Aldrich H. E., 1999):

- 1) Pressures toward internal stability and homogeneity
- 2) Internal persistence of past external criteria that are no longer relevant
- 3) The willingness of founders and managers to accept a low performance threshold

Retention and diffusion

Retention is the process that preserves, duplicates, or otherwise reproduces selected variations (Aldrich H. E., 1999). In a stable environment, this is the key to continuity. Organizations use routines, structures and procedures to preserve existing organizational forms as long as they fit the selection criteria (Aldrich H. E., 1999).

Retention and diffusion is also found at the population-level. Examples are technological and managerial competences that are used by all organizations collectively (Aldrich H. E., 1999). Retained variations, preserved as "best practices", culture, and values, are diffused through observation, education, training, and the movement of people between organizations. However, diffusion may be affected by hostility, mistakes, incompetence, and unwillingness to learn (Aldrich H. E., 1999).

The struggle over scarce resources

The fourth process involves the scarcity of resources within organizations, between organizations, and between populations (Aldrich H. E., 1999). In their search for effective variations, organizations must deal with members pursuing individual incentives, and other organizations or populations pursuing the same resources.

As can be seen, evolutionary models do not conform to stages or phases of growth. Rather, an individual organization's growth is conceptualized as an evolutionary struggle to find the

internal variations best fit with the environment. The unique circumstances of each firm will thus determine the nature and timing of a firm's growth (Dobbs & Hamilton, 2007).

The evolutionary perspective brings important insight on the importance of organizational fit to the environment. This is the basis of the next proposition:

Proposition 3: Evolutionary mechanisms of internal and external selection make certain organizational configurations (or variations) more or less suitable for survival and growth.

3.3.4 Resource based view of SME growth

The resource-based view of the firm states that the competitive advantage of a firm lies primarily in heterogeneous firm-specific resources and capabilities. This line of theory stems from the work of Penrose (1959), and as she states in her book: "*There is a good reason to believe that the amount of resources administered by a firm has in itself a significant influence on the opportunities for expansion open to the firm*" (p. 217).

The body of research was named by Birger Wernerfelt (Wernerfelt, 1984), who claimed that the idea of looking at firms as a set of resources had received little attention since Penrose (1959). Wernerfelt defined resources as "*those (tangible or intangible) assets which are tied semipermanently to the firm*" (Wernerfelt, 1984, p. 172).

Resources may be categorized into three broad groups: Physical capital resources (e.g. technology, equipment, and location), Human capital resources (e.g. training, relationships and insights of managers and workers), and Organizational capital resources (e.g. formal reporting structures, coordinating systems, and planning) (Barney, 1991).

The combination and deployment of a firm's resources allows it to achieve a competitive advantage (Conner, 1991). Further, following Barney (1991), to form the basis of a *sustained competitive advantage*, the resources must be (1) valuable, (2) rare, (3) imperfectly imitable, and (4) imperfectly substitutable. Such resources are usually intangible and built on the knowledge stocks of the firm (Teece, Pisano, & Shuen, 1997).

An important extension of the resource-based view is the dynamic capabilities of the firm. 'Dynamic' refers to the capacity to renew competences to achieve congruence with a changing

business environment, and ‘capabilities’ emphasize the role of strategic management in “*appropriately adapting, integrating, and reconfiguring internal and external organizational skills, resources and functional competences to match the requirements of a changing environment*” (Teece, Pisano, & Shuen, 1997, p. 515).

The normative implication is that a firm’s strategy should be based upon resource capabilities and a dynamic ‘fit’ with environmental opportunities (Mahoney, 1995). This will enable the firms to generate ‘rents’, defined as return in excess of a resource owner’s alternative use cost. As it is the firm’s managers that recombine the firm’s resources, the *resource of management* becomes a catalyst for the resource based theory (Mahoney, 1995). The role of management has been emphasized in several books and studies of small firm growth (Penrose, 1959; Castanias & Helfat, 1991; Castanias & Helfat, 2001; Mahoney, 1995).

In addition to the managerial resources, three other groups of resources are represented in a number of studies of growth: human resources, financial resources, and network resources. Although managerial resources are a part of the human resource base of the company, this thesis makes a distinction between the managerial/administrative resources and the *productive* resources at the disposal of the company (defined here as human resources). This distinction is in line with both Mintzberg and Penrose (Mintzberg, 1980; Penrose, 1959), and allows a discussion of productive resources and their effects on growth separately from the managerial resources.

Managerial Resources and small firm growth

Managers of a firm play a central role in making the strategic choices of a firm, including choosing the firm’s path and direction, choosing the markets to participate in, and choosing how to make best use of the other resources available to the firm.

Managerial capabilities, defined as the skills and abilities of managers, are therefore a key element in the analysis of the growth process of SMEs. Managers acquire such skills through prior experience, education and other sources of knowledge. However, most researchers use managerial work experience as the main empirical indicator of managerial human capital, and assume that effective management involves learning-by-doing and requires practice (Castanias & Helfat, 2001).

One of the classic researchers pinpointing the importance of managerial resources and capabilities in firm growth was Edith T. Penrose with her book “The Theory of the Growth of the Firm” (Penrose, 1959). According to this theory, firm growth is limited by the *ability* of the manager or managerial team to coordinate resources. Further, limited *availability* of managerial resources with *tacit* knowledge of the firm limits the rate at which a firm can pursue new growth opportunities, as these managers must maintain the current operations at the same time.

Management is responsible for the administrative structure of the firm, general policies, and decision-making where no others have the authority to act. Further, the managerial team is responsible for coordinating the resources and converting their services into rent-generating capabilities. Through the management team, processes and routines are established and readjusted to make the firm’s resources unique and valuable over time (Penrose, 1959).

Another related model describing the importance of managerial resources is “The managerial rents model” (Castanias & Helfat, 2001; Castanias & Helfat, 1991). This theory states that the skills of top management combined with other firm assets and capabilities have the potential to generate rents through strategic and operational decisions. The assumption is that higher managerial skills lead to better strategic actions producing better outcomes for the firm.

Managerial resources may also be seen a source of *sustained* competitive advantage. The argument is that (Castanias & Helfat, 1991; Castanias & Helfat, 2001; Mahoney, 1995):

- 1) Relevant managerial resources are potentially *valuable* to firms by exploiting opportunities and/or neutralizing threats in a firm’s environment.
- 2) A managerial resource is *scarce* if a manager possesses higher quality skill relative to her competitors. It is also rare in terms of firm-specific knowledge of the individual manager as well as in the managerial team.
- 3) Managerial skills are largely tacit and involve learning by doing. Hence they are *difficult to replicate or imitate*, especially for firm-specific knowledge.
- 4) A managerial resource by itself may be substituted, but may be *harder to substitute* as a part of a managerial team with its internal dynamics, and within a firm in a particular circumstance.

A firm’s growth is limited by the size and experience of the managerial group (Penrose, 1959). Professional management experience shapes the knowledge, confidence, and imagination of managers (Penrose, 1959). Castanias and Helfat (1991) made a distinction between generic (or

general), industry-specific, and firm-specific skills of managers that are shaped through experience. When managers move between firms, the generic skills are transferred, the firm-specific skills are lost, and the transferability of industry-specific skills depend on the industry of the new firm. Kor (2003) proposed that “... *firm-specific, shared team-specific, and industry-specific experiences of managers have independent and additive effects on the collective competence of the top management team.*” (p. 708)

Hence, building and adding managerial capabilities is essential for the growth of the firm. Both firm-specific and industry-specific experiences take time to develop, and this may be a significant factor determining the rate at which a firm can seize new opportunities for growth (Kor, 2003; Penrose, 1959). The training and integration of new managers into the workforce will occupy time and attention from the existing managerial resources, reducing the managerial services available for expansion (Mahoney, 1995). A sustainable growth path thus involves balancing the *exploitation* of existing managerial resources and *development* of new ones (Penrose, 1959; Mahoney, 1995). This constraint on growth based on managerial resources is called the “Penrose Effect” (Slater, 1980).

Proposition 4: SME growth is limited by the size and experience of the managerial group. Sustainable growth involves a balance between exploiting the existing managerial resources, and developing and training new ones.

Even though managers have the potential to generate rents, this potential is not exploited if the managerial effort or motivation is lacking or misdirected (Castanias & Helfat, 1991; Barringer & Jones, 2004). Managerial resources do not generate rents unless the organization directs their efforts through the right incentives. Further, as the company and management team grows, founders and managers may differ in their goals, priorities and level of engagement, leading to a divergence between their strategic choices (Kor, 2003). This implies the necessity of aligning the interests of managers, founders and shareholders to achieve growth. In addition to direct financial incentives, many non-financial incentives (e.g. educational reimbursement and employee recognition awards) have been found to indirectly contribute to growth ambitions of a firm (Barringer & Jones, 2004).

Proposition 5: The interests of managers, founders and shareholders must be aligned in order for managerial resources to contribute to growth.

The shared experiences of managers working as a team enable them to make decisions more efficiently and implement changes more successfully, and thus sets the rate of entrepreneurial growth under conditions of environmental uncertainty (Kor, 2003; Penrose, 1959). It is also suggested that founders' participation in the management team add value to the competence of the team in generating entrepreneurial growth, as founders have experiential knowledge of matching the firm's capabilities with new opportunities (Kor, 2003).

Proposition 6: Founder participation in the management team has a positive effect on firm growth.

Human Resources

As mentioned earlier, managerial resources are part of the human resource base of the firm – but the distinction between managerial/administrative resources (management) and productive/operational resources (employees) is justified by the body of literature found on each aspect separately. Human resources, or employees, are critical resources to achieve and maintain a sustainable growth (Dobbs & Hamilton, 2007). As a firm grows and the need for employees increases, it becomes increasingly difficult to find the right talent, place them in the right positions, and provide adequate supervision (Barringer & Jones, 2004). Especially in markets with a high employment rate, limited access to the right talent may be an obstacle for further growth.

Even though they are not “owned” by the firm, employees can be treated as more or less fixed or durable (Penrose, 1959). To represent a competitive advantage, the firm's resources must be unique and difficult to imitate (Barney, 1991). This means that firms will need to develop human resources with *specific* knowledge, and the behavior of these resources will need to be aligned with organizational goals through the right people management practices (Wright, Dunford, & Snell, 2001). Prior research has shown that human resource management practices have a major impact on both turnover, productivity and financial performance (Huselid, 1995).

While most research on Human Resource practices has been focused on larger firms, recent studies have turned to the relationship between such practices and small firm growth (Rauch, Frese, & Utsch, 2005). Special focus has been on the practices of talent acquisition, training and development, socialization, and the alignment of individual and organizational goals.

It has been shown that high standards during recruitment and selection of employees have an impact on sustainable growth (Barringer & Jones, 2004; Huselid, 1995). Developing organizational capabilities of recruiting is therefore an important part of the SME growth process.

Internal training and development of employees is also important, as the small firm is not likely to find *specific* and *unique* skills in the open labor market (Rauch, Frese, & Utsch, 2005). Such capabilities also help in aligning the employees' behavior and attitudes with the organizational goals. Further, the training and development of employees facilitate the socialization process in addition to developing the possible services the resources can provide (Barringer & Jones, 2004).

Through socialization, employees become familiar with the culture of the organization, and establish trusting relationships with their colleagues (Barringer & Jones, 2004). Thus, incorporating a capability of socializing new employees is important to the growing firm.

Proposition 7: The SMEs capabilities of recruiting, training and socializing new employees will affect its ability to grow.

To exploit the skills of the employees, it also becomes necessary to provide the right motivation and align the behavior with organizational goals (Wright, Dunford, & Snell, 2001). As the firm grows and adds employees, the new-hires do not necessarily have the same ownership incentives as the original founders and early employees, resulting in a propensity to avoid duties and responsibilities – also referred to as “moral hazard” (Barringer & Jones, 2004). Financial incentives, such as profit sharing and stock options, are shown to align the interests of employees and the firm (Barringer & Jones, 2004). Decision making involvement and empowering of employees is also related to commitment and achievement of business outcomes (Huselid, 1995; Rauch, Frese, & Utsch, 2005).

Finally, it is shown that verbal and written communication of the firm's vision, as well as the attributes and content (e.g. growth ambition) of the vision, affect venture growth in entrepreneurial firms (Baum, Locke, & Kirkpatrick, 1998).

Proposition 8: Growth of the SME may introduce “moral hazard”. The growing organization should incorporate mechanisms to align employee behavior with organizational goals.

Financial Resources

Financial resources are the primary resource base for growth (Brush, Ceru, & Blackburn, 2009), as they enable firms to *implement* and *execute* their growth strategies (Gilbert, McDougall, & Audretsch, 2006). Financial capital is also the most *general* type of resources, as it can be easily converted into other types of resources (Wiklund, Patzelt, & Shepherd, 2009). However, due to lack of financial resources, small companies may suffer from an “exploitation ability” disadvantage (Steffens, Davidsson, & Fitzsimmons, 2009).

A fundamental decision for business owners is whether or not to accept *external* equity finance to fund further growth when available (Dobbs & Hamilton, 2007). Higher availability of external finance has been shown to lead to faster growth of small and medium sized firms (Becchetti & Giovanni, 2002; Beck & Demirguc-Kunt, 2006; Gilbert, McDougall, & Audretsch, 2006). However, many small firms decide to bootstrap their operations, either due to lack of access to external sources of finance, or a desire to retain control of the business (Dobbs & Hamilton, 2007; Ebben & Johnson, 2006). Owner-managers tend to prefer bootstrapping to debt, and debt to external equity finance (Steffens, Davidsson, & Fitzsimmons, 2009).

Research suggests that for most small firms, growth is constrained by the availability of *internally* generated finance (Carpenter & Petersen, 2002). Formal sources of *external* finance are often less accessible to these firms (Beck & Demirguc-Kunt, 2006), and are more costly than internal sources of financing (Ebben & Johnson, 2006; Carpenter & Petersen, 2002). Due to fixed transaction costs and information asymmetries, small firms will face higher relative transaction costs and higher risk premiums than larger firms would when raising external financing (Beck & Demirguc-Kunt, 2006). This increases the necessity for the SME to have an already profitable operation in order to grow.

Whether being financed through external investors, bank financing, bootstrapping, or other means, firms need access to financial resources in order to grow.

Proposition 9: The availability of internal or external financing affects the SMEs ability to grow.

Network Resources

There is a strong consensus that access to outsider competencies, or network resources, is beneficial for the growth of the firm (Gilbert, McDougall, & Audretsch, 2006). Such resources can be divided into inter-organizational, intra-organizational, and inter-personal networks (Wiklund, Patzelt, & Shepherd, 2009).

Inter-organizational networks are the strategic alliances the firm has with other organizations, such as universities, other small firms, or larger organizations (Wiklund, Patzelt, & Shepherd, 2009). Such alliances can provide access to a broader base of resources, managerial talent, and intellectual capital (Dobbs & Hamilton, 2007), and rapid growing SMEs are shown to have a higher degree of participation in such networks (Barringer & Jones, 2004). Management of the network resources depends on the development of three meta-capabilities in the SME (Lechner & Dowling, 2003):

- *Relational capability*: the ability to select the right partners, and to establish and maintain relationships with other firms
- *Combinative capability*: the ability to combine outside and in-house elements
- *Absorptive capacity*: the capacity to absorb external knowledge

Stuart (2000) also argues that alliances can be used to exchange *signals* that convey social status and recognition. For a small firm, an alliance can build public confidence in the value of the products or services it provides, facilitating further efforts to attract customers and other partners. Even though most partnerships fail to achieve the intended goals, the mere survival of a due diligence of a prominent strategic partner may lead to an upgrade of the SME's reputation (Stuart, 2000).

Proposition 10: The SME's existing strategic alliances, as well as the ability to establish and manage such alliances, affect the ability to grow.

Intra-organizational networks are the relationships that a small business owner has to the management team (Wiklund, Patzelt, & Shepherd, 2009). As mentioned earlier, Kor (2003) found that founder's participation in the management team contribute to the competence of the team. Further, good relationships between the owner and the management team lowers the level of destructive conflicts and politics (Wiklund, Patzelt, & Shepherd, 2009).

Finally, the **interpersonal networks** are the social connections available to the firm, initially through the founder(s) (Wiklund, Patzelt, & Shepherd, 2009). These personal networks are shown to have an effect on the growth of the firm (Ostgaard, 1996). Especially in the early years of the firm, the network size that the entrepreneur brings into the company strongly influences growth (Lechner & Dowling, 2003).

Proposition 11: *The social network of the founder(s) influences SME growth, however this influence is strongest in the early years of operation.*

3.3.5 Learning perspective of SME growth

Following the categorization by Dobbs and Hamilton (2007), the learning perspective is treated separately from the evolutionary and resource-based approaches even though they have strong linkages. According to this perspective, evolution of the business comes from the resource of knowledge in the decision makers, and this resource is built through learning (Dobbs & Hamilton, 2007). As stated by De Geus (1988): “*The ability to learn faster than your competitors may be the only sustainable competitive advantage*” (p. 71).

Penrose (1959) highlighted the need for managerial and entrepreneurial resources, as well as the time and effort it takes to develop new such resources. These resources are essential to explore and exploit available opportunities (Penrose, 1959), as well as to *resolve the crises* that arise as the company grows (Macpherson, 2005).

The basic assumption is that as companies grow, a series of concurrent crises or “business problems” arise that each require a solution (Deakins & Freel, 1998). These crises require idiosyncratic solutions, and the resolution depends on the organizations existing experience, the managers’ perception of the crises, and access to relevant knowledge (Macpherson, 2005).

The response to the crisis is the *application* of knowledge, resulting in new organizational structures and systems to adapt to the situation (Macpherson, 2005). When historical experiences fail to provide solutions to the problems, *learning* becomes the essential process through which new knowledge is acquired. Beach (as cited in (Gibb A. A., 1997, p. 15)) defines learning as “*the human process by which skills, knowledge, habit and attitudes are acquired and altered in such a way that behavior is modified*”.

Through the process of learning, the company acquires knowledge that may be held and maintained as individual cognition or codified in organizational systems through patterns of activity (Macpherson & Holt, 2007) or ‘routines’ (Deakins & Freel, 1998). Learning is also cumulative and self-reinforcing, as it is easier to build knowledge on existing expertise (Deakins & Freel, 1998; Cohen & Levinthal, 1990). Such accumulation of knowledge is seen as an important part of organizational growth, as it may provide solutions to future crises or problems (Macpherson, 2005).

In addition to the internal knowledge of the firm, knowledge can also be assimilated from the environment. For instance, the interaction with other participants of the business relationship network (e.g. customers, suppliers, partners, associations) may be an important source for knowledge (Gibb A. A., 1997; Deakins & Freel, 1998).

A normative conceptualization of the learning abilities of firms can be found in their “absorptive capacity”, defined as the “*ability of a firm to recognize the value of new, external information, assimilate it, and apply it to commercial ends*” (Cohen & Levinthal, 1990, p. 128). While the concept was originally developed in the context of innovation and R&D, it is equally useful for understanding the learning process related to SME growth (Bessant, Phelps, & Adams, 2005). Liao et al. (2003) found that the absorptive capacity of growth-oriented SMEs was positively related to organizational responsiveness, thus making them more adaptive to environmental changes and better able to exploit opportunities.

Proposition 12: The absorptive capacity of the SME is positively related to sustainable growth through increased adaptability to the environment and the ability to exploit opportunities.

To be able to assimilate and use new knowledge (learning), the organization needs prior related knowledge. The total absorptive capacity of the organization will also depend on the absorptive capacities of its individual members, making knowledge *diversity* and investment in training important (Cohen & Levinthal, 1990). However, the absorptive capacity of the company as a whole also depends on its ability to *exploit* the cumulated knowledge, making knowledge *sharing* an important part of the concept (Cohen & Levinthal, 1990). Further, the ability to look outside the organization for knowledge, as well as inside, is important to prevent the “not invented here” syndrome (Cohen & Levinthal, 1990). The construct of absorptive capacity has since its introduction been elaborated in a range of studies, covering several areas in addition

to innovation and R&D. A review of other extensions of absorptive capacity in the context of firm growth is presented in Bessant et al. (2005).

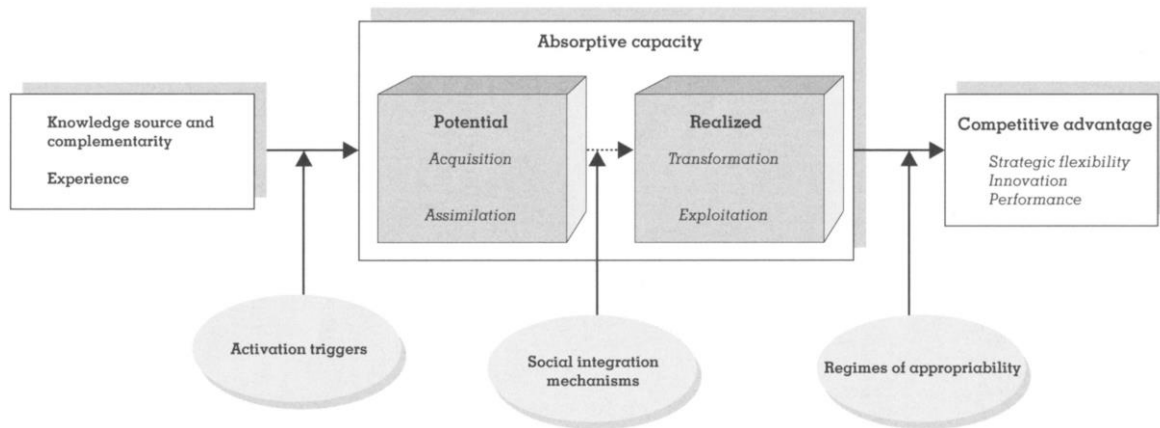


Figure 3.4: A Model of Absorptive Capacity

Source: (Zahra & George, 2002)

Zahra and George (2002, p. 186) redefined absorptive capacity as “a set of organizational routines and processes by which firms acquire, assimilate, transform, and exploit knowledge to produce a dynamic organizational capability”. Further, they made the distinction between potential and realized absorptive capacity; the *potential* is the capability to value and acquire external knowledge, and the *realized* is the ability to transform and exploit this knowledge in the organizations context. A model of this process is presented in Figure 3.4.

Until recently, most researchers have used R&D proxies to measure absorptive capacity, through outputs (e.g. patents) and inputs (e.g. investments) (Flatten, Engelen, Zahra, & Brettel, 2011). Recently, Flatten et al. (2011) developed and validated a multidimensional measure of absorptive capacity (termed “ACAP”) based on the work by Zahra and George (2002). The study consisted of an extensive literature survey, a series of pre-tests, and two large studies of German companies. The final “ACAP scale” used a seven-Point Likert-type response scale and consisted of 14 items: 3 related to knowledge acquisition, 4 related to knowledge assimilation, 4 related to knowledge transformation, and 3 related to knowledge exploitation. The included questions are shown in Figure 3.5.

Final ACAP scale	
<i>Acquisition</i>	
Please specify to what extent your company uses external resources to obtain information (e.g., personal networks, consultants, seminars, internet, database, professional journals, academic publications, market research, regulations, and laws concerning environment/technique/health/security):	
Acquire 4	The search for relevant information concerning our industry is every-day business in our company.
Acquire 5	Our management motivates the employees to use information sources within our industry.
Acquire 7	Our management expects that the employees deal with information beyond our industry.
<i>Assimilation</i>	
Please rate to what extent the following statements fit the communication structure in your company:	
Assimilate 1	In our company ideas and concepts are communicated cross-departmental.
Assimilate 2	Our management emphasizes cross-departmental support to solve problems.
Assimilate 4	In our company there is a quick information flow, e.g., if a business unit obtains important information it communicates this information promptly to all other business units or departments.
Assimilate 5	Our management demands periodical cross-departmental meetings to interchange new developments, problems, and achievements.
<i>Transformation</i>	
Please specify to what extent the following statements fit the knowledge processing in your company:	
Transform 1	Our employees have the ability to structure and to use collected knowledge.
Transform 4	Our employees are used to absorb new knowledge as well as to prepare it for further purposes and to make it available.
Transform 6	Our employees successfully link existing knowledge with new insights.
Transform 10	Our employees are able to apply new knowledge in their practical work.
<i>Exploitation</i>	
Please specify to what extent the following statements fit the commercial exploitation of new knowledge in your company (NB: Please think about all company divisions such as R&D, production, marketing, and accounting):	
Exploit 2	Our management supports the development of prototypes.
Exploit 4	Our company regularly reconsiders technologies and adapts them accordant to new knowledge.
Exploit 5	Our company has the ability to work more effective by adopting new technologies.

Figure 3.5: Scale measuring Absorptive Capacity
 Source: (Flatten, Engelen, Zahra, & Brettel, 2011)

3.3.6 Deterministic approaches

The objective of a deterministic approach to SME growth is to identify a stable set of variables (the *antecedents* of growth) explaining a major proportion of the variation in business growth rates (the *amount* of growth) – hence the opposite of the stochastic approach. The rationale for this large body of research is simple: if we know what causes growth, SMEs may use this knowledge prescriptively. While “antecedents of growth” are not the focus of this thesis, such determinants are likely to affect the growth process as well, and thus deserve some attention.

Factors determining growth

The deterministic studies are mainly quantitative, where a selected number of possible determinants are tested against cross-sectional data sets to find the significance of associations between the determinants and the growth rates. Dobbs and Hamilton (2007) provide an overview of 34 studies published since the mid 1990s – showing that they featured over thirty

independent variables, falling in to categories of: management strategies, characteristics of the entrepreneur, environmental/industry specific factors, and characteristics of the firm.

There are, however, significant challenges with this line of research, as described by Davidsson et al. (2007):

- The *indicators* of growth differ (e.g. sales, employment, and assets).
- The “*mode*” of growth measured differ (e.g. organic growth vs. growth through acquisition)
- The *formula* used to measure growth differ (e.g. percentage vs. absolute growth)
- The number of *data points* differ (e.g. only first- and last year vs. regression lines over multi-period data)

Having this in mind, the research still sheds important light on the importance of some factors on the SME growth process. As extensive literature reviews of previous research on such factors already exist (e.g., Davidsson, Achtenhagen, & Naldi, 2007; Dobbs & Hamilton, 2007), I will provide a summary of the factors presented in these reviews based on the categories from Dobbs & Hamilton (2007) .

Management strategies

A number of studies show a relation between factors related to management strategies and SME growth. The focus of these studies are the owner-manager’s (or founder’s) policies and strategies. A positive effect on growth is shown in several studies for technological sophistication, market positioning, and new product introduction.

However, a number of factors have been used across studies, and these may be divided into the following subcategories:

- **Growth objective:** The management’s growth objective is seen as one of the most important factors determining growth. Commitment to growth may, for instance, be seen in the vision statement of the firm.
- **Employee recruitment and development:** As described under the resource-based view, the firms’ employees are seen as critical resources for growth. Positive associations are shown between employee skill levels, training, and HRM-practices and growth. *Management training* has been found to be of particular importance.

- **Product-market development:** Studies have shown that strategies of differentiation are positively related to growth. Market-, competitor, and technology awareness, as well as R&D competencies, are all found significant to the growth of SMEs.
- **Financial resources:** The importance of financial resources was thoroughly discussed under the resource-based view. Access to financial resources is important to fund growth strategies and pursue market opportunities.
- **Internationalization and business collaboration:** The organizations export behavior signals its desire and ability to grow. However, due to the limited resources of the firm, business collaborations are often seen as essential to successful internationalization.
- **Flexibility:** Flexibility to respond to market changes and the ability to anticipate changes in the environment are found to be significant to SME growth.

Although studies show a strong relationship between growth and individual determinants, it is argued that strategy must be adapted to the environment. This is a likely reason why findings are hard to generalize across many studies.

Proposition 13: The policies and strategies of the SME, adapted to the environment, affect the prosperity for growth.

The entrepreneur

In small firms, the founder (or owner-manager), typically play a more prominent role than in larger firms. These business owners (often termed the *entrepreneurs*) often maintain high control over the company, affecting both the strategies and culture of the company, and through this influence the growth aspirations. Several studies have sought to find relationships between the characteristics of the business owner(s) and the growth of the firm.

- **Motivation:** While the founders' motivation for starting a firm may affect the growth, it is not found that the motivation itself converts into growth. However, Wasserman (2006) found that the conflict between two major entrepreneurial motivations (profit vs. control) may result in a dilemma hindering the growth of the firm. For instance, a high need for control may reduce the access to external financing through equity.
 - **Education:** The educational background of the founder is hypothesized to affect the management resource base of the firm, as well as (amongst others) the motivation and imagination of the business owner.
-

- **Experience:** The owner's entrepreneurial experience is often used as an explanatory variable for business growth. This relates closely to the learning perspective described previously.
- **Size and diversity of the founding team:** The size of the founding team, as well as the social ties and level of homophily (Ruef, Aldrich, & Carter, 2003; Beckman, 2006), are found to affect the firm behavior and thus the prosperity for growth.

Proposition 14: The size and diversity of the founding team, as well as the founders' motivation for growth, education backgrounds, and experiences, affect the SME's prosperity for growth.

The environment and industry

Environmental and industry-specific factors have received much attention in explaining organizational growth. The business environment in which the firm operates acts as both a source of information and a stock of resources (Aldrich & Mindlin, 1978). Further, the size of the demand side of the local market, i.e. the number of potential customers, is expected to affect the growth opportunities. It is also suggested that the *choice* of environment is more critical to growth than the behavior within that environment.

There are also studies of small firm growth that focus on institutions such as regulation, taxation, wage setting, and labor market legislation, without giving indisputable evidence. However, a high availability of capital in the environment, through e.g. external debt and equity capital, is suggested to positively affect small firm growth.

A relevant framework for discussing environmental influence on firm growth is found in Dess and Beard (1984). They defined three dimensions that affect the distribution of resources in environments:

- **Environmental Munificence:** The scarcity or abundance of critical resources needed by one or more firms within the environment. Scarcity of critical resources is often resulting in increased hostility between the competitors.
- **Environmental Dynamism:** The degree of uncertainty and rate of unpredictable change in the environment.

- **Environmental Complexity:** The heterogeneity of the environment, e.g. a large number of inputs necessary and outputs produced by the firm increases the complexity and thus the need for strategic activities.

The **industry life cycle** is also found to influence the growth of SMEs. Eisenhardt and Schoonhoven (1990) found that “*technology-based firms founded in growth-stage markets are more likely to become large than those founded in emergent or mature markets*” (p. 524). The reason, they conclude, may be that the resource opportunities in such markets give a substantial advantage. Further, Afuah and Utterback (1997) argue that as technology evolves, so do industry characteristics, products and critical success factors – forcing firms without the right capabilities to exit. Their paper connects the industry life cycle with both the product-market positioning and the resource based view, explaining the importance of different strategies at different stages of the industry life cycles.

Proposition 15: The growth of the SME is constrained by the environment it has chosen to operate in.

Characteristics of the firm

Lastly, some studies treat the firm more as a “black box”, and focus instead on the general characteristics of the firm. Especially age, size, legal form, and location have all been used as determinants of firm growth. For instance, a number of studies suggest that firm growth rates decrease with firm *size*, and that younger firms grow more rapidly than older ones. However, due to opposite and ambiguous results from other studies; there is no agreement on the relationship between such characteristics and growth. Especially, the variation in growth measures used makes it hard to confirm results across studies.

Integrative models: Contingency- and interaction effects

As has been shown, previous studies have resulted in a range of possible factors that are suggested to affect growth. However, to provide a deterministic model aspiring for a full explanation of the growth phenomenon would require including a large set of variables or determinants.

More recently, researchers have started focusing on contingency- and interaction effects between the determinants of firm growth (Davidsson, Achtenhagen, & Naldi, 2007). Although

prior studies have found relatively strong links between *individual* determinants and growth, the results have been hard to reproduce under other circumstances. In addition, the recognition of the idiosyncratic nature of firm growth has fueled this line of research that allows for inclusion of situational contingencies in the models.

By using the concepts of “contingency- and interaction effects” some researchers have attempted to integrate a broad range of determinants into causal models explaining SME growth (e.g., Davidsson (1991)) and performance (e.g., Naman & Slevin (1993)). Contingency- and interaction effects are often included by using words such as *fit*, *contingent upon*, and *consistent with*. However, several studies have used the categorization defined by Venkatraman (1989) , as presented in Table 3.3, to explain the concept of fit included in their model.

Table 3.3: Categories of Fit (Venkatraman, 1989)

Moderation:	The impact that the determinant has on growth is dependent on the level of a second determinant (the moderator)
Mediation:	In these models, there exist a significant intervening mechanism (mediator) between the determinant and growth. The mediator accounts for a significant proportion of the relation between the determinant and its effect on growth.
Matching:	The determinant requires a match with a second related determinant, without specifying how this affects growth
Gestalts:	When more than two determinants are included in the analysis, “gestalts” may be used to describe patterns of attributes or configurations that represent a set of relationships in a temporary state of balance. Gestalts are viewed as products of cluster analysis.
Profile Deviation:	An ideal profile (configuration of determinants) is established, and performance (growth) is directly related to adherence to this profile.
Covariation:	According to this perspective, fit is a pattern of covariation (internal consistency) among the determinants. The degree of internal consistency determines the effect on growth.

Although not all studies use this exact categorization to define what sort of contingency- or interaction effects they describe, it is a useful framework for understanding the underlying assumptions made by the researchers.

3.3.7 Entrepreneurial Orientation (EO) and SME growth

A final theoretical perspective on SME growth is found in the area of entrepreneurship research, or more specifically Entrepreneurial Orientation (EO) research.

The EO construct is intended to represent what it means for a firm to be entrepreneurial, and to capture those factors that are either requisite or relevant to label a firm as such (Covin & Lumpkin, 2011). In other words, it is a construct of entrepreneurship as an overall strategic posture of the firm. Further, the construct enables researchers to “*theorize about the level(s) of entrepreneurship manifested by a firm*” (Covin & Lumpkin, 2011, p. 862).

Entrepreneurial orientation is an attribute reflecting the entrepreneurial *behavior* of the firm (Covin & Lumpkin, 2011). This means that, to infer the existence of an EO, the firm must show an entrepreneurial pattern of behavior that can be recognized as *a defining attribute of the firm*. These behavioral patterns are conceptualized in measurement models that are meant to capture whether or not the firm shows an entrepreneurial orientation.

In the EO tradition, it is assumed to be a relationship between the Entrepreneurial Orientation of the SME and its performance and growth. Moreno and Casillas (2008) suggested that EO and growth are positively related, although moderated by the external context (dynamism and hostility in the environment) and internal context (availability of resources). Eggers et al. (2013) found that sustainable SME growth seems “*impossible without an EO*” (p. 537), and that EO drives growth through its emphasis on innovation that renews the firms’ growth trajectory. Similar results were found in a recent study of 194 Finnish SMEs, where EO was shown to be positively related to future growth aspirations (measured through the growth orientation of the firm), as well as actual growth in the past five years (measured through sales growth) (Soininen, Martikainen, Puumalainen, & Kyläheiko, 2012).

Proposition 16: The strategic posture of the SME, measured through Entrepreneurial Orientation (EO), is positively related to sustainable growth.

Covin and Lumpkin (2011) commented that research on EO is now growing at an increasing rate, which demonstrates the importance of including the construct as an aspect of this thesis. However, the construct has been criticized for not being conceptually coherent, and the scholarly community has yet to agree on a particular conceptualization (Basso, Fayolle, &

Bouchard, 2009; Covin & Lumpkin, 2011). The reason for this ambiguity is the two principal ways in which the construct has been conceptualized and measured: the unidimensional approach (Miller, 1983; Covin & Slevin, 1989) and the multidimensional approach (Lumpkin & Dess, 1996). To understand the construct better, the next sections will discuss these two conceptualizations.

Entrepreneurial Orientation as a unidimensional construct

The origin of the EO concept is often credited to Danny Miller (1983), even though he did not use the term in his original writing. Miller's objective was to discover the determinants of entrepreneurship, which he defined as "*the process by which organizations renew themselves and their markets by pioneering, innovation, and risk taking*" (Miller, 1983, p. 770). Covin and Slevin (1989), building on the work by Miller, sought to find the right strategic responses to environmental hostility among small manufacturing firms. They defined firms in terms of their organizational structure (organic vs. mechanistic), strategic posture (entrepreneurial vs. conservative), and competitive profile.

According to the construct coming from this theoretical development, entrepreneurial orientation is defined in terms of three dimensions: innovation, proactiveness, and risk taking. A firm has an entrepreneurial orientation only in the case that it manifests all three dimensions. In other words, EO is the shared variance among the three dimensions.

To measure EO, Covin and Slevin (1989) developed a nine-item scale to capture what they defined as the *strategic posture* of the firm. In a review of measurements of EO, Covin and Wales (2012) argue that this scale is still a methodologically defensible approach to assessing this EO construct. Figure 3.6 shows the scale as presented in Covin and Wales (2012).

Innovativeness items		
In general, the top managers of my firm favor . . .		
A strong emphasis on the marketing of tried-and-true products or services	1 2 3 4 5 6 7	A strong emphasis on R&D, technological leadership, and innovations
How many new lines of products or services has your firm marketed in the past five years (or since its establishment)?		
No new lines of products or services	1 2 3 4 5 6 7	Very many new lines of products or services
Changes in product or service lines have been mostly of a minor nature	1 2 3 4 5 6 7	Changes in product or service lines have usually been quite dramatic
Proactiveness items		
In dealing with its competitors, my firm . . .		
Typically responds to actions which competitors initiate	1 2 3 4 5 6 7	Typically initiates actions to which competitors then respond
Is very seldom the first business to introduce new products/services, administrative techniques, operating technologies, etc.	1 2 3 4 5 6 7	Is very often the first business to introduce new products/services, administrative techniques, operating technologies, etc.
Typically seeks to avoid competitive clashes, preferring a "live-and-let-live" posture	1 2 3 4 5 6 7	Typically adopts a very competitive, "undo-the-competitors" posture
Risk-taking items		
In general, the top managers of my firm have . . .		
A strong proclivity for low-risk projects (with normal and certain rates of return)	1 2 3 4 5 6 7	A strong proclivity for high-risk projects (with chances of very high returns)
In general, the top managers of my firm believe that . . .		
Owing to the nature of the environment, it is best to explore it gradually via cautious, incremental behavior	1 2 3 4 5 6 7	Owing to the nature of the environment, bold, wide-ranging acts are necessary to achieve the firm's objectives
When confronted with decision-making situations involving uncertainty, my firm . . .		
Typically adopts a cautious, "wait-and-see" posture in order to minimize the probability of making costly decisions	1 2 3 4 5 6 7	Typically adopts a bold, aggressive posture in order to maximize the probability of exploiting potential opportunities

Figure 3.6: The Miller / Covin and Slevin EO Scale
 Source: (Covin & Wales, 2012)

Entrepreneurial Orientation as a multidimensional construct

Building on the work of Covin and Slevin, Lumpkin and Dess (1996) proposed a clarification of the EO construct. They redefined entrepreneurship as *new entry* accomplished “*by entering new or established markets with new or existing goods or services*” (Lumpkin & Dess, 1996, p. 136). Entrepreneurial orientation then refers to the processes, practices and decision-making activities that lead to new entry - and hence growth.

According to this view, five independent dimensions constitute the EO construct: risk taking, innovativeness, proactiveness, competitive aggressiveness, and autonomy – as presented in Figure 3.7. In addition to adding two new dimensions, the construct also introduced some slack regarding the presence of each dimension. The dimensions that characterize EO need not covariate in order for EO to be claimed, and the importance of each dimension on performance is moderated by environmental and organizational factors of the firm.

To measure EO according to this construct, Covin and Wales (2012) suggest using the scale developed by Hughes and Morgan (2007), presented in Figure 3.8.

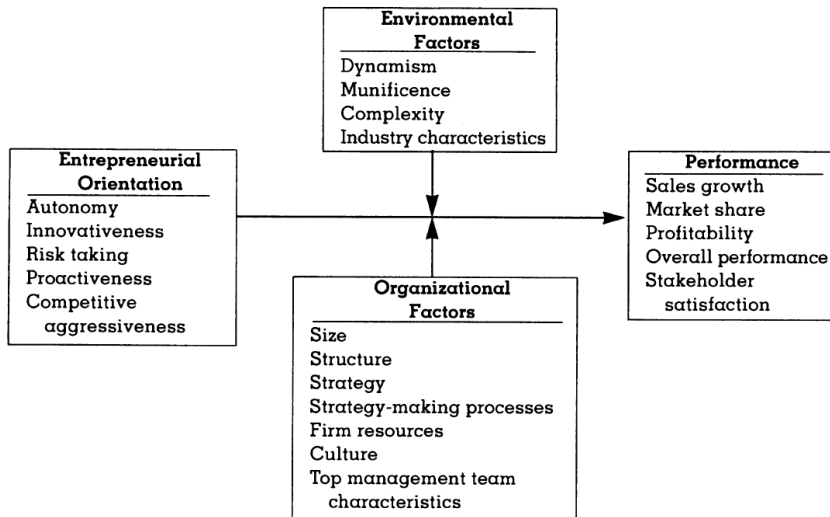


Figure 3.7: Conceptual Framework of Entrepreneurial Orientation
Source: (Lumpkin & Dess, 1996)

Risk-taking items

- The term “risk taker” is considered a positive attribute for people in our business.
- People in our business are encouraged to take calculated risks with new ideas.
- Our business emphasizes both exploration and experimentation for opportunities.

Innovativeness items

- We actively introduce improvements and innovations in our business.
- Our business is creative in its methods of operation.
- Our business seeks out new ways to do things.

Proactiveness items

- We always try to take the initiative in every situation (e.g., against competitors, in projects when working with others).
- We excel at identifying opportunities.
- We initiate actions to which other organizations respond.

Competitive aggressiveness items

- Our business is intensely competitive.
- In general, our business takes a bold or aggressive approach when competing.
- We try to undo and out-manuever the competition as best as we can.

Autonomy items

- Employees are permitted to act and think without interference.
- Employees perform jobs that allow them to make and instigate changes in the way they perform their work tasks.
- Employees are given freedom and independence to decide on their own how to go about doing their work.
- Employees are given freedom to communicate without interference.
- Employees are given authority and responsibility to act alone if they think it to be in the best interests of the business.
- Employees have access to all vital information.

Note: All items rated on 7-point, Likert-type scales ranging from “Strongly disagree” (=1) to “Strongly agree” (=7).

Figure 3.8: The Hughes and Morgan EO Scale
Source: (Covin & Wales, 2012)

3.4 Literature findings

What can easily be observed from this literature review is that the research field is highly fragmented, with several approaches to understanding how and why companies grow. However, by having an integrative mindset throughout the literature review, some insights are made that will be highlighted in this section.

The **stochastic models** of growth assume that firm growth is a result of chance, irrespective of management and strategies. This approach may be interesting for analyzing growth on industry level, and has indeed played an important role in economic models designed to explain size distribution of firms. However, the goal of this thesis is to develop a new conceptualization of how individual SMEs are *affected* by growth, and describing growth as a “random walk” is too pessimistic for such a goal. Even so, any pragmatic model of SME growth should acknowledge the existence of a range of factors that may affect the growth rate of the SME. To incorporate all factors in a conceptual framework would result in a model too comprehensive for any practical use.

While the actual growth of SMEs may not be as linear as portrayed by the so-called “**stage models**”, these models provide a useful framework for the organizational challenges that the SME is likely to face when it grows. Further, these models focus on the growth *process* rather than the *causes* for this growth, and several of the models have an emphasis on SMEs. The relevance then lies in the recognition that the company and the founder(s) need to adapt through managerial practices and organizational configurations as the complexity of the company increases.

However, a model of the SME growth process will need to incorporate the idiosyncratic nature of firms rather than a “one size fits all” approach. As the firm responds to the challenges of growing, the findings from **evolutionary models** provide some insight into how some responses are preferable over other. Responses that create “variations” that do not fit with the environment are likely to have a negative impact on the firm’s ability to draw resources from the environment. Further, internal selectors, such as forces pushing for internal stability and homogeneity, may create responses that lead to a suboptimal fit with the environment. For instance, organizations use routines and structures to maintain firm-specific “variations”. When these “variations” no longer fit with the environment (internal or external), the forces of internal and external selection create a “crisis” that needs to be resolved through a new “variation”.

It is suggested in the **learning perspective** that the crises are resolved through the application of *knowledge*, and that new knowledge is acquired through *learning* either from experiences or from external sources. The absorptive capacity of the SME is a conceptualization of its ability to acquire, assimilate, transform and exploit knowledge, and is suggested positively related to sustainable growth.

As proposed by the **resource based view**, SME growth is limited by the managerial resources available to the firm. Most firms start small, with everyone in the firm doing just about everything. As the complexity of the company grows, the need for managerial resources to coordinate resources and exploit opportunities also grows. However, the limited availability of managerial resources with *tacit*, firm-specific knowledge may affect the rate of sustainable growth. The available managerial resources are also required to train new managers for subsequent growth, forcing the SME to balance between exploiting the existing managerial resources and developing and training new ones. The interests of the managers will also need to be aligned with those of the founders and shareholders.

Further, human resource practices are shown to have an impact on SME growth. As the company grows, it may become increasingly difficult to find, train and manage new employees. Especially, the SMEs capabilities of recruiting, training and socializing new employees will affect its ability to grow. The possibility of “moral hazard” will also require introduction of mechanisms to align employee behavior with the organizational goals.

The availability of financial resources is said to be the primary resource base for growth, and SMEs need such resources to reach customers and fund growth. Financial capital may be available internally through bootstrapping or a good revenue model, or through external finance. However, financial capital may be an important constraint to SME growth, either due to lack of access to the external sources of finance, or because of a desire to retain control of the business.

The final resources highlighted by the literature on SME growth are network resources. The SMEs existing strategic alliances, as well as the ability to establish and manage such alliances, may affect the ability to grow. The relational and combinative capabilities of the managers and founders, as well as the absorptive capacity of the SME, are likely to affect the establishment and management of such alliances. In the early years, it is also shown that the social networks of the founder(s) have an impact on SME growth.

Studies classified under **deterministic approaches** have sought to find a stable set of variables explaining the causes of SME growth. Several of these variables are also included in other theoretical perspectives, but this perspective has sought to find deterministic relationships with SME growth through quantitative analysis. The studies have several significant limitations, but point to important dimensions that may affect – or be affected by – SME growth: 1) the policies and strategies of the SME, 2) the founding team characteristics and their motivation, 3) the environment the SME operates in, and 4) certain characteristics of the firm (e.g. size, age, and legal form).

Finally, the strategic posture of the SME, measured through the **Entrepreneurial Orientation** (EO) construct, is found to be positively related to SME performance and growth. Even though the conceptualization of the construct varies, the core concept is that the construct reflects the entrepreneurial behavior of the firm. Such behavior is observable through the innovativeness, proactiveness, and risk taking of the firm.

Based on the literature review, I have suggested the following propositions related to SME growth:

<i>Proposition 1:</i>	As the SME grows, the complexity of the company increases, forcing the company and the founder(s) to adapt through managerial practices and organizational design.
<i>Proposition 2:</i>	The founders' and managers' perceptions of the advantages and disadvantages of growth will influence the growth of the SME.
<i>Proposition 3:</i>	Evolutionary mechanisms of internal and external selection make certain organizational configurations (or variations) more or less suitable for survival and growth.
<i>Proposition 4:</i>	SME growth is limited by the size and experience of the managerial group. Sustainable growth involves a balance between exploiting the existing managerial resources, and developing and training new ones.
<i>Proposition 5:</i>	The interests of managers, founders and shareholders must be aligned in order for managerial resources to contribute to growth.
<i>Proposition 6:</i>	Founder participation in the management team has a positive effect on firm growth.
<i>Proposition 7:</i>	The SMEs capabilities of recruiting, training and socializing new employees will affect its ability to grow.
<i>Proposition 8:</i>	Growth of the SME may introduce “moral hazard”. The growing organization should incorporate mechanisms to align employee behavior with organizational goals.

Proposition 9:	The availability of internal or external financing affects the SMEs ability to grow.
Proposition 10:	The SME's existing strategic alliances, as well as the ability to establish and manage such alliances, affect the ability to grow.
Proposition 11:	The social network of the founder(s) influences SME growth, however this influence is strongest in the early years of operation.
Proposition 12:	The absorptive capacity of the SME is positively related to sustainable growth through increased adaptability to the environment and the ability to exploit opportunities.
Proposition 13:	The policies and strategies of the SME, adapted to the environment, affect the prosperity for growth.
Proposition 14:	The size and diversity of the founding team, as well as the founders' motivation for growth, education backgrounds, and experiences, affect the SME's prosperity for growth.
Proposition 15:	The growth of the SME is constrained by the environment it has chosen to operate in.
Proposition 16:	The strategic posture of the SME, measured through Entrepreneurial Orientation (EO), is positively related to sustainable growth.

3.5 Literature critique

The literature review shows that there is in fact a high amount of studies on SME growth, and that the field has received much attention from the research community the past two decades. This has resulted in an understanding in the research communities that small firms are not only quantitatively but also qualitatively different from their larger counterparts. For researchers, this realization provides new research opportunities, where the current theories applicable for larger firms are reevaluated through the lenses of SMEs.

Most of the research on SME growth consider growth as an *outcome*; e.g. growth is the dependent variable, and the studies try to explain the varying growth rates of companies. Following such research, a number of factors are found that are of importance to facilitate the growth of SMEs. However, further studies of the relative importance of each factor are probably of little significance to enhance our understanding, as the heterogeneous nature of the firms makes it hard to build theory upon the findings. Further, many of the factors found cannot be directly affected by managers and practitioners, and hence bear little potential to enhance management practice.

Some researchers have tried to explain the outcome of growth and the internal growth process (e.g. the “stage models”), and these theories are thus closely related to the purpose of this thesis. However, this stream of research is often deterministic, assuming that firms must use the same organizational arrangements as they grow. They also assume that firms move through a singular growth process of specific “phases” or “stages”, and that there is an optimal configurational approach to solve the challenges of each phase. This research stream has been highly criticized for such assumptions, as described in the section about stage models, resulting in a call for improved conceptualizations.

Finally, most studies assume that growth is a goal for all SMEs, and do not take into account the possibility of firms that deliberately stay small. While some studies have focused on the motivation of SME owners to grow, this factor is usually not incorporated into research focusing on SME growth.

However, for the purpose of this study, the research field on SME growth still appears fragmented – and no satisfactory integrative framework of the SME growth *process* and *challenges* was found during the literature review that could answer the goal of this thesis. SME growth is a complex phenomenon, as it may be understood as both a process and a change in size or amount. There are important limitations to the theories available, making it hard for practitioners to take advantage of the research. Further, there are differences in theoretical approaches, measurements of growth (e.g. sales, employment, market share, etc.), and the conceptualization of the underlying phenomenon being studied.

Based on the literature review, I believe that the current state of the academic field makes it hard for practitioners to fully grasp and take advantage of the available research. However, a considerable body of research now exist, coming from several schools of thought and research traditions. Separately, these theories are able to explain parts of the growth phenomenon; and taken together I believe that they can be built upon to enhance our understanding.

4 Case study

In theory, there is no difference between theory and practice.

In practice there is.

Yogi Berra

4.1 Introduction and structure of case study

Based on the findings from the literature review, the goal for the case study was to increase the understanding of how growth was experienced in an SME. This relates back to the second research question of this thesis: *How is growth experienced by practitioners in an SME?* More specifically, the case study had the following research goals:

- To understand how the employees of an SME perceive the growth process.
- To understand how challenges emerge as the SME grows, and how the decision makers observe such challenges.
- To understand how the SME has solved the challenges.

The case study was conducted during the fall of 2015 in a Norwegian software company and its subsidiary. In addition to the founders, several employees in both companies were interviewed to expand the amount of information and bring in other perspectives on growth and development in the companies. In total, the interviews spanned over 21 hours, 12 of which with the founders of the company.

The interviews were arranged as semi-structured in-depth interviews partially based on a set of predefined questions related to my research. The open-ended questions answered by all participants were:

- When did the participant join the company, and what did the participant remember about how the company was organized and managed at that time?
- Had there been any periods where the participant experienced a growth in the company in any dimension? (E.g. number of customers, number of employees, revenue, etc.)
- Did the participant remember any challenges or changes that arose based on this growth? How did they experience the challenges or changes? How were the challenges revealed, and what actions were taken to overcome them?
- Has the participant experienced any changes in the organization in general, and what are the suggested reasons for these changes?
- What challenges did the participants expect to arise as the company continues to grow?

The participants were also asked to give a personal narrative of how the company had developed during their years of employment. Further, additional questions were added to triangulate answers from previous interviews or to further explore specific events. This was especially useful where there was a need to understand the meanings that the participants ascribed to various phenomena.

The remainder of the chapter is arranged as follows:

- Section 4.2 presents a narrative of the history of the company. The narrative is focused upon the growth of the company, and highlights specific periods that have defined how the company has evolved.
- Section 4.3 presents an analysis of the case and the findings that can be extracted from the case study.
- Section 4.4 presents some concluding remarks regarding the case study.

4.2 Case study narrative: Steady growth at Genus

The narrative presented in this section is based on interviews with employees and founders in the company, as well as documentation provided by the company. It serves as a readable story that summarizes the context of the case study and the key events that have shaped the growth process of the company.

It was a cold and rainy morning in Oslo in early November 2015 as Geir Bergheim – inventor, founder and owner of Genus, hung up the phone and put it to rest on his desk. At an age of 51, he was a self-made millionaire from almost thirty years of hard work and dedication to the idea of a product he once had only envisioned. Now that same idea was staring back at him from the computer screen as a functioning software – used by thousands of people.

The man he had been talking to was Erik, his close friend and advisor, and the subject was the future of the company and the actions he now needed to take. At this moment, the rough weather outside the windows was nothing compared to the storms of thoughts inside his head. Almost fifty employees were waiting for his direction on how they should proceed; a direction eagerly anticipated.

4.2.1 Background

The idea that would shape the rest of Bergheim’s life started already as a student at the Norwegian University of Science and Technology in the late 1980s. While taking the mandatory classes in compiler technology, programming, and circuitry, Bergheim had a feeling that software should be developed in a better – and easier - way. Bergheim recalls:

Already during the second or third year of my degree, I found the way we developed software to be overly complicated. Why should you start over every time you develop a new system? At the university, I only found one professor that had similar thoughts as I did. The others didn’t seem to share my frustration.

In the last year of his degree, he decided to immerse himself in the ideas he had, and wrote a thesis on meta-models and how the functionality and behaviors of systems could be described at a higher level than what was the current programming paradigm. The thesis laid the foundation of a model-based approach to establish a system of meta levels.

In 1989, he joined Andersen Consulting in Oslo and temporarily put the ideas from the university to rest. He was soon included in a team that was to develop the new operational system for the Norwegian police in time for the 1994 Winter Olympics at Lillehammer. As a part of this project, he was able to try out some of the ideas from his master thesis in the new software. Once again, the urge to simplify software development started to shape his thoughts.

4.2.2 Round one

Inspired by Ayn Rand's novel "The Fountainhead", Bergheim started to see his mission in life. Having experienced how the large technology consulting companies were exploiting their customers through ineffective use of technology and opportunistic behavior, he wanted to prove that his ideas could increase the productivity and provide more value than the existing solutions in the market. The basic vision was to build a product that would enable re-use of functionality in software across customers in different industries, and at the same time be tailored to each customer's need. Convinced by two coworkers and friends in Andersen Consulting, he decided to follow his heart and bring the ideas to life – and in 1995, they established a new company (hereinafter referred to as The Consultancy Firm). However, even though he believed the ideas could revolutionize software development, his motivation was not in the money:

We were not just chasing the money. Our intention was never to build a company to sell it. Neither did we have the capacity to grow fast. The idea was to build something good, as we had seen all the "rotten" software that was on the market.

The founders immediately started thinking about who to bring with them on the team, and Bergheim contacted a manager from one of his previous summer internships for advice. The manager recommended a former intern, currently studying computer science in England, and Geir gave him a call. The two immediately connected at an intellectual level and by a shared vision of what they could create. The founding team now consisted of people with purely technological backgrounds, who all shared the dream of creating a new type of software that none of them believed existed in the world. Even though they did not have a grand strategic plan, they were all dedicated to the task of developing the software. As one of the early employees recall:

We had no idea what we were doing – but we knew that we were on to something good.

The founders soon realized that they needed a steady cash flow to fund the product development, and decided to expand the focus of the business to include consulting and professional services. They started hiring through their networks, and by 1996, the company had 17 employees, a revenue of more than 13 MNOK, and their first license-paying customer.

The services-part of the company continued to grow, while the R&D team remained consistent with the original four employees. This structure provided the financial resources that allowed the founders to focus on continuous evolution of the product they had envisioned. Bringing in external funding was never an option, as one of the founders recall:

We never wanted external investors, as we needed control of our business. We were really worried that someone from the outside would act opportunistically and force our focus in other directions than we wanted.

In 1998, the founders decided to create a separate company to hold the intellectual property of their product. In addition to the original founders, some of the employees in The Consultancy Firm were allowed to buy shares in the new company.

4.2.3 Genus

The new company, Genus AS, consisted of the former employees from the R&D-department of The Consultancy Firm. Within the first year, the company had seven employees and a revenue of 8 MNOK⁶. In addition to continuously improving the product, all of the employees were working on consultancy projects on the side to secure the cash flow for the company. In a news article from May 1999, the founders stated that they had a clear ambition to become a “significant international company”.

By their side, The Consultancy Firm was still marketing and selling the product, as well as delivering professional services to implement it with approximately 50 consultants within management- and IT-consulting. However, a new wind was blowing in the software industry. In the late 1990s, with low interest rates and easy access to capital, a tidal wave of new Internet-companies started to get most of the attention from the IT-industry. As their competencies were tightly linked to the needs of this new market, The Consultancy Firm saw a potential to take their share of the growing investments. In December 1999, The Consultancy Firm announced a merger with Icon Medialab - a major Swedish Internet-consulting company. The former

⁶ The revenue was still routed through The Consultancy Firm

employees in The Consultancy Firm were now employed in Icon Medialab, with a non-compete contract constraining them from joining Genus.

Discussions of active ownership

Some of the prior employees in The Consultancy Firm were also owners in Genus, and discussions of the future direction of Genus arose with the clear separation of the two companies. Some of the external shareholders wanted a clear plan for future growth, and pushed for a strategic approach on how to further develop the business. There were suggestions to bring in external investors, as well as to plan for an IPO within a known timeframe. On the other hand, Bergheim and his team of developers wanted to maintain control of the new business – and pushed for a requirement of active ownership (i.e. only employees were allowed to own shares). The discussions resulted in the “passive” owners selling their shares to Genus employees at a valuation based on projected future growth. Once again, Bergheim was in full control of the business.

A new adventure

While there was an intention to continue the relationship with Icon Medialab, it soon became apparent that this company would not focus on selling the product that Genus delivered. Without such strategic alliance, Genus was forced to continue growth by itself. Around them, the market was trembling with what would later be known as the “dot-com bubble”. Between 2000 and 2002, Genus grew from seven to eighteen employees – and the revenue went from 12 to 19 MNOK. Once again, they had recruited new employees by tapping into their networks, in addition to buy-outs of some of their former employees from the non-compete agreements with Icon Medialab.

At this time, everyone in the company were doing just about everything – and it was established that even the core developers should spend at least twenty percent of their time in customer consulting projects to ensure enough funding for the product development. The new employees were inspired by working in such a dynamic environment where “everybody knew each other”, and the employees “hustled” to bring in new customers. Once again, they were able to secure the necessary profitability.

Despite the rapid growth, the expressed market strategy was actually to “constrain growth to ensure product quality”. The founders insisted on focusing on the market for high-end products

and services for medium- to large customers. The focus was still on the product, and Bergheim was afraid that an unsustainable growth would have a negative impact on quality.

While the early employees and founders in Genus had a passion, almost at a philosophical level, for what the product they were developing – the later employees did not always seem to share this passion. Being 18 employees, the decision making was still centralized in Bergheim – who insisted on perfection and quality in everything they did. As one of the early employees recall:

He [Bergheim] would enter the room, nearly screaming in my face how bad my work was if it did not meet his requirements. His intention was probably never to offend us, but I think he was continuously trying to shape us into “clones” of himself – forcing us to understand the importance and value of the product we developed.

While the early employees were getting used to the founder’s intense passion for the product, some of the newly employed were rather startled.

The bubble bursts

In 2002-2003, after the “bubble” had burst, the market for software vendors started to dry up. The initial growth that Genus had experienced was now constrained by a world of disbelief in software and the potential of digital transformations. For the first time, Bergheim was forced to lay off some of his employees. Some customers remained loyal and continued their relationship, but the company needed a new business model to survive without external capital infusion. The top priority for Bergheim was to ensure that the core developers of the company could continue the development of the “big idea” that he had been working on for so long.

Bergheim decided that the new business model should focus mainly on licenses rather than consulting. Even though the company still relied on the income from consulting services, recurring revenue from license agreements were seen as vital to secure the income necessary for the continuous evolution of the product. Further, the vision for how the product should end up started to take shape. As a result, Bergheim saw the need for a complete redesign of the entire software solution - data model, business logic and user interface. With a stable revenue stream from a handful of customers, they started working on the product while continuously nurturing the existing customer relationships through consulting.

During the following years, the company was in a “stealth mode” with little or no new sales. The core programmers spent less time on consulting, while the remaining employees worked hard to ensure that the existing customers were satisfied. While the early employees, often referred to as the “core team”, were aligned through their shared experiences, some of the later employees started to feel disconnected. As one of the employees recall:

I think we had a vision statement, but that seemed to be mostly to please the customers. To the outside world, it was communicated that we were an ambitious company that wanted to grow – but that was never expressed internally. I didn't really see any changes in our focus during these years, and not much happened within the company either. I guess it's hard to find motivation when the employees don't know the direction we're going.

In the small company, there was a flat organizational structure with no managers other than Bergheim. As some of the more senior employees had been working together for many years, they saw no point in introducing typical HR-tasks such as appraisal interviews, training or social events. At the same time, many of the employees were now establishing families, making them more risk averse than previously. From time to time, Bergheim gave inspirational speeches about the huge international potential of the product; but the employees never recognized any organized initiatives for further growth. While the product was steadily improving, there were no major changes in customers, employees, revenue, or strategic orientation, and the company was moving slowly into a “lifestyle business”.

A new spring

In late 2006, the market responded once again – with increasing IT budgets providing new hope for software vendors. Genus was soon hit by a wave of requests from their existing customers, and as a result found itself understaffed. The company was now facing a challenge: the networks of the employees, previously being the primary source of recruiting, were exhausted; and the company had no connections with the universities – a common source of candidates for technology companies. With no capabilities in recruiting, Genus turned to “head hunting” companies to find new employees. However, the few candidates that were recruited found it hard to become a part of the small company and some of them quit shortly after being employed.

Bergheim started to realize that the product-centered culture that had evolved over the years made it hard to attract and retain the right talent. At the same time, he was worried that the current employees would not handle the workload they were facing for much longer. The employees were working 60-80 hours a week just to keep up with all the requests from existing customers. An attempt was made to structure the company according to “perspectives”, in order to clarify responsibilities and focus areas of the employees. However, the attempt was soon abandoned, as it became apparent that they needed to maintain the flexibility of assigning tasks across perspectives.

Being out of options, Bergheim decided to co-found a new company with younger employees to get a fresh start. He allied with another IT-consulting company, CommITment, to start the new venture called Accedo in 2008. Genus, CommITment, and the employees of the new company would each own 1/3 of the shares. As Bergheim recalls:

We tried to hire more people, but this proved to be hard – if not impossible. The few that were employed were never able to penetrate the “core” of early employees and become part of the team. That’s why we decided to start Accedo. We wanted a company to develop that was not destroyed by the culture in Genus. We had hired a few good people before this, but it proved hard for them to establish themselves in our company.

The three founders of the new company were a prior employee of Genus (Simen Larsen), an employee of CommITment, and a PHD student at the University of Oslo. Larsen, who would become the CEO of the new company, recalls:

My motivation for co-founding Accedo was an enormous belief in the product that Genus was developing. I saw that this product could be a great resource for a new company! In addition, I saw it as an opportunity for personal development. Of course, ownership in the company was important, but just as important was the prospect of being able to contribute to a company that could grow. I guess growth was a motivator for me back then.

The intent was to establish Accedo as a company that could grow independent of Genus. In addition to consultancy projects for the customers of Genus, the company was at first allowed to take on other tasks. However, Genus wanted to influence the direction of the company through participation in the board of directors. In addition, the two companies were sharing offices – and the revenue was routed through Genus, who took a cut of the revenues from

projects Accedo were working on. The main task for Accedo soon became recruiting to meet the demand from existing customers of Genus. They attracted young professionals through the networks of the founders, and the new employees soon saw the potential of the company. As an early employee of Accedo recall:

When I joined Accedo, I had the feeling of shaping a new company. You can say that it was like an entrepreneurial calling, and I wanted to be a part of that process. In addition, I knew the others who were joining the company, and thus it didn't feel like a major risk - I knew they were smart people. My ambition when joining the company was to be a part of a company in growth. I wanted us to become an important consultancy company where our competitive advantage was partly based on the product we delivered – and partly based on the competences of the employees.

With Accedo on board, Genus almost immediately experienced a boost in revenue from their customers. A challenge for the companies was the tight strategic relationship they established, and early on there was a feeling of distrust as they became increasingly more dependent on each other. They were struggling to agree on the direction, and were not guided by a strong vision of where any of them were heading. A further frustration was the perceived lack of autonomy in the subsidiary, making it hard for them to act on their ambitions. Effectively, Accedo was controlled by Genus through the revenue stream and the customer relationships that still belonged to Genus – and Genus was dependent on the consultants from Accedo to deliver high quality services based on their product. With the organic growth through existing customers, there was no need for a sales organization in any of the companies, and decision-making for both companies was effectively centralized in Genus.

In 2011, Genus bought a new part of the shares from CommITment and became a majority owner of Accedo. Genus now had 17 employees while Accedo had 13 – making them 30 employees in total. Until this time, all employees in Accedo had been offered shares in the company as a part of their contract, and most of the employees in Genus were also shareholders in their company. However, all available shares were now distributed – and ownership was no longer offered to new candidates.

While the founders in the subsidiary had nearly exhausted their personal networks of candidates, they had also established a strong relationship with the universities and were starting to attract highly qualified graduates. This put new pressure on the recruiting

capabilities, and the level of formality in the process started to increase. This was caused both by expectations from the candidates, and by an internal need for better evaluation of the unknown applicants. The subsidiary had also established a training program to facilitate the onboarding process of new employees, as well as appraisal interviews to improve employee satisfaction.

Brothers in arms?

The two companies were now facing a situation where they needed new customers fast to secure the revenue stream and continue their growth. Genus had withdrawn several of their consultants to focus on R&D, and there were no new customers in the pipeline. The vision that Bergheim had set for the product in 2003 was nearly reached, but the world around them was quickly changing. With the introduction of smartphones and tablets, the market for solutions on mobile devices was opening up – but the product only supported desktop solutions for back office users. In addition, new products with sophisticated user interfaces were dominating the market Genus had focused on in their original offerings from the 1990s: data analysis and reporting. While the founders had been able to remain in control of their company through bootstrapping, the product was now starting to lag behind the development in the market. As Bergheim recalls:

There has always been an ongoing “struggle” between two opposing forces. On one hand, we see the technological development going on around us, and know we should react to them to improve our product and make it more salable. On the other hand, we want the technology to be as “pure” as possible, and the core model and concept must not yield to trends or fads. If we had followed every hype that’s been in the market, we wouldn’t have the technological advantage we have today.

This time, however, there were clear indications that the technological development they saw in the market was here to stay. Even more of the employees in Genus, in addition to some of the consultants in Accedo, were brought in to strengthen the R&D capabilities in Genus, and the need for further financing of this product development was apparent. The profitability of the licensing business model was declining due to increased R&D expenses and less revenue from consulting.

However, the companies had little experience in marketing and sales – and the frustration was growing. Further, there was a belief among the founders that the product should be good enough to sell itself. As one of the founders of Genus said:

Our goal is to make the product as good as possible, and then we hope the market will follow. However, the product must be good enough before we focus on marketing.

The employees of Accedo wanted more marketing and a higher visibility, while Genus wanted a more controlled approach as they were afraid the product and the company was not yet ready for the mass-market. In addition, there was no expressed or unified vision of where the companies were heading. Accedo was still an IT-consulting company that needed new projects and new customers to secure their future revenue stream, while Genus was slowly becoming a pure product company focusing on recurring revenue from licenses.

A modest joint sales effort was initiated where a few employees from both companies started “cold calling” some of the larger Norwegian companies with sales pitches. While they got some opportunities to present their product offering, the limited effort was far from successful - with just a few new customers showing interest.

At the same time, Accedo continued their search for more talent, and by 2013 they were 22 employees. At the same time, Genus had 16 employees – making them 38 employees in total. The flat organizational structure came into question, as it became increasingly harder to coordinate initiatives within and between the companies. Some of the more senior employees in Genus were given temporary unofficial responsibilities as an attempt to distribute decision-making authority and improve coordination. However, it was hard for the new employees to understand how the two organizations were actually managed, and tasks were at times assigned with conflicting priorities. Some political behavior was introduced as well, as the employees tried to figure out who actually had decision-making power in the organizations. As one of the employees in Accedo said:

The company appears “flat” in titles, but it doesn’t really work that way. An internal structure exists, but it isn’t shown in any organizational charts. I think this is somewhat challenging for the new employees - they have to navigate within the company without knowing the “rules” that are established.

In 2015, Genus bought the rest of the shares in Accedo from CommITment – and now owned two-thirds of the company. Further, it was decided to change the name of the subsidiary to Genus Professional Services to ensure mutual branding. At this time, five of the twenty-eight employees in the subsidiary were working with R&D in Genus. While there was no official organizational structure, specialization of employees was more visible and some formalization was introduced in terms of best practices and reporting. Genus started focusing on other strategic alliances as well, this time with international consulting organizations. The reasoning was that new and larger partners would have more sophisticated sales organizations that could be exploited to reach new customers. New sales efforts often included both Genus, the subsidiary, and an attempted strategic partner.

4.2.4 Current tensions and challenges

In the autumn of 2015, there were several concerns within the organizations. In total, they were now 44 employees, with a turnover of approximately 60 MNOK (million Norwegian Kroners). While the companies had been able to grow steadily together since 2008, the employees were starting to question the strategic orientation. The lack of communicated vision for the future made it hard to align the interests of all employees, and the focus on strategic alliances with other organizations were by some seen as a direct threat towards the future growth of the subsidiary. Some employees were concerned by the lack of autonomy in the subsidiary, while others didn't see why they were two companies when decision making authority was clearly centralized in the parent company - and the employees were actually working across company boundaries. On the other hand, there seemed to be a low willingness towards risk, and several of the employees in both companies stated that their priorities had changed as they became older – making job security more important than growth and entrepreneurship.

The employees also questioned the lack of plans. While the founders of Genus expressed that they had “no belief in plans”, the employees of both companies struggled with the emergent priorities. It was also challenging for the employees to see what the company would look like just a few years ahead. Bergheim and the core team of developers were still determined that the software needed to be “ready” before they could scale, but the major part of the employees were not directly engaged in product development or R&D – and found little motivation in

waiting for the product to be ready. As one of the employees expressed: *“I’m not sure if the product is being created for the company, or if it’s really the other way around.”*

Some employees were also concerned by the lack of strategic awareness in the companies. There was little or no external training of the employees, and knowledge about technological trends and competitive environment was mainly based on what the employees were able to catch up with in their spare time. The exception was database training for new employees, and project management training for selected senior employees. There were also complaints that the companies were often unable to assimilate the ideas and information that was actually brought in. As one employee stated: *“At times it feels like we suffer from the “not invented here”-syndrome where we don’t really care what’s going on around us. I’m not sure if it’s really like this, but it seems like there is some degree of arrogance in the company.”*

While the subsidiary had a good track record of recruiting consultants, the need for more developers in the parent company was now apparent. To be able to move faster, they needed more employees in the R&D department, but their recruiting capabilities weren’t aimed at finding the right candidates. Further, the companies had no capabilities in socializing and training new software developers to ensure they were quickly integrated in the core development teams.

The urgent need for increased financing of product development still wasn’t resolved, but the original founders maintained that no external financing should be brought in and organic growth and bootstrapping was to be continued. This also implied that the majority of the employees needed to continue their focus on consultancy projects to secure revenue, while other organizational functions such as marketing, sales, and recruiting were mainly organized as projects on-demand.

The companies took pride in the flat organizational structure they had been able to maintain, but the same structure was also leading to a lack of development of managerial- and leadership capabilities. Further, employees were pushing for more responsibilities and influence in the company. Some employees commented that the lack of structure and specialization resulted in low efficiency at times, as the employees needed to balance emergent internal duties (e.g. recruiting and sales) with external projects without necessarily having right capabilities - nor the time or motivation to develop such capabilities.

4.2.5 Rally the troops

Bergheim glanced at his notes lying on the table, written in haste during the conversation with Erik. They were mostly questions:

- “Possible merger with the subsidiary? Are we ready? Will someone oppose this?”
- “Organizational structure? Are we large enough for a new design? How will this affect the employees and their well-being?”
- “How can we delegate responsibility without losing focus on product development?”
- “Why are we unable to attract developers to R&D?”
- “Is the product ready for the mass-market?”

By the time he left the office late in the evening, he had yet to decide on how to proceed. He knew that most of the early employees enjoyed the flexible and informal way the company was managed, and the company really depended on them. At the same time, he understood that they would need to make some changes in order to continue their growth.

Figure 4.1 shows the sales revenue and number of employees in the company between 1998 and 2014. The total number of employees from 2008 and forward represent both Genus and the subsidiary.

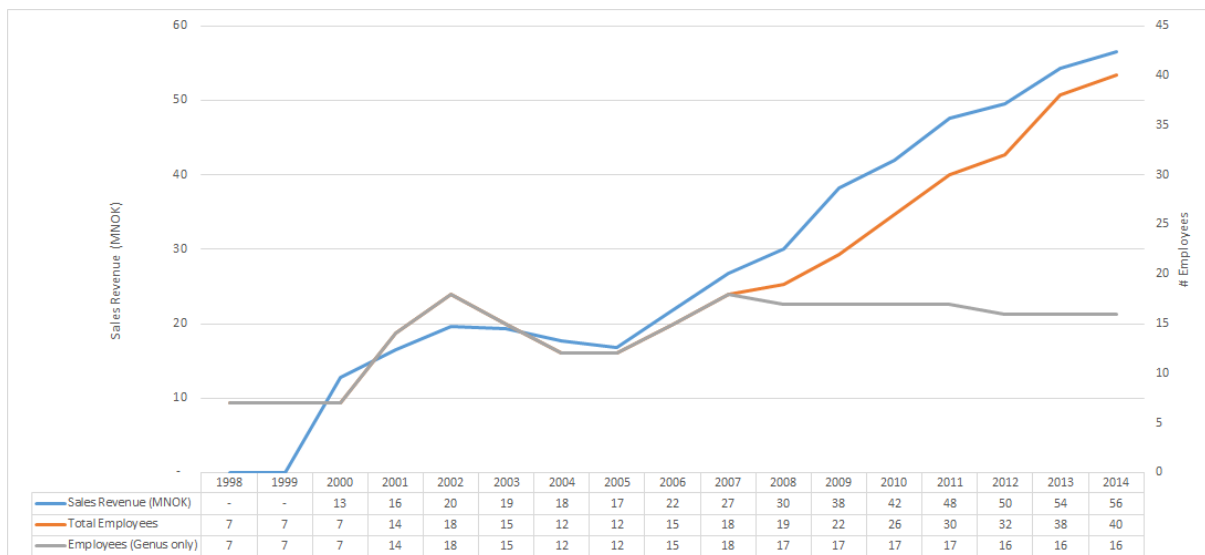


Figure 4.1: Growth in Sales Revenue and Employees

4.3 Analysis and findings

The company in the case study does not represent an extreme or exponential growth situation, nor does it represent a failure. More likely, it represents the alternating growth rates that many SMEs experience – especially during their early years. The challenges coming from growth are thus emerging more slowly than in “extreme” cases of growth, allowing the company to weigh their decisions carefully on how to proceed.

As can be seen, the company has grown in both revenue and number of employees. However, the growth in both dimensions have mainly come from the subsidiary since 2008. The reason for including both companies in the case study is thus the tight relationship, as should be apparent from the narrative presented in the previous section.

Another observation that should be apparent is that the initial growth was followed by a period of stability – and even decline – before the company once again was able to get traction. Such growth is not well described by the “stages of growth” models presented in the previous chapter.

The remainder of this section will display the findings from the interviews and documentation provided by the company. In addition to findings that can be drawn directly from the narrative of the previous section, more general findings that span across the narrative are included. Such findings are based on the interviewees’ descriptions of the growth *process* and the changes that had occurred, rather than specific periods of time in the company history.

Control versus growth – a founders’ dilemma

One of the more visible findings from the case study was the founder’s need for control over the technological evolution - and how this may have impeded the growth process of the company. The company was founded based on a technological invention (or *idea*) - and the founder and inventor has remained the central authority of the company as it has evolved, continuously pursuing his goal of developing a high quality product based on his original idea. The personal goals of the founder are thus also established as the goals of the company, and the focus has been on research and development rather than entrepreneurship and growth. Some of the interviewees who wanted a more aggressive growth saw this as a challenge.

Formal and informal organizational structure

The company has been able to keep what the founders and employees referred to as a “flat” organizational structure, and there were no organizational charts in either the parent company or the subsidiary. None of the employees had formal job descriptions, and the flexibility of assigning employees to projects and tasks “by demand” was seen as a competitive advantage. There was a fear that titles, structure, and job descriptions would make the organization more rigid. Several of the interviewees, especially the early employees of Genus, also stated that they were afraid that more structure and formalization would impair the innovativeness and employee well-being. There had been some prior attempts to implement organizational structures in the parent company – e.g. according to focus areas, where employees were assigned to be part of a “perspective” of the company. However, these attempts were never fully implemented and were soon abandoned.

The establishment of a subsidiary may also be seen as a way of structuring the company through legal entities. Each legal entity could then remain quite small and independent, allowing the companies to avoid bureaucratization, hierarchies and formalization. However, the independence was soon challenged as the parent and subsidiary became increasingly more interweaved.

Several interviewees commented that there had been more delegation of responsibility the past few years due to increased complexity. This had resulted in an “informal” structure, where a few senior employees were given more decision-making authority. Some interviewees also referred to this as the reason for increased political behavior, as the formal and informal decision making structure differed.

Finally, internal and external pressures have now forced the company to consider a more formalized organizational structure. Several employees advocated that structure and role definitions would lead to less ambiguity and a more efficient organization. In addition, customers and partners often expected to see how the company was organized, leading to presentations of “fictional” organizational charts.

Finding and recruiting the right talent

One major challenge that arose around 2006-2008 was the lack of capabilities to find and recruit new employees to meet the increasing demands from customers. The recruiting

practices in the parent company had been informal, and mainly relied on the networks of the founders and employees. The challenge was temporarily solved as the company used external sources (i.e. a recruiting company) to recruit new employees.

With the establishment of the subsidiary, recruiting was once again based on informal recruiting practices and the networks of the founders. However, in the subsidiary the practices changed as they continued to grow. The past years they have started recruiting directly from universities, and the recruiting process has become more formal and standardized in terms of interview questions and evaluation of the candidates. The reasons described were a combination of higher expectations from the candidates for a professional process and the need for a more structured process internally as the number of candidates applying for positions increased.

Even so, the companies still treat recruiting as a “process” rather than an organizational function, and while some employees are more involved in the process than others are, the interviewees described no specific attempts to improve the capabilities. Further, they now found it challenging to recruit new employees for “research and development”, as they had mainly focused on recruiting consultants this far.

Training and socialization of employees

The companies also experienced challenges in the onboarding of new employees. After the years of limited growth between 2003 and 2006, Genus lacked the human resource capabilities to socialize, train, and integrate new employees. The small assembly of existing employees knew each other well, and were able to discuss issues as they emerged – leading to a lack of formalization of the human resource practices that are often seen in larger companies.

The subsidiary has experienced a steady growth in number of employees since the founding. This growth process resulted in the need for a more structured approach to onboarding of employees. As a result, they established a one-week internal training program for all new employees as well as external training in database technologies for employees with limited prior experience. Further, they arrange a number of events to enhance the socialization of employees, and have implemented annual appraisal interviews. While these practices were not necessary during the first years, the increasing number of employees forced the company to continuously improve and standardize the practices to retain the newly employed.

As for training of existing employees, both the parent and subsidiary still relied heavily on on-the-work experience, and they considered external training to have limited benefits. However, due to requirements from customers as well as internal pressure for competence development, the subsidiary recently started sending some senior employees on external project management training.

Motivational alignment

A challenge that most interviewees agreed on, was the lack of motivational alignment of the employees. This challenge had become more apparent as the companies had grown, and the reasons presented by the interviewees were:

- New employees were not shareholders, and their incentives were thus not directly aligned with the goals of the companies
- Some employees were shareholders in the subsidiary and others in the parent company, sometimes leading to a conflict of interests
- The decision-makers found it hard to find the right incentives for employees, especially incentives that were not based on number of hours charged
- Unclear vision of the companies, and the employees did not know the future direction

The founder (Bergheim) further commented that he saw a challenge in the employees' lack of motivation for developing each other, as he perceived them as mainly focused on their own day-to-day responsibilities. Such individualistic behavior may come from the lack of delegation of managerial responsibilities, political opportunism, or a misalignment of motivational mechanisms and incentives. As the company grows, the employees are likely to align their behavior to the perceived reality and complexities, and not necessarily to the goals of the company.

Developing managerial capabilities

The interviewees described a history of little or no focus on developing *managerial* capabilities, and delegation of responsibility that was often temporary. In line with the aversion for organizational structures, there was a fear that delegation would lead to the abuse of power and authority as well as a more rigid organization.

On the other hand, some interviewees described a situation where there was a growing lack of leadership as well as unclear communication of priorities. While resource allocation appeared

to be centralized, the employees often received conflicting information from different sources regarding priorities. These challenges had become more apparent as the number of employees increased.

Further, several employees were pushing for more responsibilities and decision-making power as they had been working in the company for some time. While some interviewees described the mere symbolic value of titles and job descriptions as a motivation, others saw the need for developing managerial capabilities to prepare the company for future growth.

Establishing strategic alliances

The company had recently started focusing on strategic alliances with larger consulting companies. The reasoning was that such partners would be in a better position to acquire new customers, and that they had better capabilities in sales and marketing. Further, potential customers often requested larger suppliers, making alliance partners necessary to win new contracts. However, the alliances were not formalized by the end of the case study, and the company was still working on finding the incentive arrangements that would align their interests with those of the proposed partners.

Financial resources

The company showed a clear preference for internally generated financial resources. While the founders described that they possibly could have grown faster through more financing, there was a strong belief that external financing from e.g. venture capitalists would result in a loss of control over the development of the product. The increasing need for more capital was thus solved through bootstrapping and financial arrangements between the companies.

Strategic orientation and planning horizon

According to the interviewees, there had been little long-term planning in the companies. Most initiatives and priorities were emergent and reactive, mainly based on the founders' intuition and thoughts about the future. While they always had a vision for what they wanted from the *product*, the founders reported that they don't believe in long-term plans for the *company*. The goal was to make the product as good as possible, and they then assumed that the market would respond.

As a result, the direction of the company was rarely communicated to the employees, customers or partners. The employees reported that they did not know the plans for the future or the vision

of the company. Some interviewees reported that they saw this as an important challenge that became more apparent as the number of employees increased, and that a communicated direction and plan for the companies would ease the alignment of initiatives and increase the motivation of the employees for future growth.

Willingness to take risks

A topic that arose during the interviews was the perceived willingness to take risks and the entrepreneurial spirit in the company. Several of the interviewees reported they felt that the company was less willing to take risk now than during the early years of operation. They hypothesized that due to the slow growth of the company, the personal priorities of the employees may have changed to obligations outside the business, possibly making them more sensitive to risk.

4.4 Concluding remarks

The case study was conducted based on three primary goals:

- To understand how the employees of an SME perceive the growth process.
- To understand how challenges emerge as the SME grows, and how the decision makers observe such challenges.
- To understand how the SME has solved the challenges.

The interviewees' narrative description of the growth process was presented in section 4.2. The general impression from the case study was that growth was not a primary objective for the company, and as a result, they had not deliberately planned for growth. The growth process was perceived more as a natural evolution, and had received little attention from the founders. While this finding is unlikely to be transferrable to all cases, it indicates that growth is an idiosyncratic process – and that deterministic theories prescribing a singular growth pattern are of little value to SME managers.

Section 4.3 presented an analysis and categorization of the challenges that had emerged as the SME grew. The findings imply that the challenges and changes in the company were a result of internal and external pressure from the founders, the increasing number of employees, customers, and partners – as well as technological development and other changes in their business environment. As the company grew, the current organizational configurations and routines were challenged and required a response. The case study also uncovered that not all

challenges were apparent to the decision makers, and were thus allowed to evolve for some time before they were acknowledged.

The case study further imply that solutions to the challenges were primarily based on the intuition and knowledge of the decision makers (e.g. initial recruiting and financial bootstrapping). Further, some challenges were solved through learning from the environment and mimicking “best practices” (e.g. training and socialization of employees and appraisal interviews). However, a few challenges were allowed to remain in the company, especially those who required a radical change in the organizational configuration, resources, or capabilities (e.g. organizational structure, managerial capabilities, and strategic planning).

5 Discussion

Growth demands a temporary surrender of security. It may mean giving up familiar but limiting patterns, safe but unrewarding work, values no longer believed in, and relationships that have lost their meaning.

John C. Maxwell

5.1 Introduction

The goal of the discussion is to have a discourse on the propositions and findings outlined in the literature review alongside the empirical findings from the case study. In addition, the findings from the case study will be used to enrich and enlighten the understanding of how SMEs perceive growth, outside what was found in the literature.

By combining these sources of prior research and empirical data, the aim is to propose a holistic and integrative conceptual framework that may forward the field of SME growth research and aid practitioners in understanding and responding to the challenges that may arise as their company grows.

The rest of this chapter is arranged as follows:

- Section 5.2 presents a discourse on the findings from the literature review and case study.
- Section 5.3 proposes a conceptual framework that builds on the findings from this thesis.
- Section 5.4 gives some concluding remarks about the framework and its relevance.

5.2 Linking literature and case study findings

From the literature review, 16 propositions regarding SME growth were extracted, and a critique of the current state of research was presented. One of the critiques was that the research field is highly fragmented, making it hard for practitioners to take advantage of the available research. Based on these findings, the case study was conducted to gain insight into how growth was perceived by those who had been involved in such a process, as well as to better understand the challenges that accompany growth.

The next sections will present a discussion on the findings from the literature and the case study, and aims to link these findings in order to propose new theory.

5.2.1 Findings on the growth process

The goal of research on the growth *process* is to identify the internal nature of growth in terms of what goes on within the firm while it is growing (McKelvie & Wiklund, 2010). From the literature review, the following theories included process descriptions of growth:

- Stochastic growth models describe the growth process as a “random walk”, where growth is a result of chance irrespective of strategy and managerial choices.
- Stage models describe growth as a linear process, and elaborates on how SMEs can adapt to this growth internally. The main criticism towards the models is the way they depict growth as a singular sequence of stages applicable to all firms.
- Evolutionary models incorporate the idiosyncratic nature of growth, and describe the contingency of internal and external forces on the growth process. The organizational configurations (or *variations*) are subject to internal and external selection, and the surviving configurations are those best able to obtain resources.
- The resource-based view describes the growth process as a struggle over resources, and the importance of acquiring and developing firm-specific resources and capabilities. Further, growth requires a successful matching of perceived opportunities with a combination of resources. Unfavorable firm routines, or a lack of managerial or financial resources, may constrain the ability pursue opportunities.
- The learning perspective describes the growth process as a continuous adaption to the organizational complexities through application of knowledge and learning. Absorptive capacity relates to the ability to acquire and exploit information from external sources.

- Entrepreneurial Orientation describes the posture of a firm that is more likely to grow. While not explicitly describing the process, the theories incorporate the importance of maintaining innovativeness, proactiveness, and risk-taking as the SME grows.

One goal of the case study was to better understand how an SME had experienced the growth process, and we are now able to link the findings back to the existing theories.

The first finding from the case study is that the growth of the company was not well described through the traditional stage models. Rather than growing through a linear set of stages, the company has experienced both rapid growth and periods of stagnation or decline. Further, the company did not describe any “revolutions” in the growth process, but rather minor adaptations in one or more dimensions of the organizational configuration. However, the managerial challenges described in the stage models were to a certain degree observed in the growth process. The main proposition from the stage models was that as the company grows, the complexity will increase – and it will become necessary to adapt through managerial practices and organizational design (**Proposition 1**). In the case study, we could see how the complexity was affected by the number of internal and external stakeholders; e.g. employees, customers, partners, and owners.

The company in the case study described their experience with growth as an “evolutionary process”. While the company had not planned specifically for growth, they tried to adapt to the complexities and stabilize the company as it grew. The main fear of the founders was that growth would lead to a loss of control over the company and the quality of the product. **Proposition 3** from the literature review relates to the evolutionary mechanisms of internal and external selection. The evolutionary theories propose a dynamic view of the growth process rooted on learning, uncertainty, and path-dependency. This view corresponds well to how growth was explained in the case study, in example:

- Changes in recruiting practices were a result of increased demands and expectations from the candidates. However, the parent company found it hard to adapt due to years of “retention” on existing organizational practices.
- Formalization of organizational structures are considered as a result of internal pressure from employees, as well as expectations from partners and customers (external).

When it comes to finding solutions to the challenges, **Proposition 12** stated that the absorptive capacity of the company is related to sustainable growth through increased adaptability to the

environment and the ability to exploit opportunities. The founders in the case study described that most challenges were solved through applying “intuition”. However, when they were unable to find solutions, they searched for solutions by involving employees or external resources.

Finally, the case study exposed how changes in the business environment affected the growth process. When the “IT bubble” burst in the early 2000s, the company struggled to survive and was forced to lay off employees. **Proposition 15** stated that growth is constrained by the environment in which the SME has chosen to operate. While many software companies continued to thrive and grow throughout the crisis, such events put additional pressure on the capabilities of the SME.

The main finding on the growth process of SMEs is that none of the theoretical perspectives successfully describes all the complexity. However, for the purpose of this thesis, the findings from the literature review provide the necessary foundation to understand *why* challenges arise as the company grows. Further, the case study has provided important insight into the heterogeneity of the process. To summarize the findings, the following description of how growth leads to challenges is proposed:

Challenges from SME growth arise as a result of a mismatch between the SME’s current organizational configurations, its productive opportunity set (resources), the expectations and pressures from internal and external stakeholders, the opportunities in the business environment, and the ability or willingness of the decision makers in the SME to react and adapt. The timing and severity of challenges are thus unique to each company based on (amongst other) changes in these dimensions.

The challenges are resolved through utilization of knowledge, either existing or acquired through learning, to find a new state of temporary equilibrium.

5.2.2 Findings on growth challenges

While the previous section presented the findings on the growth *process* leading to challenges, this section will present a discourse on the *effects* of this process – in terms of the challenges that come from growth. In the literature review, challenges found in previous research were highlighted and presented through propositions. Further, the case study exposed how founders

and employees experienced challenges as a small company had grown. Based on these two approaches, the remainder of this section will elaborate on the findings from the case study and literature review – and how they relate to each other.

Proposition 2 stated that the founders' and managers' perceptions of advantages and disadvantages will influence growth. Related to this, **Proposition 14** stated that the size and diversity of the founding team, as well as the founders' motivation for growth, education backgrounds, and experience, affect the SME's prosperity for growth. Further, some researchers highlighted the importance of the founders (or *entrepreneurs*) in the growth process, and criticized the absence of this factor in most existing theories. In the case study, it was clearly observed how the founders' perception of growth affected the growth process. Rather than pursuing growth, the founders were more concerned with maintaining control over the research and development of the product. While the company was initially founded based on the idea of the founder, a growing number of stakeholders now each have an opinion on what is in the best interest of the company. Thus, a challenge may arise from the misalignment between the motivation and intentions of the founders and the interests of the other stakeholders.

Further, related to the founders, is the importance of the social networks they bring with them into the company (**Proposition 11**). While these networks proved to be important in the early days of the case-study company in order to acquire employees and customers, the importance of the founders' networks appeared to decrease as the company grew. This may be seen as a challenge, as this feature of the founder as a firm resource is depleted.

Proposition 9 stated that the availability of internal and external financing affects the SMEs ability to grow. From the case study, we could see how the SME showed a clear preference for internally generated financial resources. This is in line with founder preferences described in previous research as well. However, internally generated financial resources may not be sufficient to fuel growth, and the SME may face the decision of whether to maintain control and grow slowly or accept external equity finance to enable a more rapid growth. In addition, the internally generated financial resources are often scarce in SMEs, and must be distributed amongst both growth- and R&D initiatives, as well as dividends to shareholders.

Edith Penrose suggested that a lack of managerial resources was one of the main challenges facing a growing firm (Penrose, 1959). While her theory of growth was not specifically focused

on SMEs, this aspect of the resource based view of the firm has been highlighted in SME research as well (Kor, 2003). **Proposition 4** stated that SME growth is limited by the size and experience of the managerial group, and that SMEs must balance their exploitation and development of managerial resources. Management can be seen as the coordination of the activities and resources of the business, and as the business grows from the entrepreneurial “everyone doing everything” company to a more complex organization, the founder will not be able to maintain control over the operations alone. However, developing managers with firm-specific capabilities takes time, and delegation of responsibility requires trust. As could be seen in the case study, there was a fear that delegation would lead to abuse of power and authority. Thus, the interests of managers, founders, and shareholders must be aligned in order for managerial resources to contribute to growth (**Proposition 5**). It is also suggested that founder participation in the management team has a positive effect on firm growth, as it is important to maintain the firm-specific knowledge that the founder(s) possess (**Proposition 6**). Overall, this time-consuming and challenging process of developing managerial capabilities may stall growth if not sufficiently addressed.

Proposition 10 highlighted the importance of establishing and maintaining strategic alliances in order to grow. As could be seen from the case study, the company had recently started focusing on strategic alliances with larger consulting firms. The ability to exploit such alliances may impact the growth rate of the SME, e.g. by providing access to scarce resources and valuable capabilities. However, to reach the goals of such alliances requires relational and combinative capabilities, as well as the capacity to absorb the external knowledge coming from the relationship. Further, strategic alliances introduce new stakeholders with their own interests and agendas, adding to the complexity of the SME. Thus, while having the potential to influence the growth process of the SME, strategic alliances may introduce new challenges that the SME must solve.

As for the human resources of the SME, **Proposition 7** stated that growth is affected by the capabilities of recruiting, training and socializing employees. The lack of such human resource management capabilities were also found to be a challenge in the case study. During the first years, talent was mainly found through the networks of the founder(s). However, when these networks were exhausted, the requirements for more formalized practices became apparent to ensure a match between employer and employee. Further, training and socialization of employees becomes increasingly more important in order to maintain the level of quality in

services and products, as well as an organizational culture that includes all employees. However, developing such human resource management capabilities may be a challenge for the SME, as it requires both time, resources and knowledge.

Related to human resource management, **Proposition 8** stated that growth of the SME may introduce “moral hazard”. The term refers to a situation where the goals of the employees are not aligned with the goals of the company, leading to a propensity to avoid duties and responsibilities. Thus, incentive mechanisms should be implemented to ensure motivational alignment of all employees. This challenge was also found in the case study, where it may even have been reinforced by the choice to create two legal entities where some employees were also shareholders in one or the other. Further, an unclear vision of the companies was said to be one of the reasons for motivational misalignment.

The case study also showed that the SME mainly relied on short-term operational decisions, and had limited experience with strategic planning. An important part of strategy is the alignment of firm resources, capabilities, and activities with the opportunities in the environment to reach a goal or vision. As **Proposition 13** states, the policies and strategies of the firm, adapted to the environment, affect the prosperity for growth. It can thus be argued that as the amount of resources, capabilities, and activities increase, the strategic options for the company also expand, and that this calls for strategic planning in order to optimize value for the SME. Further, as shown in the case study, employees and other stakeholders will most likely request information about the plans and the vision of the company. However, the move from an opportunistic and reactive mindset towards more deliberate strategic planning may become a challenge for the SME if it does not have the necessary capabilities.

Proposition 16 includes the concept of Entrepreneurial Orientation. The construct embodies the features of an entrepreneurial firm – innovativeness, proactiveness, and risk-taking. According to Entrepreneurial Orientation theorists, these features are related to the performance and growth of the SME. The case indicated that the employees’ willingness to take risk had decreased as the company had grown. The interviews also indicated that the company had become more reactive than proactive, as seen in the responses to user interfaces for mobile devices and business intelligence tools. This indicates that maintaining entrepreneurship may become a challenge as the company grows.

Finally, the case study exposed how internal pressure from the employees, as well as external pressure from customers and partners, had led the company to consider new organizational structures and formalization. The “adhocracy” that had worked sufficiently until recently, now led to increased political behavior and organizational ambiguity. There was also a belief that a more professional structure would improve the efficiency of the operations. This relates well to the findings from the stage models, where **Proposition 1** stated that companies adapt to organizational complexity through managerial practices and organizational design. Further, the stage models highlight the “crisis” that arise when existing systems fail to cope with the complexity or changed environmental conditions, and result in errors or reduced efficiency. Further, functional specialization of employees are suggested to be a precondition for economies of scale and experience curve effects. On the other hand, organizational structures and systems may direct the attention of organizational members towards routine rather than innovative activities (Van de Ven, 1986). Thus, the SME may face a challenge of finding the right level of formality and structure.

5.3 A conceptual framework of SME growth

One of the main goals of this thesis has been to develop a conceptual framework of SME growth and the accompanying challenges. The rationale behind the goal is twofold. First, previous literature reviews have called for a body of integrative theory that recognize the idiosyncratic nature of SMEs and *how* they grow (e.g., Davidsson, Achtenhagen, & Naldi, 2007; Dobbs & Hamilton, 2007). Second, I wanted to present the findings from the thesis in a way that enables practitioners to take advantage of available research, and thus enhance their understanding of what is going on inside the organization as it grows.

The proposed conceptual framework serves as a holistic and integrative conceptualization of the challenges that SMEs may face as they grow, as well as the process *leading to* these challenges. The stance of this thesis is that firms do not grow through a predictable sequence of stages, nor do they necessarily share the same problems as they grow. Growth is path-dependent and unique to each firm, and the framework does not attempt to prescribe the specific challenges of firms based on age or size. Rather, it presents *some* categories of challenges found through the working on this thesis, and introduce additional literature on each subject to guide researchers and practitioners towards further readings.

Figure 5.1 depicts the proposed conceptual framework of SME growth process and challenges, derived from the findings and propositions in this thesis; connecting the literature review, the case study, and the discussion into one integrative conceptualization. The framework will serve as the foundation for further discussion in the subsequent sections.

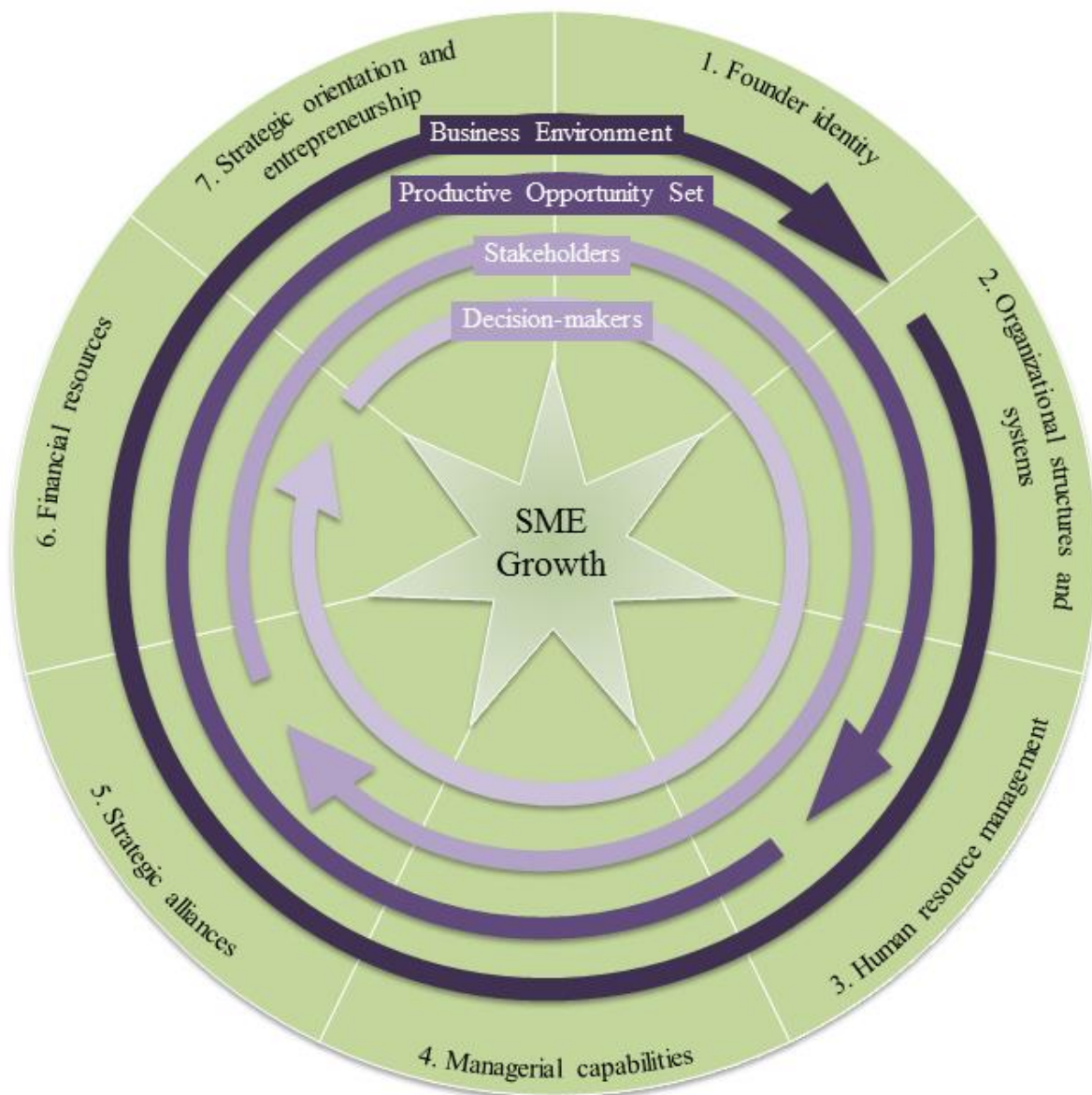


Figure 5.1: Conceptual framework of the SME growth process and challenges

5.3.1 The concept in brief

The conceptual framework depicts **four forces** affecting the direction of the SME, presented as circular arrows. The four forces are:

- **Decision-makers:** The individuals with actual decision-making power in the organization (e.g., founders, executives).
- **Stakeholders:** all persons, groups, or organizations affected by the actions taken by the SME, but without the decision-making power necessary to affect these actions directly (e.g., employees, strategic partners, customers).
- **Productive Opportunity Set:** The total number of ways the company can combine its available resources to create value and pursue opportunities.
- **Business Environment:** The environment(s) the SME compete in, providing growth opportunities and resources.

These forces all *affect* the SME by putting pressure on the future direction of the firm, and are *affected by* SME growth through of changes in content (e.g., number of stakeholders, type of business environment) and nature of pressure. The pressure from the forces may be towards *change* or towards *stability*. The pace of growth is further assumed to alter the *velocity* of pressure from the forces.

Further, the **seven categories of challenges** found through this thesis are presented in the “slices” of the framework. The framework builds partly on the findings from the evolutionary perspective, where internal and external selection processes challenge the current “variations”. Translated into the context of the framework, the company will experience challenges when the pressures coming from the forces are sufficiently misaligned, either internally - or with the current organizational configuration of the SME (e.g., structures, practices, resources, or capabilities). The challenges that arise should be addressed by a response - that may in turn be challenged by forces having other selection criteria (e.g., internal selectors seeking stability).

The SME may choose not to respond to the challenges, avoiding the changes and instead try to stabilize the organization based on the current configuration. However, to continue growth, the SME must seek a new variation and undergo a transformation that resolves the challenge. The SME can then continue to grow in a temporary equilibrium until a new combination of pressures reaches a threshold where response is necessary. The framework thus relates closely

to the theory of **punctuated equilibrium**, described as “... *an alternation between long periods when stable infrastructures permit only incremental adaptations, and brief periods of revolutionary upheaval*” (Gersick, 1991, p. 10). However, the pace of growth is assumed to alter the sensation of revolutionary change, and slower growing firms will experience the changes as less intrusive than faster growing firms will.

As the challenges come from *combinations* of pressure from the forces, each firm will experience challenges based on their idiosyncratic growth pattern rather than a predetermined sequence of challenges. Further, the evolution of organizational configurations that come from responses to the challenges makes the growth process path-dependent. It is also implied that the required *responses* to the challenges are to some degree unique to each company, further connecting the framework to the learning perspective - where the ability to resolve challenges is related to the existing knowledge and absorptive capacity of the firm.

The next sections will further describe the four forces of the conceptual framework, and the categories of challenges found through this thesis.

5.3.2 The four forces of the growth process

The decision-makers

The birth of the SME typically starts with an entrepreneur assembling a founding team, where one of the founders take the role as the CEO of the company. This entrepreneurial firm tends to depend on a few key individuals, be highly centralized, lack adequate middle-management skills, and exhibit a paternalistic atmosphere (Rubenson & Gupta, 1992).

However, as the company grows, the complexity of managing the company will increase. If we assume that normal individuals pursue personal objectives and opportunities, problems will arise when the objectives of the decision-makers are at variance or in conflict with the opportunities of the organization. For the founder CEO, the personal objectives of starting the company may be self-fulfillment, independence and control, while the continued growth of the company requires changes in conflict with these personal goals.

It is also often assumed that professional management must at some time be brought in to replace the founder CEO, when the later does not possess the necessary skills of managing a growing or more mature firm, or does not have the will or ability to adapt. Alternatively, additional executives may be brought in to complement the skills of the founder (Hambrick &

Crozier, 1985). This, however, requires the founders' willingness and ability to delegate decision-making power.

While research has shown that founder CEOs are in fact often able to learn and adapt (Willard, Krueger, & Feeser, 1992), growth is likely to introduce additional decision-makers with their own personal objectives. In addition to new executives, the company will often establish a board of directors, and introduce other middle-managers with decision-making power. All of these decision-makers will put pressure on the SME, both through their opinions about the *direction* of the firm, and how the firm should be organized and managed.

The stakeholders

As the SME grows, an increasing amount of *stakeholders* will have opinions about the direction of the company, how it is organized, and how it is managed. The stakeholders of the framework are all persons, groups, or organizations affected by the actions taken by the SME, but without the decision-making power necessary to affect these actions directly.

Examples of stakeholders are employees, families, bankers, investors, customers, suppliers, strategic alliance partners, regulatory authorities, and more. The network of stakeholders will expand with the growth of the firm, and the stakeholders will have different needs and wishes that must be balanced by the SME.

While these stakeholders do not have decision-making power, they do have the power to *influence* the direction of the SME. In example, employees will desire a company that offers opportunities for personal growth and development, as well as job security and other needs. Partners in a strategic alliance may desire attention from the SME, insight into the strategies and plans, as well as the possibility to influence the future direction.

In addition to adding to the complexity of managing the company, the stakeholders will affect the future growth trajectory of the SME. The "selection criteria" they impose may be conflicting with the objectives of the decision-makers, the possibilities of the productive opportunity set, or the opportunities in the business environment. Further, stakeholders may put pressure towards internal stability and homogeneity in the SME, opposing the changes necessary to resolve challenges.

The productive opportunity set

As thoroughly described in Penrose (1959), firms can be seen as administrative entities made up of potentially valuable resources. The managers of the SME are responsible for the deployment of resources, as well as configuring the activities of the firm. According to Penrose, firms must have both entrepreneurial and managerial capabilities. While the entrepreneurial capabilities are necessary, they are not sufficient to secure sustainable growth.

The productive opportunity set of the SME is the *total number of ways that the firm can combine its resources to create value and pursue opportunities*. Growth thus depends on managers that can both *see* these opportunities (entrepreneurial capabilities), and that are able to *act upon* the opportunities by exploiting the existing resources.

As the company grows, the amount of resources (and thus the productive opportunity set) will also grow. A growing resource base requires more managerial capabilities, and the new managers must have both generic, industry-specific, and firm-specific managerial skills. However, as the firms grow they also develop routines, and these routines may constrain the ability to recombine the existing resources (McKelvie & Wiklund, 2010). Further, the development of new managerial capabilities requires delegation of responsibilities, which may be a challenge for control-oriented founders. Finally, development of new managers requires attention from the existing managerial team, who may be preoccupied with the managing existing organizational complexities.

The business environment

The business environment provides the growth opportunities that the SME can exploit, as well as the resources necessary for growth. The SME will be affected by the munificence, dynamism, and complexity of the environment it competes in (Dess & Beard, 1984). Further, the environment will impose a set of selection criteria that determines whether the SME will be able to acquire the resources necessary to sustain growth.

As the company grows, the business environment will also change. In example, the industry may mature, the SME may choose to be present in several geographic locations, new trends may come and go, and the competitive environment may change. Such changes in the environment will put new pressure on the SME in terms of e.g. customer demands, requirements for innovation, and availability of resources.

5.3.3 The seven categories of growth challenges

The pressure from the forces described in the previous section will result in challenges that the SME is likely to meet as it grows. Throughout this thesis, several challenges of SME growth have been highlighted, based on the findings from the literature review and the case study.

The conceptual framework distills these challenges into seven categories:

1. Founder identity
2. Organizational structures and systems
3. Human resource management
4. Managerial capabilities
5. Strategic alliances
6. Financial resources
7. Strategic orientation and entrepreneurship

These categories of challenges are further elaborated in the subsequent sections, along with additional literature references to guide researchers and practitioners towards further readings.

1. Founder Identity

The founder(s) of the SME form a central dimension affecting whether or not the firm is likely to grow (Gibb & Davies, 1990). In the start-up phase of the small firm, the founders often manage everything in the business – from exploring opportunities to developing the products or delivering the services. The founders often see their organization as an extension of themselves, established to reach their own personal goals (Stevenson & Jarillo-Mossi, 1986). One reason for companies staying small is that ownership and management continue to reside in the same persons (the founders). Company growth may then be determined by the personal goals of these founders rather than commercial considerations and the opportunities in the business environment (O'Farrell & Hitchens, 1988).

Motivational alignment towards growth

As stated previously in this thesis, the founders' perception of the advantages and disadvantages of growth will influence the growth trajectory of the SME. Growth of the SME involves changes and risks for the founder(s), and founders satisfied with the current state may seek to preserve status quo. However, problems may arise when the personal goals of the

founder(s) are at variance with the opportunities of the organization (Stevenson & Jarillo-Mossi, 1986). Morrison et al. (2003) distinguished between the SMEs intention, ability, and opportunity to grow. Their conclusion was that both the intention of the owner-manager (founder), the abilities of the company (the productive opportunity set), and the opportunities in the business environment had to be in place in order for a company to expand.

Wasserman (2006) describes the two main motivations to start a new venture, the profit motive and the control motive, and concludes that there is a low probability of achieving both. Thus, the ability to grow is related to the founders' willingness to accept some loss of control over the company in order to grow and achieve higher profitability. A growth strategy is usually also related to the need for financing, as will be discussed in a subsequent section. In most cases, such financing will involve external equity investment, diluting the founders' ownership in the SME (O'Farrell & Hitchens, 1988). When ownership and control is important to the founders, growth can be a threat to their identity, creating a challenge for the SME of how to resolve this dilemma.

The founder's role in the growing company

As the SME grows, the family-like firm with the founders in the center may be threatened by the increasing complexity that follows. The founder's aversion to structure and formalization, preference for personalized relationships, and unwillingness or inability to delegate authority are all referred to as impediments to growth (O'Farrell & Hitchens, 1988).

In the early years of the company, the founders' social networks will highly influence the growth of the SME. The first employees, customers, and suppliers are likely to come from the founders' own social networks. Further, these networks can be valuable sources of information for the young firm. As the SME grows, the networks available will be enriched through other sources such as other employees, customers, and strategic alliances.

Even though structural and managerial changes may be necessary in order to cope with the increasing complexities that come with growth, founder succession is not always necessary. If the founder is able to learn and adapt to the new organizational complexities, the company may achieve the same performance as if it had introduced a "professional" CEO (Willard, Krueger, & Feeser, 1992). The founders' continued participation in the management team is also found to have a positive impact on the ability to grow (Kor, 2003). The founders' belief that "*success is possible because of the uniqueness of the idea and the strength of the product*" needs to be

built into the organization through the managerial team in order to preserve entrepreneurship (Stevenson & Jarillo-Mossi, 1986). Further, founders bring value to the competence of the management team in generating entrepreneurial growth, as well as their knowledge of the firm's history and resources (Kor, 2003). Their active participation is especially important in periods where new managers without industry-specific managerial experience are part of the management team (Kor, 2003). Even so, the roles of the founders are often challenged by growth, and this may become a challenge for the SME.

2. Organizational structures and systems

As the SME grows, the scale and scope of its operations will grow with it – leading to a more complex organizational environment. This puts a pressure on the owners to increase their staff and implement new organizational designs to optimize processes and communication.

Organizational structures

In the start-up phase, the small firm is usually built around the founder(s) and trusted “first employees”, where the same people are both shareholders, top management, and decision makers. The SME is often highly dependent on the founders for their survival in the first years of operation, making ‘micro-management’ and ‘autocracy’ a natural way of organizing the business (Mazzarol, 2003). Small firms tend to use simple organizational structures, since they have not yet reached the scale of operations required for bureaucratization, and thus want to maintain centralized control of the operations (Mintzberg, 1980).

However, the complexity of managing and coordinating the resources of the firm will increase as the firm grows, and owner micro-management becomes insufficient to deal with the complexities. This may create a pressure for a shift towards more professional organizational structures with increased delegation of responsibilities and decentralization of decision-making. There may also be a pressure from the employees, finding themselves restricted by the cumbersome and centralized decision-making processes (Greiner, 1972). The relevance of research from “stage models” becomes apparent, as they highlight the requirement for the owner-managers to adapt both new managerial practices and new organizational structures as the SME grows. The small-business managers may experience a challenge if they do not have the time or abilities to learn how to delegate, or the knowledge of how to create environments where employees assume responsibilities (Mazzarol, 2003). There may also be a dilemma of

whether the adoption of more efficient professional structures will impair the flexibility necessary to stay entrepreneurial and innovative.

Functional specialization

Another area closely related to organizational structures is functional specialization. In the simple entrepreneurial structure, you will often find broad and overlapping roles and responsibilities. However, as organizations grow in size and complexity, specialized assignments follow from the differentiated functional structure and the new roles required due to changes in scale and scope (Hanks & Chandler, 1994; Gilbert, McDougall, & Audretsch, 2006). The rationale for using resources more specialized in a larger organization also lies in the opportunity to extract more value from the contributions of each resource (Penrose, 1959), and functional specialization enables employees to gain expertise in specific areas and perform the functions more efficiently.

However, SMEs may see a trade off in moving towards specialization. While specialization may lead to higher efficiency and less role conflicts, small firm managers often perceive specialization and job descriptions as rigid and thus influencing the flexibility of the SME (Kotey & Slade, 2005).

3. Human Resource Management

HRM practices in growing SMEs have received little attention from researchers (Tansky & Heneman, 2003), as HRM research has mostly been focused on large, bureaucratic, highly structured companies (Phelps, Adams, & Bessant, 2007). However, it is shown that developing HRM policies and practices is critical to long term success of the SME, and companies that don't develop these aspects as they grow may face higher than average personnel-related problems (Mazzarol, 2003).

Recruiting

It is expected that the informal recruitment sources, often preferred by owner-managers, will no longer be sufficient as the SME grows (Kotey & Slade, 2005; Mazzarol, 2003). In the small firm, new hires are often recruited through the personal networks of existing employees. However, growth leads to requirements for more specialized employees, changing the sources of candidates and the requirements for formalized selection techniques (Kotey & Slade, 2005).

Further, a lack of legitimacy may constraint the access to the best resources (Cardon & Stevens, 2004). Thus, small firms may find it challenging to scale their operations due to limited access to qualified resources and lack of recruiting capabilities.

Training and socialization

In addition to finding and recruiting new employees, onboarding and scaling those employees through socialization and training also becomes more important as the SME grows. Growth leads to shifts in roles and responsibilities, and some sort of training and development is vital to the success of the employees and the business (Cardon & Stevens, 2004). However, the training methods for small businesses are often informal and on the job, with no systematic approach to training (Kotey & Slade, 2005), and the SME may find it challenging to develop the capabilities required for further growth.

The lack of formal and/or external employee training may inhibit both the absorptive capacity of the SME and the ability to develop sustained competitive advantages. In a review of the existing research, Kotey and Folker (2007) summarize that the reasons for SMEs preferring informal internal training may be:

- 1) Costs of formal training
- 2) Short planning horizons
- 3) Fear of losing employees due to lack of internal promotion opportunities
- 4) The need for flexibility rather than specialization
- 5) Inability to establish a direct positive link between training and performance

Goal alignment

As described in the discussion of this thesis, growth may introduce moral hazard when the goals of the employees are not aligned with the organizational goals. The early employees are often rewarded through either ownership or seniority in the company, while the later are not (Cardon & Stevens, 2004). Further growth will include change and risks, and only those employees that desire such change will promote it. The SME must therefore generate personal opportunity coming from growth for all employees, that includes both money, status, and power (Stevenson & Jarillo-Mossi, 1986). Small business managers often struggle to find goal-alignment mechanisms that are able to scale as the organization grows (Cardon & Stevens, 2004).

4. Managerial Capabilities

As commented previously, smaller companies usually have a simple organizational structure, with management and decision-making power centralized in one or a few persons – often the founder(s). As the firm's productive opportunity set grows to a complexity that cannot easily be managed by this centralized decision-making unit, the SME may experience a crisis of leadership and a void in managerial competence. Resolving this crisis often involves a combination of new organizational designs and developing managerial capabilities.

Developing managerial capabilities

Penrose (1959) argued that firm growth is limited by the *ability* and *availability* of managerial resources; and that there is a trade-off in developing and training new managerial resources and exploiting the existing ones. As Penrose explains, the administrative framework of the firm consists of both *entrepreneurial* and *managerial* services. While the entrepreneurial services generate new market-, product-, and service ideas, the managerial services facilitate profitable execution through coordination and deployment of the firm's resources. As the SME grows, the growth will put more pressure on the managerial resources, while these same resources must also be involved in developing new managers with firm-specific and shared team-specific capabilities. This dilemma is referred to as the *managerial capacity problem* (Barringer & Jones, 2004).

Finding the right managers may also become a challenge for the SME. While the existing employees may have firm-specific skills, they often lack the generic managerial skills. Generic managerial skills may be developed through internal training (e.g. mentoring and experience) or external training (e.g. management schools), but both alternatives are time consuming and have their trade-offs. On the other hand, recruiting new employees with generic and/or industry-specific skills may be difficult, and will require the lengthy process of organizational socialization and development of firm-specific skills (Barringer & Jones, 2004). In addition, new managers will need to develop shared team-specific experiences with the other managers to establish the trust required to function properly (Kor, 2003). This is especially important in small firms where the founders, who initially handled most of the management and planning, may be reluctant to delegate responsibilities. However, Kor (2003) also found that a too high level of team-specific experience in the managerial team may lead to group-think and lower performance levels, as the management team becomes less inclined to question each other's

decisions. The introduction of new managers with different backgrounds may therefore be necessary in order to balance the managerial team.

Growth motivation and alignment of interests

The interests of managers must be aligned with those of the founders and shareholders in order to contribute to growth. If the growth motivation of the managers is lacking or misdirected, the SME may not be able to pursue the opportunities available in the business environment.

As the SME grows and introduces new managers, it most likely moves towards a separation of ownership and control. Delegation of decision-making authority will result in principal-agent problems (Jensen & Meckling, 1976), where the founders and shareholders must establish incentives and monitoring mechanisms to ensure that the new managers act in the interest of the firm. The possibility of opportunistic behavior and politics may be reduced through organizational mechanisms, but the SME may lack the knowledge of how to establish the right financial- and non-financial incentives. However, organizational socialization of new managers and the use of growth-oriented mission statements (Barringer & Jones, 2004), as well as the founders' participation in the management team (Kor, 2003), may provide direction and alignment of interests in favor of future growth.

5. Strategic alliances

Strategic alliances act as sources of resources for the SME, where resources may be both tangible (e.g., financial, technological) and intangible (e.g., reputation, managerial capabilities). Further, strategic alliances are often established to share the risks involved in market activities between the partners, and are found to more often emerge in highly competitive industries or when a firm has a pioneering technology (Eisenhardt & Schoonhoven, 1996). As stated previously in this thesis, the ability to establish and manage strategic alliances affects the growth of SMEs. In example, growth-oriented firms may reduce the gap in managerial capacity through partnerships with other organizations (Barringer & Harrison, 2000; Barringer & Jones, 2004).

According to Eisenhardt and Schoonhoven (1996), strategic alliances are formed either because of a vulnerable strategic position where the firms needs the resources that alliances can provide, or when firms have a strong social position with the resources necessary to know, attract, and engage partners. For the SME, this means that they must also have the resources that the partner

needs in order to form an alliance, or they must have social advantages through personal relationships with the alliance partners.

While the conditions of the business environment may suggest that alliances are necessary for growth (e.g. hostility and scarcity of resources), other forces of the SME may inhibit the establishment. A challenge that may come from strategic alliances is the SME becoming overly dependent on their larger partner, resulting in a loss of control over their own business decisions (Street & Cameron, 2007). For a control-oriented founder, the prospects of a large company affecting the decisions in the SME may result in a reluctance to establish alliances.

Further, successful establishment and management of alliances requires relational-, combinative-, and absorptive capabilities (Lechner & Dowling, 2003), and the SME may not possess such managerial capabilities. Hoffman and Schlosser (2001) found that the strategic rationale of the collaboration, the fit between the SME and the partner, and the chosen configuration of the alliance together form the foundation that shapes the success or failure of the partnership. As described previously, strategic planning may not be a core capability of the SME, and they may thus have a disadvantage in the formation and establishment of the alliances.

Strategic alliances also require a continuous management of the boundary or interface between the organizations, as well as coordination of the ongoing activities (Street & Cameron, 2007). As the interests and motivations of the stakeholders and decision-makers of the SME and the partner may not be aligned, the alliances could introduce principal-agent problems that require incentives to align the interests in order to meet the expectations. Thus, the transaction-costs of alliance relationships can be high.

To conclude, the establishment and management of strategic alliances requires both resources and capabilities that are already scarce in the SME. In addition to selecting the right partners and planning the configuration of the relationship, the SME must continuously coordinate and manage the activities. Partners may also introduce new pressure on the direction of the SME, and thus increase the complexity of managing the firm. It may not come as a surprise that, even though strategic alliances are important to growth, it is shown that most alliances fail to accomplish their intended goals (Barringer & Harrison, 2000).

6. Financial Resources

Small firms will often need to grow in order to reap the economies of scale, or they will have a cost disadvantage compared to their larger competitors (O'Farrell & Hitchens, 1988). However, in order to grow they will need working capital to reach customers and fund the growth initiatives. Without the necessary access to internal or external financial resources, the SME may suffer from an “exploitation ability” disadvantage, meaning it cannot pursue the opportunities available in the business environment.

Profit-driven growth

In an ideal scenario, the internally generated profit of the SME is sufficient to fuel subsequent growth. This, however, requires that the SME is an already profitable business. Steffens et al. (2009) found that businesses focusing first on above-average profitability before pursuing growth are more likely to achieve sustained performance than those pursuing growth before profitability. In the case of an already profitable business, financial resources for growth may however be limited by the preference of business owners and shareholders to extract dividends rather than fueling subsequent growth.

Bootstrapping

Not all SMEs are able to generate the required financial resources through a profitable business. Often, the focus in the early years of the business is value *creation* (e.g. innovation and development of products or services) rather than *capturing* value. It may also be the case that a good revenue model is not yet found.

In this case, resources for further growth is limited by the available working capital. Financial bootstrapping refers to methods to meet the need for resources without using external financing through debt-holders or new owners (long-term external finance). Bootstrapping-methods are used to reduce the overall capital requirements, improve cash flow, and take advantage of personal sources of financing (Ebben & Johnson, 2006).

In a study of bootstrapping-behavior in 264 Swedish firms, Winborg and Landström (2001) found that firms use several “modes” of bootstrapping: (1) Internal mode (e.g. delaying payments, owner financing, withholding managers salary), (2) Social mode (e.g. joint utilization of resources with others), and (3) Quasi-market mode (e.g. government subsidies). However, they argue that such methods of obtaining finance are not given enough attention in

the education of small business managers. Hence, the managers may struggle to find ways to fund their growth through bootstrapping.

External financing

The amount of financial resources required to grow is often beyond what is available through the SMEs operational profit or bootstrapping. External financing refers to long-term financing through bank loans or external investors. SMEs often have limited access to such financing, either because the internal shareholders prefer to maintain control, or due to limited access and high costs coming from information asymmetries and fixed transaction costs. As mentioned previously in this thesis, owner-managers tend to prefer debt to external equity finance (Steffens, Davidsson, & Fitzsimmons, 2009), but banks are often reluctant to provide loans to what they perceive as high-risk new ventures. Venture capitalists and other investors may then be the only source for financing growth, leaving the SME founders in a dilemma of whether to grow or to maintain control of their business. This relates back to the founders' growth orientation as discussed previously. Further, the SME founders' and managers' *ability* to obtain capital from such sources may be of great importance to the growth of the firm (Gilbert, McDougall, & Audretsch, 2006).

7. Strategic orientation and entrepreneurship

There is no commonly accepted or universal definition of strategy. According to Porter (1996), strategy is about defining a company's position, making trade-offs, and forging a fit among activities. There is also an important distinction between corporate-level strategy (what business the company will compete in) and business level strategy (how the company will compete in that business). It should be recognized that the strategy of the SME will affect (and be affected by) the other dimensions in the framework presented. Further, it is important to recognize that strategy is more than the content of a written document – it encompasses the *process* required in both formulating and deploying the strategic plan (O'Regan & Ghobadian, 2002). Following the descriptions by Stonehouse and Pemberton (2002), this thesis will use the following definitions related to strategy:

- **Strategic management:** The use of a set of theories and frameworks, supported by tools and techniques, designed to assist in thinking, planning and acting strategically.

- **Strategic thinking:** Thinking beyond the day-to-day business to develop a long-term “strategic intent” for the business.
- **Strategic learning:** The process by which organizations learn about themselves and their environment.
- **Strategic planning:** The setting of long-term organizational objectives, and the developments of plans to achieve those objectives.

In this thesis, the “strategic orientation” of relates to the degree the SME utilizes all these dimensions of strategy in order to grow. In short, it relates to the capabilities and willingness to learn about themselves and the environments, and the ability to use this information to think and plan according to a long-term vision for the business. It is also important to acknowledge that strategic thinking is a separate process from the planning activity, and cannot substitute for a plan (Anderson & Atkins, 2001).

The relationship between strategy and growth

SME owner-managers are often reluctant to take advantage of strategic management and planning, and uncertain of whether strategy really matters to the growth of the SME. Research has shown that the fit between strategy, structures and process is more important to performance and growth than the particular strategy the SME decides to follow (Eisenhardt & Schoonhoven, 1990). Chandler and Hanks (1994) found that the strategy-growth relationship is contingent on the *resources* the company has to support the specific strategy. Lyles et al. (1993) concluded that formal strategic planning helped SMEs make better long-term decisions, but that the *process* of planning was more important than the plan itself. Berry (1998) found that owner-managers who lacked strategic *awareness* were likely to hold back the growth of the SME and put its survival at risk.

It is also widely acknowledged that strategy needs to be adapted to the business environment and the industry life cycle, making strategy a continuous process. As the industry characteristics, competing products, and critical success factors change, the strategies of the firm must also change (Afuah & Utterback, 1997). Thus, findings on *specific* strategy-growth relationships (for instance suggesting that a differentiation strategy is more likely to lead to growth than a low-cost strategy) are unlikely to be generalizable across studies (Davidsson, Achtenhagen, & Naldi, 2007).

Changes in the strategic orientation of the SME as it grows

As the firm grows, it usually implies a shift in the strategic orientation of the SME. In small firms, the strategic orientation is often towards short-term and operational tactics rather than long-term strategic planning, and decision-making is *reactive* rather than proactive (Wang, Walker, & Redmond, 2007). These firms rarely use tools and frameworks for strategic management, and lack strategic thinking (Stonehouse & Pemberton, 2002). Mintzberg and Waters (1985) commented that small firm strategy is often “emergent”, and involves identification and pursuit of initially unforeseen opportunities - which may be described as an *opportunistic* approach to strategy. Others have commented that SME owner-managers often suffer from “strategic myopia”, characterized by short sighted focus on the daily *operational* matters (Mazzarol, Reboud, & Soutar, 2009). Further, it is found that many SMEs are not “entrepreneurial” in the first place, and will never engage in strategic planning or active growth activities. This is related to the owner motivation, where owners with non-economic personal agendas show lower levels of strategic planning than those with a pro-growth agenda (Wang, Walker, & Redmond, 2007).

Research shows that the sophistication and formalization of strategic planning evolves as the SME grows in size (Stonehouse & Pemberton, 2002). Gibson & Cassar (2005) found that strategic planning is more likely to be introduced in the SME *after* a period of high growth than before. The formalization of strategic planning is also suggested in the stage models, e.g. Scott & Bruce (1987), where increasing organizational complexity is suggested to push strategic planning from “eyeball control”, through forecasting, towards externally oriented and proactive planning of the firm’s future. Formalization and professionalization of the planning process comes from both internal and external pressure (Stone & Brush, 1996; Anderson & Atkins, 2001). External stakeholders, such as investors, customers, banks, and shareholders will require a long-term plan for the development of the SME, and a growing number of employees will need to know the direction and vision of the company to ensure alignment of efforts.

Challenges faced by the SME

In order to achieve sustainable growth, it is important that the SME has a clear strategic vision, and that it is able to communicate this vision to its stakeholders – especially employees (Mazzarol, Reboud, & Soutar, 2009). It is further suggested that a more formalized approach

to strategic planning in the SME leads to fewer barriers in implementation (O'Regan & Ghobadian, 2002).

However, the SME may face several challenges in breaking from an opportunistic, reactive, and short-termed strategic orientation. It has been shown that SMEs led by entrepreneurs with solely technical skills often lack the *capabilities* to perform strategic planning (Berry, 1998). Further, owners without growth-motivation are less likely to be *motivated* to engage in long-term strategic planning (Wang, Walker, & Redmond, 2007). It has also been suggested that strategic planning in SMEs is compromised by the managers' lack of time, uncertainty about the strategy process, lack of strategic expertise, and hesitance towards sharing strategic plans with employees and outsiders (Robinson & Pearce, 1984). Finally, hiring specialized managers with expertise in strategic planning may not be feasible, as the size of the company makes it impossible to keep them fully employed (O'Farrell & Hitchens, 1988).

Other researchers have argued that having a strategic plan in the SME may actually lead to reduced strategic *thinking* (Anderson & Atkins, 2001). The entrepreneurial environment is unpredictable, and a formalized or rigid planning process may inhibit the flexibility and adaptability of the SME in response to changing market conditions. Matthews & Scott (1995) found that higher levels of environmental uncertainty was related to decreased levels of strategic planning due to uncertainty about the effectiveness of following a specific course of action. Thus, finding the right level of formality and sophistication for the strategic planning process, that at the same time accommodates the pressure from the forces described in the framework of this thesis, may become a challenge.

A strategic posture reflecting an Entrepreneurial Orientation (innovativeness, pro-activeness, and risk-taking) is assumed to be positively related to sustainable growth. Lumpkin et al. (2010) argued that a long-term strategic orientation would be positively associated with innovativeness and pro-activeness, but negatively associated with risk-taking. Dess et al. (1997) suggested that a strategy-making process reflecting Entrepreneurial Orientation combines a bold, directive, and opportunity-seeking style with risk taking and experimentation. Thus, SMEs with an Entrepreneurial Orientation will need to be good at both strategic thinking, -learning, -planning, and execution. However, researchers have argued that the idea of EO being *universally* beneficial for growth may be overly simplistic (Wiklund, Patzelt, & Shepherd, 2009), and that environmental dynamism, access to capital, and organizational factors are important moderators (Lumpkin & Dess, 2001; Wiklund & Shepherd, 2005).

5.4 Concluding remarks

This chapter has presented a discourse on the findings from the literature review and the case study, in order to construct a new conceptual framework that connects the growth process and the effects in terms of challenges that comes from growth. The chapter thus answers the third research question of this thesis: *How can different theoretical perspectives be integrated to present a holistic and integrative view of the challenges SMEs face during growth?*

The framework depicts the growth process as periods of convergence (or equilibrium), punctuated by a challenge that comes from a mismatch between the established organizational configuration and pressure from the internal and external forces affecting the direction of the SME. The faster the growth, the more “dramatic” are the challenges, as the increased velocity imply a more urgent and radical shift from the current practices in order to reach a stable state.

The framework is thus an alternative to the stage models that have dominated much of the literature on organizational evolution and growth, and it acknowledges the idiosyncratic and path-dependent growth patterns of SMEs. The framework further combines the findings from several schools-of-thought and theoretical perspectives, in addition to empirical findings from the case study. As a result, the conceptualization may help researchers converge on at least some aspects of the growth phenomenon.

I also believe that the conceptualization of the growth process and effects may help practitioners better understand *why* growth implies necessary changes in the organizational configurations. The challenges coming from growth, or the “*growing pains*”, are not always apparent to decision-makers – as was seen in the case study. The conceptual framework may thus help these decision-makers understand and resolve the challenges more efficiently, by serving as a guide towards where to look for challenges, as well as why they occur.

6 Conclusion

So in business a lot of things are folklore. They are done because they were done yesterday. And the day before. What it means is, if you are willing to ask a lot of questions and think about things and work really hard, you can learn business pretty fast. It's not the hardest thing in the world. It's not rocket science.

Steve Jobs

6.1 Introduction

Growth is an important indicator of the prosperity and success of SMEs. While an extensive and increasing amount of literature has made progress in explaining the phenomenon of SME growth, the field is still highly fragmented and limited by a lack of conceptual development. In this thesis, I have developed a conceptual framework of the SME growth process and effects. The conceptualization may help practitioners ask the right questions as their business grows. It is novel in its structure, and draws upon several decades of research from the academic field. Furthermore, the framework is enlightened by empirical data from an in-depth case study. As such, it is my belief that it represents a well-grounded framework.

In addition, I have structured and presented a thorough review of the literature on SME growth. While the review is not exhaustive, it provides a guide for new researchers and practitioners who want to familiarize themselves with the fragmented field of SME growth research.

In this chapter, I will briefly revisit my problem statement and research questions; and argue to what degree they have been answered through the thesis. Next, I will discuss the limitations of the thesis, before concluding the thesis by providing suggestions for future research.

6.2 Problem statement revisited

This thesis had three research questions:

Research Question 1: *How is the phenomenon of SME growth explained in the literature?*

Chapter 3 of this thesis contains a literature review of the research on SME growth. The review categorized the research into seven theoretical “perspectives”: *stochastic models, stage models, evolutionary models, resource based view, learning perspective, deterministic approaches*, and *Entrepreneurial Orientation* research. Each of these perspectives contribute to our understanding of SME growth, albeit through differing conceptualizations of the phenomenon. As previously commented by other researchers (cf. Davidsson, Achtenhagen, & Naldi, 2007; Wiklund, Patzelt, & Shepherd, 2009; Dobbs & Hamilton, 2007), the fragmented research field also makes it hard to distill a coherent picture. As for the problem statement of this thesis, I did not find an existing satisfactory theory explaining the growth *process* and *challenges* of SMEs. However, the literature review resulted in 16 propositions that were utilized throughout the thesis.

Research Question 2: *How is growth experienced by practitioners in an SME?*

Chapter 4 of the thesis presents the case study of a Norwegian SME. The in-depth case study provided insight into the process and challenges of growth, described through the experiences of practitioners. The main finding from the case study was that growth was experienced as an evolutionary process, where the challenges emerged gradually as the complexities of the organization increased. While the single case study does not create a validity of the findings, it indicated the need for a conceptualization of the growth process that takes into account the path-dependency of organizational configurations. Several challenges were also highlighted that shed light on the findings from the literature review. Especially, the case study illustrated the challenge of control vs. growth in the SME.

Research Question 3: *How can different theoretical perspectives be integrated to present a holistic and integrative view of the challenges SMEs face during growth?*

Based on the findings from the first two research questions, Chapter 5 presented a discourse on the process of SME growth and the accompanying challenges. By combining the findings from prior research and the empirical data from the case study, I proposed a conceptual framework that aimed to integrate these findings. The framework depicts the SME growth

process as periods of equilibrium, punctuated by challenges coming from the pressure from four forces (decision-makers, stakeholders, the productive opportunity set, and the business environment). When the SME's organizational configurations are sufficiently misaligned with the pressure from these forces, it will experience a challenge that must be resolved to continue the growth process. The framework further introduced seven *categories* of challenges, based on the findings from the literature review and case study, and provided additional references to literature that may guide researchers and practitioners toward more specialized research on each challenge.

The **problem statement** of the thesis was:

Given the current research on SME growth, contrasted against how the phenomenon is experienced by practitioners, how can we better conceptualize the process of growth and the challenges that SMEs face as they grow?

This problem statement summarizes the research questions, and highlights the conceptualization of the growth process and challenges. Based on the answers to the research questions, and the presentation and discussion of the conceptual framework in Chapter 5, I argue that I have fully answered the problem statement of the thesis, which also served as the main research question. The conceptual framework presented in this thesis is novel in its structure, and represents an improved conceptualization that draws upon several research streams and schools-of-thought.

Further, based on the keyword '*better*' in the problem statement, another question arose while conducting the study: *May the conceptual framework be practical and advantageous for practitioners?* This question was not empirically answered, but the findings from the thesis indicate that the conceptualizations found in the literature review either do not represent the idiosyncratic and path-dependent growth of SMEs, or are too theoretical to be advantageous for practitioners. The conceptual framework presented in this thesis may help practitioners ask the right questions as their company grows, and thus be both practical and advantageous. Furthermore, the findings from the case study indicated that not all challenges in the organization were obvious to decision-makers, and that a conceptualization such as the one provided in this thesis may help these decision-makers understand and resolve issues at an earlier stage. Therefore, while the framework was not tested *ex post* to verify its applicability, I argue that the framework may be both practical and advantageous for practitioners.

While further research on the field of SME growth, and especially the process and effects, is necessary in order to establish an adequately coherent theory of the phenomenon, I claim that my contribution has added value to the field and that the problem statement of the thesis was both relevant and sufficiently answered.

6.3 Limitations

As with all research, there are limitations to the scope and configuration of this thesis that should be noted.

In the literature review, I presented an extensive review where I tried to include the most salient works and the most prevalent theoretical perspectives related to the problem statement of the thesis. However, the selection of literature is not exhaustive, and may have left out research that would have been relevant. In addition, newer and novel research may have been excluded due to the partly reliance on citations as a proxy for relevance. Finally, in order to present a review that covered all perspectives without being overwhelming, the theories were presented in a less comprehensive way than what would have been necessary to allow the reader to fully grasp the concepts. It is thus advisable for the reader to further review the literature in order to gain a thorough understanding of the theoretical perspectives and their nuances.

Furthermore, due to the time constraints of a master's thesis, the empirical research conducted through the case study was limited to a single company. While the approach of an in-depth case study was both appropriate and sufficient to implicate the process and effects on growth in an SME, and the contributions toward deriving theory in this master's thesis were invaluable, I acknowledge the limitations of validity due to the sample size. Further, the case study was retrospective, and primarily relied on the memory of the interviewees. While this challenge was partly resolved by increasing the number of interviewees and triangulating the information, validity would be improved by conducting a longitudinal case study. Finally, the case study was from a single industry, which may impair the transferability of the results.

Finally, I have proposed a conceptual framework that aimed to integrate the most important findings from existing theoretical perspectives, and which was further enriched by the findings from the case study. However, the framework has not been subject to empirical validation, and is limited by the findings from a single case study. While I argue that the framework should be both practical and advantageous to practitioners, it does not represent the full range of

challenges that SMEs may face as they grow. In addition, further research should be conducted to explore the relationship between the forces putting pressure on the SME and the challenges they result in.

Considering these limitations, I still believe that the findings and results from this thesis has novel value to the academic field, and that the contribution through the conceptual framework might inspire practitioner application.

6.4 Future research

The conceptual framework presented in this thesis is novel in its presentation, and may have raised more questions than it has answered. As stated previously, there are several limitations to the theoretical value of the framework. I will thus present a selection of research opportunities that I hope future researchers will be enticed to take advantage of in order to bring forward the academic field.

6.4.1 Empirical examination of the conceptual framework:

The conceptual framework has not been empirically tested, and is only suggested as an improved conceptualization of the growth process of SMEs and how this process may lead to challenges. Further empirical testing would be necessary in order to improve the credibility and transferability. Some research suggestions are:

- Qualitative testing of the framework in one or more high-growth SMEs, as the growth rate is suggested to expose the challenges more easily. This may also reveal additional challenges that were not found during the development of the current framework.
- Qualitative testing of the framework in another industry to improve the transferability or to reveal flaws that disables the framework from being applicable in other industries.
- Qualitative testing of the framework in another cultural setting. While culture was not exposed as an explicit dimension of the framework, it is assumed that culture may affect both the pressure applied from the forces, and the nature of the challenges that arise. In example, other cultures may have different levels of risk-willingness or attitudes towards management.

6.4.2 Improvements of the conceptualization

In addition to testing the applicability of the framework, several areas would need improvement in order to enhance the *theoretical* value of the framework. The following suggestions for future research would bring the conceptual framework to a new level of theory development:

- Qualitative and/or quantitative studies of the relationships between the forces of the framework and the associated challenges. This thesis proposes that the combinations of pressure from the forces create organizational issues, rather than each force by itself. However, the research has not exposed in detail to what degree each force affects the organization. This research area would allow a variety of future studies.
- Further qualitative case studies, preferably with a longitudinal research approach, should be able to expose additional organizational and managerial challenges and their relations to the forces.
- This thesis proposes a linkage between the growth rate of the business and the severity of the challenges. This linkage is merely theorized, and should be further explored in quantitative and/or qualitative studies. Especially, the framework may allow for a multidimensional analysis of the growth rate, where growth affects each of the forces putting pressure on the SME.

6.4.3 Expanding the conceptual framework

In addition to the testing and improvement of the existing conceptualization, I suggest that future researchers should be able to *expand* the framework. Especially, the following expansions should be considered:

- This thesis proposes that challenges are resolved through application of existing knowledge or by learning, as suggested in the learning perspective presented in the literature review. However, the linkage to resolutions is not comprehensively described, and researchers should seek to clarify the relationship between challenges and the resolutions.
- The conceptual framework draws largely upon ideas from the evolutionary perspective of growth. However, further research could be conducted to clarify the linkage to evolutionary theories, with special attention to the punctuated equilibrium paradigm.

- Finally, the linkages to the other research foci of SME growth are not explored. Research that seeks to connect the conceptual development from this thesis with the *antecedents*, *mode*, and *amount* of growth would be of high value to the coherence of the academic field.

6 Conclusion

7 References

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