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Do high-growth entrepreneurial firms have a specific system of governance?

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Abstract: From a meta-model linking a firm's corporate governance system to managerial discretion (Charreaux, 2008), this article presents a specific corporate governance model for the high growth entrepreneurial firm. A survey of the empirical literature on the governance of entrepreneurial firms confirms the plausibility of this theoretical framework, especially with respect to the cognitive dimension of corporate governance.

Keywords: High growth – governance – managerial discretion – cognitive dimension – discipline.

JEL codes: G3, M13

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Certain mechanisms of governance have been identified as important vectors in the implementation of a high growth strategy for dynamic entrepreneurial firms. Daily and Dalton (1992, p. 382), for example, have established a link between the structure of the board of directors and the growth rhythm of entrepreneurial firms: "The board of directors […] may be the sensible tool to utilize when striving for firm growth". Certain founding managers thus volunteer to open the board to independent external directors with the aim of reinforcing the base of strategic and managerial competences, in order to better manage the entrepreneurial process. Rather than just a structure to monitor the behavior and integrity of the manager, the strategic aid brought by directors would be a particularly valuable resource for young high growth enterprises that would need this advice to support the manager in the quality and speed of decision-making (Grundei and Talaulicar, 2002). Yet, the traditional approach to governance is based on the theory of agency referring to the large managerial firm (Berle and Means, 1932; Fama and Jensen, 1983) keeping the accent essentially on the function of manager surveillance with the aim of avoiding the appropriation of personal benefits especially when dealing with a widely dispersed stockholder group. In this sense, the board of directors plays the role of a counter-power, essentially charged with ratifying decisions and monitoring their implementation (Fama and Jensen, 1983), not as a support in strategy formulation and implementation. However, certain research studies on the particular case of high growth entrepreneurial firms put the emphasis on the role played by the board of directors in the acquisition of managerial competences, in order to better handle the dynamics of high growth (Hambrick and Crozier, 1985, p. 37). This sweeps aside the conception of a unique model of governance and opens the way to a study based on roles of governance mechanisms, being contingent on firm characteristics, among which growth opportunities seemingly occupy a significant place (Lehn *et al.*, 2003).

The board of directors is, however, only one mechanism of governance among many, and true governance of an enterprise is a system where several mechanisms react and interact in a dynamic manner (Charreaux, 1997). Research on the structural specifics of growing entrepreneurial firms have identified, in addition to the board of directors, a managerial team (that surrounds the chief executive officer, CEO) and venture capitalists as actors who are particularly important to governance (Daily *et al*., 2002). Questioning the specifics of the governance of young dynamic firms raises the reflection to at least two levels: (1) If the ideal system of governance for growing entrepreneurial firms is truly contingent on firm characteristics, what is its form or morphology? In other words, what are the different mechanisms involved, what is their nature, how do they interact? (2) What is the precise role played by these different governance mechanisms in the very particular context of entrepreneurial firms pursuing a growth strategy? Do they function principally in such a way as to minimize conflicts of interest between managers and stockholders as the dominant approach would have it (Fama and Jensen, 1983), or are they above all a cognitive lever supporting managerial discretion in the pursuit of a high growth strategy (Forbes and Milliken, 1999; Hambrick and Crozier, 1985; Rindova, 1999)?

The present article begins with the premise that the specificities of governance systems for firms are a function of both their characteristics and their stage of development (Filatotchev and Wright, 2005), understanding that particularly strong growth typically characterizes them as young in their life cycle, heading towards “adolescence” (Zahra and Hayton, 2005).

To structure our study on the specifics of governance for young growth firms, we begin with the meta-model linking systems of governance and managerial discretion, recently proposed by Charreaux (2008). The first part of this paper is a description of this meta-model. Its

advantage is the focus on the various levers possible in the interaction between governance and managerial latitude, as the action of the CEO and the competences of the different actors that surround him (managerial team, directors, venture capitalists) have been identified as essential vectors in the strategic success of entrepreneurial firms (Bourgeois and Eisenhardt, 1988; Daily and Dalton, 1992; Hambrick and Crozier, 1985). Being a meta-model, it is *a priori* sufficiently large to accommodate the multitude of more specific governance models, it doesn't focus on one mechanism of governance (the board of directors, for instance) and is not only reserved to certain types of enterprises *à la* Berle and Means. Notably, it allows for the identification of the different possible governance mechanisms and, from that, the understanding of their interaction with the CEO (and the managerial team). In addition, it acknowledges that the system of governance assumes multiple and changing roles that, in a perspective of organizational efficiency, may limit managerial discretion within either a disciplinary perspective or, on the contrary, give it increased managerial power on strategy within a cognitive perspective. Charreaux's (2008) very general meta-model on governance and managerial discretion can then be applied to the particular case of a high growth entrepreneurial firm. The second part of the paper will be a review of the empirical literature concerning the governance of entrepreneurial firms. This literature review will first identify (IIA) the most significant mechanisms typically characterizing young growing enterprises. We will attempt to clarify their nature and their interaction, while underlining the importance of their sometimes informal working mode, beyond the usually studied structural and formal characteristics. We will then show (IIB) that even though the tools for the governance of entrepreneurial firms take on a double role, both disciplinary and cognitive, the empowering cognitive dimension – where the governance mechanisms contribute to the acquisition and construction of cognitive resources – globally appears to be most important in firms that take the strategic challenge of high growth.

I. From a meta-model of governance and managerial discretion…

Charreaux (1997) defines corporate governance as "the group of mechanisms that define powers and influence decisions of the chief executive, in other words, the mechanisms that 'govern' his behavior and define managerial discretion". This definition portrays governance as a system, within which mechanisms of different levels and natures co-exist. There are mechanisms specific to particular firms (example: the board of directors of a particular firm is made up of certain people, with certain characteristics…) as well as non-specific mechanisms (example: regulations and legal frameworks) that apply to a larger population of enterprises. In addition, within these two levels, there are intentional mechanisms (example: institutional stockholders can intentionnaly pursue a strategy of imposing high levels of independent directors within the corporate board) and mechanisms that emerge spontaneously from the interaction between various actors of governance and the CEO and which are not written (work atmosphere and the trust that can exist between directors and managers as a result of their specific interactions). The entirety of these mechanisms form, in the case of one particular firm, a complex and dynamic device that will interact with the CEO who is more or less free in the formulation and implementation of strategic decisions.

According to this rather wide definition of the governance system, it can assume different roles. The dominant theoretical approach of governance has come from agency theory (Daily *et al.*, 2003). It puts the accent on the disciplinary role of governance, whose principal function is to manage conflicts of interest in organizations that are marked by a strong separation between control and ownership (Fama and Jensen, 1983). Agency theory studies

different mechanisms of governance as well as their interactions. Hence, Fama (1980) was interested in the relationship between various mechanisms such as the intentional and specific, for example, as is the case with a board of directors, and other mechanisms, specific and non-specific. Among the mechanisms described by Fama (1980), we find a reciprocal monitoring among managers (a specific and spontaneous mechanism according to Charreaux's 1997 classification) as well as the managerial labor and financial markets (both spontaneous and non-specific mechanism). In addition to the aforementioned mechanisms of governance, mainstream financial research attaches great importance to the legal tradition of a country (a mechanism of intentional and non-specific governance) on which the proper functioning of spontaneous market mechanisms, notably financial (La Porta *et al.*, 1998) more or less depends. Thus, Fama (1980) had already analyzed corporate governance as a system, directed by a group of mechanisms of different natures and intervening at different levels according to varied modalities. This traditional approach is however limited as its focus is almost exclusively on the disciplinary role of governance and only on the mechanisms of incentives and control, not allowing the approach to attain the status of a universal model. This was not the intention, as the first supporters of agency theory took care to specify the conditions under which their models could be applied. The theoretical reflections of Fama (1980) were explicitly conducted in the context of large and open stockholder corporations (p. 288). To construct this fundamental model of governance within agency theory, the "entrepreneur is [...] laid to rest" (*ibid*), which shows the difficulty of a simple transposition to a high growth entrepreneurial firm where, by definition, the entrepreneur is the central actor. In the search of a meta-model of governance, it was thus necessary to open up theoretical perspective. One of the weaknesses of the dominant disciplinary approach concerns its lack of development for the emergence of strategies. Strategic opportunities for the creation of value are, in effect, implicitly assumed to come from the outside – a given menu from which to choose. In such a

context, the role of governance mechanisms simply requires strong discipline within the decision process, of the type that will lead to "good" projects and avoid personal enrichment for the manager. Fama and Jensen (1983) show a 4-step decision process (initiation, ratification, implementation and monitoring) and demonstrate a clear separation of roles between managers (initiation and implementation) and the board (ratification and monitoring), with its theoretical capacity to lessen agency costs and thus, increase value. Governance mechanisms, according to this perspective, will intervene essentially as a disciplinary measure to ratify and objectively keep a watch on manager decisions, thus greatly limiting managerial discretion.

More recently, new perspectives on governance question this strict separation of roles between the manager and the system of governance. Cognitive and behavioral approaches in governance (Charreaux and Wirtz, 2006; Forbes and Milliken, 1999; Rindova, 1999), notably allow us to understand that, in reality, all strategic opportunities are far from coming externally from the environment and, yet, this is a necessary condition in order to employ objective discipline. On the contrary, the strategy builds itself through the actors involved – among others, those who intervene in governance mechanisms – in function of their knowledge, specific competencies and various interactions. It is possible then to admit that certain governance mechanisms such as the board of directors could play a role that, far from limiting the manager by unilaterally imposing strict financial discipline, permits the manager to use it as a support for his/her action. In other words, governance mechanisms can be empowering, supporting, for example, a strategy of high growth for the manager-entrepreneur in a complex and changing world. Such support is apt to take different forms. It could, for example, increase expertise in terms of problem resolution (Rindova, 1999) using the diverse knowledge and competencies made available from the recruitment of directors with varying

profiles. We can imagine that such multiplicity of perspectives is not without influence on the processes that the managers use to forge a vision of strategic challenges, enabling them to achieve stronger strategic initiatives. The system of governance intervenes as soon as the decisional process is initiated (phase 1 in the Fama and Jensen model: "initiative"). In some cases, certain mechanisms, such as the board of directors and managerial labor market, could act directly in the implementation of certain of the manager's projects, by providing the functional and managerial competences necessary to master these managerial stakes (phase 3: "implementation"). As a result, the governance system is not only there to limit managerial discretion by surveillance. In certain cases, it can also increase it, acting as professional support to better control the stakes involved in a high growth strategy. It is prudent, however, to underline the fact that the cognitive role of a governance system has complex implications. The cognitive contributions could, on the one hand, be enabling for the manager, as described previously. On the other hand, they could equally lead to a limitation of managerial discretion due to diverging interpretations made by the other actors of governance, of cause and effect between the CEO's decisions and corporate performance (Haleblian and Rajagopalan, 2006). This means that the CEO and certain actors in the governance system sometimes may disagree simply as a function of mutually inconsistent mindsets and independently of any problem of conflicting interests. If the actors in the governance system are powerful enough, they may succeed in imposing their viewpoint, hence constraining managerial discretion. Consequently, the cognitive dimension, by which the system of governance influences a corporation's decisional process, could, depending on the case, limit or increase managerial discretion.

Charreaux (2008) proposes a meta-model of governance and managerial discretion. It integrates, at the same time, (1) the contribution of disciplinary, cognitive and behavioral

theories of corporate governance in order to have a better understanding of the different possible roles of governance mechanisms and (2) the theory of upper echelons[1] that emphasizes the importance of the management team in the strategic process. To more clearly show the potential dual role of the cognitive and behavioral dimensions, Figure 1 presents a slightly adapted version of Charreaux's model. The cognitive and behavioral vectors could limit or, on the contrary, increase managerial discretion in function of certain contingency factors.

Insert Figure 1 about here

In this model, strategy – with its implications in terms of performance, growth[2], etc. – is constructed and implemented within the field of interaction between the CEO and the system of governance. The latter has an influence on managerial discretion through its use of disciplinary, cognitive and behavioral dimensions. The impact of the cognitive and behavioral levers on the area of a manager's discretion intervenes on two possible levels. It could, in the case of persistent strategic disagreement between the managers and the actors in governance (directors, for example) be felt as an interference and lead to the implementation of strict control, or it could be received as a welcomed contribution of cognitive and managerial resources and actually widen the capacity for managerial action[3].

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[1] This trend is due to Hambrick and Mason (1984). Serveral studies (for example: Bourgeois and Eisenhardt, 1988; Daily *et al.*, 2002; Hambrick and Crozier, 1985) concerning the strategic process in entrepreneurial firms underline the central role played by the characteristics and interactions of the members of the top management team.

[2] In Hambrick and Mason's model (1984, p. 198) of upper echelons, growth is one of the criteria that was closely studied and was the object of theoretical hypotheses. The significant functional experience of the members of the top management team in sales and marketing favors strong growth (p. 199).

[3] According to Hambrick and Mason (1984), managers' strategic choices are limited by their "cognitive base" and their values which act as a filter of perception of the environment, influencing the interpretation of perceived information creating priorities among the choices. Rindova (1999) demonstrated that a governance mechanism such as the board of directors can, in fact, serve to broaden the group of strategic options available to the

This generic model can be used to describe very different situations. Depending on the nature of the corporations studied, it apparently gives way to different configurations, specifically in terms of the relative importance given to the different dimensions (disciplinary, cognitive and behavioral). The dominant governance approach has thus, above all, been developed in accordance with challenges of the large managerial firm characterized by a certain maturity with a salaried chief executive handling information and confronted with numerous and dispersed stockholders. It is the enterprise *à la* Berle and Means, and the high potential of conflicts of interest within it, that creates the need for counter-powers that are both efficient and strong. The major challenge of governance in this type of enterprise is the strict framing of managerial discretion with a strong separation of roles, where the mechanism of governance intervenes, above all, as an instance of ratification and control playing on the disciplinary dimension[4] (Fama and Jensen, 1983). We are thus in a logic of role separation, where a governance mechanism is, above all, a constraint or a judge. The typical configuration of the system of governance of a large managerial corporation in maturity can theoretically be presented as shown in Figure 2.

Insert Figure 2 about here

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manager, due to a broadened view of the environment (*scanning*) and to the more varied models of interpretation contributed by directors with more heterogeneous experience. It is, thus, a case of reinforcement of the managers' discretionary space due to cognitive and behavorial dimensions of governance.

[4] Let us note, however, that it is not because the traditional form of large company governance places the accent on the disciplinary dimension, that the cognitive and behavioral phenomena are absent from large managerial corporations. Certain research has shown that the merger of large listed corporations could be the result of an over-confidence bias of cognitive origin on the part of the manager-initiator (Roll, 1986; Fanto, 2001). However, even though it may exist, one could also think that the content of a cognitive and behavioral lever is quite different in a managerial enterprise compared to an entrepreneurial firm in a high growth phase, taking into account the specificities of context. The dominant approach doesn't really explore that aspect. Fama and Jensen (1983), in their work on those firms characterized by strong separation of ownership and control (entreprises *à la* Berle and Means), simply predict the separation of the functions of initiative and implementation (going back to the managers) on one part, and of ratification and monitoring (going back to governance) on the other. Figure 2 takes this into account, in the sense that both the cognitive and behavioral levers being present take a different form and strength than that of the entrepreneurial firm.

In a growing entrepreneurial firm, the action of the manager-entrepreneur is central. The problems of control are not, initially, of great importance, as the concentration of capital is in the hands of the founder. On the other hand, an ambitious strategy of development and growth needs to be supported by strong organizational and managerial levers and requires a large contribution of resources, not only financial, but also cognitive. The "mechanisms that govern the behavior of the manager" (Charreaux, 1997) can also be seen as playing a primarily enabling role in this type of context, pushing strong growth and helping to master its specific challenges (Hambrick and Crozier, 1985). This particular configuration of a system of governance and its action on the decision process, in the case of the high growth entrepreneurial firm, is shown in Figure 3.

Insert Figure 3 about here

Growth creates a great need for resources, financial as well as cognitive. Generally, the financial needs due to high growth are largely beyond the financial capacity of the manager-entrepreneurs and they will find themselves led to external investors such as venture capitalists. This multiplication of stockholders potentially creates conflicts of agency (Jensen and Meckling, 1976[5]), and it appears that these new capital investors, at the moment when their entry is being negotiated, obtain the implementation of certain governance mechanisms, permitting them to play on the disciplinary dimension. Comparatively, with the large managerial firm, we can suppose that the conflicts of agency, however, remain relatively

[5] In Jensen and Meckling's model (1976), growth (or expansion) of the firm depends on its capacity to continue to push budgetary constraints by attracting external investors. Growth opportunities are, however, by definition and construction, exogenous to the model allowing its authors to focus analysis only on the challenges of incentives and control (and thus, discipline).

limited for at least two reasons. Primarily, the manager-entrepreneur often conserves a significant part of the capital, which, in itself, will diminish potential conflicts of interests which stockholders may present. Secondly, capital investors at the high growth stage, given the fact that they are specialized investors in this type of intervention (venture capitalist and capital developers), have both the competences and motivations to reduce any asymmetry of information better than anonymous minority shareholders. In summary, the opening of capital induced by high-growth creates conditions of introduction of a disciplinary dimension within the system of governance. We can however, suppose that this disciplinary dimension is relatively weaker than is found in large managerial firms, due to the weak separation between ownership and control. This relative weakness is graphically represented in Figure 3 by the narrow correspondent arrows.

Contrary to the disciplinary dimension, the cognitive and behavioral dimensions are apparently strong in high growth entrepreneurial firms (represented in Figure 3 by the bold arrows). Theoretically, extremely high growth increases the entrepreneur’s perception of complexity and uncertainty. The cognitive approach of governance leads us to expect increasing aid from certain governance mechanisms in the strategic process: “The higher the complexity and uncertainty associated with a strategic decision, the more likely the participation of directors in it” (Rindova, 1999, p. 960). Being supported by a system of governance that has a cognitive dimension can permit the manager to reduce uncertainty and better control the strategic and managerial challenges of growth.

II. … towards a governance model for high growth entrepreneurial firms.

From the above developments based on Charreaux's (2008) meta-model, we can draw two general conclusions as to the nature and roles of systems of corporate governance:

- It is a complex and contingent system that dynamically interacts with managerial discretion;
- Depending on the case, it could have either a limiting or empowering effect for the manager's strategy.

This reflection suggests that a specific system of governance exists for entrepreneurial firms[6] in general, and for those in a high growth, in particular. We can question the relative importance of the disciplinary and cognitive dimensions within this system. The following section of the article aims to take inventory of the group of empirical works on the subject of governance of high growth entrepreneurial firms in order to observe the mechanisms put in place (IIA) and to appreciate the concrete impact on discretionary space for the manager-entrepreneur (IIB).

IIA. The principal components of the governance system and their interactions

In their synthesis of the literature on governance and leadership in entrepreneurial firms, Daily *et al*. (2002) identify different actors who are recognized as particularly important, who interact with the manager and thus contribute in governing his/her behavior. This particularly concerns the top management team, directors as well as venture capitalists.

[6] Daily *et al*. (2002) adopt a broad definition of the entrepreneurial firm, including those enterprises created by one or more persons independent of an existing organization. This definition puts an emphasis on the independence and driving force of the entrepreneur.

The management team is a part of governance that is rarely studied within the dominant disciplinary approach, even if it is not altogether absent from the founding work on agency theory. Recall the role that Fama (1980) attributes to the management team for the reduction of information asymmetry, which is due to the possibility of a reciprocal monitoring among managers. According to Charreaux's (1997) typology, this monitoring is a part of the specific and spontaneous mechanisms of governance. In the specific context for entrepreneurial firms, the attentive examination of the empirical literature led by Daily *et al*. (2002, p. 397-398) shows a strong convergence of results, specifically in the area of growth. Growth appears to be favored by the functional heterogeneity of top management and by the maintenance of a certain level of "constructive conflict" within the team, thus avoiding the placement of narrow limits on strategic perspectives. Literature on developing entrepreneurial firms regularly emphasizes the importance of the *management team,* not only the lone CEO, in strategic processes (Bourgeois and Eisenhardt, 1988; Daily *et al*. 2002). In their insightful study of four enterprises in the extremely turbulent, high growth micro-computer sectors in the 80's, Bourgeois and Eisenhardt (1988) closely examine the interaction between the CEO and the management team and its impact on strategic decisions. This interaction basically depends on the "climate" that reigns within the team and affects the respective power of the different members. This climate, or decisional culture, apparently develops in interaction and differs from one enterprise to another. Thus, the reigning decisional culture within the management team can be considered as a spontaneous governance mechanism particularly relevant in the study of the governance of entrepreneurial firms. In other words, beyond the composition of the management team and the characteristics of its members (Hambrick and Mason, 1984), what is important is the dynamics of their concrete interactions. Bourgeois and Eisenhardt (1988) specifically analyze the respective power (or managerial discretion) of the CEO and

the team. One of their results shows that, in a turbulent environment, enterprises whose CEO retains the essential decision-making power and whose team is weak are those whose performance and growth are relatively mediocre. On the other hand, enterprises with a strong CEO whose team is equally strong and contains complementary functional competencies are those whose strategy results in strong growth figures. Thus strong managerial latitude as well as an equally strong governance mechanism (managerial team) would have the tendency to mutually reinforce their strengths with a positive impact on performance, specifically in terms of growth. This aspect seems to be linked to a decision-making processes that permits the consideration of a large number of alternative solutions. A strong and competent managerial team, with a richer capacity to analyze and diversify ways of interpretation, could also be considered as a governance mechanism that strengthens the manager.

The board of directors is certainly one of the governance mechanisms that have received the most attention in governance research. However, Daily *et al*. (2002) state that most studies on the subject have been conducted on large listed corporations and that the study of boards within entrepreneurial firms is still at its beginning. The composition of the board, according to its internal or external origin or the independence of its directors, is often the result of a deliberated decision and thus an intentional and specific governance mechanism.

In the context of the entrepreneurial firm, certain studies are effectively interested in the board's composition as is the case with the study by Daily and Dalton (1992). These authors refer, first of all to a literature review concerning small enterprises. The majority of previous research in this area found a preference for internal directors, permitting the manager-founder to maintain strong control. Entrepreneurial firms would thus favor non-independent directors over others. Given this observation, Daily and Dalton (1992) conducted a study on a sample

of small listed companies, ranked as among the top 100 with highest growth. They concentrate uniquely on high growth entrepreneurial firms and note that for those – contrary to what previous studies supposed – their founders voluntarily called on external directors. Daily and Dalton conclude that founders of enterprises confronted with a very high growth rate do recognize the potential contribution of external directors in the entrepreneurial process. They intentionally open their board to external directors not to hinder their capacities, but to help them meet the challenge of high growth.

Deakins *et al*. (2000) seek to "contribute to an improved understanding of the use of NEDs [non executive directors] in the growth process of small firms" (p. 112). They studied a sample of medium-sized Scottish companies who had nominated at least one external director (non-executive director) to their board. According to the authors, and conforming to the conclusions drawn by Daily and Dalton (1992), these non-executive directors play a significant role in the growth process. Selecting a sample of medium-sized firms according to the criteria of the presence of non-executive directors may theoretically create a sample bias in favor of high growth enterprises. This has been effectively confirmed by the authors' data, showing an average growth rate of 68% over three years for the firms in their sample. It is, on the other hand, interesting to note the origin of the nominations of external directors. Deakins *et al*. (2000, p. 119) reveal three types of initiatives: (1) the presence of an external director is actively sought by the entrepreneur who feels the need for this type of advice (44%); (2) the presence of external directors has been imposed by the venture-capitalists at the moment of their capital investment (39%); (3) other silent partners (*business angels*, public agencies …) who demand external administrators (17%).

Certain studies (Deakins *et al*., 2000; Gabrielsson and Huse, 2002), beyond its composition, equally examine the modes of functioning of the board of directors and the interaction between directors and managers. Putting the accent on the process itself, these studies demonstrate that, in the concrete functioning of the board, there are certain aspects that escape codification and rather reveal an aptitude, sometimes implied, for mutual cooperation[7].

For example, Gabrielsson and Huse (2002) report on the models of functioning for the board of directors of two entrepreneurial firms financed by venture capital. In these cases, the venture capitalists regularly sent several board representatives to the firms in their portfolio and they appear to be particularly active board members. The venture capitalists have a significant impact on the board's working style, imposing formal meetings on a regular basis, while before their entry into the business there was little formality in the working style. In addition, and by way of completing the picture, the regular informal discussions held between the board's chairman and the CEO contribute to the management of the relationship among stakeholders. These interactions within, and around, the board of directors as well as the working style that results, is the object of a tacit agreement among the different actors concerned[8].

This tacit and spontaneous dimension of the functioning of the boards of directors is a potential explanation for the relatively mixed results concerning the impact of the board's composition and size from the empirical study by Daily *et al*. (2002, p. 399) for entrepreneurial firms. It is thus possible to imagine that the strong growth of certain entrepreneurial firms can rather be due to, if not dependent on, the reigning climate within the board and the attitudes of its members – a spontaneous product of its functioning – than due to

[7] "The other thing is the individuals involved. It has to be persons that you believe in and can work together with. Personal chemistry is a must …" (Gabrielsson and Huse, 2002, p. 138)
[8] "There was an unspoken agreement […]" (Gabrielsson and Huse, 2002, p. 139).

the objective qualities (internal or external) of the directors. This statement on the spontaneous emergence of certain characteristics of a board of directors and their relation with the dynamics of growth, remains, however, at least for the moment, highly speculative and calls for a closer examination through subsequent empirical studies.

The venture-capitalist has been identified as a central actor in the governance of entrepreneurial firms (Daily *et al*., 2002; Deakins *et al*., 2000; Gabrielsson and Huse, 2002; Rosenstein *et al*., 1993; Sapienza *et al*., 1996). He can influence the behavior of the manager through various types of governance mechanisms, both formal and informal. Among the formal mechanisms, intervention, in terms of participation in the board of directors, is common (Deakins *et al*., 2000; Gabrielsson and Huse, 2002; Rosenstein *et al*., 1993). In addition, venture-capitalists can base their action on contractual mechanisms, implemented at the moment when their entry was negotiated. Cumming and Johan (2007) examine the contract terms linking the venture-capitalists to the financed firms and conclude that formal contracts are an important mechanism for facilitating intense advisory activity on the part of the financiers with regard to the managers. Beyond contractual clauses directly negotiated between the venture-capitalist and the entrepreneur, these authors also observed the importance of a legal framework for the management of the relationship between the entrepreneurial firms and their investors. Specifically, venture-capitalists invest more time in their relationship with the firm in countries where the legal framework provides very little protection (Cumming and Johan, 2007, p. 23).

The methods of intervention by the venture-capitalists in the governance of entrepreneurial firms also depend on the institutional context. Sapienza *et al*. (1996) conducted a comparative study of the governance undertaken by venture-capitalists in four countries (the United States,

the United Kingdom, the Netherlands and France) and note a certain number of differences. In particular, they studied the direct “one on one” interaction between the venture-capitalist and the entrepreneur. In addition to contractual mechanisms (investment agreements) and structural mechanisms (board of directors), the venture-capitalist can weigh heavily on managerial discretion through use of interactions that are more informal and more direct. According to Sapienza *et al*. (1996, p. 444), “structural and contractual devices are crude mechanisms of control” and it appears that “VCs influence entrepreneurial behavior through their personal contact with entrepreneurial CEOs”. Different attitudes of capital investors are, in principle, possible to imagine in terms of their influence on the decisional process of the enterprise. The venture-capitalist could be active (a hands-on approach) or passive (hands-off approach). Sapienza *et al*. (1996) measure the intensity of influence by measuring the frequency of direct interactions with the manager-entrepreneur.

Except for France, all countries studied showed a frequency of intervention, on average, more than once a month. For France the score was slightly lower[9]. In France, the results indicate a more passive attitude on the part of the actors of venture capital towards the governance of the firms in their portfolio. Sapienza *et al*. (1996) tested several explanations for the intensity of intervention by venture-capitalists. The country itself shows significant explanatory power (p. 460). The degree of uncertainty characterizing the entrepreneurial firms is measured by stage of development (venture stage) and shows up as a determinant variable, as well. In other words, firms in a relatively early stage of their life cycle have the most contact between the venture-capitalist and the manager-entrepreneur. This is interesting in the sense that it specifically concerns a segment of enterprises particularly sensitive to the phenomenon of high growth. Structurally, one must note that the French venture-capitalist profession invests

[9] For France the score was 2.67 (Sapienza *et al*., 1996, p. 454), a value of 2 corresponds to one intervention a trimester and 3 to one intervention per month.

more at a later stage in the life cycle than its counterpart in the States, where early stage investment is more developed (Sapienza *et al*., 1996, p. 451 and 455).

Beyond the individual relationship each of these governance mechanisms has with the discretionary space of the CEO, certain authors reveal the importance of the dynamics of the mechanisms taken as group. Different governance mechanisms interact, with complementary effects and/or substitution, and the concrete impact of the governance mechanism can be supposed to be dependent on the dynamics of the group of mechanisms as a whole. The influence of the venture-capitalist on the managers choices can be direct, through formal (investment agreements, stockholder alliances, Cumming and Johan, 2007) or informal channels (face-to-face meetings, Sapienza *et al*. 1996), or indirect, through mediating mechanisms of governance, such as the board of directors, (Gabriellson and Huse, 2002; Rosenstein *et al*. 1993). The actual functioning of certain intentional mechanisms is apt to be adapted in a spontaneous and informal manner, if particular circumstances demand it. It is what Grundei and Talaulicar (2002) have shown with a sample of German start-ups in high growth industries. These authors explain the important recourse to the social form of a stock-based enterprise (*Aktiengesellschaft*) rather than alternative forms, as stocks provide advantages vis-à-vis financing growth. At the same time, in German law, opting for an enterprise by stock investment brings with it relatively rigid obligations regarding the implementation of governance structures, structures which are poorly adapted for the specific needs of an entrepreneurial firm in high growth. In particular, German law imposes the implementation of a system with executive and supervisory board, and assigns this latter board a strong disciplinary role, to the detriment of the role of counsel and assistance that entrepreneurial firms in a high growth phase particularly need. Grundei and Talaulicar (2002) show that while high-technology German start-ups respect the formal obligation to put into

place a supervisory board, they also implement a sort of hidden strategy to bypass these restrictions and, as a result, the supervisory board has a function that is less constraining than one might be led to expect (in the sense of strict surveillance). Thus, German start-ups in a growth phase spontaneously replace the concrete and legally defined function of the board with a role of counsel and support.

Table I summarizes the typical system of governance for a high growth entrepreneurial firm, as presented previously.

Insert Table I about here

Spontaneous (as opposed to intentional) mechanisms, as well as dynamic interaction among mechanisms, cannot be codified as they are contained in largely tacit premises. It must be noted that resource based theory (Penrose, 1959; Wernerfelt, 1984) considers the tacit character of certain immaterial resources, such as organizational routines, as a source of competitive advantage. It seems reasonable to suppose that this equally holds for the tacit functioning of certain routines in terms of governance.

IIB. Managerial discretion in the high growth entrepreneurial firm: an empowering model of governance

According to Hambrick and Crozier (1985), the phenomenon of extremely high growth could be typical of enterprises at a very particular stage in their life cycle. High growth enterprises

would be those passing through “Phase II” of their development at an extremely high speed (Hambrick and Crozier, 1985, p. 34), with a growth rate of more than 50%. Figure 4 demonstrates this rapid acceleration.

Insert Figure 4 about here

These firms have gone beyond functioning on a small intimate scale, without having first stabilized their functioning and their structures, which are characteristic of a more mature stage, and as a result create uncertainty and certain fragility. According to Hambrick and Crozier (1985), such accelerated development can have its roots in a major technological advance, ingenious and/or aggressive marketing or a market with clear and abundant needs, etc. It presents managers with major challenges and requires particular managerial competences. Strong growth creates great needs in terms of resources, obviously financial but also managerial. The dynamics of high growth demand a visionary aptitude from managers who are capable of anticipating the structural demands linked to rapid extension of operations. It will allow them to avoid the trap of overconfidence in the organizational solutions found during the successful “childhood” of the company but inappropriate for Phase II. In this context, certain governance mechanisms could help managers better meet their challenges: “Successful high growth companies also try to tap big-company expertise on their board of directors. As with their managers, they seek to acquire this expertise before it is needed, recognizing that at the rate they are growing it will be needed very soon, and that it is more difficult to correct chaos than to prevent it by having good talent available” (Hambrick and Crozier, 1985, p. 37).

In other words, recruitment of directors by a young company anticipating strong growth will be done essentially based on the experience and supposed competences of certain directors, not to limit the manager's strategy development, but to help with its successful implementation based on the advice brought to the table. Thus, an enabling role for the board of directors would be of primary importance in mastering a high growth strategy.

Zahra and Hayton (2005) have studied the changes in governance structure during the transition between different life cycle phases. They are particularly interested in the so-called "start-up" and "adolescent" phases within young high-tech companies. These authors consider that the major strategic challenges along with the composition of the board of directors differ significantly between start-up and adolescent companies.

The first phase essentially brings the need to establish legitimacy, to develop a viable niche, and to gain access to external resources, while the second would be preoccupied with feeding its strong growth and extending the product line. Growth during the adolescent stage brings with it particular needs in relation to certain functions within the enterprise, necessitating advanced professionalism. This particularly concerns commercial and administrative functions and the board of directors would be able to help acquire these competences. Consistent with these arguments, Zahra and Hayton (2005) effectively found significant differences in the composition of the boards between the start-up and the adolescent firms, as shown in Table II.

Insert Table II about here

Zahra and Hayton (2005) show an increase in the competence base in certain areas of governance, concerning mostly the top management team and board of directors. The average size of the management team more than doubles as the company passes from the start-up to adolescent phase, marked by high growth. This increase in the size of the team allows the manager to be surrounded by growing expertise. The board of directors also fills out, going from an average of 4.1 to 6.7 members. In addition to the size of the board, its composition changes with an increase in competences that will help the manager meet the challenges of the increased growth that comes with the adolescent phase. Thus, the functional variety of the directors augments considerably. The variety index goes from 0.34 to 0.59 which indicates that the proportion of directors having the same functional competencies (technological, for example) has diminished. This index used by Zahra and Hayton (2005), changes inversely to the level of concentration of competences. The increase in the size of the board is accomplished by integrating new functional competences. The enlargement of the base of available competencies does not only concern the functional experience of the directors but also their initial training. At that level, the variety index increases significantly, from 0.51 to 0.73 for an entrepreneurial firm in its "adolescence".

What remains to be seen is how these supplementary competences are employed concretely in the functioning of the board. Rosenstein *et al.* (1993) report the results of a study concerning managers from a sample of high-tech companies financed by venture capitalists. They are interested in the role of external directors and how they are perceived by the managers. What shows up as most important is the function of a sounding board for the manager, against which the manager can test and develop ideas. In 38.27% of the firms questioned, this

function is singled out as one of the three most useful functions for external directors. As a sounding board, external directors facilitate learning and as a result make a cognitive contribution. The second most important role (37.65%) is the role of interface with investor groups. External directors are also seen (by 11.11% of the managers questioned) as making a significant contribution to the development of new strategy within the context of adapting to changing circumstances, while 9.26% declared that external directors were involved in the development of their original strategy. Most of the managers questioned perceive external directors as useful in both conceiving and developing their strategic objectives. Equally cited (by 16.05%) is the disciplinary and financial monitoring role for the external members of the board, but while it is mentioned, it does not appear very important. The study conducted by Rosenstein *et al.* (1993) confirms the importance of the cognitive dimension of governance as invaluable in the development of strategy by the managers of entrepreneurial firms. According to this same study, that role appears to weaken in importance as the company matures.

Venture capitalists figure among the external directors studied by Rosenstein *et al.* (1993). Quoting one of the managers, the authors confirm the existence of a contribution above and beyond the strict financial monitoring carried out by the venture capitalists: “Venture capitalists helped formulate strategy, opened up business contacts, helped with acquisitions and investment bankers. More importantly, they were helpful in recruiting top executives. They also enforced strategy despite the difficulty you encounter.” (p. 109). However, all the managers in the study do not share this same positive evaluation of the role of venture capitalists as invaluable in strategy development, and the study in general concludes that the role is one of assistance, at best equivalent but hardly more important when compared to other external directors.

Deakins *et al.* (2000) studied the role of external directors in a sample of high growth Scottish entrepreneurial firms (68% growth in turnover on average over a 3 year period). They base their conclusions on 46 face-to-face interviews with manager-entrepreneurs of SMEs having at least one external director. Their results indicate that the entrepreneurs cite the capacity of these external directors to provide a different strategic perspective and to give advice as being their most important role (p. 119). The managers interviewed were asked to rank the relative importance of individual roles in a list given to them. The first eight items ranked by managers were essentially from the cognitive and behavioral domain (orientation and support, problem discussion, discussion of alternative solutions, constructive criticism, application of previous experience, emotional support, feed-back, and identification of strengths and weaknesses). Imposition of any particular discipline only figures in ninth position (p. 120). While it appears that entrepreneurs highly value the assistance rendered to them by external directors, it must be taken into account that the type of contribution brought differs and depends on whether the external director was put on the board at the request of the venture capitalist or independently by the manager. In this last case, Deakins *et al*. (2000) observed, above all, a contribution of general managerial competence by the external directors. In the other case, where the external director is named by the venture capitalist, the expertise is more of a specialized managerial competence. This appears to help the manager better respond to and manage change. Focusing on entrepreneurial firms financed by venture capital, 73% state an improvement in their capacity to manage change due to the help of external directors, compared to only 50% in enterprises without venture capitalists (p. 121). Certain observations by Deakins *et al.* (2000) show that the roles taken on by the non-executive directors can change dynamically in the course of interactions. The authors cite the example of a manager who explained that the initial role of financial monitoring progressively gave way to a more

strategic contribution during the course of the relationship[10]. They conclude that the venture capitalists leave the external directors a certain flexibility in carrying out their functions, given that the problems of agency are less important in entrepreneurial firms than in large corporations.

Sapienza *et al.* (1996) have shown that venture capitalists govern the behavior of the manager, not only through the board of directors but equally through face-to-face interactions. The studies by questionnaire confirm the great importance given to the cognitive contribution of this actor in the governance of entrepreneurial firms. As in the study by Rosenstein *et al.,* (1993) on the role of external directors, the aptitude of certain governance mechanisms to serve as a "sounding board" for managers occupies first place.

From the previous developments we see that the cognitive dimension of governance is particularly important in high growth entrepreneurial firms. This lever could serve to either limit managerial discretion or support it, in function of the founder's competence. Wasserman (2001) demonstrated that venture capitalists push for the replacement of the manager-founder when certain organizational thresholds are passed and they perceive the founder's incapacity to handle new demands. Wasserman (2001, p. 26) also quotes a venture capitalist of a large (northeastern) American firm: "In situation after situation we have found that if we are really focused on building a big and important business, and we do a great job of launching a company quickly, growth often outstrips the founding CEO's ability to manage". In such a situation the venture capitalists constrain managerial discretion, not for disciplinary reasons but because of a perceived gap between needs and competences. This is coherent with the results of Zahra and Hayton (2005), that show that firms in their high growth "adolescence"

[10] "During the bedding down period, there was quite a lot of oversight going on and – monitoring. [Now] there still is a monitoring role, but that has begun to take a lesser role and there is, and has been, a large strategic input." (Deakins *et al*., 2000, p. 123).

who have the original founder as principal manager are less numerous than *start-ups* managed by their founder (the percentage goes from 92% to 71%). It is possible to interpret this result as an example of the potentially coercive (*vs.* empowering) nature of the cognitive lever of governance linked to the problem of rapid growth. The manager-founders, overwhelmed by the managerial challenges that high growth brings, are then replaced by professional managers.

At the same time, we do see that the proportion of founders that remain in their original function is relatively high (71%), and it is probable that, in these cases, the cognitive dimension plays an important and empowering role. It may be that certain founders are capable of changing their mental structures, of acquiring the competences necessary to handle growth through the governance mechanisms that surround them. Thus, Daily and Dalton (1992) affirm that “CEOs can, in fact, learn to manage the entrepreneurial process better over time […] and continue to foster the growth and success of the firm” (p. 382). These authors suggest that external directors play a non-negligible role at this level, by providing invaluable strategic assistance to the firm experiencing high-growth (p. 383). The type of assistance needed to support performance will depend, however, on the stage of the enterprise’s life cycle.

Certain empirical studies indicate that the empowering aspect of the cognitive lever is globally more important in entrepreneurial firms in high growth, than the potentially constraining (or coercive) character of governance. Grundei and Talaulicar (2002), using a sample of high-tech German entrepreneurial firms (average growth rate in turnover in 2000: 445%, cf. p. 14), show that in only 9 cases does the supervisory board effectively accomplish a monitoring task of the managers. On the other hand, in 25 cases, the supervisory board

essentially provides advice to the managers and in 18 cases directors procure external contacts using their developed personal network (cf. p. 16). The empowering role of counsel is clearly predominant in the majority of entrepreneurial firms studied by Grundei and Talaulicar (2002). Managerial discretion for the top management team is apparently reinforced.

Haagen (2008) studied a sample of German and British biotechnology firms financed by venture capital. The average age of the firms studied was 6.93 years, and so we can consider that most of them were at the "adolescence" of their life cycle (p. 406). Haagen was interested in the interaction between the venture capitalists and the managers. In particular, he sought to know if the actions of the venture capitalists are felt as support or interference by the managers. The latter concerns influence exerted by the investor which is not welcomed by the manager and thus represents a constraint on his discretionary space. The support provided represents the empowering dimension of governance ensured by the venture capitalist. In the study, the researchers showed the managers a list of six important areas[11], potential areas of intervention by the venture capitalists, and asked the mangers to evaluate the intensity of feelings in regards to these interventions, and to differentiate between supportive activities (reinforcement of managerial discretion) and interference (restriction of discretionary space). The results of the study (Haagen, 2008, p. 408) show that while the activities of interference exist, they have weak scores and are systematically situated well below activities of support. It is thus possible to conclude, in this sample of biotechnology firms studied by Haagen, that the venture capitalists, when they act on the behavior of the managers, more often use the cognitive dimension rather than limit managerial discretion. In addition, Haagen (2008, p. 412) observed that support efforts on the part of the venture capitalists are more frequent in

[11] The list was as follows: introduction of new strategies, introduction of new organizational structures, changes in sales strategy, recruitment of top management members, establishment of new alliances, raising additional funds. In each of these areas interventions could be perceived by the manager as a support (reinforcing managerial discretion) or as interference (imposition of choice, and thus limitation of discretionary space).

firms where the manager already possesses previous entrepreneurial experience. He explains these results by citing a better understanding on the part of the “repeat entrepreneurs” of the support that the venture capitalists could bring. This is also coherent with the results of Cumming and Johan (2007) who studied two types of interactions between venture capitalists and entrepreneurs: advice and conflict management. They found that the “VCs give more advice to, and disagree less with, more experienced entrepreneurs” (p. 39). These entrepreneurs have thus learned to take full advantage of the cognitive dimension that various actors of governance may bring them in support of their entrepreneurial project and thus strengthening their discretionary space.

Conclusion

Using a generic model of the interaction between the system of governance and the CEO’s discretionary space (Charreaux, 2008), the present article proposes an analysis specifically devoted to the study of firms in high growth. According to this framework, the composition and function of governance in high growth enterprises show a certain number of particularities. Specifically, the system of governance of an entrepreneurial firm that appears to be able to support high growth is characterized by a strong cognitive dimension. This strengthens managerial discretion and allows the manager to better control the strategic and managerial challenges of growth.

Several articles dedicated to high growth entrepreneurial firms have been analyzed within the theoretical framework developed in the first section of the present contribution. These analyses confirm the essential of the theoretical intuitions. A certain number of mechanisms

and actors of governance systematically meet in the cases of high growth enterprises: a strong and competent managerial team, a board of directors with diverse competences and venture capitalists, intervening through mechanisms that are more or less formal, regularly playing a major role in "governing the manager's behavior". Even though these governance mechanisms are there in part to instill a certain financial discipline through the monitoring of managerial behavior, the particularity of high growth entrepreneurial firms is that the cognitive dimensions plays a relatively more important role than the disciplinary dimension.

These observations have several implications. They support the idea of a contingency of governance models in particular in function of the enterprises' stage of development (Filatotchev and Wright, 2005). From the point of view of efficiency, the functions of the governance mechanisms are not the same for a start-up, for an enterprise in a hypergrowth phase of "adolescence" or for a mature corporation.

The dynamics of hypergrowth necessitate a capacity for learning on the part of the CEO as the managerial demands change from the initial start-up phase. The behavior that once proved successful could be counter-productive in the continuing pursuit of a high growth strategy (Hambrick and Crozier, 1985). A governance device whose function is clearly cognitive and behavioral can support this needed learning through, for example, external directors recruited to complement the competences of the managers. The CEO can then use the board of directors as a sounding board to test ideas and so be helped to adapt and develop the company's strategic vision.

This article is of an exploratory character, and the directions taken call for further research, with more profound exploration, in particular using empirical research. The hypothesis, that a

governance mechanism favoring strong cognitive and behavioral dimensions would be a necessary condition to support the phenomenon of high growth, should be tested more rigorously in future work.

In addition, few studies have been conducted on the subject of the governance of high growth enterprises in France. Sapienza *et al.* (1996) observed less activity on the part of venture capitalists in France as compared to Anglo-Saxon countries, and one may wonder whether this, in itself, weakens the levers of growth. If yes, it may be possible to compensate for this weakness by reinforcing the roles of other actors in governance capable of bringing a cognitive contribution.

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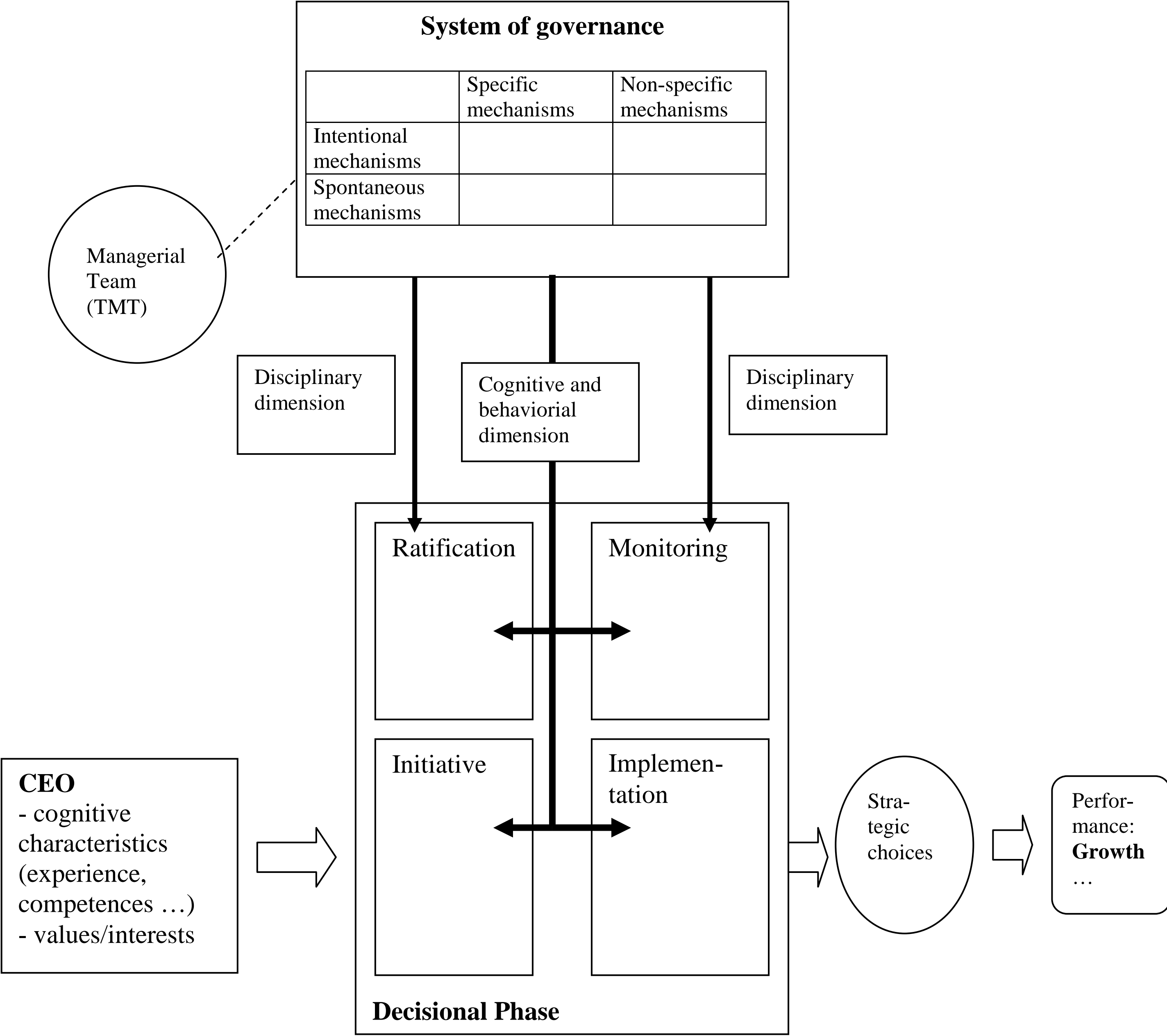
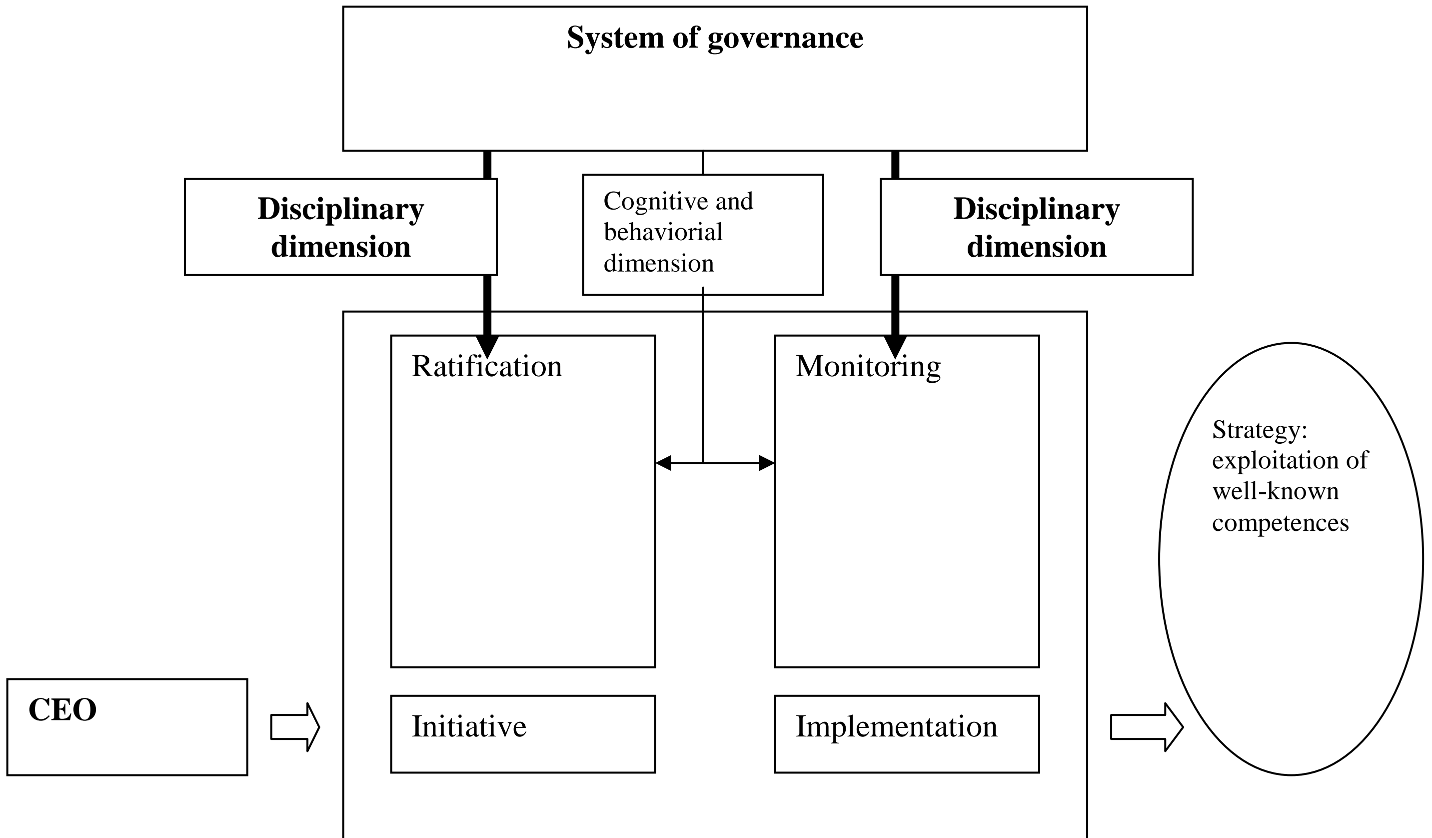
Figure 1 – *Charreaux's (2008) meta-model of governance and the CEO's discretionary space*



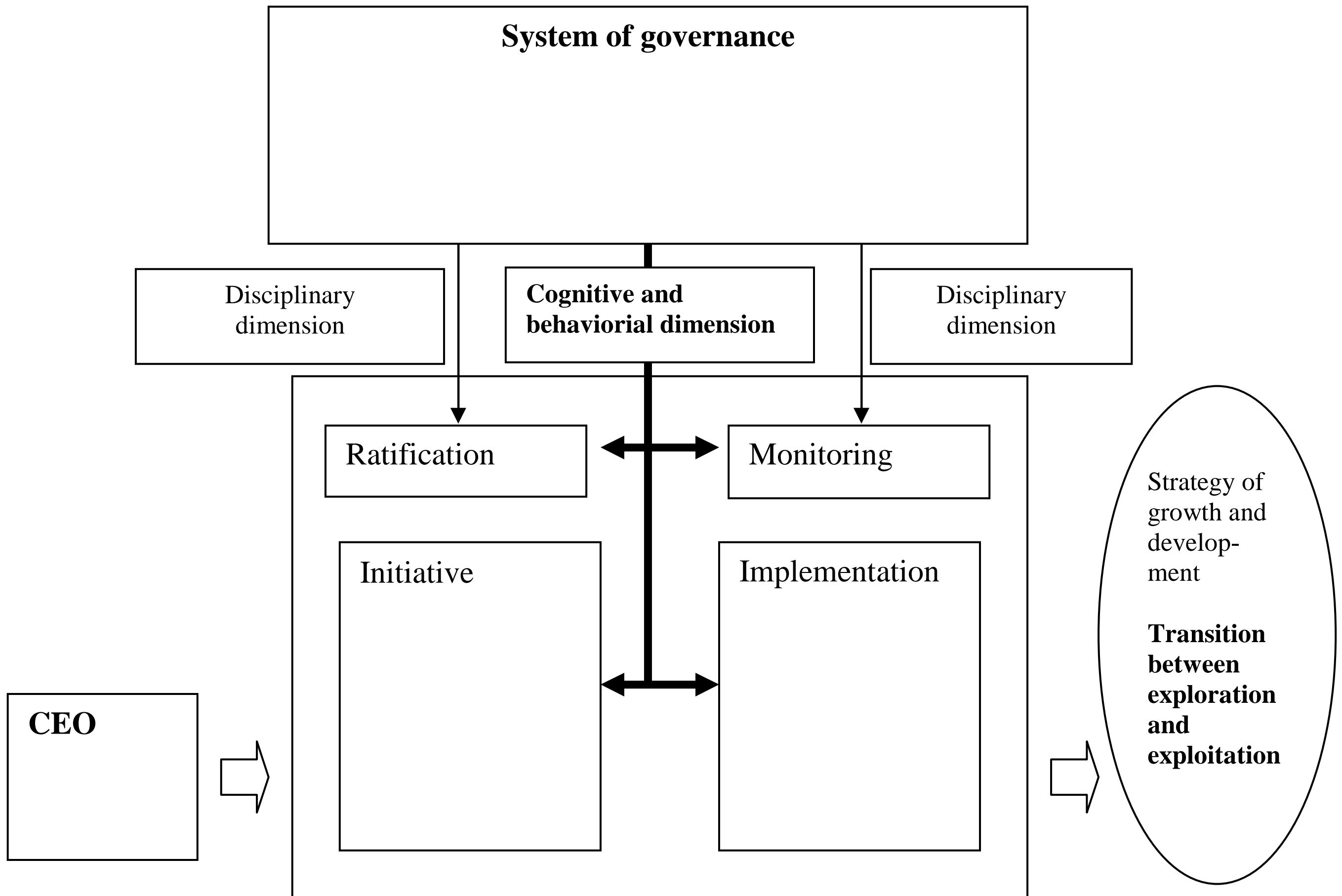
Source: Adapted from Charreaux (2008)

Figure 2 – *Application of the meta-model to the specific case of the governance of a large managerial enterprise in its maturity stage*



N.B. Bold arrows symbolize a theoretically strong impact.

Figure 3 - *Application of the meta-model to the specific case of the governance of a high growth entrepreneurial firm*



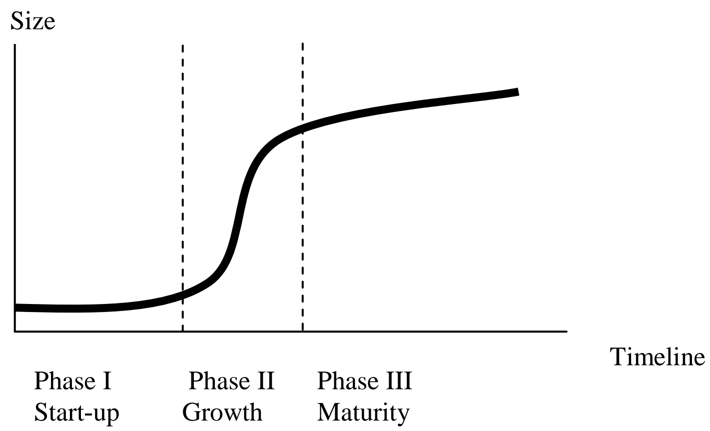
N.B. Bold arrows symbolize a theoretically strong impact.

Table I – *Standard type of governance for the entrepreneurial firm in growth phase*

	Specific mechanisms	Non-specific mechanisms
Intentional mechanisms	- Direct stockholder control (specifically venture capitalists with frequent face-to-face interactions) - Investment agreements, shareholders alliance, business plan… - Management team (formal structure of responsibilities) - Board of Directors (proportion of external members including venture capitalists; diversity of functional experience)	- Legal and regulatory environment (regulations concerning capital investors, listing requirements, existence of a specific organized market, such as Alternext in France) - Existence of an organized profession of capital investors (recent in Europe but growing rapidly Sapienza *et al.*, 1996)
Spontaneous mechanisms	- Culture of decision-making by the management team (practice of power, dominant logic, political coalitions vs. valorization of competence) - Board process - Network of personal relationships among directors - Network of personal relationships among managers	- Network of venture capitalists (in finance, industry and politics) - Managerial labor market (animated by venture capitalists, sometimes the driving force in the replacement of start-up managers and in the professionalism of management teams) - Business culture that more or less values risk-taking (more in the early stage in the U.S. than in France) - Investors' dominant investor philosophy: *Hands on* or *hands off*

Source: Adapted from Charreaux (1997, p. 427).

Figure 4 – *Representation of life cycle with accelerated growth*



Source: Hambrick and Crozier (1985)

Table II – *Difference in governance structures between start-ups and adolescent firms*

Variables	Start-up phase	“Adolescence” phase	Significant difference
CEO is founder	0.92	0.71	yes
Size of the managerial team	2.19	4.83	yes
Board size	4.1	6.7	yes
% of external directors on Board	56	66	yes
% of venture capitalists on Board	19	15	no
Variety of functions of the Board	0.34	0.59	yes
Variety in director education	0.51	0.73	yes

Source: Zahra and Hayton (2005, p. 43)