Entrepreneurs = Recovery = Prosperity

An Interview with Carl J. Schramm, Ph.D.
President and Chief Executive Officer, Ewing Marion Kauffman Foundation

EDITORS' NOTE *Having held his current post since 2002, Dr. Carl Schramm is one of the world's most recognized thought leaders on fostering and advancing entrepreneurship. He was appointed in 2007 by then-U.S. Secretary of Commerce Carlos Gutierrez to serve as Chairperson of the Department of Commerce's Measuring Innovation in the 21st Century Economic Advisory Committee. Before joining the Kauffman Foundation, Dr. Schramm was a Cofounder of HCIA, Inc. and Patient Choice Health Care, and he also founded Greenspring Advisors. Dr. Schramm also served as Executive Vice President of Fortis (now Assurant) and as President of its health insurance operations. He began his career on the faculty of Johns Hopkins University and founded the Johns Hopkins Center for Health Care Finance and Management in 1980. In 1987, he chaired the American Assembly on Health Care Costs. He left Johns Hopkins to head the Health Insurance Association of America. He is a Batten Fellow at the Darden School of the University of Virginia, a Fellow of the New York Academy of Medicine, a member of the Council on Foreign Relations, and a fellow of the Royal Society of Arts. He received an honorary doctorate from the University of Illinois in 2008. Dr. Schramm is the Author of* The Entrepreneurial Imperative *and the Coauthor of* Good Capitalism, Bad Capitalism, *which is available in seven languages.*


Dr. Carl J. Schramm

FOUNDATION BRIEF *Based in Kansas City, Missouri, the Ewing Marion Kauffman Foundation (www.kauffman.org) was established in the mid-1960s by the late entrepreneur and philanthropist Ewing Marion Kauffman, and is among the 30 largest foundations in the United States with an asset base of approximately $1.6 billion. Known as "The Foundation of Entrepreneurship," the foundation's vision is to foster a society of economically independent individuals who are engaged citizens, contributing to the improvement of their communities. Kauffman focuses its grant-making and operations on two areas: advancing entrepreneurship and improving the education of children and youth, and the mission is carried out through four programmatic areas: Entrepreneurship, Advancing Innovation, Education, and Research and Policy.*

What are the key areas of focus for the Kauffman Foundation and how do you define the mission?

We wanted to make the entrepreneurial experience more accessible for many more people in the United States principally, but also around the world. So the first thing we do is try to make the phenomenon and experience of entrepreneurship comprehensible and approachable, which leads us to do a great deal of training. At the middle school level, we explain to students the option of entrepreneurship as a career; we developed a game with Disney called hotshotbusiness.com where kids can create their own businesses online, and we've had about 60 million kids between the ages of 10 and 14 play that game. At the college level, half a million full-time university students are on what we call Kauffman Campuses, where we are experimenting with the means to make sure that college students appreciate entrepreneurship as a career choice.

In addition, much of what we do is driven by research, so we fund a great deal of research on economics – we're probably the first or second ranked private funder of basic economic research in the United States. A very important focus for us is our policy work, which ranges from prompting the federal government to do more research on firm formation to supporting the work of economists. We now have a cadre of very important economists who are preaching to policy-makers and inducing other economists to focus on the moment when businesses start, because the importance of the entrepreneur to starting businesses and growing the economy is lost on many people.

Also, we help entrepreneurs through unique programs that we've developed like FastTrac, which is a quick way for people to figure out whether or not they want to start a business and, if they do, the steps they need to take to do it. And we have a very deep presence on the Internet so people can benefit by information and coaching online.

In many ways, the Kauffman Foundation was founded for moments like this. A third of the Gross Domestic Product in the United States this year comes from firms that didn't exist in 1980. Here's another telling statistic: from the period 1980 to 2005, all net job creation in this country came from firms less than five years old. That's how important entrepreneurs are.

In big firms, that history can sometimes be oblique and often the entrepreneurial spirit is lost with it. So the Kauffman Foundation also pays some attention to the remodeling of big firms around their entrepreneurial roots. We published *Good Capitalism, Bad Capitalism* two years ago in which we outlined the different types of capitalism. We developed a theme of big-firm/small-firm capitalism, which is what characterizes the United States. One of the reasons entrepreneurship and the creation of small and, in many cases, high-growth, high-technology, firms is so important is because they have played a huge role in refreshing and revivifying entrepreneurship in many larger corporations. It's now commonplace for huge companies like Microsoft, Johnson & Johnson, Hewlett-Packard, or Intel to buy, in some cases, hundreds of small companies every year.

We see ourselves as a hinge point in the dynamics of understanding the economy, and the reason we're in a unique position is because we are in the business of delivering programs that help people create firms. To do that effectively, we have to make sure that the information and the mentoring we deliver is accurate, meaning we have to research what we teach. It's a very pragmatic cycle that we invented and that we're in the business of expanding and propagating.

You have talked much about the success of the foundation being about the leadership-through-leverage approach you take. How do you define that approach, and what does it really mean for the foundation?

That comes in different ways. When we sought the partnership with Disney for hotshotbusiness.com, we did the content and they did the distribution. We also sponsor a program with Ernst & Young called "Entrepreneur of the Year" to recognize role models in many cities and industries. So part of our leverage comes in finding partners that have wide reach and can help carry our message.

On a global scale, there is a university in Singapore that established itself with our permission and our involvement as the first Kauffman Campus outside the United States, and they did it with no money from us. They were taken with the idea and the concept and they implemented it. We were also approached by someone who is starting a foundation in South Africa and wants to replicate the Kauffman content in his country; this is the fourth foundation that has done this. So that is another kind of leverage – when people adopt our ideas and our programs without our funding.

In addition, a lot of our leverage comes off our own writing. I did a piece for *Foreign Affairs* in 2004 called, "Building Entrepreneurial Economies." Gordon Brown read the article when he was Chancellor of the Exchequer, and we met to discuss some ideas. As a result, the budget message that went to Commons included an outline of a program with the Kauffman Foundation, which the then-Chancellor Brown described as a reverse Rhodes Scholar program, where the government would send new university graduates to Kauffman to learn how to take their ideas and turn them into real businesses. The U.K. would pay the Kauffman Foundation to have those young men and women come to the Kauffman Foundation and study with us. That program, called Global Scholars, is now in its fourth year, and we have kids participating from all over the world.

The first-ever Global Entrepreneurship Week is a fantastic program we cooked up with Gordon Brown, as well. About five years back, as part of his interest in entrepreneurship, he initiated a week in the U.K. that he called Enterprise Week. He asked me to come over and keynote it, and I was so impressed that we partnered and did an Entrepreneurship Week in the United States in 2007. It was evident then that we had to make this a global effort. So we committed $1 million and the U.K. committed several million, and we had three corporate sponsors join us: the NYSE Euronext, Ernst & Young, and IBM. Millions of people from some 75 countries got involved and, this year, from November 16 to 22, we'll have 100 countries participating. The leverage from this has been amazing.

In a very important way, the Kauffman Foundation, through all of our leverage outreach, is an extraordinary articulator of the American economic order. We see ourselves playing a very important role in the civic institutional fabric of the United States, both domestically through our commitment to job creation through entrepreneurship and our commitment to growth, and internationally by spreading the message of the importance of entrepreneurship as one of the foundations of successful modern economies.

To affect leverage, we regard the assets of the foundation in an odd way. We believe our first asset is reputation. Our second asset is the extraordinary people who work here. Our founder was emphatic that the foundation had to have the very best intellects. Third is the ideas that are synthesized here. For instance, we brought the phrase "entrepreneurial capitalism" into usage. Our fourth asset is our networks, which includes major corporations in the United States, our outreach efforts all over the world, and our networks in the political and educational realm where we're trying to influence economists, policy-makers, and professors and, of course, our network of entrepreneurs. We constantly evaluate our assets. To every foundation committed to improving human welfare, almost everything looks like a good idea, because if you're giving money for free to someone, you appear to be improving their welfare. At Kauffman, the challenge is how to leverage – through ideas, networks, partners, our internal people, and our reputation – every outbound dollar of Kauffman to the greatest expansion of human welfare.

Often, the perception is that entrepreneurial means small, but that isn't necessarily the case. As companies grow, how much more challenging is it to maintain that entrepreneurial culture and spirit?

Every new business can grow to be a business of vast scale. Now if you've become a business of vast scale, but it's not growing like it used to grow, how do you bring forth new entrepreneurial energy into an existent large-scale business? One way is to understand that a lot of businesses that were once great and important businesses have failed, and that the rate of failure of huge businesses has been picking up. Kauffman research tells us that in the 25 years ending 2005, the velocity of Fortune 100 companies that went in and out – new names that didn't exist in 1980 – was close to 70 out of the 100. In the previous 25 years, it was more like 17 out of 100. So how one maintains its status as an existing large-scale business is a central issue in entrepreneurship. There have been two major issues: capital markets keep forcing firms to become bigger and stay bigger, and if there's one good thing that could come of this disruptive moment in the economy, it is that we might refashion the question of how capital markets value things. A lot of big firms are genuinely struggling to become entrepreneurial, but they can't get past the structural restraint on how the capital market works.

The second issue is what the culture needs to look like in terms of renewal. That takes you to the question of bureaucracy. One of the most interesting books ever written on this topic is *The Protestant Ethic and the Spirit of Capitalism* by Max Weber. It's a book on charisma, and his great focal point is bureaucracy in big organizations. The important point is that Max Weber was writing this at the time when companies of any size were first coming into being. Before the Civil War, there were no big companies. It was the railroad companies, and then the iron/steel companies, that required scale and got big. At Kauffman, we look at giant firms as probably being a transitory phenomenon. If you run a giant firm, what you're really confronting is how you can break up your firm into units so each can be a lot more entrepreneurial, and the challenge for big managers is how to conduct many smaller companies as one symphony that makes money for the shareholders; we have very few examples of that. In fact, the preeminent example of how this has been done for decades is Johnson & Johnson.

With regard to the economic recovery, there are many executives who have suggested that the government has done what it needed to do, but true recovery will only come about through entrepreneurship and innovation. Do you agree with that, and are you concerned that there's not enough of a focus to help spur that part of the recovery?

There is a huge amount of discussion out there in business circles that focuses on the premise that, when this is over, things will be like they used to be; that's not the case now, and it's never been the case. It's certainly not the case with a recession as dramatic as this one; things are not going to be as they were. I'm writing a book now where I'm trying to puzzle through the changes in the economic order that were already under way before the recession. In a way, you can think about this recession as being induced by government policy over housing. That involved two factors: unauthorized activity by the legislature, i.e. informal activity to push expansion of home ownership, which was never public policy, coupled with a huge burst of creativity in the creation of new financial instruments, namely derivatives – that's what brought it on. Now it's not easily corrected. In many ways, we're symbolically sending all kinds of confused messages to an economy that desperately needs entrepreneurs in order to grow out of this. If you want to see growth by entrepreneurship, you don't say to the world that you're going to save giant companies at any cost. You don't say to the world that one reason we might save giant companies is because we actually want to save giant labor unions. And you don't say to the world, incidentally, we'll abrogate bond covenance to get this job done. One of the things Kauffman takes to the outside world is that, if you want growth and a stable economy, establish the rule of law and let free markets determine who is a winner and who is a loser. Kauffman research tells us that after the past seven recessions, it has been entrepreneurs who have led the recovery. If there's any good news coming out of this recession, it's that the number of new businesses being started has gone up. There is more entrepreneurship happening than before.

But the question is, should something be done about this? We have a phrase here that describes so much of our attitude – we call it "messy capitalism." Right now, there is a huge contest in the United States between messy capitalism and neat capitalism. Keynesians want to have a central government-planned outcome for this recession, which is like a cow giving goat cheese – it can't be done. It's messy capitalism that has created this enormous surge of growth over the past 25 years. Many, during a time like this will, in effect, try to will away reality and announce that this is the collapse of capitalism or that capitalism made this happen, when it has nothing to do with the narrative at all. The good news is that a poll we did early this year in the U.S. shows that the vast majority of American people get that capitalism is still our best economic system and that, without a doubt, entrepreneurship and innovation is what will allow us to grow.

Many entrepreneurs who have built companies over the years, fear that it would be difficult for them to do today in this environment of regulation and restrictive policies. Do you believe that public policy is stymieing the entrepreneurship and innovation needed for recovery?

There is a big stifling going on. In July, we ran a major conference in California as part of our initiative on law and innovation. It has received a $10 million investment from us, and has some of the most important law professors and engineering professors in the country participating. We've been at this for three years, and we have a fantastic new book out of this exercise called *The Theory of the Firm* by Daniel Spulber, an economist who teaches at the law school at Northwestern. The premise of this conference is that the law is stifling technological development. Class action suits, among other things, are now so much a part of the fabric of business that people don't even want to start a business in the first place, particularly in areas where there's going to be high risk and lots of litigation, like pharmaceuticals. We are paying an enormous cost for this kind of runaway legal practice. The federal government, in particular, enables this, yet we never have real discussions about reform. This is the price we pay: we enrich lawyers as what economists call rent takers; they don't create wealth – they basically move wealth around. We need people who will create wealth. So what you're hearing from businesspeople is genuine. Sarbanes-Oxley is forcing American firms offshore. If we have more and more regulation, reaching into things as important as compensation, we will drive business offshore into areas that aren't as well regulated. What's really bad about this is that the premise is very much alive. But the trouble we got into economically wasn't caused by business or big business in particular. It was caused by a handful of people who were too zealous with derivatives and a handful of people in Congress who were trying to affect public policy without legislation as it pertained to the housing market. If you don't understand the diagnosis, you can't fix the disease.

Having built companies as an entrepreneur, do you feel that you're born with an entrepreneurial gene? And with regard to Kauffman's focus on education, do you believe you can really teach entrepreneurship?

I was a professor and an entrepreneur, and often, those things don't go together well. There are misinformed professors of business who actually propagate this notion that it's genetic, but that doesn't explain a 60-year-old starting a company. Our research tells us that the average age of the technology entrepreneur, at the founding of his or her company, is 30 and, today, the highest rate of entrepreneurial activity is among 55- to 64-year-olds. So if it comes from a gene, it sure takes a long time expressing itself. Those 55- to 64-year olds, by and large, probably now have a risk-taking personality that they might not have had when they were 19. I know somebody who spent a risk-averse career at the Social Security Administration and then created a fantastic business when he was in his mid-40s. Entrepreneurs emerge at points in their lives where they are ready to take the risks that the entrepreneur must take.

When they decide to take that risk, the task and the real question has to be, can you teach people skills that will make this a more successful decision? And we believe, fundamentally, the answer is yes. There's history that can be consolidated and brought to bear, and there are points in the transit of a company's history that are recurring and are common. There are points of danger. All of these things can be laid in front of entrepreneurs. We have a mentor's network through which we work with entrepreneurs all over the country. We've seen and heard evidence of what the education and the mentoring can do. We've had graduates come back and say they couldn't have done it without us.

This leads us to our newest initiative – Kauffman Laboratories for Enterprise Creation. It's not completely settled, because we don't fully know what the right things are to teach. Business professors can't teach us – we know that for sure. Economists have no interest in this stuff. So we had to go to ground zero in order to commit ourselves to being able to teach people the right things and to improve success. Kauffman Laboratories will oversee the creation of businesses. As we develop it, we will have researchers observing the process up close, because if you go to a business school and talk about entrepreneurship now, it's typically done by discussing case studies after the fact. But if you deal with entrepreneurs, like Richard Branson for example, for whom I have huge admiration, and he tells you the history of how he got his company started, it won't be entirely accurate because it's virtually impossible to remember it exactly as it happened; that's just a problem of human nature. Once people wanting to start businesses come on the radar, determining what we can do to make them more successful is the real trick. We want more people taking that step and that's what our outreach focuses on: taking that step of real consequential importance and helping them improve their chances for success.

Kauffman research tells us that after the past seven recessions, it has been entrepreneurs who have led the recovery.

Throughout your career and now at the foundation, you've had an executive team in place for a number of years, which knows you well. If I was talking to some of them without you in the room and asked them what it's like to work for Carl Schramm, what do you think they'd say?

The first thing they'd say is we are committed to talking constantly here, so it's a never-ending dialogue. We argue and we discuss every grant as a group. Everyone comes together in the foundation to talk about various grants, and half of them get turned down because someone has a better idea or it doesn't quite fit. It's not a rubber stamp group, and that's what is really unique about our culture.

The second thing they'd say is that we never stop to talk about strategy; strategy is an ongoing, developing process here. From early on, I let other people lead. I want people to be the president of their own organization. Within the Kauffman Foundation, you're the president of your own desk.

Every associate here knows that I abhor bureaucracy. I like to say that bureaucracy eats strategy for lunch. So we don't tolerate bureaucracy at Kauffman. We don't have an organization chart in this organization, and that's symbolic, because the minute you have one, people are able to say, no, I work for so and so, or no I don't want to work with you because we don't have division structure.

But on the other end of it, people would say, don't mistake Carl's style for being anything other than at the outer bounds of discipline. We are an astoundingly disciplined organization. Everybody who works here understands the enormity of our task and the outsized ambition of this organization, and we are always touching back to the founder. He had an extraordinary vision. He turned a huge amount of money over to us. We test everything in terms of the efficiency and the entrepreneurial approach we take ourselves. Mr. Kauffman gave our trustees and me an impossible task. We have to maximize or manage against inconceivable constraints. He gave us tons of money and told us to operate like an entrepreneurial organization. So there are only a handful of organizations like ours in the country; that is to say, all of our revenue needs into the indefinite future are met. So how do you operate as an entrepreneurial organization in that context? We have no stakeholders; we have no shareholders; we have no constituency. Customers can't tell us if we're doing right or wrong. Who do we make happy? I'm fond of saying, as one of my own managing axioms, in an organization without market signals, excellence has to be driven from within.

In most foundations, a job like mine is corrosive because people come to you with an endless amount of flattery; we just don't entertain that here. Rather, we work with large numbers of people in our networks; we develop areas that have to be worked on, and then we ask people to work on them for us. That broadens our dialogue and our network hugely, and makes the people who work with us passionate about things because they were in on it from the beginning. At the same time, it saves us from the risk of this corrosive behavior of people petitioning for money; that's a moral issue for human beings. One of the things I've tried to do is shield us from that so people can feel very good about the work they do and not have to reference people on the outside saying, you do very good work.

Your organization is very lean and fast moving, but you're dealing with issues that are ongoing and, frankly, slow to take hold. Does that frustrate you at times, and is it hard to deal with the slow pace that is sometimes needed to achieve results?

Yes, but there is a great old slogan I live by – make haste slowly. We are ridiculously driven to get things done yesterday, but we're playing with the macro-environment at every level. I sometimes think that we've achieved more than anybody could have ever imagined.

When I was Executive Vice President of Fortis, I worked with a guy who gave me very good advice. He said, you will overestimate what you think you'll get done in one year and always underestimate what you actually got done in five. There is a huge amount of truth in that.

In addition, being based in Kansas City makes us more productive. If we were in Washington or New York, I don't think we could have accomplished as much as we have. People would have forced upon us the expectations of other foundations. Here, we're a long way away and, thus, we have a lot of time to spend thinking and talking among ourselves and focusing on getting the job done. Similarly, we had the Mayo Clinic here yesterday and I told the incoming President, John Noseworthy, that one of the great blessings is that the Mayo Clinic is in Rochester, Minnesota.

I said not long ago that we have outsized ambitions. We want to change the rate of growth for the American economy and the world economy – we want to lift everybody out of poverty. And we want to add another full percent to GDP growth, to see the American economy restored to growth at a 4 percent rate on a stable basis. Well, that's a preposterous goal. We'd like to see at least 1,000 new high-growth firms; something less than 1,000 new firms account for one third of GDP. That's also a preposterous ambition. But we always remind ourselves that it was a group of reformers smaller than us, called the Clapham Circle, that led the campaign to emancipate British slaves and brought world trafficking in slavery to an end. When you think about the creation of the United States, fewer than 10 people brought this country into existence. There are all kinds of small groups of people that do astounding things. We're small, and we don't have much money so we have to be very clever about it. It's why leverage is so key. To hit these ambitious goals, we have to be very smart and work with people who are very smart, and as we talk to each other, we all grow.

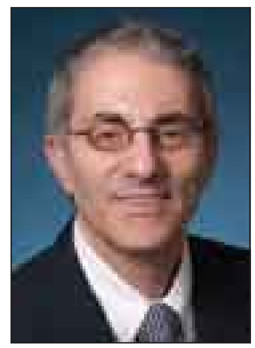
There is such passion in the way you talk about the mission and what you're doing. Do you ever think about slowing down?

I look laconic compared to the index of passion here. At the speed at which we have to do things, you sometimes wish you could stop the world for a day and get off. But, partly because we work so closely together and have such a stable management team, even growing demand is made much easier by continuously sharing workloads. Also, as I've mentioned, we are more productive because of the people outside of Kauffman with whom we work.

I also believe we all feel this is the most fun, important job we've ever had. It's evident; if you're here, you feel it. We're dealing with the world's biggest issue – how to affect economic growth. Our founder understood that. He didn't go to college, but he understood that economic growth was the result of more entrepreneurship. I never met Mr. Kauffman, but in an odd way, I have a hunch that if you were talking to him, the message would probably be very much the same, as would the speed, the commitment, and the passion. That was who he was, and it's something we strive to keep alive every day. ●

How to Foster Entrepreneurship

An Interview with Robert E. Litan, Ph.D.,
Vice President of Research and Policy, Kauffman Foundation



Dr. Robert E. Litan

EDITORS' NOTE *In addition to his current post, Dr. Robert Litan is a senior fellow in Economic Studies at the Brookings Institution, where he previously was Vice President and Director of Economic Studies. During his career, Dr. Litan has co-authored two Congressionally-mandated studies for the Treasury Department on the role of the Community Reinvestment Act after the Financial Modernization Act of 1999. During 1996 to 1997, he served as a consultant to the Treasury Department and was the lead author of its report to Congress on the future of the financial services industry, and in 1998 to 1999, he was the main author of the Report of the President's Commission to Study Capital Budgeting. In 1998, he also chaired the National Academy of Sciences Committee on Assessing the Costs of Natural Disasters. During 1995 and 1996, he was Associate Director of the Office of Management and Budget. From 1993 to 1995, he was Deputy Assistant Attorney General, in charge of civil antitrust litigation and regulatory issues at the Department of Justice. From 1977 to 1979, he was the regulatory and legal staff specialist at the President's Council of Economic Advisers. In the early 1990s, Dr. Litan was a member of the Commission on the Causes of the Savings and Loan Crisis.*

Will you provide a brief overview of your role in leading the research and policy area for Kauffman Foundation and the critical work you do within the organization?

I've been here about six years, and one of our main missions, which we are well on the way to accomplishing, is to considerably lift the importance of entrepreneurship within the economics profession narrowly and, more broadly, on the policy stage – federal, state, and local – which we do by funding research from top scholars.

The second thing we do is finance the construction of large databases, because you can't do research without data. We started focusing on well-known economists and high-level professors at business schools. We've since branched out into funding top-notch legal scholars on the notion that the law can have both a very important positive and negative impact when it comes to entrepreneurship. You need a sound legal infrastructure to give people certainty that the money they make they can keep and that the contracts they write will be enforced. However, if taxes get too high, or regulation too excessive, or uncertainty too great in the legal environment, it will discourage entrepreneurship.

We now finance, or have backed, the work of some of the leading economists in the country, including Ned Phelps at Columbia, who won the Nobel Prize in 2006. In the next 10 or 20 years, I wouldn't be surprised to see several more Nobels awarded to the people we're funding.

We also influence the direction of research. When we started, there was no recognized category of entrepreneurship research within the economics profession. The American Economic Association didn't even have a special category called entrepreneurship; it now does. One of our largest grantees is the National Bureau of Economic Research, and we fund two working groups on entrepreneurship and innovation, and have been doing that for five years. We've also funded a variety of data initiatives.

In addition to all that, we write incessantly, and that distinguishes us from a number of other foundations. We're not just a provider of money; it's important for us to push scholars and policy-makers to better understand these issues. Often, the best way to do that is to write ourselves, because a lot of the academics that we fund will be writing things to make points and earn tenure within their profession, but they may not be reaching a broader audience. Carl Schramm has written *The Entrepreneurial Imperative*, and the two of us co-authored *Good Capitalism, Bad Capitalism*, which is being used as a textbook in a variety of courses around the country. All this writing and research is necessary, not just so that economists can better understand what's driving entrepreneurship and what policies are needed to promote entrepreneurship and innovation but, ultimately, to reach a policy audience. It's very important to have entrepreneurship and innovation on the top of minds of economists who then go into government service.

The other way we have policy influence is through direct contact. We have developed a nonpartisan reputation and a level of stature that allows people from different political

