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Legal Mirrors of Entrepreneurship

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LEGAL MIRRORS OF ENTREPRENEURSHIP

Mirit Eyal-Cohen*

ABSTRACT

Small businesses are regarded the engine of the economy. But just what is a “small” business? Depending on where one looks in the law, the definitions vary and they differ from one section to another. Unfortunately, what these various size classifications fail to assess, are the policy considerations and the legislative intent for granting regulatory preferences to small concerns to begin with.

In the last century, the U.S. government has been cultivating one such policy of fiscal and economic growth. Consequently, Congress and private institutions have been acting to incentivize, support and reward entrepreneurship through the law in order to stimulate the economy. Nevertheless, rather than targeting entrepreneurial businesses directly, the law grants preferences to entities according to their size reflecting an obsolescent mirror of past economies. Today, while most entrepreneurial firms may start small, not all small firms innovate and create new economic value.

This article applies “mirror theory” and proposes a novel legal model that strives to correlate between the design of our legal rules, the goals they set to advance, and the societal trends they reflect. The article suggests replacing the current size-based approach in our laws with a model that measures firms’ entrepreneurial orientation. Unlike the current binary small-or-not standard, this multi-tiered, simple, and flexible model reduces the intrinsic arbitrariness, complexity, and uncertainty in current legal definitions.

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**INTRODUCTION**

Over the past half century, there has been a growing awareness to the positive externalities small businesses create in the economy.\(^1\) What is a “small” business? The answer is in the eyes of the beholder. Today, definitions of the term vary widely in each area of the law and from one section to another.\(^2\) At the same time, small businesses are depicted as the engine of the American economy and a primary source of entrepreneurship and innovation.\(^3\) Indeed, they have come to represent the essence of the American dream and the free enterprise economic system.

This depiction can be traced to the history of small firms and the way these entities have been defined by law. According to the Small Business Administration, in the 2010 Small Business Economy, A Report to the President, Executive Summary, \(^1\) available at http://www.sba.gov/sites/default/files/sb_econ2010.pdf [hereinafter Small Business Economy].


\(^2\) For a survey of small business legal favoritism see Eyal-Cohen, Down-Sizing the “Little Guy” Myth in Legal Definitions, infra note 5 (surveying the different small business definitions in securities law, health law, labor and employment law, patent law, government contracting law, and tax law).

Administration delineation, “small businesses” are those entities with fewer than 500 employees. This definition is met by 97 percent of firms in the United States. And throughout history, these firms have received beneficial rules and regulatory exemptions, solely by virtue of their size. When the majority of a group receives preferential treatment, one can only wonder whether these rules could be designed more effectively.

In a previous paper, I argued that our legal system is filled with preferences granted to small entities. These benefits contain inconsistent and contrasting notions of size, are over-inclusive, and create data distortions. With 97 percent of firms meeting the definition of “small business,” it becomes readily apparent why studies find a positive correlation between such entities and the growth of the American economy. Thus, legal favoritism of small entities results in the waste of revenues and the misallocation of government resources by focusing on size rather than on a more efficient way of promoting economic growth.

This paper seeks to remedy this misconception by considering the role of legal rules in upholding this skewed picture of society. “Mirror theory,” originated from the works of scholars of social studies of law viewing the law as a human institution and a product of culture. Legal Historian Lawrence Friedman further established this theory by describing law as a product of social forces. To his view, social pressures from interest-group pluralism, legal institutions, and economic

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4 This definition varies according to each NAISC classification code. See Small Business Economy, supra note 1.
5 See Miri Eyal-Cohen, Down-Sizing the “Little Guy” Myth in Legal Definitions, 98 IOWA L. REV. 1041 (2012) (demonstrating how certain government programs that aim to promote entrepreneurship result in a waste of resources because they focus on small business).
6 Id.
7 See, e.g., CHARLES-LOUIS DE SECONDAT DE MONTESQUIEU, THE SPIRIT OF THE LAWS, pt. 1, bk. 1, ch. 3, at 105 (David Wallace Carrihers ed. & trans., 1977) (noting that it is unlikely that law that fits one nation can suit another); see also Lawrence M. Friedman, The Law & Society Movement, 38 STAN. L. REV. 763 (1986) (referring to older texts, in Montesquieu, Jhering, or Aristotle while opining that “the law and society movement, in the sense I use the phrase, really begins in the nineteenth century, with figures like Sir Henry Maine, who published Ancient Law in 1861, and Max Weber, who was one of the founding parents”).
9 LAWRENCE M. FRIEDMAN, LAW AND SOCIETY: AN INTRODUCTION 595 (1977) (“The law is a mirror held up against life.... It is whatever results from the scheming, plotting, and striving of people and groups, with and against each other.”). Id. at 577 (describing the contribution of interest groups to the evolution of civil liberties Friedman by noting...
conditions, change the law by coercing the legal system to respond to these forces. Later on, Friedman added that the legal system not only responds to social trends but also influences society and shapes social values. In some regards, he argued, society mirrors law. Law not only follows society but also circumscribes thoughts, reinforces ideology, and generates social change.

Legal rules favoring small entities is one instance where law does not always provide a concurrent reflection of society. This legal favoritism initiated in a time of fear and dislike of the mounting power of big businesses and simultaneous appreciation of small business firms as key to free enterprise system. However, this social image is very different today. Recent studies show that small businesses are not necessarily responsible for social goods, and certainly not by virtue of their size. In fact, scholars found that small businesses create many negative externalities. For example, employment in small firms is generally unstable and unskilled. Most small businesses are “job destroyers” due to rapid job turnover, layoffs and frequent bankruptcies. Likewise, the quality of employment in such livelihood businesses is usually low paying and lacks job security, benefits and opportunities for advancement. These observations recently began to shift the terms of the debate on small business contribution to the economy to focus rather on growth potential of young entities, creating a need for further

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"Blocked interest groups, at least those with strong purposes, tried one path after another, like mice running through a maze, until they found the one with the cheese"). But see Mark V. Tushnet, Commentary, Perspectives on the Development of American Law: A Critical Review of Friedman’s “A History of American Law,” 1977 WIS. L. REV. 81, 82 (criticizing the “materialist perspective” in LAWRENCE M. FRIEDMAN, HISTORY OF AMERICAN LAW (1973)).

10 Friedman, supra note 7, at 763, 771. See also FRIEDMAN, supra note 8, at 306 (1998) (“Our concern is with law—more specifically, with the role legal institutions play either in helping to bring these changes about, in resisting them, in adapting to them, or in altering their form.”).

11 Friedman, supra note 7, at 763, 773.

12 LAWRENCE M. FRIEDMAN, A HISTORY OF AMERICAN LAW ix (Simon & Schuster 3d ed., 2005) (“Perhaps it is a distorted mirror. Perhaps in some regards society mirrors law. Surely law and society interact. The central point remains: Law is the product of social forces, working in society. If it has a life of its own, it is a narrow and restricted life.”).

13 FRIEDMAN, supra note 8 (“Ultimately, a social demand—a social force—called the bridge into being. But once the bridge is in place, spanning the river, it begins inevitably to have its own, independent effect on community life.”). See also MARK KELMAN, A GUIDE TO CRITICAL LEGAL STUDIES 243 (1987).

14 See infra note 167 and accompanying text.

15 See, e.g., infra notes 98, 202-207.

16 Martin A. Sullivan, When Should Small Businesses Get a Tax Break?, infra note 24 (contending that big firms pay higher wages, provide better health and pension benefits, and have lower turnover than small firms).

17 Id.
While there is no one element that drives economic growth, since the 16th century, scholars have recognized the essential role of entrepreneurship in the development of the economy. Today, there is general agreement among economists and policymakers that entrepreneurship is a vital component in economic stimulus. The key investigation of the sources of economic growth.


20 For example, Professor Drucker cited French economist Jean-Baptiste Say (1767-1832) describing an entrepreneur as someone who “shifts economic resources out of an area of lower and into an area of higher productivity and greater yield.” Peter F. Drucker, Innovation and Entrepreneurship: Practice and Principles 21 (1985). See also Joseph A. Schumpeter, The Theory of Economic Development: An Inquiry into Profits, Capital, Credit, Interest, and the Business Cycle 74 (3d ed. 1949) (referring to entrepreneurship as the “fundamental phenomenon of economic development.”). See also David A. Harper, Foundations of Entrepreneurship and Economic Development 2 (2003) (“. . . entrepreneurship itself often generates more entrepreneurship, so that economic development is a process that can be kept in motion by endogenous economic forces rather than exogenous shocks. . . .”); Frank H. Knight, Risk, Uncertainty, and Profit 41 (1921) (holding that by taking risks the entrepreneur plays a unique importance in a productive economy); William J. Baumol, Entrepreneurship in Economic Theory, 58 AM. ECON. REV. 64, 65 (1968) (contending that the entrepreneur has an important role in economic development); Harvey Leibenstein, Entrepreneurship and Development, 58 AM. ECON. REV. 72, 72 (1968) (arguing that entrepreneurship has a unique and critical role in the economic growth process). But see Israel M. Kirzner, Competition and Entrepreneurship 81 (1978) (“for me [entrepreneurship] is important primarily in enabling the market process to work itself out in all contexts—with the possibility of economic development merely as a special case”).

21 Id. See also Martin A. Carree & Roy A. Thurik, The Impact of Entrepreneurship on Economic Growth, in David B. Audretsch & Zoltan J. Acs, Handbook of Entrepreneurship Research: An Interdisciplinary Survey and Introduction 557 (2d ed. 2010) (arguing that entrepreneurship is positively related to growth); Amir Licht, The Entrepreneurial Spirit and What the Law Can Do About It, 28 COMP. LAB. L. & POL’Y J. 817, 817 (2007) (noting that entrepreneurship is key for a number of desirable social outcomes, including economic growth, lower unemployment, and technological modernization); Roy Thurik & Sander Wennekers, Linking Entrepreneurship and Economic Growth, 13 SM. BUS. ECON. 27 (1999) (surveying the literature that supports
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predicator of commercial success is entrepreneurial character—that is the ability to innovate and deliver innovation to the market successfully.22 Nevertheless, many fail to distinguish between small business owners and entrepreneurs.23 Rather than reviving the economy, most small traditional businesses today exist primarily to provide means of support to the owners and their families.24 Successful entrepreneurial entities, by contrast, take high risks by pursuing novel ideas, and when they are successful, result in rapid and substantial wealth and labor creation. Yet, in the name of entrepreneurship and economic stimuli, the government repeatedly offers significant benefits to people who operate small firms or own stocks in them.25 Small business congressional committees and the Small Business Administration, I previously argued, reinforce this path dependency of small business favoritism inherent in the American legal system.26 And that continuous conflation of small businesses and entrepreneurs in and of itself hampers entrepreneurship because the regulatory relief small business owners receive does not necessarily match the support essential to entrepreneurs.27

We must ask, then, if we acknowledge the fact that the focus on size in legal definitions is inappropriate, what alternative remains? In other words, if entrepreneurship is a well-known element central to the development of an economy, how can the law mirror it? This paper aims to answer these important questions. Since law affects societies, markets, people and firms, it has the power of benefiting or harming the

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22 Ács et al., Why Entrepreneurship Matters, infra note 175, at 9 (“The mandate for public policy in the entrepreneurial economy spans a broad spectrum of institutions, policy agencies, and instruments, ranging from education to immigration and health care. In addition, it also involves all levels of policy, from the most local to the broadest, such as the European Union. However, the goal is singular: how to increase entrepreneurial capital.”).


25 Id.
development of entrepreneurship, directly and indirectly.\(^{28}\) Accordingly, it becomes imperative to target these entrepreneurial entities accurately.\(^{29}\) To date, such efforts have proved unsuccessful.

This paper creates a new legal model of entrepreneurial proclivity by utilizing the Austrian School of economics, which perceives the market as a process rather than as a configuration of prices.\(^{30}\) It then proposes to replace references in the law to “small business” with a flexible, graduated model of entrepreneurial orientation.\(^{31}\) As opposed to the current small-or-not standard, this paper proves that the deployment of a multi-tiered legal model of entrepreneurship correlates more effectively between the design of our legal rules and the social trends they reflect.

Part I of the paper reviews the elements of economic development theory. Part II develops these characteristics by offering a multi-dimensional legal model of entrepreneurship. Using economic history of small business, Part III demonstrates that the current legal focus on size reflects an anachronistic picture of past economy and obsolescent social views. Part IV surveys policies and possible criticism of the proposed model while illustrating how it can be applied more efficiently by replacing some of the current legal size definitions. Lastly, Part IV concludes by highlighting the complex dynamic between entrepreneurship and the law.

I. THE ELEMENTS OF ECONOMIC DEVELOPMENT

Every practical model must be founded on theory.\(^{32}\) Joseph Schumpeter, the most influential figure from the Austrian School of economic thought, defined economic development as a dynamic process

\(^{28}\) See Licht, supra note 21, at 821; Markus C. Becker, Thorbjorn Knudsen & Richard Swedberg, Introduction, in JOSEPH A. SCHUMPETER, THE ENTREPRENEUR, CLASSIC TEXTS 1, 37 (2011) (expressing a concern that social and economic policies would probably try to favor conditions that fall somewhere in between these two poles of either entirely suppressing or always endorsing novelty).

\(^{29}\) See Licht, supra note 21, at 821 n.9; Smith & Ueda, infra note 39, at 357 (holding that law and entrepreneurship studies should focus on the study of the optimal legal structures that facilitate the commercialization of entrepreneurial opportunities, as well as the regulation of entrepreneurial firms). See also Craig K. Elwell, Long-Term Growth of the U.S. Economy: Significance, Determinants, and Policy, Congressional Research Service Report 15 (May 25, 2006), available at http://assets.opencrs.com/rpts/RL32987_20060525.pdf (“This infrastructure [of economic growth] is comprised of laws, government policies, socio-economic institutions, and cultural attitudes that are conducive to the entrepreneurial activity that generates sustained long-term economic growth.”).


\(^{31}\) Anywhere these references seek to promote economic growth through entrepreneurship.

\(^{32}\) See, e.g., Sylvia A. Law, Rethinking Sex and the Constitution, 132 U. PA. L. REV. 955 (1984) (arguing there is a need to develop a viable legal model of gender equality, take to account for sex differences as a key concept in modern political theory and practice).
of change. He established his famous theoretical schema of economic development as a dynamic process of change. As opposed to Adam Smith, Schumpeter argued that there is no invisible hand that directs the forces of the economy toward stability and growth. Schumpeter believed that the circular flow of economic life evolves through a process of “Creative Destruction”—cycles of punctuated equilibria disrupted by sudden leaps of endogenous innovation.

The principal agents of these changes and the destabilizing force in the economy, according to Schumpeter, are entrepreneurs. These “economic leaders,” as Schumpeter often described them, are avant-garde in that they create new combinations, creations that confront and eventually defeat previously existing economic orders. These innovations destroy the basis of the old economy while paving the way for a new economic order with higher levels of prosperity and welfare.

In order to place the proposed model in a proper context, this part provides a brief overview of the main elements of economic development theory.

A. Novelty

What distinguishes entrepreneurial activity that changes economic orders from other business undertakings is novelty, according to Schumpeter. In his essay *The Analysis of Economic Change*, Schumpeter introduced the concept of “new combinations,” which he
defined as the driving force that disturbs the market’s static state of equilibrium. The innovative aspect of entrepreneurial activity is vital to the economy, he argued, because novelty and creativity challenge the current body of knowledge and premises and eventually push society forward by destroying old premises.

Schumpeter identified five principle methods of innovation in the production process:

1. the production and sale of new products or new qualities of products
2. the introduction of new and untested production methods or of new ways of handling commodities commercially
3. the creation of new forms of industrial organization
4. the opening up of new markets
5. the opening up of new supply sources

Not all new combinations, Schumpeter stated, constitute entrepreneurship that leads to economic development. He distinguished innovation from invention or experimentation by asserting that unless inventions are successfully delivered to the market, they are economically insignificant. Entrepreneurship, therefore, is erroneously equated with technological inventions. The task of the entrepreneur is to successfully bring the invention to market, which is quite different from the undertaking of the inventor. While in reality most entrepreneurs are also inventors or financiers, their key function is executing innovations effectively. The entrepreneur, Schumpeter emphasized, “is the man

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41 Joseph A. Schumpeter, The Theory of Economic Development (1934), reprinted in JOSEPH A. SCHUMPER, THE ENTREPRENEUR, in THE ENTREPRENEUR, CLASSIC TEXTS BY JOSEPH A. SCHUMPETER 50 (2011) (“Development in our sense is then defined by the carrying out of new combinations.”).
45 SCHUMPETER, supra note 40, at 67. See also SCHUMPETER, ENTREPRENEUR, supra note 43, at 248 (2011) (“As long as they are not carried into practice, inventions are economically irrelevant. And to carry any improvement into effect is a task entirely different from the inventing of it, and a task, moreover, requiring entirely different kinds of aptitudes.”).
46 Id.
47 SCHUMPETER, supra note 40, at 67, 266. See also SCHUMPETER, ENTREPRENEUR, supra note 43, at 248 (“Although entrepreneurs of course may be inventors just as they
who gets things done and not necessarily the man who invents.” 48 And he identified “enterprise” as the conduit for implementing novel ideas and discoveries that transform economic markets. 49

However, not all new combinations delivered to the market contribute to the development of the economy. Those that are carried out in response to existing demand in the market are a prime example. 50 Innovation has to occur independently, and has to create a new demand in the market. 51 Yet, tracing innovation to previously existing market demands is not an easy task, especially since innovations are not isolated, but tend to cluster as first some and then other firms follow in the wake of a successful innovation and to expand to other related industries. 52

B. Value

In the dynamic process of economic cycles, entrepreneurs innovate and create incremental value. 53 This economic value is what Schumpeter termed “entrepreneurial profits,” 54 which he distinguished from other business profits by the scope and timing of their onset. Entrepreneurial profits, Schumpeter argued, are the portion over and above a normal profit. 55 These profits follow new combinations that create new market demand, which in turn attracts other competitors to imitate the cutting-edge innovation. Therefore, Schumpeter concluded, entrepreneurial profit is only a temporary premium for successful innovation. 56 And for the short period of time until competitors follow, these entrepreneurial gains also constitute monopoly gains. 57 Once competitors follow, that

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48 Schumpeter, supra note 34, at 266.

49 Schumpeter, Business Cycles, supra note 43, at 300 (“For actions which consist in carrying out innovations we reserve the term Enterprise; the individuals who carry them out we call Entrepreneurs.”).

50 Id. at 293.

51 Id.

52 Id. at 298. See also infra notes 206, 197-198, 298.


54 See infra note 56.

55 Id.

56 JOSEPH A. SCHUMPETER, The Entrepreneur in Today’s Economy (1928), reprinted in JOSEPH A. SCHUMPETER, THE ENTREPRENEUR, in THE ENTREPRENEUR, CLASSIC TEXTS BY JOSEPH A. SCHUMPETER 272 (2011) (“Entrepreneurial profit is “a profit that in each individual case is temporary.”).

57 Schumpeter, supra note 34, at 260 (contending that the economy is dominated by a series of transitory monopolies that compete with each other on the next breakthrough innovation). See also PAUL STONEMAN, ECONOMIC ANALYSIS OF TECHNOLOGICAL CHANGE 13-27 (1983) (stressing the importance of profit making in converting an invention into an innovation and then into an essential product).
special premium is transformed into common business profits.\footnote{They are temporary because no matter how much the entrepreneur struggles to preserve that stream of entrepreneurial profits by filing patent applications, imposing secrecy restrictions, or engaging in monopolistic strategies, in a competitive economy innovations are destined to diffuse to other market players, related industries, and the entire economy, resulting in the forfeiture of the entrepreneur’s monopolistic position.}{58}

This is also where entrepreneurship aligns with Schumpeter’s economic theory of business cycles. He posited that entrepreneurs, as economic agents who successfully deliver innovations to the market, create new demand that attracts other businessmen to imitate their innovative ideas.\footnote{Schumpeter, supra note 56, at 270 (‘‘entrepreneurial profit’’ is “the premium put upon successful innovation in capitalist society and is temporary by nature: it will vanish in the subsequent process of competition and adaptation.”).}{59} At that juncture, the economy starts to build an upward cycle. The result of these entrepreneurial profits, and of the common business profits that follow, is the creation of wealth and economic growth.\footnote{That accumulation of profits also facilitates economic and social mobility to the entrepreneur. Schumpeter, Business Cycles, supra note 43, at 304.}{60} Once the innovation trickles down to local businesses in related industries, it also increases nationwide prosperity.\footnote{Schumpeter’s shift in way of thinking occurred as a response to the criticism on his idea of monopoly gains and associated with the depersonalization of the entrepreneurial function. Id. at 18-19.}{61}

But as more market players reproduce the initial entrepreneur’s success, speculation and over-investment begin to drive down the level of profits, which brings the economy to a downturn.\footnote{Schumpeter, supra note 40, at 57; Schumpeter, Business Cycle, supra note 43, at 294.}{62} At that point, other entrepreneurs are required to successfully deliver new combinations to start a new upward business cycle, and vice versa.

\section*{C. Size Doesn’t Matter}

How do small businesses fit in this picture? In the past, most entrepreneurs were self-employed or independent small firms that struggled to get capital funding. Yet, as a shift in Schumpeter’s later work demonstrated,\footnote{This term was first coined by economists in the 1980s. See, e.g., Norman Macrae, Intrapreneurial Now, THE ECONOMIST 67 (1982); see generally Karina S. Christensen, Enabling Intrapreneurship: The Case of a Knowledge-Intensive Industrial Company, 8 EUR. J. INNOVATION MGMT. 305 (2005).}{63} entrepreneurs are not necessarily small businessmen but also employees of “big, particularly of ‘giant,’ concerns, which often are but shells within which an ever-changing personnel may go from innovation to innovation.”\footnote{Becker et al., supra note 28, at 5.}{64} This phenomenon has come to be known as “intrapreneurship,”\footnote{Schumpeter, supra note 34, at 258.}{65} which refers to divisions or employees that are responsible for developing internal
entrepreneurship within large or established firms with market experience, exposure and resources. By pioneering innovations within a firm’s existing structure, entrepreneur-employees contribute to their firm’s entrepreneurial viability.

Decades before intrapreneurship became a buzzword, Schumpeter proposed a more nuanced understanding of entrepreneurship. In his later work he argued that while entrepreneurial ventures may start small, not all small businesses are necessarily entrepreneurial. Therefore, if small businesses indeed contribute to economic development, it is not by virtue of their size but due to their entrepreneurial character. Entrepreneurial businesses are those that stimulate the economy and incite market changes. In fact, Schumpeter observed, large, established firms are often more entrepreneurial and innovative than small firms because they have more resources to invest in innovation and to attract and incentivize entrepreneur-employees. Large firms are more devoted to innovation in their routine operation, he concluded, because they are more inclined to invest daily resources in research and development in search of the next breakthrough innovation.

D. Contemporary Thoughts on Economic Development

American economist and Nobel laureate Robert Solow is well-respected for his work on economic growth. Identifying himself as a neo-Keynesian, Solow placed Schumpeter’s work on economic theory among the most defining of the 20th century:

Today, some sixty years after their deaths, Schumpeter’s star probably outshines Keynes’s... the lessons that Keynes taught have been learned by central banks and finance ministries. Instead, long-term economic growth has moved to the top of the

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66 Smith & Ueda, Law & Entrepreneurship: Do Courts Matter?, supra note 39, at 356. Up until the last decade, units that were divisions of large firms were excluded from the definition of entrepreneurs because it was difficult to establish their autonomy. Khan & Manopichetwattana, infra note 220.

67 Id. (“Scholarly interests in ‘Intrapreneurship’ are clustered around the issue of how to circumvent organizational inertia in established firms and to get novel things done, as opposed to conducting routine business.”).

68 SCHUMPETER, supra note 40, at 57; SCHUMPETER, Business Cycle, supra note 43, at 294.

69 Id. See also Becker et al., supra note 28, at 18-19. This Schumpeterian hypothesis that large firms are more innovative than small firms has been criticized. See, e.g., William B. Gartner & Nancy M. Carter, Entrepreneurial Behavior and Firm Organizing Processes, in ZOLTÁN J. ÁCS & DAVID B. AUDRETSCH, HANDBOOK OF ENTREPRENEURSHIP RESEARCH 195 (2003) (“Entrepreneurial behavior involves the activities of individuals who are associated with creating new organizations rather than the activities of individuals who are involved with maintaining or changing the operations of on-going establishes organizations.”).

70 Schumpeter, supra note 34, at 260; SCHUMPETER, ENTREPRENEUR, supra note 43, at 249. Nevertheless, Schumpeter seemed to be dismayed by the fact that entrepreneurs in big firms are sometimes constrained by the firm’s bureaucratic structure. Id.
political and intellectual agenda, and that was Schumpeter’s topic.  

Schumpeter’s ideas continue to have a large impact on contemporary economic literature. Even though some of his ideas have been revised and refined over time, Schumpeter’s commitment to a vision of economics based on technological innovation has successfully endured. Modern economists, most notably William Baumol, Israel Kirzner and others, continue to develop Schumpeter’s theory by portraying entrepreneurship as a function of innovation and economic evolution. Most of them also found no significant correlation between economic growth and the size of the firm.

William Baumol, one of the most influential economists of our time, emphasized the importance of entrepreneurship in stimulating economic growth. Like Schumpeter, Baumol’s greatest contribution was putting

76 See, e.g., RICHARD R. NELSON & SIDNEY G. WINTER, AN EVOLUTIONARY THEORY OF ECONOMIC CHANGE (1982); Richard R. Nelson & Sidney G. Winter, The Schumpeterian Tradeoff Revisited, 72 Am. Econ. Rev. 32 (1982) (developing a theory of economic evolution that built on and expanded on Schumpeter’s most important ideas).
77 For example, HOWARD H. STEVENSON ET AL., NEW BUSINESS VENTURES AND THE ENTREPRENEUR 16 (2d ed. 1985) (summarizing the entrepreneurship concept as “the process of creating value by pulling together a unique package of resources to exploit an opportunity”). But see Stanley J. Metcalfe, Entrepreneurship: An Evolutionary Perspective, in MARC CASSET ET AL., THE OXFORD DICTIONARY OF ENTREPRENEURSHIP 59-90 (Oxford Univ. Press 2006) (criticizing Schumpeter for gender preference as his entrepreneur has always been a male operating in a world of male culture).
79 BAUMOL, supra note 74, at ch. 1 (“once capitalism was in place and fully operational, a flow of innovation and the consequent rise in productivity and per capita
forth a formal theoretical analysis of the entrepreneur’s role in economic life. Baumol argued that there are certain features that are crucial to growth in the free market. He singled out two main determinants in particular, innovation as a prime competitive weapon and entrepreneurs who devote themselves to productive innovation. Baumol relied on Schumpeter’s depiction of innovation, and similarly, distinguished between the innovative entrepreneur, who comes up with new ideas and puts them into practice, and the replicative entrepreneur, who can be anyone who launches a new business venture, regardless of whether similar ventures already exist. Once institutional impediments are removed, Baumol argued, the free market grows by itself and generates innovation and growth.

Baumol, like Schumpeter, attributed the success of the capitalist economy primarily to competitive pressures not present in other types of economies. These competitive pressures, he argued, are the result of oligopolistic competition among large, technological firms, with innovation as a prime competitive weapon. But distancing himself from not only Schumpeter but also F.M. Scherer and John Kenneth Galbraith, who believed the days of the individual small-business-entrepreneurs were waning, Baumol argued that such individuals were responsible for revolutionary breakthroughs. He pointed out that younger entrepreneurial firms are responsible for a disproportionate share of breakthrough inventions.

Baumol identified two main classes of private suppliers of innovation, large firms and inventor-entrepreneurs. In this David and Goliath symbiosis, as Baumol described it, pricing and economies of scale are no longer the key for success; instead, it is cutting-edge innovation. In other words, entrepreneurship in small and large firms originates from competitive forces that drive firms to invest in innovation and in rapid diffusion of technology throughout the economy, which
ultimately results in economic growth. Small and large businesses ensure their existence and growth through continued innovative activities. What matters, in his account, is not the size of the firm but its innovative value.

Renowned Professor of Economics Israel Kirzner also observed economic value in the form of entrepreneurial profit, but added some important variations to the body of economic growth theory. He criticized price theories that assume perfect competition and market equilibrium, which creates an erroneous assumption of perfect knowledge. Where perfect knowledge exists in a state of equilibrium, he maintained, there is no room for entrepreneurs. Only in disequilibrium are there opportunities for entrepreneurial profit, for the purchase of inputs at a cost lower than the revenue obtainable from the sale of their potential output.

While Schumpeter focused on the disequilibrating and destructive force of entrepreneurs, Kirzner viewed economic development as a process driven by entrepreneurs who act as agents responsible for equilibrating the market and correcting economic errors. Kirzner indicated that the existence of as-yet-unexploited opportunities for entrepreneurial profits means that the existing state of affairs, no matter how evenly it seems to flow, is in fact in a state of disequilibrium. Entrepreneurship, according to Kirzner, is created by a state of disequilibrium, and ensures a tendency toward equilibrium of the economy. Entrepreneurs are unique in that they can identify and grasp opportunities ignored by others.

Kirzner also refined Schumpeter’s views on innovation, putting knowledge at the center of his theory. Kirzner asserted that the market performs a crucial function in discovering knowledge that nobody

87 Id. (“It is clear that innovation plays a far larger role in the activities of many key firms and industries than the current theoretical literature takes into account.”).
88 Baumeol points to the computer industry for example, “whose new and improved models appear constantly, each manufacturer battling to stay ahead of its rivals.” BAUMOL, supra note 74, at ch. 1.
89 Id. at 26 (“Each side of large firm-small firm interaction is only part of the story of the evolving role of the entrepreneur, and, as a result, overlooks much of its essence.”).
91 ISRAEL M. KIRZNER, PERCEPTION, OPPORTUNITY AND PROFIT STUDIES IN THE THEORY OF ENTREPRENEURSHIP 110 (1979).
92 Id. at 111.
93 Id. at 109 (“the essence of the entrepreneurial decision consists in grasping the knowledge that might otherwise remain unexploited”).
realizes exists. Knowledge—consisting of beliefs, expectations and speculations to the extent that people can base their actions upon them—can, according to Kirzner, be new or previously ignored by others. Such knowledge is acquired in one of two ways, either through deliberate investment and cost-conscious search, or through spontaneous efforts. He coins the phrase “entrepreneurial alertness” to signify that when entrepreneurs are dissatisfied with both the quantity and the quality of current information, that dissatisfaction inspires them to search for more and better knowledge. The market process then takes those systematically unnoticed opportunities the entrepreneurs discovered and translates them into profitable exchanges.

Steven Klepper recently reiterated these ideas in a study on knowledge spillover in Silicon Valley. He showed that entrepreneurs function as a conduit for facilitating spillover of knowledge, as they take knowledge that might otherwise have remained uncommercialized and use it to launch start-ups.

American economists Zoltán J. Ács and David B. Audretsch offer a unique assessment of the interplay between economic growth, entrepreneurship and firm size. Similar to Schumpeter and Kirzner, Ács and Audretsch argue that entrepreneurship capital exhibits a higher level of economic growth and is valuable to the development of the economy. They propose a knowledge-spillover theory of entrepreneurship, which posits that as knowledge context increases, entrepreneurship becomes more important because it provides a missing link for economic growth by commercializing investments in knowledge and ideas that might otherwise have remained uncommercialized.

But unlike Schumpeter’s later work highlighting innovation in large firms, Ács and Audretsch argue that large corporations often suffer from a “knowledge filter,” which they defined as knowledge barriers that impede entrepreneurship and economic growth. They state that large

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95 Id. at 140.
96 Id. at 143-45, 148. Social institutional arrangements such as universities and research organizations, therefore, are highly desirable according to Kirzner because they minimize ignorance and generate the greatest volume of spontaneous, undeliberate learning. Id. at 147.
97 Id. at 150.
100 See also CLAYTON M. CHRISTENSEN, THE INNOVATOR’S DILEMMA: WHEN NEW TECHNOLOGIES CAUSE GREAT FIRMS TO FAIL 86 (1997) (contending that established firms are also captive to the financial structure and organizational culture inherent in the value
corporations repeatedly decide not to pursue new ideas that ultimately lead to valuable innovations and ultimately economic growth. On the other hand, like Kirzner, they claim that entrepreneurship in smaller firms contributes to economic growth by serving as a conduit for the spillover of knowledge and ideas that might otherwise have been abandoned or remained dormant in the organizations that created the ideas in the first place.

That does not mean that firm size necessarily matters. Ács and Audretsch provided empirical data that shows a mixed correlation between a firm’s size its entrepreneurial character and industrial environment. Thus, they view beneficial entrepreneurship activity that leads to economic growth as not associated with size, but rather is strongly linked to the existence of new firms and start-ups. They argue that entrepreneurship is good for economic growth because entrepreneurs create new businesses, and new businesses, in turn, create jobs, intensify competition and may even increase productivity through technological change. Indeed, former U.S. Census Bureau chief economist John Haltiwanger has illustrated that while most young firms are small, once

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101 They give various examples such as the copy machine fax machine, personal computer and flat screen. See Zoltán J. Ács, David B. Audretsch & Robert J. Strom, Why Entrepreneurship Matters, in ZOLTÁN J. ÁCS, DAVID B. AUDRETSCH & ROBERT J. STROM, ENTREPRENEURSHIP, GROWTH, AND PUBLIC POLICY 7 (2006) (“all of these ideas were caught in the knowledge filter of an incumbent large corporation”).


103 See, e.g., Zoltán J. Ács & David B. Audretsch, Innovation, Market Structure, and Firm Size, 69 REV. ECON. & STAT. 567, 567 (1987) (finding that large firms tend to have an innovation advantage in industries that are capital-intensive, concentrated, highly unionized, and produce a differentiated good. Small firms tend to have the relative advantages in industries which are highly innovative, utilize a large component of skilled labor, and tend to be composed of a relatively high proportion of large firms); for an overview of the various studies on firm size and innovation, see George Symeonidis, Innovation, Firm Size and Market Structure: Schumpeterian Hypotheses and Some New Themes, OECD Economic Studies No. 27, 37 (1996), available at http://www.iseg.uel.pt/aula/cad172/3.%20Bibliografia/Parte%202/%20G.%20SYMEONIDIS%20(1996).pdf.

104 ZOLTÁN J. ÁCS & DAVID B. AUDRETSCH, ENTREPRENEURSHIP, INNOVATION AND TECHNOLOGICAL CHANGE 1 (2005). See also William B. Gartner & Nancy M. Carter, Entrepreneurial Behavior and Firm Organizing Processes, in ZOLTÁN J. ÁCS & DAVID B. AUDRETSCH, HANDBOOK OF ENTREPRENEURSHIP RESEARCH 195 (2003) (“Entrepreneurial behavior involves the activities of individuals who are associated with creating new organizations rather than the activities of individuals who are involves with maintaining or changing the operations of on-going establishes organizations.”).
size is isolated as a variable, it is young, entrepreneurial firms that are the engine of employment growth in the United States.\textsuperscript{105} Ács, in a separate essay called for a distinction between different types of new businesses. Ács differentiates between “necessity entrepreneurship,” which is created because of a lack of other employment options, and “opportunity entrepreneurship,” which is an active choice to start a new enterprise based on the perception that an unexploited or underexploited business opportunity exists. He finds that “necessity entrepreneurship” causes negative GDP growth, while opportunity entrepreneurship has a positive and significant effect on economic development.\textsuperscript{106} A nation’s economic development, he concludes, depends on successful entrepreneurship combined with the force of established corporations.\textsuperscript{107}

In conclusion, most economic theorists view innovation as a determinant executed by firms of all sizes, and as a variable that distinguishes livelihood businesses from entrepreneurial firms that can stimulate an economy.\textsuperscript{108} Schumpeter’s vision of the key role of entrepreneurship in economic development continues to be applied and developed today.\textsuperscript{109} The past three decades in particular have witnessed a “Schumpeterian renaissance” and a growing interest in his theories.\textsuperscript{110} A


\textsuperscript{106} Zoltán J. Ács, \textit{How is Entrepreneurship Good for Economic Growth?}, 1 INNOVATIONS 97, 98 (2006).

\textsuperscript{107} Id. at 97, 104. See also Zoltán J. Ács, “Entrepreneurial Capitalism” in Capitalist Development: Toward a Synthesis of Capitalist Development and the “Economy as a Whole,” in ZOLTÁN J. ÁCS, DAVID B. AUDRETSCH & ROBERT J. STROM, \textit{ENTREPRENEURSHIP, GROWTH, AND PUBLIC POLICY} 319 (2006).


\textsuperscript{110} See Chris Freeman, \textit{A Schumpeterian Renaissance?}, Science and Technology Policy Research, University of Sussex, UK, Working Paper No. 102 (July 2003), available at \url{http://www.admin.susx.ac.uk/Units/spnu/publications/imprint/sewp/sewp102/sewp102.pdf} (arguing __). See also John Phillimore, \textit{Schumpeter, Schumacher and the Greening of
The neo-Schumpeterian school of economic thought has started to emerge, following in the footsteps of Schumpeter in the areas of technology and innovation studies.\footnote{111} Such scholars posit that technological change is a core variable of economic growth driven by the introduction of innovation and shaped by government policy.\footnote{112} In the essay “The Age of Schumpeter,” the Peter Drucker declared:

> [I]t is Schumpeter who will shape the thinking … on economic theory and economic policy for the rest of this century, if not for the next thirty or fifty years…. It is, in brief, increasingly realized that Schumpeter’s way of analyzing the economy has much to contribute. His phrase ‘creative destruction’ has nearly become as popular as Adam Smith’s ‘invisible hand’ and Milton Freidman’s ‘there is no free lunch.’\footnote{113}

Schumpeter’s work has been given its due in neo-classical studies of economics, but it has not received similar attention in legal studies.\footnote{114} Despite the fact that Schumpeter’s views on democracy have been cited often in legal journals,\footnote{115} his economic perspectives have been

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\footnote{113}{Peter Drucker, \textit{Schumpeter and Keynes}, Forbes 124 (May 23, 1983). See also Herbert Giersh, \textit{The Age of Schumpeter}, 74 Am. Econ. Rev. 103-09 (1984).}

\footnote{114}{See Merges, supra note 109, at 844.}

overlooked by law and economics scholars, who have tended to focus on micro-economic perspectives of the law. Nevertheless, some legal scholars found Schumpeterian hypotheses to be useful in legal analysis. They argue that Schumpeterian perspectives are well-suited to the study of legal rules, and have called for their use in places where law affects innovation. The next part examines how the proposed model incorporates these goals in a more accurate and effective manner.

II. THE MODEL AS A MODERN LEGAL MIRROR

A. Mirror Theory

Law is not isolated from social influences but is instead a mirror of the society it regulates. This part demonstrates that the current legal focus on size reflects an anachronistic picture of an economy. An economy driven by mom-and-pop shops, local traders, and only a few dominant enterprises. A bygone society that glorified small business to counteract fears about big business’s rapid influence on democracy in America.

B. A Précis of Small Business History

Until the end of the 19th century, success in business meant success as a small business owner. Small firms were the norm, and the typical business enterprise was minor, local and personal. Over the course of the 19th century rapid economic growth created opportunities for small business owners. In most industries technological, market and financial limitations precluded the development of big businesses. Until such

116 See, e.g., RICHARD POSNER, ANTITRUST LAW AN ECONOMIC PERSPECTIVE 8 (1976) (applying a microeconomic analysis to examine monopoly power).
118 Merges, supra note 109, at 844 (“[T]his Article explicitly adopts a Schumpeterian framework for its analysis.”). See also Solow, supra note 71.
119 FRIEDMAN, supra note 8, at 107 (“In the long run, society molds legal thought in its image.”).
121 Id.
122 BLACKFORD, A HISTORY OF SMALL BUSINESS IN AMERICA, supra note 18, at 11.
restrictions began to be lifted, small firms made up the bulk of America’s business system, and local and regional commerce was the main stimulus for economic growth.\footnote{Id.}

Small businessmen were merchants, brokers and skilled workers who facilitated the exchange of goods through single-unit, non-bureaucratic enterprises that lacked managerial hierarchies.\footnote{BLACKFORD, A HISTORY OF SMALL BUSINESS IN AMERICA, supra note 18, at 16.} They sought economic gain less for themselves than for their families and their livelihood.\footnote{Margaret B. Hay, Law and Social Work in a Rural Community, 145 L. & Soc. Welfare 137, 137 (1929).} As noted by historian Mansel Blackford, small business ownership was a way of life:

The United States has developed as a nation with a business culture, and business people have generally been admired and looked up to as leaders in American society…. beyond economic matters, many Americans adhered to the notion that it was only upon a base of widespread property holdings that a framework of political freedom and morality could stand.\footnote{BLACKFORD, A HISTORY OF SMALL BUSINESS IN AMERICA, supra note 18, at 37.}

Since the majority of businesses were small, size had no special consequence. The relative importance of magnitude originated with the rise of big businesses during the Gilded Age.\footnote{BARRY SUPPLE, THE RISE OF BIG BUSINESS xi (Barry Supple ed., 1992).} Although the number of small businesses continued to increase in absolute numbers, their significance to the economy declined.\footnote{Id.} Developments in transportation and communications, as well as innovations in manufacturing, created fertile conditions for the rise of big businesses. The adoption of new technologies in the late 19\textsuperscript{th} century made the industry increasingly more capital intensive, and led to a trend toward concentration. Informal arrangements and employment based on family and personal ties were replaced with management systems, bureaucratic committees and functional departments, all charged with the task of handling the company’s operations.\footnote{See generally CHARLES VICTOR BROWN, EMPLOYERS LARGE AND SMALL (2000).}

In the turn of the 20\textsuperscript{th} century, large companies came to dominate markets by taking advantage of scale economies in production and by setting up their own nationwide marketing networks.\footnote{BLACKFORD, A HISTORY OF SMALL BUSINESS IN AMERICA, supra note 18, at 104 (arguing that while smaller companies participated in industrial research their relative decline was due more to the continued existence and exploitation of economies of scale in manufacturing by the larger firms).} They used economies of scale to combine mass production with mass distribution. Mergers and vertical integration became a widely used competitive
business practice. Large firms became vertically integrated enterprises which controlled all or most of the production and sales of their products.

Small firms either adapted to these new conditions or went out of business. For instance, developments such as mail-order houses, department stores and chain stores threatened the existence of small retail stores. Small business remained significant by carving out market niches, or by operating in interior towns away from the big cities. They also served as producers during times of peak demand in industries where economies of scale did not exist, such as farming, services and sales. They served as suppliers of parts in secondary sectors, acted in seasonal markets, and operated in industries with unstable demand.

Over time, however, many small firms were unable to sustain the competitive forces and fail. Simply put, they had difficulties adapting to the new economic environment. Small companies often secured fewer government procurement contracts than their larger competition, which were able to increase output rapidly to meet changing government demands. Accordingly, public attitudes and government policies toward small and big businesses began to swing.

Congress took actions to try to correct this situation with the creation of the Smaller War Plant Division, the Smaller War Plants Corporation and the passage of the Small Business Act of 1953. See Blackford, A History of Small Business in America, supra note 18, at 100.

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134 See, e.g., JOHN HUEY, SAM WALTON: MADE IN AMERICA: MY STORY (NEW YORK 1993).
135 BLACKFORD, A HISTORY OF SMALL BUSINESS IN AMERICA, supra note 18, at 53-57 (describing the new demands of mass retailers put strains on these small manufacturers and eventually overwhelmed them).
137 Richard Sutch, Business Incorporations and Failures—Numbers and Liabilities: 1857-1998 Table Ch. 408B413, in HISTORICAL STATISTICS OF THE UNITED STATES, EARLIEST TIMES TO THE PRESENT: MILLENNIAL EDITION ch. 408B13 (Susan B. Carter et al. eds., 2006).
138 BLACKFORD, A HISTORY OF SMALL BUSINESS IN AMERICA, supra note 18, at 66 (pointing to country stores that by 1920 and 1930 disappeared from the scene except in isolated rural areas).
concern about the future of free enterprise. While some associated big businesses with positive externalities, such as increasing wealth, efficiency in production, and a rise in standard of living, others feared them. On the other hand, the public developed a sentimental attraction to small business and the proverbial “little guy.” It maintained a desire to preserve these entities, although many saw them as anachronistic, obsolete and inefficient, and predicted their failure as a natural evolutionary step.

Social, political and legal environments responded to the changes in public attitudes toward small business in a twofold manner: congressional policies began to control and regulate the operations of big businesses, while providing favoritism to small firms. For example, small business benefits, such as tax preferences, became abundant in the tax code. Regulatory exemptions from health, labor, and safety

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141 BLACKFORD, A HISTORY OF SMALL BUSINESS IN AMERICA, supra note 18, at 115 (2003) (citing the Temporary National Economic Committee: “Unless the federal government intervened more forcefully than it had so far, the future of small business was dim. . . . There can be no denying the fact that the long-run trend of the competitive battle in most lines has been against small business . . . the small businessman has been displaced from entire industries.”).


143 BLACKFORD, A HISTORY OF SMALL BUSINESS IN AMERICA, supra note 18, at 48.


145 For example, Congress set up the Senate Committee on Small Business in 1940 and the House Committee on Small Business a year later to look after the needs of small businesses. A Small Business Division was established within the Department of Commerce charged with resisting the trend of concentration. See BLACKFORD, A HISTORY OF SMALL BUSINESS IN AMERICA, supra note 18, at 50, 98.

146 Anthony C. Infanti, Tax Reform Discourse, 32 VA. TAX REV. 205, 254-55 (2012) (arguing that tax preferences were—and are—more than just a functional necessity, they are a reflection of our society rather than technical and apolitical).
guidelines were granted to small firms. Legislators began to utilize the law to restrict big businesses they viewed as engaging in unfair methods, including limiting competition, price discrimination, and other monopolistic practices. At the same time, Congress used the law to reward small businesses, which signified economic freedom and economic independence.

Legal changes, Historian Lawrence Friedman argues, derive from concrete demands on the institutions that make up the legal system. In the small business sphere, many of the legal preferences and regulatory exemptions were indeed proposed and advocated by government-appropriated small business institutions, such as the Small Business Administration and the House and Senate Small Business Committees. Created in the 1940s and 1950s, these institutions were instrumental in bringing forth changes to the laws governing small business. They conducted nationwide hearings, investigated the problems of small businesses, and advocated for the interests of small businesses.

147 For a survey of the main small business benefits, see generally Eyal-Cohen, Down-Sizing the “Little Guy” Myth in Legal Definitions, supra note 5.

148 See supra note 144. See also FRIEDMAN, supra note 9, at 585 (arguing that at that time the government needed causes because its size was only excusable if it pursued the national interest).

149 BLACKFORD, A HISTORY OF SMALL BUSINESS IN AMERICA, supra note 18, at 111 (citing Senator Wright Patman: “There are a great many people who feel that if we are to preserve democracy in government, in America, we have to preserve a democracy in business operation.”); Statement of Senator Gaylord A. Nelson (D-WI), 124 Cong. Rec. 35198 (Oct. 10, 1978) (“Small businesses are the heart and soul of the competitive free enterprise system. We all want this system to flourish and grow. It must be nourished from the roots.”).

150 Friedman, supra note 7, at 763, 771 (“Legal institutions also tend to transform demands as they handle them; that is, they change their terms, they translate them into ‘legal’ concepts, they work on them in patterned ways.”).

151 Historian Jonathan Bean summarized Congress’s purpose in establishing the SBA: “The primary legislative intent was to retain a governmental source of credit for small business... Anticommmunist ideologies supported the creation of a small business agency to defend independent enterprise from the ‘Pinkos and the Marxist Reds’ who threatened the American life. Clearly, the shades of meaning invested in the SBA were as varied as the small business ideology itself. The only losers were the laissez-faire conservatives...” JONATHAN J. BEAN, BIG GOVERNMENT AND AFFIRMATIVE ACTION: THE SCANDALOUS HISTORY OF THE SMALL BUSINESS ADMINISTRATION 9 (2001). In 1953, Congress enacted the Small Business Act of 1953, Pub. L. No. 83-163, 67 Stat. 232 (1953), which formed the SBA to “aid, counsel, assist and protect, insofar as is possible, the interests of small business concerns,” and was made permanent in the Small Business Act of 1958, Pub. L. No. 85-536, 72 Stat. 384 (1958).

152 For example in 1981 the Regulatory Flexibility Act (“RFA”) required that any agency conducting a notice and comment rulemaking to consider fully the rules’ effect on ‘small entities.’ In 1996, Congress further expanded these responsibilities by passing the Small Business Regulatory Enforcement Fairness Act. This Act gives the RFA sharper teeth by providing for judicial review of federal agencies’ RFA analysis. Joshua E. Husbands, Comment, The Elusive Meaning of Small Business, 2 J. SMALL & EMERGING BUS. L. 355, 368 (1998).
businesses, and translated their demands into legal favoritism.\textsuperscript{153} The response to this preferential output of the legal system toward small business in and of itself generated social change, by driving business planning, opportunities, and additional demands of small business owners for regulatory preferences. These outcomes affected small business culture and increased pressure on political representatives and legal institutions.\textsuperscript{154}

During times of economic crisis small businesses saw an increase in their development to some extent.\textsuperscript{155} For example, during the recession of the 1970s, with hikes in energy prices, large unemployment and high inflation, large multinational foreign companies began competing with American firms in mass production industries and exports to overseas markets.\textsuperscript{156} During this period growth and employment decreased at large firms, leading many to look to small business as the source of revitalization for America’s unhinged economy.\textsuperscript{157} Small firms used computers and other technological developments more widely to their advantage occupied market niches, and provided big businesses reliable subcontracting alternatives to mass production.\textsuperscript{158}

Yet, while the rhetoric in the 1970s and 1980s celebrated small business for stepping in with technological breakthroughs and creating new jobs, the numbers told a somewhat more nuanced story.\textsuperscript{159} In the early and mid-1980s, small firms remained an important source of innovation by focusing on projects requiring specialized knowledge.\textsuperscript{160}

\textsuperscript{153} See, e.g., Greater Federal Aid to Small Businesses Urged by House Unit, WALL ST. J., Jan. 10, 1963, at 13. Consequently, small business committees were frequent initiators of leading small business acts in Congress. See, e.g., Senate Unit Asks Change in Small Business Investment Program to Make It a Success, WALL ST. J., Apr. 27, 1960, at 6. See also Arlen J. Large, R & D Funding for Small Firms Sets Off Big Fight in Congress, WALL ST. J., Apr. 19, 1982, at 29. See generally Friedman, supra note 7, at 763, 771 (“Legal institutions also tend to transform demands as they handle them; that is, they change their terms, they translate them into ‘legal’ concepts, they work on them in patterned ways.”).

\textsuperscript{154} See Eyal-Cohen, supra note 26, at 16.

\textsuperscript{155} Id. at 17 (“Seen as a particularly vulnerable part of the production chain, small business favoritism was further expanded during crises.”).

\textsuperscript{156} Can America Compete?, BUS. WK., Apr. 27, 1987, at 45 (“U.S. producers met fierce competition from foreign industries that churned out high-quality goods made by low-wage workers.”).

\textsuperscript{157} BLACKFORD, A HISTORY OF SMALL BUSINESS IN AMERICA, supra note 18, at 166 (“Between 1976 and 1984, firms with fewer than 500 workers increased their share of the nation’s total employment from 51 percent to 53 percent.”).

\textsuperscript{158} Sanford L. Jacobs, Small Business; Small Concerns Find a Niche Solving Problems of Big Firms, WALL ST. J., Apr. 21, 1986, at 25 (arguing small concerns find segments of the market big companies are not serving).

\textsuperscript{159} Id. at 176 (“A close examination of the roles of small businesses in these fields [innovation and job creation] reveals, however, a spotty record.”).

\textsuperscript{160} Some of those examples are aerosol can, biosynthetic insulin, double-knit fabrics, quick-frozen food, zippers, and computer software. Id.; DAVID J. STOREY, THE SMALL FIRM: AN INTERNATIONAL SURVEY 23 (1983) (citing to a study of the U.S. Office of
But while small businesses created more jobs, they also discharged employees and failed at a high rate, thus succeeding no more than larger firms in net job creation. Nonetheless, small business institutions continued to advocate for small business development, including increasing loan programs and the share of small business in government procurement contracts.

And even this return to economic prominence for small business remained brief. Over the course of the 1980s companies slowly grew in size, and the rate of self-employed workforce declined. By the end of the 1990s, with smaller management structures and new production methods, large firms reclaimed their place in the economy. Often, they drove small business out of business by acting more efficiently, allowing lower-rank management more independence, focusing on internal groups, teamwork and smaller units, and investing in knowledge procurement and entrepreneurship. Large firms were once again America’s primary engine of economic growth.

C. The Economy Today

Throughout history, the emphasis on magnitude did not derive directly from the role small business played in the economy. It originated as a response to economies of scale and the rapid rise of big business. During the turn of the 20th century, size became a significant social distinction that differentiated between personal service and standardized packages; between free enterprise and society of trusts; and generally between what was perceived to be good and bad. Today, however,
these differences between small and large are less significant. Gradually, society came to accept the benefits of big business, and appreciated the ways these firms contribute to society and demonstrate corporate responsibility.\textsuperscript{168} Moreover, the industrial and technological revolutions changed the face of American society. Developments in high-tech firms emphasized the importance of innovation and flexibility to the success of businesses of all sizes.\textsuperscript{169}

With the widespread availability and affordability of fast means of transportation, such as automobiles and public transportation, businesses were able to locate their stores on the outskirts of town, where land is cheap and there is plenty of space for large parking lots. Furthermore, with the improvement of postal services, airmail and internet access, online shopping became widespread and geographic distance became less and less significant over the last century. The United States has transformed from a land of isolated small farms, shops and towns into part of a worldwide market, one where more and more products can now be ordered from foreign countries, at lower prices, and arrive within a few days.

Today, livelihood businesses still operate mostly in rural and small-town America relying mainly on local geographical-driven demand. Their economic importance today is to provide market diversity and fill market niches ignored by larger businesses. They contribute to local and regional revitalization and the diversity of local goods.\textsuperscript{170} They succeed by focusing on specialty products with only limited demand, securing non-standardized orders overlooked by large mass-production firms, providing personal service, and building on their reputation. Some small-scale firms are formed in order to act as franchised agents or subcontractors of larger firms.\textsuperscript{171} Many such businesses fulfill a market

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\textsuperscript{168} Cynthia A. Williams, \textit{Corporate Social Responsibility in an Era of Economic Globalization}, 35 U.C. DAVIS L. REV. 705, 721-24 (2002) (providing a survey of social and environmental responsibility issues that multinational corporations face today). \textit{See also} BLACKFORD, \textit{A HISTORY OF SMALL BUSINESS IN AMERICA}, supra note 18, at 93 (claiming that the acceptance of big business did not, however, preclude Americans from liking the small business hoping, upon retiring, to start their own independent small businesses).

\textsuperscript{169} BLACKFORD, \textit{A HISTORY OF SMALL BUSINESS IN AMERICA}, supra note 18, at 165.

\textsuperscript{170} Many areas struck by natural disasters and poverty that are undeveloped by large firms remained insignificant and depressed unless basic service companies agree to reopen their stores. When laid off by large firms or lack of other employment options, some try to survive by setting up their own small businesses. See SBA Disaster Assistance, http://www.sba.gov/services/disasterassistance/ (last visited July 17, 2013).

\textsuperscript{171} BLACKFORD, \textit{A HISTORY OF SMALL BUSINESS IN AMERICA}, supra note 18, at 173 (noting that Americans viewed franchising as a way to fulfill their dreams of becoming independent business people while benefiting from belonging to large supportive
demand created by other firms, without much desire to change the market in which they operate. Other smaller businesses succeed and change their market by thinking “outside the box” and coming up with a new product or a more efficient way of producing existing products. They are usually young firms that start with a few employees and, when successful, grow into a significant market prominence. Those new businesses that are able to survive the first few years after their establishment do so by being entrepreneurial.

The past several decades have illustrated that successful businesses are those which employ intelligent, innovative workers and use the most advanced technologies. By carving out market niches, by continuing to be responsive to changing consumer preferences, and by developing new production methods, businesses can remain independent enterprises, successfully coexisting with larger firms.

D. Reflecting Present-day Society

The dawn of the 21st century has seen internet-driven globalization redefine the nature of foreign trade. At the ease of a click, one is able to communicate and reach even the most remote places in the world. In the new global environment, size has become irrelevant to buyers. The focus has shifted from size to technology, from the dimensions of the firm to the level of sophistication of its products. Consequently, the significance of small business to the economy has shrunk even further. Entrepreneurship has taken the place of size in the set of factors that spur economic growth. Despite the widespread rhetoric today depicting small business as the source of economic growth, in reality these types of entities are not necessarily responsible for the development of the economy. On the other hand, entities that innovate and create value are those who contribute to the development of the economy, irrespective of their size.

Even though we live in an age of constant acceleration, an era of never-ending change, the laws governing small business remained “preservationist”. They attempt to sustain entities that otherwise go out of business due to their inherent inefficiency. Yet, major changes in

organizations). See also Brown & Buck, New Owners of Franchises Belie Mom-and-Pop Image, WALL ST. J., Aug. 29, 1988, at 11 (arguing that during the 1990s there was a shift in franchising toward more-sophisticated buyers with proven business skills and deep pockets).

172 Id.

173 BLACKFORD, A HISTORY OF SMALL BUSINESS IN AMERICA, supra note 18, at 53-54.

174 Id. (“We seem to live in an age of constant acceleration—a restless, even frantic era of perpetual change.”).

economic and social relations unavoidably produce significant legal change.\textsuperscript{176} With globalization opening new markets and free trade opportunities, the rules of the game have changed. Physical capital today is less important than knowledge capital.\textsuperscript{177} Competition is no longer confined to the borders of domestic trade.\textsuperscript{178} The dichotomy of small versus big has become irrelevant, and laws that remain fixed on this distinction become outdated. They reflect neither current economic realities nor changes in society. Today, the key predictor of success is a business’s ability to innovate and deliver innovation to the market successfully.\textsuperscript{179}

In order to ensure that America’s laws and institutions are truly effective in promoting entrepreneurship and economic growth, legal rules must be targeted toward appropriate audiences and provide appropriate incentives. For any modern economy focused on growth and development, understanding the identity and role of key market participants is crucial. And determining the requisites for participants’ effective participation is key to effectively legislating how to provide benefits and appropriations that promote growth.\textsuperscript{180} The next part applies the main elements of economic development theory to the legal landscape, shifting the focus from size to entrepreneurship. It does so by prescribing a multi-dimensional legal model that reflects an economy no longer driven by small or large businesses, but by innovative ones.

III. A FIVE-DIMENSIONAL LEGAL MODEL OF ECONOMIC ENTREPRENEURSHIP

As illustrated above, the importance of small business to economic development has long been overinflated. Instead, many policymakers today are focused on finding the determinants, effects and spillovers of entrepreneurship, in the hope of fostering economic growth.\textsuperscript{181} It is with that legislative intent in mind that this part offers a conceptual model for measuring entrepreneurial viability. The model builds on Schumpeter, Baumol, and Kirzner’s entrepreneurship theories, as well as on other modern economic notions of entrepreneurship. Given the many

\textsuperscript{176} FRIEDMAN, supra note 8, at 296.
\textsuperscript{177} Ács et al., Why Entrepreneurship Matters, supra note 175, at 6.
\textsuperscript{178} For example, Ács and Audretsch noted that imported autos and steel poured into the United States from more efficient competitors in Germany and Japan. Id.
\textsuperscript{179} Ács et al., Why Entrepreneurship Matters, supra note 175, at 9 (“The mandate for public policy in the entrepreneurial economy spans a broad spectrum of institutions, policy agencies, and instruments, ranging from education to immigration and health care. In addition, it also involves all levels of policy, from the most local to the broadest, such as the European Union. However, the goal is singular: how to increase entrepreneurial capital.”).
\textsuperscript{180} But see Infanti, supra note 146, at 205, 219 (critiquing the focus on economic growth and called for a broader view of human development).
\textsuperscript{181} See supra note 21.
dimensions of entrepreneurship, the identification of a single indicator that measures entrepreneurship may result in an arbitrary and skewed picture. This model, therefore, presents a menu of the main and widely-accepted common features and measures of for-profit firms that are most likely to display entrepreneurial qualities.

The selection of variables was based on methodological soundness, simplicity, administrability and measurability, as well as their overall relationship to the concept of entrepreneurship. Therefore, it is possible that, if examined separately, the chosen factors would not exclusively indicate entrepreneurial proclivity. Rather, it is the combination of these measures that provides a composite portrait of a firm’s inclination to be entrepreneurial. What makes this model more accurate and more efficient than the current small-or-not model is that the factors chosen here better pronounce the entrepreneurial phenomenon in the current economic reality, in which innovation is a greater indicator than size.

Over the past several decades a vast amount has been written on the individual characteristics of entrepreneurs, particularly from a psychological perspective. This scholarship has generally portrayed entrepreneurs as special individuals who tend to exhibit a particular combination of psychological attributes that enables them to assume the role of innovators in the economy. While entrepreneurial behavior is displayed through the actions of entrepreneurs, the proposed model underlines the most common entrepreneurial behaviors of firms.

A firm-behavior model of entrepreneurship has a number of advantages over other models that focus on individuals’ traits. First, the causal relationship between individual traits and entrepreneurial success has not been established. Actions rather than psychological attributes

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182 On the entrepreneurial spirit and an overview of the psychological theories of entrepreneurial attributes, see Licht, supra note 21, at 827. See also Becker et al., supra note 28, at 16.

183 See Viktor Mayer-Schonberger, The Law as Stimulus: The Role of Law in Fostering Innovative Entrepreneurship, 6 INFORM. SOC’Y J.L. & POL’Y 153, 170-73 (2010) (holding that entrepreneurs have a better ability to understand and evaluate certain risks and their returns); Daniel Ellsberg, Risk, Ambiguity, and the Savage Axioms, 75 Q. J. ECON. 643 (1961) (finding that entrepreneurs are usually able to identify opportunities due to their knowledge in a particular sector or industry, therefore perceive lower risks than others do); Daniel Kahneman & Amos Tversky, Prospect Theory: An Analysis of Decision Under Risk, 47 ECONOMETRICA 263 (1979) (arguing that entrepreneurs take risks more often); Licht, supra note 21, at 823 (noting that independence, confidence and resilience were found to affect the entrepreneur’s decision to take risks and be innovative). But see Robert H. Brockhaus, Risk Taking Propensity of Entrepreneurs, 23 THE ACAD. MGMT. J. 509 (1980) (arguing that risk taking behavior cannot be used as a distinguishing characteristic of entrepreneurship).

184 HANDBOOK OF ENTREPRENEURSHIP RESEARCH 101 (Zoltán J. Ács & David B. Audretsch eds., 2010).

185 Some studies even found that personality factors are not a key factor in predicting entrepreneurial success and are not correlated with innovation. See, e.g., Covin & Slevin, infra note 226, at 5; A.M. Kahn, Entrepreneur Characteristics and the Prediction of New
are what give meaning to the entrepreneurial process. Second, entrepreneurial effectiveness manifests itself at a firm-level analysis and is easier to measure in terms of firms’ performances. Third, while an individual entrepreneur’s qualities may affect an organization’s actions, it is the collection of individuals’ acts manifested in the firm’s performance in the market that ultimately result in organizational achievements. The following prescribes a simple legal model that identifies a firm’s proclivity to be entrepreneurial according to the main elements of the economic theory of entrepreneurship. An illustration of this model is presented in Figure 1 in the Appendix.

A. Firm’s Age

While hardly a perfect predictor, many economists consider firm longevity as a general factor in gauging entrepreneurship. Ács and Audretsch argued that entrepreneurship entails the creation of new enterprises. In Schumpeter’s eyes, a new organization is yet another form of what he considered “a new combination.” Baumol acknowledged the fact that novel ideas are often, but not always, embodied in new firms. Nowadays, new firms are not necessarily small ones. Whether new firms are entrepreneurial is contingent upon their ability to convert original ideas into success.

Therefore, the connection between a firm’s age and its entrepreneurial character is a functional return. Namely, innovation is frequently manifested by the creation of a new formal organization due to the role of the firm as an instrument for accruing entrepreneurial profit. In order to facilitate the accounting of entrepreneurial activity, to receive credit and finance the development of innovations, and to

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Venture Success, 14 OMEGA 365 (1986); D. Miller & J.M. Toulouse, Chief Executive Personality and Corporate Strategy and Structure in Small Firms, 32 MGMT. SCI. 1389 (1986); Carl P. Kaiser, Entrepreneurship and Resource Allocation, 16 E. ECON. J. 10 (1990) ("... prospective entrepreneurs will differ with respect to how much risk they are willing to bear, and with respect to how much utility they receive from undertaking ‘their own’ projects.").

186 Covin & Slevin, infra note 226, at 7.
187 Licht, supra note 21, at 832 (Needless to say, this does not mean that all entrepreneurs exhibit these attributes equally strongly during their entire career...”).
188 See infra notes 202-209 and accompanying text.
189 Ács & Audretsch, supra note 104.
190 Schumpeter, Business Cycles, supra note 43, at 295 (noting that “innovations still emerge primarily with the ‘young’ ones, and the ‘old’ ones display as a rule symptoms of what is euphemistically called conservatism”).
191 BAUMOL, supra note 80.
193 Id. at 293.
194 Id. at 305.
achieve legal autonomy, it is more advantageous for the entrepreneur to establish a separate legal entity.\textsuperscript{195}

Of course, not all new firms innovate and succeed. Entrepreneurial failure is just as important as entrepreneurial success because it is economically and culturally valuable and productive.\textsuperscript{196} Entrepreneurial failure diffuses knowledge among competitive entrepreneurs and emphasizes the skillsets they need to be resilient and eventually successful.\textsuperscript{197} It educates investors and allows them to better choose their investments.\textsuperscript{198} Failure also introduces “churn” into labor markets, which eventually leads to greater economic growth.\textsuperscript{199} For these and other reasons, a number of scholars have posited that creating a new firm (or a new venture within an existing firm) is itself an entrepreneurial act—\textsuperscript{200} and so the entry of more new firms has become a well-accepted measure of economic wealth.\textsuperscript{201}

Today, in fact, many scholars view the act of creating new organizations as the essence of entrepreneurship.\textsuperscript{202} Creating new ventures or new departments in existing firms are seen as indicators of emergent entrepreneurship and novelty.\textsuperscript{203} New organizations are

\begin{itemize}
  \item \textsuperscript{195} Id. at 234.
  \item \textsuperscript{196} See, e.g., AnnaLee Saxenian, \textit{Regional Advantage: Culture and Competition in Silicon Valley and Route 128}, 111 (1994) (arguing that learning from failure increases the competitiveness of the region).
  \item \textsuperscript{199} See Saxenian, supra note 196, at 111.
  \item \textsuperscript{200} See infra notes 202-209. See also Avinash K. Dixit & Joseph E. Stiglitz, \textit{Monopolistic Competition and Optimum Product Diversity}, 67 AM. ECON. REV. 297, 297 (1977) (expanding the definition of entrepreneurship to encompass firms that earn profits by selling substitutable goods).
  \item \textsuperscript{201} Id. See also Agarwal et al., supra note 198, at 265 (“[I]nnovation of new entrants generate selection pressures on existing firms.”); Bosma et al., \textit{Global Entrepreneurship Monitor Manual}, infra note 207.
  \item \textsuperscript{202} See, e.g., Howard Aldrich, \textit{Entrepreneurship}, in THE HANDBOOK OF ECONOMIC SOCIOLOGY 451 (Neil Smelser & Richard Swedberg eds., 2005) (arguing that entrepreneurship ensures the reproduction of existing organizational populations and lays a foundation for the creation of new populations).
  \item \textsuperscript{203} See, e.g., Diego B. Avanzini, \textit{Designing Composite Entrepreneurship Indicators: An Application Using Consensus PCA} 3 (June 20, 2009), in \textit{ENTREPRENEURSHIP AN ECONOMIC DEVELOPMENT: DESIGNING COMPOSITE ENTREPRENEURSHIP INDICATORS} ch. 3 (Wim Naudé & Palgrave MacMillan eds., 2011), available at http://ssrn.com/abstract=1988954 (“New entry is the act of launching a new venture,
perceived as serving a function through which entrepreneurs produce new combinations by successfully transforming resources into final goods.204 With the development of limited-liability doctrines that became useful in protecting entrepreneurs from the risk of being personally liable for their entities’ defaults, forming new entities became an ordinary first step in the establishment of an entrepreneurial venture.205

Recent studies on organizational demography support this assertion.206 For example, the New Entrepreneurship International (“GEM”) project is an initiative that surveys entrepreneurship indicators in more than 80 nations in order to explore the widely accepted link between entrepreneurship and economic development.207 One of the key indicators GEM assesses is the business dynamics of firms and jobs. The project reports entrepreneurial activity by computing nascent entrepreneurship, which includes only new firms that are less than 3.5

either by a start-up firm, through an existing . . . firm, or via ‘internal corporate venturing.’

204 See Smith & Ueda, Law & Entrepreneurship: Do Courts Matter?, supra note 39, at 357 (“... the process of creating value operates through the creation of a multiperson system (organization) that transforms input such as materials, money, and time into output such as product and services.”). 205 See, e.g., Mitchell F. Crusto, Extending the Veil to Solo Entrepreneurs: A Limited Liability Sole Proprietorship Act (LLSP), 2001 COLUM. BUS. L. REV. 381 (2001) (arguing that to encourage would-be entrepreneurs to create businesses, the law should enact a limited liability statute designed for the sole proprietor); David W. Leebron, Limited Liability, Tort Victims, and Creditors, 91 COLUM. L. REV. 1565, 1630 (1991) (“arguing unlimited liability would probably result in excessive risk aversion by entrepreneurs, particularly given the inability of such investors to diversify”). See also Lynn M. LoPucki, The Death of Liability, 106 YALE L.J. 1, 92 n.78 (1996) (suggesting that as an alternative to insurance, entrepreneurs could demonstrate financial responsibility).


years old. Similarly, the Kauffman Foundation, one of the world’s largest foundations devoted to entrepreneurship, releases the Kauffman Index of Entrepreneurial Activity, a leading indicator of new business creation in the United States.

Yet, these studies that focus on a firm’s age ignore to some extent the phenomenon of intrapreneurship — that is, instances in which established firms have employees or departments that continuously seek innovation and are entrepreneurial in their character. Indeed, recent studies emphasize that entrepreneurship can also occur through teams of entrepreneurs. Yet while this paper acknowledges the concept of intrapreneurship, the model proposed here also considers other indicators to denote different grades of entrepreneurial behavior. It recognizes that firm age in and of itself is inadequate in predicting innovation.

B. Knowledge Procurement

Measuring innovation is hardly a simple task. Innovation generally refers to the making of superior products, technologies, or...
processes. Schumpeter viewed innovation in the form of new goods, new methods of production, new markets, new sources of supply of raw materials, and the carrying out of new organizations of industries. Yet, novelty in the manufacturing industry is different than innovation in the service industry. While innovation is usually associated with technological changes, it may well occur in non-technological fields. In these industries, innovation can be portrayed by improving the access and attractiveness of existing products and customer needs.

Scholars have been skeptical regarding the existence of a method that can truly grasp every dimension of novelty. Yet, in most models of innovation knowledge procurement has been the first stage. One of the

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See Christensen, supra note 100, at 1, 10 (giving examples of established firms' new processes such as Sears that was innovative at that time); Thomas H. Davenport, Process Innovation: Reengineering Work Through Information Technology 3 (1993).

Becker et al., supra note 28, at 25.


See, e.g., Steven H. Hobbs, Toward a Theory of Law and Entrepreneurship, 26 CAP. U.L. REV. 241, 278 (1997) (contending that innovation can take place in low-tech industries such as the finance and service industries.); see also Arshad M. Khan & V. Manopichetwattana, Innovative and Noninnovative Small Firms: Types and Characteristics, 35 MGMT. SCI. 597, 598 (1989); Thomas J. Peters & Robert H. Waterman, Jr., In Search of Excellence: Lessons from America's Best-Run Companies 224 (1982).


Matthew R. Marvell & G.T. Lumpkin, Technology Entrepreneurs’ Human Capital and Its Effects on Innovation Radicalness, 31 ENTREPRENEURSHIP THEORY AND
most common ways of measuring a firm’s investment in innovation is by focusing on the cost of its innovation input.\textsuperscript{223} This cost of procuring knowledge includes, but is not limited to, R&D expenditures, external acquisitions of knowledge (such as patents, licenses and technical services), the acquisition of machinery and equipment that incorporates new technology when producing a new product, and other tools and staff training.\textsuperscript{224} 

The model proposed here suggests incorporating a wide array of outlays to indicate investment in knowledge as an objective criterion.\textsuperscript{225} Today, innovation efforts are viewed as a proxy, in both popular and academic literature, for long-term growth not only of firms, but also of industries and even nations.\textsuperscript{226} Such efforts signify the firm’s commitment to producing knowledge and new ideas that, if successful, result in innovation output.\textsuperscript{227} Such efforts also indicate the amount of

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\textsuperscript{223} For example, the Internal Revenue Code provides an R&D tax credit for certain qualified expenditures on R&D, namely amounts paid for the performance of research in the pursuit of new scientific knowledge, counting labor and capital costs. \textit{See generally} 26 U.S.C. § 41. These expenditures usually include the wages of employees engaged in performing, supervising, or supporting R&D (26 U.S.C. § 41(b)(2)(D)); supplies, prototypes, testing materials, and any tangible property directly linked to R&D activities (26 U.S.C. § 41(b)(2)(C)); payments for R&D services performed under contracts with third parties and basic research payments to non-profit organizations and institutions for performing fundamental research that focuses on evaluating theories and hypotheses (26 U.S.C. § 41(e)(2)).


\textsuperscript{225} \textit{See} \textit{supra} Part I.A.


\textsuperscript{227} \textit{See supra} Part I.A.
\end{flushright}
financial resources a firm is devoting to the development of innovation, thereby demonstrating the firm’s commitment to entrepreneurship. 228

Investment in knowledge alone, to be clear, is not sufficient for attaining economic growth. 229 Entrepreneurship involves the act of successfully transforming innovation into business value. 230 For example, a firm may be able to achieve a breakthrough invention, but may then fail in commercializing and converting that invention into economic value. 231 On the other hand, as noted by Kirzner, entrepreneurial firms are also those which achieve innovation by pursuing opportunities and knowledge ignored by others. 232 Therefore, as opposed to other models that focus exclusively on innovation input, the model proposed here seeks to combine factors other than just investment in knowledge and discovering of opportunities.

C. Innovation Yield

Investment in innovation involves the combination of inputs in the hope of attaining positive outputs. 233 Innovation outcomes are a key part of economic development theory stressing the significance of a successful innovative process in creating value for the economy. 234 The most common signal of innovation outcomes has been a firm’s intellectual products, such as patents, copyrights, licenses, trademarks, service marks, product designs, trial production and publications. 235

Indeed, many studies measure the productivity of innovation and a


229 See supra note 44 and accompanying text.

230 See supra note 45 and accompanying text.

231 See supra Part I.B.

232 KIRZNER, supra note 91.

233 Stone et al., supra note 221, at II-1.


firm’s ability to generate new knowledge by the number of patents, copyrights and trademarks it introduces. Other studies use bibliometric information, such as the number of scientific publications, books, research and grant proposals, presentations and cite counts in other publications. However, what these studies fail to account for is the quality of innovation. A firm’s R&D department may be extremely productive when measured by the quantity of patents obtained, but still fail to further the company’s business goals. Similarly, an invention can be considered scientifically groundbreaking by outside evaluators and journal editorial boards, but have little or no commercial value to a corporation. Moreover, many firms today file patent applications as a strategic way to block potential competitors. Accordingly, simply counting output is not enough; outcomes must also be measured by


237 See, e.g., Covin & Slevin, supra note 226.


239 See, e.g., DAVID B. AUDRETSCH & STEVEN KLEPPER, INNOVATION, EVOLUTION OF INDUSTRY AND ECONOMIC GROWTH 11 (2000). See also Evangelista et al., supra note 221, at 311 (1998) (“Patent data . . . tells us only about the invention phase of the innovation process, and little about commercialization and hence the economic value or economic impact of an invention. Bibliometric data tells us much about the changing shape of fundamental research, but little about the innovation process.”); Zvi Griliches, Patents: Recent Trends & Puzzles, BROOKINGS PAPERS ECON. ACTIVITY 291, 312 (1989) (arguing that patent counts do not inform us about the quality of patents); Jay P. Kesan & Andres A. Gallo, Why “Bad” Patents Survive in the Market and How Should We Change?—The Private and Social Costs of Patents, 55 EMORY L.J. 61, 67-68 & n.29 (2006) (arguing that the USPTO loose practices lead to issuance of low quality patents).


241 For example, academic articles or cultural inventions can include innovations that advance our understanding of processes, certain behaviors but have no commercial value. See, e.g., Allan Hanson, The Making of the Maori: Culture Invention & Its Logic, 91 AM. ANTHROPOLOGIST 890, 890 (1989) (discussing cultural inventions).

considering the real value an innovation adds to the firm. An invention is not necessarily an innovation.\(^{243}\)

A useful alternative indicator is innovation yield, which incorporates the quality of investment in knowledge and the successful implementation of that knowledge — in other words, the essence of the entrepreneurial process.\(^{244}\) This measure indicates the effectiveness of a firm’s innovation efforts by determining the relationship between the commercial value of knowledge and the investments required to generate that knowledge.\(^{245}\) Indeed, companies demand their employees not only produce innovations, but also establish the value of these innovations to the organization.\(^{246}\)

\(\text{D. Labor Expansion}\)

Entrepreneurial firms are considered biggest contributors to the nation’s economic growth due to their rapid employment expansion:

How is entrepreneurship good for economic growth? This question would seem to have a simple answer: Entrepreneurs create new businesses, and new businesses in turn create jobs, intensify competition, and may even increase productivity through technological change. High measured levels of entrepreneurship will thus translate directly into high levels of economic growth.\(^{247}\)

Once an innovation is successfully implemented, a firm initiates mass production of its products by expanding the number of employees and

\(^{243}\) See supra note 44.

\(^{244}\) See supra note 45.


\(^{246}\) Mark G. Brown & Raynold A. Svenson, Measuring R&D Productivity, 41 RESEARCH TECH. MGMT. 11, 30 (1998) (holding that upper management is becoming less content with subjective measures of R&D’s contribution to the bottom line).

growing its workforce.\textsuperscript{248} Through this process, entrepreneurial firms generate long-term employment and economic growth.\textsuperscript{249}

While labor expansion is one of the most recognized positive effects of entrepreneurship and an important manifestation of its existence, nonetheless, it measures the quantity, and not the quality, of employment in a firm. It does not tell us anything about the turnover rate of employment, specifically how many employees who joined a firm left in the course of the period in question.\textsuperscript{250} It also fails to provide information on the productivity or the quality of employment in the enterprise. Therefore, as with the other indicators, employment growth alone cannot affirm the entrepreneurial character of a firm. It must be combined with other factors in order to add a small piece to the rather large puzzle of a firm’s entrepreneurial orientation.

\textbf{E. Entrepreneurial Success}

After a firm invests its resources in knowledge procurement and successfully implements the innovation in the market, a demand is created in the market for the firm’s products. When that moment occurs, the firm experiences a rapid growth in the firm’s economic activity. There are various ways that manifest this increase in economic activity, among them a rise in income levels, rise in number of employees, increase in sales, increase in international trade, surge in the return-on-assets ratio, and growth in the number and capitalization of enterprises in the stock market.\textsuperscript{251}

In its quest to remain simple, the model proposed here seeks to utilize measures that are both accessible and manageable to firms and policymakers.\textsuperscript{252} Growth in sales is a well-recognized indicator for a firm’s success that is fairly easy to observe by the firm and its investors. Sales is also the immediate proxy the firm observes for changes in market demand for its products. In some respects, therefore, growth in sales can convey entrepreneurial success because it can signal a firm’s


\textsuperscript{250} Paul M. Muchinsky & Paula C. Morrow, \textit{A Multidisciplinary Model of Voluntary Employee Turnover}, 17 J. Vocational Behav. 263, 263 (1980) (claiming that voluntary turnover depends on characteristics of the individual employee, work-related factors, and the states of certain economic variables).

\textsuperscript{251} See Avanzini, \textit{supra} note 203, at 5.

\textsuperscript{252} See generally Diffusing Potential Criticism, \textit{infra} Part IV.C.
ability to convert valuable knowledge into an increase in economic performance.\textsuperscript{253} After an important discovery has been made and a firm has invested its efforts in product development, the successful delivery of a product to the market will be first and foremost recognized via a sharp increase in a firm’s sales growth.

Economists have portrayed this type of economic wealth as the initial industrial wealth deriving from entrepreneurial success, a temporary monopoly position prior to the entrance of market competitors that imitate the entrepreneur’s innovation.\textsuperscript{254} Once other imitators enter the market and commence sales of similar products, the firm will witness decrease in sales to reflect the market’s reaction to the rise in the variety of products.

Nevertheless, as with other indicators, an increase in sales cannot alone explain whether it is attributable to entrepreneurial gains or to later stages of that process when firms fulfill preexisting market demand or utilize new marketing techniques. This problem emphasizes the benefits of a model that uses a combination of factors to develop a more comprehensive picture of a firm’s entrepreneurial orientation.

\textit{F. The Model}

The five-dimensional conceptual model of entrepreneurship in the law outlined above and illustrated in more detail in the Appendix should be designed with the following strategies: First, to achieve a better fit between the firm’s actions and its entrepreneurial character the model should be graduated and each dimension of entrepreneurship must contain several levels and layers of the entrepreneurial activity. Second, for the sake of simplicity, the model focused on the most generally recognized and easily measured dimensions of entrepreneurship. It may well be expanded to include other entrepreneurial dimensions to attain an even more refined picture of entrepreneurial activity. Third, the use of multiple dimensions, and multiple layers within, should allow firms to move from one tier to another for each indicator. Finally, the proposed model should integrate the five individual dimensions into a single composite index. Every tier in the model should provide firms with a number of points per entrepreneurial dimension and different weight to account for its relative importance to economic development and social policies as will be discussed in the next part.

While this multi-dimensional model is far from being flawless, as the next part will prove, it is certainly an improvement of the current small-or-not standard. Merely one indicator cannot capture complex outcomes. Accordingly, the model should be viewed as a starting point for further

\textsuperscript{253} \textsc{alex coad}, \textit{the growth of firms, a survey of theories and empirical evidence} 77 (2009).

\textsuperscript{254} Schumpeter, supra note 34, at 260.
studies on entrepreneurial traits and their correlation to economic growth. In the future, as studies on economic growth establish correlation to other firm behavior indicators, these gauges should be added to the model to attain a better reflection of our society.

IV. POLICY AND CRITICISM

By now, it is clear that rewarding firms merely according to their size will not necessarily accomplish economic development. Applying the ‘mirror theory’ discussed above, of all the possible standards for providing incentives through the law, the size-focused approach is inconsistent with current economic and social landscape. It reflects an outdated picture of previous economic structures. Entrepreneurship, on the other hand, directly correlates to economic development and harmonizes the law with its current policy and goals. Therefore, continuing to focus on firm size in legal definitions does not fit current realities and misses the point. This part demonstrates how the model proposed here is more efficient in satisfying general policies behind legal rules. Specifically, how it is better in encapsulating firms with entrepreneurial orientation rather than the size standards currently dominant in our legal system. Next, some possible criticisms of the proposed model are described and diffused.

A. A Flexible, Fair, and Administrable Model

Legal models are more likely to be implemented successfully when they are designed with three main objectives in mind: flexibility, fairness, and administrability. The five-dimensional conceptual model of entrepreneurship in the law outlined above and in the Appendix sets to achieve these three goals. First, the proposed model includes several levels for each indicator to remain a flexible schedule in the sense that firms are likely to move from one tier to another each year in certain indicators. Next, the model’s fairness flows from the combination of five factors and five tiers that allow a more graduated, unbiased representation of the various degrees of entrepreneurship firms may possess. Lastly, the five-dimensional conceptual model is simple and administrable as it focuses on only five widely accepted gauges of entrepreneurship. These measures are simple for firms to attain and broadly accessible to policy makers. This makes the determination of firms’ entrepreneurial orientation fairly easy.

255 Martin J. McMahon Jr., Individual Tax Reform for Fairness and Simplicity: Let Economic Growth Fend for Itself, 50 WASH. & LEE L. REV. 459 (1993) (criticizing the 1986 tax reform as some of the most significant provisions failed to implement policies of fairness and simplicity).
Entrepreneurship is temporary, as nobody is ever an entrepreneur all the time. Firms’ behavior and growth trends are expected to vary for each firm and from one year to another. This model accommodates these variances by containing different stages of entrepreneurial activity and several levels for each entrepreneurial dimension. Using a composite indicator is another way in which this model attains flexibility while maintaining fairness and administrability. The proposed model integrates the mathematical combination of each individual indicator into a single index. This method allows the incorporation of a multi-dimensional concept of entrepreneurship, which cannot be captured by any single indicator. It also provides policymakers and individual managers a point of comparison between different companies’ entrepreneurial orientations; it delivers early warning to firms that are changing their position in the market; and it can assist policymakers in anticipating future entrepreneurial conditions and trends.

The distinct weight each indicator possesses provides an additional benchmark for the significance of each entrepreneurial feature. Each indicator should be weighted differently according to the contribution to entrepreneurship, industrial variance, public and social policy etc. Since in reality, some indicators may demonstrate a stronger correlation to entrepreneurship and economic growth, when applying this model, policymakers should take existing empirical studies into consideration and adjust the relative weight of the indicators to reflect national entrepreneurial trends, an undertaking saved for a different project.

In addition, the weight of each entrepreneurial dimension may also be adjusted to accord to the structure of various industries. Relevant measures should adapt to the national context and the structure of the business population at that time. Policymakers may also use this model to reflect nationwide priorities. For example, in years that the government is more interested in incentivizing employment creation, it may give a higher weight to the entrepreneurial dimensions that have greater correlation to job creation, such as employment expansion or longevity and correspondently reduce the weight of other indicators. On

256 See SCHUMPETER, supra note 40, at 60 (“Everyone is an entrepreneur only when he actually ‘carries out new combinations,’ and loses that character as soon as he has built up his business, when he settles down to running it as other people run their businesses.”).
257 See SCHUMPETER, Business Cycle, supra note 43, at 301 (“Nobody ever is an entrepreneur all the time, and nobody can ever be only an entrepreneur.”).
258 Avanzini, supra note 203, at 8.
259 Id.
260 Using empirical studies to determine the appropriate weight of each indicator is beyond the scope of this paper but a valid charter for future projects that will refine this model.
261 For the administrative regulation of this model see infra part IV.B.
the other hand, if our policy objective is productivity growth, allotting a higher weight to growth and expansion measures may be appropriate.

The proposed legal model’s elasticity, which allows firms to move along the scale as they become more or less entrepreneurial-oriented, adds greater fairness when lawmakers incorporate this model in each area of the law. While there is not necessarily a correlation between each of the characteristics within the individual tiers, as a composite group they provide a valuable signal. When a firm’s state of affairs changes, it alters its position on the scale accordingly. This mobility is beneficial in preventing the proposed model from either understating or overstating a particular firm’s entrepreneurial orientation.

B. Several Illustrations of the Model

One of the major advantages of the proposed model is its graduated nature and its ability to take into account more variations than the classic dichotomy of large or small. Indeed, size has proven to be an inadequate indicator for entrepreneurial activity that creates value and advances the economy. In contrast to the current discrete and arbitrary size-based taxonomy, this multi-factor, multi-tiered composite indicator aims to identify firms that possess entrepreneurial characteristics or that are on their way to becoming entrepreneurial, and to allow them to receive certain benefits.

For instance, applying this model within the current tax system will likely improve fairness, promote simplicity, and increase administrability. Tax incentives granted to small-business investors provide one example of how this may be achieved. It is a well-known fact that securing credit is important function in facilitating entrepreneurship. Entrepreneurs without capital require financing in order to gain commercial value from their innovations.

The legislative purpose of items such as Section 1202 of the tax code is to promote entrepreneurship by encouraging financiers to invest in innovative firms. Nevertheless, the code focuses on size by offering significant tax benefits to those who operate small firms or own stock in them. Enacted in 1993, Section 1202 allows non-corporate taxpayers to exclude from tax gains from the sale or exchange of qualified small business

262 For example, if a firm invests in purchasing new technology that improves its entrepreneurial viability, and this change indeed results in increasing sales, this will be reflected in the innovation productivity and innovation intensity, or later on through the firm’s profitability.

263 Eyal-Cohen, Down-Sizing the “Little Guy” Myth in Legal Definitions, supra note 5.

264 See supra note 195.

265 Id.

266 David O. Kahn, Tax Tips: A Qualified Small Business Stock Tax Primer, 23 L.A. LAW. 17 n.15 (2000) (noting the legislative intent behind this benefit was to encourage investment in small high-tech startup companies); Husbands, supra note 152.

stocks. The tax code defines a qualified small business stock as that of a “C” corporation with less than $50 million in aggregate gross assets. But are all firms with gross assets of $50 million or less indeed entrepreneurial? The answer to this question is clearly not necessarily. Here is how the proposed model could work better to identify and encourage those firms that are. Section 1202 could be redesigned to allow a 100% exclusion from taxable gains from the sale or exchange of stocks of firms with high entrepreneurial orientation index. These are highly innovative, job-creating, high-growth firms that currently or potentially promote economic growth. An exclusion of a lower percentage should be afforded to firms with a lesser entrepreneurial orientation index. This tax benefit should be denied altogether to firms with an entrepreneurial orientation below a certain level regardless of their size.

Comparable tax benefits, such as those provided in Sections 1045 and 1244 of the tax code, can also be improved through the application of the proposed model as well. Section 1045 permits taxpayers to roll over capital gains on the sale of small business stock if the proceeds are reinvested in another qualifying small business stock. The legislative purpose of this provision is to incentivize entrepreneurship by pushing the effective tax rates of certain investments down to zero if all proceeds are continuously reinvested back in similar qualified investments.

268 Individuals who own qualified small business stock for at least five years (§ 1202(a)(1)) can exclude up to 50 percent of the capital gain on disposition, limited to the greater of 1) $10 million reduced by any previously excluded gain attributable to such issuer, or 2) 10 times the aggregate adjusted basis of the qualified small business stock disposed of in the taxable year at issue. 26 U.S.C. § 1202(b)(1) (2012). See generally Overview of the Conference Agreement on the Revenue Provisions of the Omnibus Budget Reconciliation Act of 1993 (H.R. 2264), Prepared by the Staff of the Joint Comm. on Taxation, 103rd Cong. 3 (Aug. 23, 1993).


Section 1244 treats losses incurred by the sale of a small business corporation’s stock as ordinary losses and not as capital losses, resulting in a bigger write-off to investors in small business stock. Nevertheless, there is a greater chance that these tax provisions will accomplish their goals and spur economic growth if they incentivize investments in entrepreneurial firms rather than small firms. If we modify this benefit to allow a graduate benefit rather than an all-encompassing write-off according to a firm’s entrepreneurial orientation we will achieve a better fit between these legal rules and their policies.

Finally, the current R&D credit provides a tax credit equal to 20% of qualifying research expenses in excess of a base amount. A 100% tax credit is granted against qualified research conducted in eligible small firms. An eligible small business is defined here as a business in which the taxpayer does not own a 50% or greater interest and in which there are 500 or fewer employees. This preference is currently available to an overly broad segment of the market. The same graduated scheme discussed above could be implemented more effectively here as well. The R&D credit could be designed to allow a 100% credit for qualified research expenses in firms with a high entrepreneurial orientation index, and lower credit percentages to firms with lower entrepreneurial orientation indices. Providing these benefits gradually in accordance with a firm’s entrepreneurial orientation will promote innovation while reducing the complexity and firms’ compliance costs associated with inconsistency of current definitions in the law.

constitute a major factor in choice of tax entity due to the interplay of this preference with the Alternative Minimum Tax (AMT)).

273 26 U.S.C. § 1244(a) (2012). A “small business corporation” is a corporation with an aggregate amount paid in surplus of $1 million or less at the time of issuance.


275 Id. at 40.


277 At present, the SBA Office of Advocacy estimates that 99 percent of firms (including non-employer firms that have no payroll) have fewer than 500 employees and over 67 percent of employer firms Frequently Asked Questions, SMALL BUSINESS ADMINISTRATION OFFICE OF ADVOCACY, http://web.sba.gov/faqsf/faqindex.cfm?areaID=24 (last visited July 17, 2013).

278 General Explanation of the Revenue Act of 1978 at 194 (H.R. 13511, 95th Cong., Pub. L. No. 95-600) (holding that many small business firms do not reap the full benefits they are entitled to—either because they are not familiar with the myriad aspects of the code or because they do not get adequate advice on how to meet the various definitions of a “small business”).
C. Defusing Potential Criticism

Naturally, with every proposal comes scrutiny. There are three main types of potential objections about the proposed model: disapproval of the choice of indicators, the lack of prospective gauges, and potential manipulation of the new model. First, finance scholars may object to the group of indicators chosen for this project. Specifically, the lack of measurements of financial performance such as investment capital, profits, return on assets, and debt-to-equity ratio may seem questionable. Yet, these measures were not ignored in the design of the model but were carefully considered and rejected. They were all found to possess one common problem: their inability to characterize a universally-recognized entrepreneurial behavior. There was also no support in economic development theory to their inclusion as there was for the other chosen entrepreneurial dimensions.

Today, the positive spillovers of innovation are not exclusive to economic growth; they are also manifested in improvement in quality of life, social progress, and standard of living. Similarly, entrepreneurship is valuable for the benefits it generates to individuals and other entities in the same industry or in related markets. Nevertheless, observing spillovers, quality of life, and social development are speculative, subjective, and difficult to capture.

Additionally, one might point to the fact that some of the entrepreneurial dimensions reward entrepreneurial entities ex post and not ex ante. In other words, it may seem unjust to some to reward entities that are already demonstrating a high entrepreneurial character rather than incentivize firms to pursue such activity. Yet, the model is doing both. It allows legislators to target those firms that already prove they have high innovation yield, but also recognize firms in the initial stage of knowledge procurement prior to harvesting its fruits. It allows firms that already expanded their labor force to receive a higher entrepreneurial index but also assist managers in predicting and calculating the increase in their labor force required to get to that mark. Additionally, as mentioned above, the weight granted to each entrepreneurial dimension can be adjusted to account for the importance policymakers may wish to give to ex post incentives or ex ante.

A final potential concern with the proposed model may be an increased manipulation and evasion potential. Simplicity does not come without a price. From a practical perspective, it is not possible to integrate multiple variables that will meaningfully encapsulate the phenomenon of entrepreneurship in the law as much as possible, while at

279 See supra notes 206, 198, 298.
280 See, e.g., William M. Landes & Richard A. Posner, Indefinitely Renewable Copyright, 70 U. Chi. L. Rev. 471, 492-93 (2003) (arguing that copyright is insufficiently broad to capture the spillover effects on the value of other works by that artist).
the same time eliminate manipulation and gaming of the system altogether. But, overinflating data does not come without a price. The interrelation of this model with other legal reporting obligations should affect the firm’s liability accordingly.\footnote{See, e.g., 26 U.S.C. § 1(h), § 45R, § 1401.} For example, the deployment of mergers and acquisitions, or the creation of new entities for the sole purpose of receiving a higher entrepreneurial orientation score will likely affect the firm’s financial and securities filing. Overinflating sales or number of employees will surely have an effect on increasing the firm’s tax liability. Policymakers can also deal with these concerns contingent upon the approach they choose to take when applying the proposed model.

V. CONCLUSION

Small business should not be favored in the name of entrepreneurship.\footnote{See Pierce, supra note 167, at 537; Carland et al., supra note 23, at 358.} There may be other valid reasons for assisting small entities.\footnote{See Eyal-Cohen, supra note 26, at 3.} First, small business promotes various moral and social goals such as benefitting disadvantaged populations of minorities, whose main access to livelihood and financial autonomy is small business ownership.\footnote{See Charles V. Dale, Cong. Research Serv., RL33284, MINORITY CONTRACTING AND AFFIRMATIVE ACTION FOR DISADVANTAGED SMALL BUSINESSES: LEGAL ISSUES (2006) (holding small business as a mechanism to advance monitories). See also Government Minority Small Business Programs: Hearing Before Subcomm. on Minority Small Bus. Enterprise of the H. Select Comm. on Small Bus., 92d Cong. 351 (1972) (“These men have become owner-operators. They like to drive, but because of discrimination by the industry, the only way a black man can be assured of driving a truck is by buying the thing and running it himself.”). See generally Small Bus. Assoc., Office of Advocacy, Minority in Business: A Demographic Review of Minority Business Ownership, at 13 (2007), available at http://www.sba.gov/advo/research/rs298tot.pdf. But see Pierce, supra note 167, at 537, 558 (arguing small business are responsible for more cases of discrimination).} Second, acknowledging the importance of small businesses and attending to their high compliance costs and tight credit problems help preserve cultural objectives such as maintaining business diversity.\footnote{See Eyal-Cohen, supra note 26, at 13.} Third, small businesses operate in neighborhood shops in urban areas, or small stores in the periphery and countryside. They are often vital element of local culture and diversity. Yet, there should be other ways to maintain such diversification. While social and cultural objectives are valid legislative goals, this article is focused on a rather different set of targets.

Today, the subject of whether Congress should utilize the law to direct behavior is still debated.\footnote{See, e.g., Infanti, supra note 146, at 205, 219 (encouraging the legislator to consider other goals aside from economic growth such as human development).} But this is a matter for another paper. Rather, this paper scrutinized the design of certain legal rules by
considering the role of law in a changing society. Lawyers and legal scholars have a central role in alerting the legislature and compelling the legal system to adjust and accord for far-reaching changes in social and economic conditions.\textsuperscript{287} By applying ‘legal mirrors’ theory in the context of current legal definitions of small business this paper demonstrated that our laws have favored small business due to a past societal sentiment about the positive spillovers these entities purportedly provide and fear of the influence of big business on American democracy. However, over time these sentiments changed deeming these laws outdated. Since law is a product of society, as such, it should reflect changes in society and economy over time.\textsuperscript{288}

We live in a century characterized by a uniquely rapid social change.\textsuperscript{289} Every aspect of life—society, technology, politics, and the economy is very different from what it used to encompass just a decade ago.\textsuperscript{290} The dichotomy of small versus big is irrelevant today. What is more important is the entrepreneurial nature, namely the ability to innovate and deliver innovation to the market successfully.\textsuperscript{291} Laws that remain fixed on this distinction are obsolescent.

The proposed model has the potential for improving both law in the books and law in action.\textsuperscript{292} First, it defines the legal frontiers of entrepreneurship by injecting economic theory of entrepreneurship into the law itself. Second, it utilizes economic history to harmonize between the law and the society it mirrors by identifying the practical elements of firms that promote novelty. Third, the model provides policymakers with more accurate tools to recognize and incentivize firms that are innovative and have the potential to improve the economy.\textsuperscript{293} Lastly, it presents a more efficient way to meet budgetary goals while promoting economic

\textsuperscript{287} \textit{Friedman, supra} note 9, at 582 (describing pressures put by lawyers and scholars during the drafting of the Restatements and the Code).

\textsuperscript{288} \textit{Friedman, supra} note 7, at 763.

\textsuperscript{289} \textit{See, e.g.}, Christina Bohannan, \textit{IP and Antitrust: Reformation and Harm}, 51 B.C. L. Rev. 905 (2010) (arguing that IP laws legal policy became disconnected from its articulated goals and began pursuing other ends); \textit{Friedman, supra} note 8 (“We seem to live in an age of constant acceleration—a restless, even frantic era of perpetual change.”).

\textsuperscript{290} \textit{Id.} (“When we look at the changes, it is clear that over the centuries the legal system has been carried along by great waves of social force. . . .”).

\textsuperscript{291} \textit{See, e.g.}, \textit{Harper, supra} note 20, at 1 (“Individual entrepreneurs and entrepreneurial teams bring to light the resources, technologies and trading opportunities that make economic development possible.”).

\textsuperscript{292} Roscoe Pound, \textit{Law in Books and Law in Action}, 44 Am. L. Rev. 12 (1910).

\textsuperscript{293} A firm that improves the state of market competition is considered in antitrust law as a “maverick firm” described as a firm with a greater economic incentive to deviate from the terms of coordination of its rivals. It does so by constraining the coordination of market dominators by, for example, refusing to take part in price increases. \textit{See Jonathan B. Baker, Mavericks, Mergers, and Exclusion: Proving Coordinated Competitive Effects Under the Antitrust Laws}, 77 N.Y.U. L. Rev. 135, 140 (2002).
growth by focusing on entrepreneurial entities that have a higher likelihood of adding value to our economy.

In recent years, there have been various attempts to consolidate the Small Business Administration with other trade agencies into one “super business agency” that will provide resources to all the entrepreneur’s needs. This agency may be the appropriate agency to administer, improve, and enhance the proposed model. Furthermore, these reorganizational proposals signify the importance of entrepreneurship to the current administration, and the beginning of a shift from size-centered to goal-driven approaches in American society.

APPENDIX

As in every normative framework, the measures depend on the nature of the policy objective. This part will illustrate one variation out of many possibilities that proposed entrepreneurial dimensions may be applied to create a simple, administrable, and flexible model that can be employed by both lawmakers and entrepreneurs.

**FIGURE 1**

**Entrepreneurial Orientation Scale***

<table>
<thead>
<tr>
<th>Points per indicator</th>
<th>Firm’s Age</th>
<th>Knowledge Procurement</th>
<th>Innovation Yield</th>
<th>Labor Expansion</th>
<th>Entrepreneurial Success</th>
</tr>
</thead>
<tbody>
<tr>
<td>100</td>
<td>α ≥ α1</td>
<td>P ≥ β1</td>
<td>Y ≥ γ1</td>
<td>E ≥ δ1</td>
<td>S ≥ ε1</td>
</tr>
<tr>
<td>80</td>
<td>α1 &gt; A ≤ α2</td>
<td>β1 &gt; P ≥ β2</td>
<td>γ1 &gt; Y ≥ γ2</td>
<td>δ1 &gt; E ≥ δ2</td>
<td>ε1 &gt; S ≥ ε2</td>
</tr>
<tr>
<td>60</td>
<td>α2 &gt; A ≤ α3</td>
<td>β2 &gt; P ≥ β3</td>
<td>γ2 &gt; Y ≥ γ3</td>
<td>δ2 &gt; E ≥ δ3</td>
<td>ε2 &gt; S ≥ ε3</td>
</tr>
<tr>
<td>40</td>
<td>α3 &gt; A ≤ α4</td>
<td>β3 &gt; P ≥ β4</td>
<td>γ3 &gt; Y ≥ γ4</td>
<td>δ3 &gt; E ≥ δ4</td>
<td>ε3 &gt; S ≥ ε4</td>
</tr>
<tr>
<td>20</td>
<td>α4 &gt; A ≤ α5</td>
<td>β4 &gt; P ≥ β5</td>
<td>γ4 &gt; Y ≥ γ5</td>
<td>δ4 &gt; E ≥ δ5</td>
<td>ε4 &gt; S ≥ ε5</td>
</tr>
</tbody>
</table>

Weight per indicator

<table>
<thead>
<tr>
<th>A</th>
<th>0.1</th>
</tr>
</thead>
<tbody>
<tr>
<td>P</td>
<td>0.25</td>
</tr>
<tr>
<td>Y</td>
<td>0.3</td>
</tr>
<tr>
<td>E</td>
<td>0.20</td>
</tr>
<tr>
<td>S</td>
<td>0.15</td>
</tr>
</tbody>
</table>

*α, β, γ, δ, ε represent constant numbers in each rage.

(P) Knowledge Procurement (year \(i\)) = \(\frac{\text{Innovation Input}_i}{\text{Sales}_i}\)

Investment in knowledge and innovation incorporates a wide array of

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294 The most recent one attempted to consolidate the SBA with the U.S. Trade and Development Agency, Overseas Private Investment Corporation, Export-Import Bank, Office of the U.S. Trade Representative and some U.S. Department of Commerce programs. See President Barack Obama, Remarks on Government Reform (Jan. 13, 2012) (video and transcript available at http://www.whitehouse.gov/photos-and-video/video/2012/01/13/president-obama-speaks-consolidating-government-departments-encour#transcript) (“one department where entrepreneurs can go from the day they come up with an idea and need a patent, to the day they start building a product and need financing for a warehouse, to the day they’re ready to export and need help breaking into new markets overseas”).
inputs such as cost of information, human capital, designs, tools, and labs. Here, this indicator consists of funds invested in knowledge procurement as a percentage of the company’s sales. This indicator provides information on how committed the firm to innovation by devoting a portion of its sales to innovation.

\[
(Y) \text{ Innovation Yield}_{(year\ i)} = \frac{\text{Innovation output}_{i}}{\text{Innovation input}_{i}}
\]

There are various ways to measure return on investment in innovation. A number of scholars, for example, have compared the growth of research stock within different firms. However, a simpler way to measure the return is by looking at the ratio of innovation output to innovation input — that is, the revenues directly derived from investment in innovation. While investment in knowledge includes, patents, information and salaries, innovation output includes any commercial value generated by new patents, products, processes or publications. Accordingly, innovation yield captures the effectiveness of investment in knowledge by measuring the profits firms directly derive from it.

When novelty is created, a firm may realize a low innovation yield
ratio to signify a higher investment in innovation the early stages of development, but once the investment is successfully developed into the innovation product, the firm starts to reap more entrepreneurial gains (numerator), and its innovation yield ratio increases. As more competitors enter the market, we expect to see innovation output decreases and the innovation yield ratio declines.

(E) Labor Expansion \( (\text{year} \, i) = \Delta E/E = (E_i - E_{i-t}) / E_{i-t} \)

\(E= \) Number of employees

There is a variety of approaches for calculating labor expansion. In order to mitigate the growth biases of very small closely held corporations firms that add a few employees over a short period time, the model should include only enterprises above a certain number of employees. For the sake of simplicity, the model proposes to measure labor expansion by focusing on the firm’s periodic net increase in the number of full-time employees.

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See also Zoltán J. Ács & Catherine Armington, Employment Growth and Entrepreneurial Activity in Cities, 38 REGIONAL STUD. 911, 921 (2004) (measuring average annual employment growth rate in year \(t+1\) as \((\text{empl}_{t+1}/\text{empl}_{t})^{1/3} - 1\)). See also Steven J. Davis, John C. Haltiwanger & Scott Schuh, Job Creation and Destruction 419-23 (1998) (the authors calculated employment growth as \((X_{t+1} - X_t)/(X_{t+1}+X_t)/2\)). See also Steven J. Davis & John C. Haltiwanger, Gross Job Creation, Gross Job Destruction, and Employment Reallocation 6 (National Bureau of Economic Research Working Paper No. 3728 June 1991), available at http://www.nber.org/papers/w3728.pdf.

302 See, e.g., Organization for Economic Co-operation and Development, Eurostat—OECD Manual on Business Demography Statistics, 61 (2007), available at http://www.oecd.org/std/39974460.pdf (setting a size threshold to avoid the growth of small enterprises distorting the picture). Nevertheless, this threshold should be set low enough to avoid excluding too many enterprises, especially newly formed corporations in their nascent stages. See supra note 302. See also Steven J. Davis, John Haltiwanger & Scott Schuh, Small Business and Job Creation: Dissecting the Myth and Reassessing the Facts, 8 SMALL BUS. ECON. 297, 297 (1996) (holding that the conventional wisdom about the job-creating prowess of small businesses rests on misleading interpretations of the data).

303 For example, in OECD Statistics Directorate, Measuring Entrepreneurship, A Digest of Indicators, OECD-Eurostat Entrepreneurship Indicators Program 18 (2008), and in Organization for Economic Co-operation and Development, Eurostat—OECD Manual of Business Demography Statistics 61 (2007) (the studies considered high-growth enterprises as those with annual employment growth of 20% a year over a three year
Entrepreneurial success is a multidimensional phenomenon, that may be comprised of many indicators that provide information on business expansion. Some of these indicators include: growth in sales, equity, income, assets, etc. Of these indicators, the proposed model uses average annual growth rate in sales based primarily on studies that concluded that other growth indicators are not as frequently correlated to innovation. This measure estimates the success of the firm’s products through increases in the firm’s sales volume over a period of time, under the assumption that the more successful the firm is in implementing innovation, the higher the sales of its innovative products in the market.

In every tier in the model the firm receives a distinct number of points per entrepreneurial dimension. In Figure 1, for purpose of simplicity, the scale increases in equal twenty point increments. Every entrepreneurial dimension is also allotted different weight. For example, Figure 1 contains random weight that emphasizes investment in knowledge over other entrepreneurial dimensions. The composite indicator works by multiplying the sum of points of each indicator by the weight of each entrepreneurial dimension to add up to the firm’s entrepreneurial orientation index score.

Firms located at the top end of the scale receive higher index to denote their stronger entrepreneurial orientation and highest proclivity to contribute to economic growth. On the other hand, there could be firms that receive no score at all and are considered trivial, non-entrepreneurial enterprises. As firms move up the scale, they attain higher entrepreneurial index. For example, Firms that receive a composite period and ten or more employees at the beginning of the observation period.\)


COAD, supra note 253, at 69.

DAVIDSSON et al., supra note 248, at 8.


indicator score of 70-100 in Figure 1 are considered predominantly entrepreneurial.

It would be advantageous to our economy if lawmakers were to offer incentives to firms with an entrepreneurial orientation score of 70-100 in Figure 1, because these firms are more likely to contribute to economic growth, if they are not already doing so. These types of firms already demonstrate innovation, increased job creation, and the cost-effective production of knowledge. Firms with entrepreneurial orientation scores of 40-70 and 1-40 in Figure 1 should receive lower level of benefits correspondingly.