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The Importance of Entrepreneurship to Economic Growth, Job Creation and Wealth Creation - Discussion Following the Remarks of David T. Morgenthaler and Dr. H. Douglas Barber

Discussion

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environment and to encourage them? This is not going to go away, and we do have to work with it.

Finally, what do we do about entrepreneurial enterprises that are designed to take value from the economy and deliver no value in return? Some of them exist in the world of intellectual property.²⁶² That's a world where proceedings are often very tough and costly. Some of these are the most hazardous to the young risking entrepreneurs whose competitive and confidence winning challenges are always pushing them to the limit. Here, the challenges often end up in the courts where the standards of ethics, justice, and rightness for the community or nation are to be maintained.

The responsibilities of governance and law are extremely important for entrepreneurs and for prosperity.²⁶³ I am actually hoping during the hours of this conference that we gain some new insights and confidence about how we develop ethical entrepreneurs and ethical systems of governance and law in which they will function. I hope this conference is going to give me some new insights. Our prosperity, economic growth, job creation, and wealth creation depend upon how well we do this.

Thank you.

DISCUSSION FOLLOWING THE REMARKS OF DAVID T. MORGENTHALER AND DR. H. DOUGLAS BARBER

DR. KING: I had a few questions, which I wanted to start the session off with. I was intrigued by this point – that we have to have a sense of ethics. We have heard from David Morgenthaler and from Douglas Barber that entrepreneurship is the lifeblood of our two economies, and I want to speak, firstly, on this.

I was party to an entrepreneurship making disposable hypodermic needles. I had to get out when I went to the top government job because we were selling to the government, but my partner sold out to Pfizer, and he made a barrel of money, and what he did was he bought everybody in the company Cadillacs. He bought a plane and a place in Cape Cod and joined a fraternity, which was known for excessive drinking.

²⁶² See, e.g., Morag Macdonald, *Beware of the Troll*, THELAWYER.COM, 26 Sept., 2005, available at <http://www.thelawyer.com/cgi-bin/item.cgi?id=116783&d=122&h=24&f=46> (explaining the “patent troll” as a company “that holds a portfolio of patents where the only business is . . . [legally] enforcing them against those who [have not] paid them for a licence [sic].”).

²⁶³ See Bailey, *supra* note 240 (“[J]ustice is incredibly important to prosperity”); see also Steve Strauss, *Government's Role in Encouraging Small Business*, E-JOURNAL USA, <http://usinfo.state.gov/journals/ites/0106/ijee/strauss.htm> (last visited Oct. 29, 2007) (“Any government that wants to encourage small business needs to produce laws that protect the innovations of entrepreneurs.”).

What I am concerned about is the business of somebody putting something back. In other words, you are successful; should we have funds which these successful entrepreneurs may have to contribute to, because beyond a certain amount of wealth is corruptive, I think. It was corruptive in this case, and I am speaking from personal experience. And I think it is a natural interest to do something like this.

You said that entrepreneurship is the lifeblood of the economy, and I would like to get both of your thoughts how you bring that into play? Where you continue this stream of entrepreneurship that has kept us going so long? And what you think of this idea of possible voluntary contribution to a fund?

I know what it is to be an entrepreneur, because it causes domestic trouble when you attempt to put a second mortgage on the house. It was not easy for me, so I have been through it, personal experience. So perhaps you could comment on that. I like the idea of the concern about ethics, and I love the history of what made America great, but let's continue that.

Do either of you have any thoughts on that?

DR. BARBER: My first thought is, if you live your life exercising your self about what is good and right, how do you promote good things for all the people that you affect?

I know at Gennum we often talked about who are our stakeholders were, because we had statements of what we were going to do for our stakeholders. It is easy to identify your customers as a stakeholder. The big difficulty that we had was when we asked the question, do we affect our competitors? And the answer was yes, we do. Then they are a stakeholder. How do we act for the good of our competitors? When you get the stakeholder spectrum that broad, the concern about how to be good is enlarged.

We broadened it beyond the city that we live in to the province, the country, and the places we trade. We know we affect all of them. Certainly, for Gennum, we have been generous to our community and to our country,²⁶⁴ even though we do almost no trade in the country.²⁶⁵ So I think it is an issue of this broader consciousness. If you just think about the good as accumulating prosperity for oneself, something has gone wrong, I think.

²⁶⁴ See McMaster University – Who Contributes, <http://www.eng.mcmaster.ca/contributing/contributors.htm> (last visited Oct. 20, 2007) (“Doug Barber, an engineer, professor and entrepreneur, and Gennum Corp. of Burlington, Ont. Have donated \$1.3 million to McMaster University to create the Barber-Gennum Chair in Information Technology.”).

²⁶⁵ See generally Gennum Reports 2006 Fourth Quarter and Year End Reports, available at http://www.gennum.com/newsroom/pdfs/Q4_06.pdf (last visited Oct. 29, 2007) (quoting revenue based by principal market for the three months ended Nov. 30, 2006, where \$6,922 in sales were to Canada, compared to \$30,084 worth to the United States, Europe, and the Pacific Rim).

DR. KING: I like Cadillacs, but I don't think in my case the partner worked out for the public good. But he did sell a lot of disposable hypodermic needles.

David?

MR. MORGENTHALER: Well, you have raised a two-part question, Henry: one is the question of ethics, which I am very glad to respond on, and the other is a question of putting back into society for the benefits we have had.

On ethics, we feel strongly about it for very practical reasons. We invested in something over 250 companies.²⁶⁶ In those 250 companies we have had five cases of some kind of fraud that we know about. There may have been others that we haven't caught. Five out of 250 is very good. Any of you academics would give me a 98% or an A for something like getting it right that many times, so we must be pretty good about picking society, of picking people, but – and this is a big but – those five have cost us over \$100 million in attained, but not yet cashed-in, profits.

Now, I am a slow learner, but losing \$100 million, that I otherwise would have but lose because somebody cheats, that will teach even me a lesson. Now, I told this story before and the joke. Some of the entrepreneurs have gone to jail. One of them died. I was asked if I had him killed, and my answer was: no, he died before I could get the contract written.

But I do think playing by the rules is critical, and we totally agree that the important thing to us is that entrepreneurs will not lie to us. I have seen thousands of business plans over the years. I have very rarely seen one made. They are always too optimistic. You have to discount for some things, but when you have an entrepreneur that will deliberately lie to you about the facts, even on small matters – we had a case recently where we had a very attractive company, an interesting new technology that may just be a cure to an important disease, and heading one of the most desirable jobs that we have in our group. A man submitted an application for it, and on his application, he showed that he had attended a certain college. He showed he had graduated from it.

We were paying a recruiter over \$100,000 to recruit for this job, and the recruiter missed the fact that the man only attended the college; that he hadn't graduated. My young partner picked it up and came to me and said, "I am troubled by this." He said, "This man has lied to us, and I know how we feel about people lying to us, and what do you think in regard to it?"

I said, "It is very simple." I said that this man is going into a medical company. We couldn't care less whether he attended this college or

²⁶⁶ See About Morgenthaler, *supra* note 2 ("We have worked with entrepreneurs in more than 250 companies since the firm's founding.").

graduated. What we care about is: does he lie to us? Because graduating did not matter, it was trivial. If he said he didn't finish there are lots of good reasons. Bill Gates didn't finish college,²⁶⁷ Steve Jobs, whom we backed,²⁶⁸ didn't finish college.²⁶⁹

I don't care whether they graduated or not. I care whether they learned. But I care a lot whether they lied to me, because the day will come that a clinical trial will come, and there will be some bad results on that trial. If he withholds that from us it may thoroughly affect the direction we take the company next. So if he lies, he will lie out of here, and we cancelled the man out immediately and didn't continue him.

Interestingly, he came out of a company where he was said to be one of the best of a company that had a very bad culture. An officer of that company has gone to jail for bad culture. We will absolutely not tolerate it. The venture business is one of the relatively cleanest businesses that I have ever been involved with, and I have been involved in a lot of industries. I have been in the scrap metal business to some degree, and God help you in that business.

I took over as chairman of our Mexican company in the early 1960s, about 40 years ago, and went down to Mexico and discovered that we had sent an Englishman down when we opened up Mexico, and I discovered that apparently his belief was that you had to bribe to do business in Mexico. So I think any time anybody put their hand out to shake hands he put money in it. We were bribing everybody we could see in Mexico. And actually, I got a Mexican president in, and we cleaned it up. So I have seen all kinds of sordid operations, but they are terrible from a business standpoint, and we won't have anything to do with them.

In the short-term, you can win sometimes – contract bidding, government contract bidding. Again, all kinds of things have been thrown, but we just won't touch it. And in venture capital, I have seen things in earlier days where venture capitalists behaved unethically. Back again many years ago, we had a major venture capitalist. At his request we showed him the business plan of one of our companies, and he showed that to one of his companies that was directly competitive. They were bidding against him on a job. They showed that plan to them, and the news got back to our company. It came

²⁶⁷ Stacy Perman, *Dropping Back In*, INC.COM, Jun. 2004, <http://www.inc.com/magazine/20040601/education.html> (“[A]fter all, college dropouts Bill Gates, Steve Jobs, and Michael Dell did just fine without a bachelor’s degree”).

²⁶⁸ See Tim Tankersley & Joshua Boak, *Investors Turn Away from Ohio as Heavy Use of Tax Dollars to Woo Jobs Doesn't Pay Off*, THE TOLEDO BLADE, Sept. 24, 2006, available at <http://www.toledoblade.com/apps/pbcs.dll/article?Date=20060924&Category=NEWS24&ArtNo=609240334&SectionCat=&Template=printart> (“Cleveland-based Morgenthaler Partners funded Apple, Nextel, and 250 other startups.”).

²⁶⁹ See Perman, *supra* note 267.

back to us with very high indignation from one of the other major venture capitalists, who was a partner, and he had the attitude of, tough, that's the way things are done.

Well, the hell that's the way things are done! So we joined in a little conspiracy just to make sure among all the deals we got, he saw only the bad ones, and that went on for a while. He got the message. He was frozen out. The bad deals where we might lose money, show them to him by all means.

We take it seriously.

DR. KING: Okay. Are there other questions? I have plenty of questions. Yes, sir, right in the front row.

MR. GROETZINGER: Question for David Morgenthaler: Out of a thousand companies that you would look at, and you said three are excellent performers and one might be arguably a mega-performer, what are the characteristics of those four that make them so superior? Is there a common thread, or is it the product or service? Is it the market they are attempting to meet?

MR. MORGENTHALER: I wish I knew for sure and I doubly wish I knew when they walked in. The trouble, of course, and the reason that you see the thousand, is that I often describe our business as shoveling rock. We shovel a ton of rock to find an ounce of gold. And when you are shoveling it, you don't know what is going to be there. Inevitably, you get everything right though. One of the problems that I have had in this region, one of the things we ought to talk a little bit about – and it is an argument that comes up a great deal with the Silicon Valley people, whether the culture is a major factor, where a number of them love to believe it is the culture that does everything – is with the willingness to let people fail.

Well, culture is certainly a factor, but the critical factor is the basic opportunity – and I still like my three-legged stool. I like metaphors and I like the concept. The whole business is a horse, a rider, and a race. The concept, the technology is the horse. The entrepreneur is obviously the rider. The race is the market that you are going into. You absolutely have got to consider all three. You have got to get all the elements right. The venture capitalist is none of those. He is an owner, a trainer. He ends up owning the horse or a good deal of it, and he provides advice to the jockey. But you fundamentally will find that there is a market; there is a kind of race. Competitors are doing certain things; your horse will do certain things. If all of those come together at a point in time –

As I have said, the S-curve theory that came out in the late 1960s, which originally was applied to technology,²⁷⁰ I think applies very much to

²⁷⁰ See generally S-Curves, INNOVATION ZEN, <http://innovationzen.com/blog/2006/08/17/innovation-management-theory-part-4/> (last visited Oct. 20, 2007) (“[T]he S-curve emerged as a mathematical model and was afterwards applied

businesses. Things mature, and we are trying to catch them down at the bottom of this flattened S-curve, when you have a long run up and catch them before they level off. The trouble with the region in the Rust Belt cities is they didn't realize the industries were at the top of their S-curves. But you catch a market. You catch a group of people who do it a little better or a little more energetically, and the competition doesn't move in as well as it should have, and they just end up winning.

We backed Apple Computer in our early careers.²⁷¹ We had figured out long since that this was going to be a huge market, and we were looking for the people that were going to win. I think we went through probably 25 companies. We were a little put off by Apple because of the two young men, Steve Jobs was a rather young promoter at that stage,²⁷² and Apple didn't have a lot of proprietary technology.²⁷³

And one of our fears was that the Asian companies would be a problem. These were fairly simple computers; and we were used to much more complicated computers, we were much more complicated. How was Apple going to win? Well, somehow it just became clear, these guys had just gotten out ahead, and they were doing the right thing, and they were going to win. So we backed it one round later, made a good deal of money out of it. We would have made ten times as much money if we had been earlier, if I hadn't been a little stubborn about not recognizing they were going to be the winner. I didn't like the name. I didn't like the immaturity of the entrepreneurs. I was wrong on a number of counts.

And then again, sometimes you just get all the elements right. One of the mistakes that is so often made in this part of the country – that is, in the older mature regions – is that people don't listen. And you tell them it takes all three elements. People fall in love with a person, and they say he or she is so wonderful he would back them in anything. That is absolute nonsense. I know some perfectly good executives in the steel industry in this country, some very fine people. If they were in some other industry, or they were at some other point in time in the steel industry, they would do very well. They are not stupid. They are not lazy. They just are in a tough time in that business and in that market. Not all the automobile executives are stupid. Some of their predecessors – I dumped General Motors out of my portfolio in personal investments back in 1965, and my investment adviser said that's un-American not to own General Motors, five percent dividend, and you should

to a variety of fields including physics, biology and economics”).

²⁷¹ See Tankersley, *supra* note 268.

²⁷² See generally *Inventor of the Week, The Personal Computer, Lemelson – MIT Program*, <http://web.mit.edu/invent/iow/apple.html> (last visited Oct. 20, 2007) (Steve Jobs was born on Feb. 24, 1955, and Apple Computer began in 1976 with Steve Wozniak).

²⁷³ See generally *id.*

own it. They have a 58 percent market share.²⁷⁴ If they get any more the antitrust department will be on their backs;²⁷⁵ we sell to them, their costs are extreme;²⁷⁶ their unions are overpaid;²⁷⁷ their management is arrogant.²⁷⁸ Get it the hell out of my portfolio! They did, and the stocks have never done better. I picked a good time to exit. You have to get all the elements together. And that's the reason I was making the point earlier.

The lack of entrepreneurship is not a cause; it is a symptom. It tells you you have a later condition than you realize, and that is the point I want to leave here. You are lacking innovation because innovation creates the little horses. If the little horses are not being born, the entrepreneurs – the jockeys – don't hang around. They go to Silicon Valley.

We find a problem today. If we find an interesting company coming out of The Cleveland Clinic, or coming out of some other source around town, and we start to look for a jockey, we usually can't find someone in town who is qualified. We go out to recruit him. Where do you find him? You find him in Silicon Valley, or you find him in Boston. Then you have a hell of a time persuading him to move here because he says, "I like you and I like the place and everything else. But if I lose my job, I don't have another kind of job to go to there. When I am in a big industrial parking lot in San Jose or Mountain View or something of that kind, if I lose my job there, I can get two more jobs in the industrial area without changing my parking place." This is part of the reality of it.

DR. KING: Well, thank you very much. Marty Gelfand?

²⁷⁴ See The General Motors Branding Lesson, Branding Strategy Insider, Oct. 8, 2007, <http://www.brandingstrategyinsider.com/2007/10/of-branding-gm-.html> ("[S]trong brands allowed GM to capture more than 57% of the U.S. market by 1955."); cf. Jerry Dubrowski, *GM Retools for Cyberspace*, CNN MONEY, Aug. 24, 2000, http://money.cnn.com/2000/08/24/companies/gm_overview/ ("GM's U.S. market share stands at just over 28 percent today, down from almost 50 percent in 1965").

²⁷⁵ See The General Motors Branding Lesson, *supra* note 274 ("Aware that pursuing more market share could lead to antitrust actions and the threat of a breakup, GM fatefully shifted its strategy").

²⁷⁶ See Terry Box, *Automaker Cutting 30,000 Jobs, Closing Plants: Experts Say GM Needs New Designs, New Deals*, DALLAS MORNING NEWS, Nov. 22, 2005, available at <http://www6.lexisnexis.com/publisher/EndUser?Action=UserDisplayFullDocument&orgId=574&topicId=100021821&docId=l:334286713&start=21> ("With General Motors' dramatic plant closure announcement Monday, the embattled corporation is striving to cut some of its huge costs and shrink itself.").

²⁷⁷ See Kathleen Hays, *Getting 'Intelligent' at GM*, CNN MONEY, Nov. 22, 2005, http://money.cnn.com/2005/11/22/commentary/column_hays/hays/index.htm ("Management can complain all it wants to about "overpaid" union workers").

²⁷⁸ See John Holusha, *Humbler G.M. is Now Listening*, N.Y. TIMES, Jan. 30, 1988, available at <http://query.nytimes.com/gst/fullpage.html?res=940DE3D9133BF933A05752C0A96E948260> ("[O]nce arrogant G.M. executives speak today in humbler tones.").

MR. GELFAND: Yeah. Professor Barber, I liked how you described entrepreneurship as human, and I think Professor King illustrated that with his own second mortgage, and you illustrated it yourself by saying that successful entrepreneurs frequently have also failed in their previous businesses.

I wanted to ask anyone from the panel if they think that our bankruptcy laws, particularly on the recent revamping of the bankruptcy laws²⁷⁹ making it more difficult to get out from an unsecured debt, have affected current efforts to be successful entrepreneurs, particularly in, you know, those stop-gap failures that inevitably happen?

DR. BARBER: I think we have to have David answer that. I keep on saying that I have been involved—

DR. KING: Did you hear the question?

DR. BARBER: Yes, I think I did. I have been involved in five startups. One hundred percent of them have been successful, which is not those kind of statistics, and I don't know where to lay the blame for that, but we have had no bankruptcies so I don't have any direct experience of that kind.

DR. KING: Do you have any experience, David, with respect to the bankruptcy laws?

MR. MORGENTHALER: Well, we usually try to sell them before they go bankrupt. But I want to talk to you, Doug, if you have got five out of five. Let's meet afterwards. Maybe we can make a deal.

I never lost money in a private company until I was over age 50, and I somehow thought I had a magic touch. I got in the venture business and made more investments, and I discovered I could lose money, and I did.

I don't think much about bankruptcy – no entrepreneur thinks about going bankrupt. That is something that happens to other people. That is not going to happen to him. He would not be a part of it. I think if you talk to factoring people – I was on a panel yesterday over at Case with their Research Data Center,²⁸⁰ and they had factoring people – those people look at that kind of thing. They are concerned about it. I don't think we think much about the bankruptcy laws. We don't lend money. Even though we structure it in a

²⁷⁹ See generally Timothy Egan, *Debtors in Rush to Bankruptcy as Change Nears*, N.Y. TIMES, Aug. 21, 2005, available at <http://www.nytimes.com/2005/08/21/national/21bankruptcy.html?pagewanted=print> (“[U]nder the revised law, debtors who earn more than the median income in their state and who can repay at least \$6,000 will no longer be able to have their debts wiped out for a fresh start under the more generous provisions of Chapter 7 of the bankruptcy code. Instead, they will have to seek protection under Chapter 13, which requires a repayment schedule.”).

²⁸⁰ See Case Western Reserve University Research Symposium, (research symposium held Apr. 11-12, 2007), available at <http://ora.ra.cwru.edu/showcase/program.html> (follow “Fast Forward -- The Future of Funding” hyperlink) (last visited Oct. 20, 2007).

convertible debt, it is basically equity, and we will end up losing it, and we just try to recover something in the end.

DR. KING: Well, I don't want to close this session. It has been a great session, but we have this clock to deal with, and as you know, I am well aware of the clock. I wanted to thank you, David Morgenthaler, for a wonderful presentation and also Douglas Barber for raising some very interesting questions. I thought this was a good session, and I thank you.