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The Theory of the Growth of the Firm, by Edith T. Penrose. Oxford: Blackwell, 1959 (Book Review)

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***The Theory of the Growth of the Firm*, by Edith T. Penrose. Oxford: Blackwell, 1959.**

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A review (in the pages of this journal) of a book published nearly fifty years ago may appear unusual—unless the book has become a “classic.”¹ Indeed, many organizational scholars (e.g., Pitelis, 2002) view it as a seminal text for the resource-based view of the firm, arguably one of the dominant theoretical perspectives in strategic management research today.

CENTRAL CONCEPTS

Chapter 1 of the book lays out its ambitious scope. In the first few pages it becomes clear that Penrose was frustrated by neoclassical economists' focus on price, output, and demand. Penrose was interested in directing the field to pay more attention to “the firm”—the metaphorical “black box.” Thus, the book was a bold challenge to the dominant paradigm in econom-

ics, yet it remains debatable how much of an influence its publication has had on this paradigm (Loasby, 2002).

Interestingly, the book's ideas had a particularly significant influence among scholars in the field of strategic management—a discipline still in an embryonic stage at the time of the book's writing. Although Penrose's book appears to have presaged Chandler's (1962) work, it is notable that neither he nor any of the other early strategy scholars (e.g., Ansoff, 1965; Hofer & Schendel, 1978; Porter, 1980) cited her work. In fact, it was left to David Teece (1982), Birger Wernerfelt (1984), and Mahoney's many papers and presentations to bring Penrose to the strategy audience. Penrose's research questions—“I am not asking what determines whether a particular firm can grow, but rather the very different question: assuming that some firms can grow, what principles will then govern their growth, and how fast and how long can they grow?” (1959: 7)—eventually resonated with strategic management scholars.

Penrose laid out the foundations of the resource-based view in Chapter 2 and examined how inherited resources influence the direction of expansion in Chapter 5. Penrose's definitions of resources, the service(s) they provide, and how they create growth and heterogeneity within an industry are worth revisiting, especially in view of the fact that there remains ambiguity about these constructs (Rugman & Verbeke, 2004). According to Penrose:

Resources . . . include the physical things a firm buys, leases or produces for its own use and the people hired on terms that make them effectively part of the firm. Services on the other hand are the contribution these resources can make to the productive operations of the firm (1959: 67).

Penrose's notion of services appears close to Barney's (1991) conceptualization of capabilities. She notes:

It is never resources themselves that are the “inputs” in the production process, but only the services that the resource can render. . . . exactly the same resource when used for different purposes or in different ways and in combination with different types or amounts of other resources provides a different service or set of services (1959: 25).

Penrose argued that heterogeneity among firms (within an industry) occurs because even firms with similar resource endowments can configure them in unique combinations that yield a

We thank Professor Jay Barney for detailed comments on an earlier version of this manuscript.

¹ A citation count on Google Scholar on February 16, 2008, revealed that Penrose's book had received 5,616 citations for the 1995 edition plus several hundred for the 1959 edition.

variety of services. Firm growth occurs because of the availability of excess resources—such excesses develop because of the lumpiness and indivisibilities of the resources that firms acquire. In contrast, lack of capabilities causes internal obstacles to growth.

While the book has become a foundation for the “internal view of the firm” in strategy literature (complementing the I/O-based “external view of the firm”), Penrose’s own views were not so compartmentalized. She realized that a firm’s resources are only meaningful in the context of its environment. However, she was clearly biased in favor of internal factors in explaining growth. As she says: “‘Demand’ is no more important, and is perhaps less important, than the existing resources of the firm” (1959: 84).

Although debates within the field of strategic management research (Barney, 2001; Priem & Butler, 2001) have tended to focus on Penrose’s contribution at a business unit level of analysis and the notion of competitive advantage, some have argued that this emphasis on competitive advantage is a distortion of her true intent (Rugman & Verbeke, 2004). Such charges have been responded to vigorously by various scholars (Kor & Mahoney, 2004; Lockett & Thompson, 2004). Indeed, her intent can clearly be discerned from the preface to the second edition of the book, where she emphasizes the preeminence of growth as an objective unto itself:

I was not impressed by the reasoning behind, nor the evidence to support, the assumption that the managers or directors of large corporations in the modern economy saw themselves in business largely for the benefit of shareholders. . . . Profits were treated as a necessary condition of expansion—or growth—and growth, therefore, was a chief reason for the interest of managers in profits (Penrose, 1995: xi, xii).

Given her central focus on growth, subsequent chapters in her book were devoted to corporate-level strategy issues, such as diversification and merger decisions. As she notes, “There may be an ‘optimum’ output for each of the firm’s product lines, but not an ‘optimum’ output for the firm as a whole” (1959: 98–99).

Penrose saw acquisition and mergers as an extension of firm’s goodwill and market position and as also driven by tax considerations, information asymmetry, and opportunity costs.

CRITIQUE AND FUTURE RESEARCH

Penrose’s book has been critiqued for its style (Lloyd, 1961) and substance (Pitelis, 2002). The debate between Priem and Butler (2001) and Barney (2001) captures the essence of the critique (and rebuttal) of the Penrosian framework and the subsequent resource-based literature that it spawned.

While Penrose may not have foreseen the impact her work would have on strategic management, a careful reading of the book reveals that she did anticipate the critique it was likely to generate.² For instance, we believe one potential criticism that could be leveled against the book is its theoretical focus that prevents the development of a richer, more complex, contingency-based model of firm growth. Furthermore, her work does not consider the professionalization of management, evolution of technology, and institutions that influence firms’ growth. Penrose preempts such criticisms by clearly emphasizing the central focus of her work:

I am not attempting to present a theory which will enable an analyst to examine a particular firm and state in advance whether it will or will not successfully grow. . . . I am not asking what determines whether a particular firm can grow, but rather the very different question: assuming that some firms can grow, what principles will then govern their growth, and how fast and how long can they grow? (1959: 7).

Another critique of the book is the testability of the theory that Penrose developed. Unlike theoretical work today, which emphasizes constructs and relationships, Penrose mostly used case histories to develop some theoretical principles and logics, and she acknowledged that testing them remained problematic. She notes:

The factors determining the maximum rate of growth of firms—on the other hand, cannot, in its present formulation at any rate, be tested against the factors of the external world, partly because of the difficulties in expressing some of the concepts in quantitative terms and partly because of the impossibility of ever knowing for any given firm what is, or would have been, its maximum rate of growth (1959: 4).

² Professor Barney wrote to us that he had met Penrose when she attended a Strategic Management Society meeting in San Francisco. At the meeting he found out that Penrose was quite surprised that strategy scholars were interested in her book. He noted that she knew very little about what strategy scholars were studying, knew nothing of the literature, and was surprised by the invitation to attend the SMS meeting!

Later, in the context of growth rates of firms of different sizes, she writes:

The testing of the theory set forth here is difficult indeed; all sorts of factors other than those controlling its "maximum" rate of growth will affect the actual rate of growth of an individual firm in specific circumstances at a particular time and the pitfalls of interpreting a "growth curve" when the end is not in sight are well known (1959: 213).

While the book was an attempt to break from neoclassic economic tradition and shed light inside the black box as it grew and changed over time, it did so by relying on constructs (such as entrepreneurship and management) that were conceived too broadly. According to her, entrepreneurship "can be treated as a psychological predisposition on the part of individuals to take a chance in the hope of gain, and in particular, to commit effort and resources to speculative activity" (1959: 33). In addition, she argued that management not only is the source of uniqueness among firms but also constrains growth. Specifically, "existing management limit the amount of new management that can be hired . . . but the plans put into effect by past management limit the rate at which newly hired personnel can gain the requisite experience" (1959: 47).

Penrose's writings on the distinction between entrepreneurial and managerial roles within firms could add to present research in this area. In particular, the entrepreneurship literature could embrace her perspective more vigorously, given the field's central focus on growth and innovation. Her observation that the entrepreneurial mind is a mirror of opportunities in the environment and her notion that "expectations and not objective facts are the immediate determinants of a firm's behavior" (1959: 41) suggest the possibility of building bridges between the resource-based view and other perspectives within strategy.

Finally, we believe Penrose's analysis of the role of uncertainty in the growth process, growth spurts, and decline of niche-based firms has the potential to enrich business strategy research.

CONCLUSION

Many economists call the unexplained variance in a regression equation the "Penrose effect." According to Barney, it was left to strategy scholars to propose that the Penrose effect comprises the intangible resources and capabilities that are the source of sustained competitive ad-

vantage, and while these phenomena may be difficult to measure directly, the implications of these phenomena for firms' operations and performance could be tested. After reviewing the passionate and prolific research that has attributed its intellectual roots to Penrose's book, it is clear to us that her work was successful in rallying scholars who sought an alternative to the standard structure-conduct-performance model within strategy. However, scholars should be careful that Penrose's theory (and the book) does not become a Rorschach blot on which they impose their own biases.

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