

Entrepreneurship development policies: principles & practice

February 2010

This discussion note has been prepared to contribute to the debate on the key components of public policy related to entrepreneurship. It is particularly relevant for public sector policy makers concerned with developing their own country's entrepreneurship policy framework. It has been written from the viewpoint of a practitioner and incorporates ideas emerging from the first International Enterprise Promotion Convention 2009.

Background

No one doubts the contribution to economies from the creation and growth of small businesses – typically they account for more than half of a country's GDP, more than half the jobs and most of the significant innovation and, in many countries, they play a clear role in the distribution of wealth – though many are quite happy to stay small. Micro-enterprises and necessity entrepreneurs may not grow very large, but they nevertheless make significant aggregate contributions to economies. The World Bank Doing Business 2010 reminds us that small and medium sized firms are the drivers of competition, growth and job creation and stresses that lower costs of entry – including the cost of regulation, enforcing contracts, hiring and firing etc – encourages entrepreneurship and enhances business productivity.¹

Larger businesses however make significant differences to the size of countries' GDPs. The Economist observes that successful economies include both large and small firms, established firms as well as start ups² – but all large businesses were small when they started – and, despite considerable effort, no-one is able to spot the winners so there is a need to nurture large numbers of new starts. Once people have started, it becomes easier to identify the entrepreneurs who are ambitious to grow and to prioritise their need for support and advice.

The Economist notes that the US economy is more dynamic than Europe's not only because they are better at giving birth to new firms, but also because they are better at letting them grow (and possibly because their social safety net is less generous than many other countries, so more people feel compelled to give it a go). They say that just five per cent of businesses started in the EU since 1980 have made into the list of the EU's 1,000 largest companies, but 22 per cent of firms in the US have made it into their 1,000 largest companies. It is startling to note³ that only three firms founded in Europe since 1975 have entered the world's 500 largest companies, compared with 25 in the US and 21 in emerging economies.

The Economist concludes that an important lesson for policy makers is not to interfere in the market, or to prop up failing companies, or to attempt to pick winners, but rather "to remove the burdens and barriers which prevent entrepreneurs from starting businesses and turning small companies into large ones".

When I was CEO of the UK Government's Small Business Service, I persuaded the government to adopt a small firms' policy that we called 'Think Small First'. This covered just three areas: culture, regulation and business support. In particular, I made a point of stressing the importance of changing

¹ World Bank (2009), "Doing Business 2010: reforming through difficult times"

² Economist, 29 Aug 2009

³ Economist, 23 May 2009, quoting from Bruegel



the culture in the UK, so that we admired entrepreneurs, rather than seeing them as crooks. Other countries admire their entrepreneurs far more than the UK does. In America, for example, some 79 per cent of the population think that entrepreneurs are critically important to job creation;⁴ in a recent survey in the US, more than 60 per cent of respondents said that schools helped give them an entrepreneurial attitude and initiative.

Despite the recession, in 2008, Americans started 530,000 businesses every month. Firms founded during the tough times tend to be tougher. The Kauffman Foundation reports that each 'bad' year in the US since the second world war produced as many firms that have grown into firms large enough to float. And it is new businesses that create the jobs: a recent study by the Kauffman Foundation notes that companies less than five years old created two thirds of the net new jobs in 2007.⁵

Another study by Kauffman notes that "challenging economic times can serve as the rebirth of entrepreneurial capitalism, leading to the creation of much-needed new jobs".⁶ They found that more than half the companies on the 2009 Fortune 500 list were launched during a recession, along with nearly half of the firms on the 2008 Inc. list of America's fastest-growing companies. The report suggests a broader economic trend, with job creation from start-up businesses proving to be less volatile and less sensitive to downturns compared to the overall economy.

Carl Schramm, president and CEO of the Kauffman Foundation says that "history has demonstrated this time and again: new firms create new jobs and fuel our economy. Policies that support entrepreneurship support recovery." The study points out that while recessions often create widespread economic grief, they also can encourage potential entrepreneurs, acting "as an extra spur to founding a new company, if the founders perceive their prospective competition might be weakened". Rising unemployment can benefit new enterprises: entrepreneurs may view unemployment as an opportunity to start a company, and seize the advantage provided by the ability to tap into a larger pool of potential employees.

The clear message is that people who have spotted an opportunity and who have the determination and the ability can start businesses which will be successful. Governments may not be able to help with opportunities or determination but they can help to create a supportive environment and they can also help people to develop the competence. That perhaps begs the questions of what they need to do to create the environment and to develop entrepreneurs.

Developing countries are interested in policy frameworks for entrepreneurship development and UNCTAD, in particular, has been exploring this area in some detail though their suggested policy components are relevant to all countries. They suggest⁷ that there should be six components:

- General entrepreneurship policy (including enabling environment)
- Awareness and network building
- Access to finance
- Entrepreneurship education and skills
- R & D and technology transfer
- Regulatory environment

Whilst agreeing that these should be part of an overall policy framework, I would place the emphasis somewhat differently.

⁴ Economist, 30 May 2009

⁵ Ewing Marion Kauffman Foundation (2009), "Where will the jobs come from?"

⁶ Ewing Marion Kauffman Foundation (2009), "The Economic Future Just Happened"

⁷ UNCTAD (2009), "Key components of entrepreneurship and innovation policy frameworks"

The policy wheel

Governments can make a difference at three levels, all of which are shown in the policy wheel. The first level applies to all their policy making. The second level recognises that governments create the environment in which businesses work, either tacitly or explicitly; governments which are concerned about strengthening their small business sector will take care not to do things that inadvertently make life more difficult for businesses. The third level requires proactivity specifically to encourage and support new and growing businesses.

Principles for public policy

Too often, Governments adopt policy without thinking through the consequences. That was one reason why, when I was at the SBS, the UK government created the 'Small Firms Litmus Test' – and all proposals for regulation were scrutinised in advance to minimise the burden on small businesses.

I believe that public policy needs to follow three Cs: be coherent, consistent and comprehensive.

Policy needs to be coherent – so that changes in environmental policy or educational policy do not run counter to policies designed to support new and growing firms, and without the unforeseen consequences that are so often prevalent in modern policy making.

Policy making must be consistent so that firms can plan in the knowledge that there not be sudden and major changes with which they have to contend. Ideally, policy should not change every time a Minister changes, as is so often the case in the UK; indeed, securing agreement across political parties on the basic tenets of policy related to business would offer even more stability. And where there is policy making at local and regional level it too needs to be consistent – and complementary to the national policy.

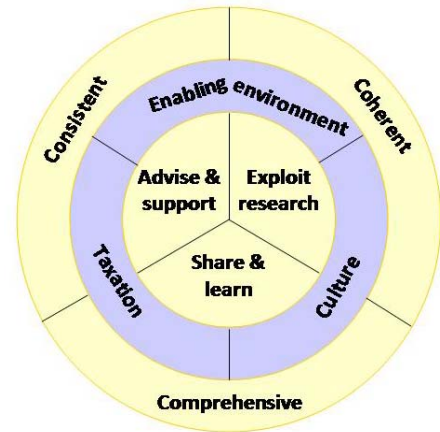
Governments that are serious about encouraging entrepreneurs will want to be comprehensive, not only doing what they can to make the environment more conducive to business but also ensuring the provision of advice and maybe other support such as micro-finance or incubator workspace. Such support needs to be of high quality and also needs to work with the market rather than compete with it. So, for example, rather than setting up loan funds or equity funds, schemes should be designed so that the private sector takes the lead and public sector support reduces (though does not eliminate) the risk.

Making a difference in climate and culture

Improve the enabling environment

Evidence from the World Bank suggests that those countries which do the most to streamline red tape and eliminate regulatory burdens see the greatest impact on economic growth – by thinking carefully before they introduce regulations and, when it is essential to regulate, doing so in a way that minimises the additional burden on business. Surveys looking at business leaders' perceptions of the enabling environment and the efforts being made by governments to improve them suggest that infrastructure and corruption are the biggest deterrents to investment.⁸

Some countries worry that migrants will 'steal' jobs but actually migrants are good for economies and creating an environment that attracts skilled people is important – and is no different to one that



⁸ See reports at www.businessadvocacy.net/survey.html

supports new and growing business. Economic growth depends on productivity and the most productive people are often also the most mobile.⁹ Some 25 per cent of US engineering and technology firms founded in the 10 years between 1995 and 2005 had an immigrant founder; a quarter of international patent applications filed from the US were the work of foreign nationals.

Richard Florida (author of books like “The Rise of Creative Class” and “Who’s Your City?”) asserts that countries, regions and cities are engaged in a global battle for talent and that the most creative people can more or less live where they want. They seek places that offer intellectual stimulation – they like to be surrounded by other creative people – as well as satisfying their material requirements. And, when clever people form clusters, they bounce ideas off each other, which in turn fosters technological progress. So, arguably, a country’s economic prospects depend on whether it is a place where people want to live and work. For emerging countries, especially those with a large number of nationals living elsewhere, attracting people back to start businesses could make a significant difference to their economies.

Simplify taxation

For many businesses, taxation is an issue – often not only making businesses less competitive but also imposing time-consuming paperwork. In too many countries, there are too many taxes, with too much administration and too many opportunities for officials to levy taxes capriciously and corruptly. The OECD notes, perhaps not surprisingly, that compliance costs increase with the number and complexity of the taxes¹⁰ so the more that can be done to simplify taxation, the easier it is for businesses, even if the total tax take is the same.

Taxation is one of the issues that contribute to the enabling environment, but it is worth considering separately. Wherever possible, governments should seek to eliminate the plethora of taxes on businesses. That is not to say that businesses should be exempt from tax. They should pay their fair share, like everyone else, but minimising the paperwork, and in some countries this also reduces the opportunities for corrupt practices, will free the entrepreneurs to get on with their business. Some governments believe that taxing business is an easy way to raise revenue, and that it makes little difference to costs but, in the end, it all works its way through to the prices paid by the customers whilst often also making businesses less competitive than their foreign competitors.

Culture

Societies ultimately depend on the taxes that are raised from private businesses (or from taxing extractive industries) to cover all their public expenditure. And governments are keen to encourage more people to start in business. Yet, curiously, many societies appear not to value people who start their own business but rather to treat them with suspicion, perhaps seeing them as little better than crooks. In the UK, there has been some success in changing societal views of entrepreneurs, though more needs to be done. In general, governments need to take the lead in changing the culture – so that society values, respects and encourages entrepreneurs.

In particular, we need to do more in schools – so that education releases and nurtures our natural entrepreneurial talent rather than beating it out of us. School students should be encouraged to be independent and to be different. It is said that after Richard Branson was expelled from school, the teachers warned the other students to behave or they end up like Richard Branson! And even if people decide ultimately not to start their own business – and that is a perfectly good outcome – they will at least understand and support those who do.

⁹ Economist, 19 Dec 2009, reporting work by Vivek Wadhura of the Harvard Law School

¹⁰ OECD (2009), “Taxation of SMEs”

Promote and support entrepreneurs

Offer appropriate advice and support

Ideally governments will encourage people to consider starting in business – and then provide, directly or indirectly, appropriate advice and support. Governments all say that they want to pick winners and direct support to them – but picking winners is impossible. However, winners can often select themselves, so the most effective support will be provided at a range of levels, with entrepreneurs deciding for themselves what they need.

Academics argue about the benefits of business training and business support, though research in the UK by Barclays Bank and the National Federation of Enterprise Agencies¹¹ suggests that it does make an important difference – but we need to ensure that advice is timely, appropriate and accurate. We need to provide support so that it is geared to local needs, and as innovatively and cost-effectively as possible, perhaps through a challenge fund – recognising that good programmes may continue to need at least some level of support – which seek to maximise leverage of support from other sources.

A major plank of necessary support can be delivered through mentoring. An Open University survey asked respondents “in which form do you think business advice and information can best be supplied” comparing 2009 results with 2002 results and using only regular respondents. Telephone support was fairly low at under one third; paper support fell from 54 per cent to 27 per cent though e-mail support rose from 30 per cent to 64 per cent. Website support rose from 48 per cent to 62 per cent. Face to face support though topped the survey both times rising from 63 per cent to 71 per cent. Almost certainly this is because there is a need to interpret the raw information and to provide advice and support in addition. It is essential therefore that a key component of any support mechanism continues to be personal mentoring.

There is also some evidence that businesses want to be able to access local support. A survey of UK business advisers by Cobweb Information¹² revealed that 49 per cent of respondents believed that their clients wanted business advice to be provided locally through local authorities and local enterprise agencies rather than regionally (33 per cent) or nationally (11 per cent).

Commercialise research more effectively

Many businesses start because someone spots a gap in the market and thinks that they can fill it profitably. This is commendable and needs to be encouraged. Indeed many of the people who start up will then spot opportunities to innovate further and their businesses will grow as a result. But if governments want to do more to encourage the formation of businesses that might grow into larger businesses, they need to be more proactive.

Since World War II, 50 per cent of all innovations and 95 per cent of all radical innovations, at least in the US, have come from new and smaller firms.¹³ Many of the most innovative, most entrepreneurial businesses in the US, certainly the technology ones, emerged from research institutes and large company research labs where bored and stifled researchers and middle managers realised that they only way to ‘do their own thing’ was to resign and find a garage. Bill Hewlett and Dave Packard started their business in a garage some 70 years ago; Steve Jobs and Steve Wozniak started Apple Computers in Jobs’ parents’ garage.

Fairchild Semiconductor, founded in 1957, for example, spawned 10 new ventures in its first eight years; indeed, most of the 31 semiconductor firms founded in Silicon Valley in the 1960s could trace their roots back to Fairchild. Examples include Intel, Advanced Micro Devices and LSI Logic. Today in

¹¹ Barclays Bank (2002), “Profiting from support”

¹² See www.cobwebinfo.com

¹³ Prof Jeffrey Timmons (1994) “New Venture Creation”, Irwin

Biographical note

David Irwin co-founded Project North East, one of the UK's first enterprise agencies. In 2000, he was appointed founder CEO of the UK Government's Small Business Service. He consults in enterprise and economic development, working with business support initiatives, social enterprises and regulatory reform programmes, mainly in Africa and the UK. He is Chairman of Cobweb Information Ltd and of the International Association for Enterprise Promotion.

Silicon Valley, new ventures are particularly likely to trace their roots to firms like IBM, Apple, Hewlett-Packard, Intel and National Semiconductor.¹⁴

Now businesses in the UK, such as H2O and Life¹⁵, are aiming to identify research which has a commercial application and then to support the researchers to do what is necessary to exploit the research effectively. Arguably, we need to do much more to encourage researchers to commercialise the results of their research.

Evaluate support programmes and share lessons

Business advisers report that they make regular efforts to evaluate their own support programmes and to learn about the success of programmes run by others, yet curiously report that there is insufficient innovation in business support.¹⁶ We need to do more to promote innovation in business support, perhaps by creating a challenge fund that can be tapped by business support organisations, and to assist in promoting more effective learning and sharing of lessons from practitioners from all round the world, through websites and conferences, but also through offering bursaries for more practitioners to engage in 'creative swiping'.

OECD has been working on a range of indicators to assess the impact of entrepreneurship support. This is welcome, but ultimately it is important that indicators demonstrate at least some level of attribution and that collecting the data does not become burdensome. Probably, the easiest way to do this effectively would be through a partnership with the banks so that businesses' turnover can be tracked and the growth rates of supported and unsupported businesses can be compared.

Conclusion

If we achieve all this, there is a real chance that countries can create environments in which new and small businesses can start and flourish – growing into large, world-class businesses, creating wealth and jobs and making their economies more resilient.

¹⁴ 'Coming From Good Stock', Capital Ideas, Vol 2, No 2, 1999, viewed at www.chicagobooth.edu/capideas/fall99/sorensen.html

¹⁵ For more on H2, see www.h2ovp.com and for more on Life, see www.life-ic.com

¹⁶ David Irwin (2009), "How business advisers learn", Cobweb Information Ltd