Building entrepreneurship ecosystems: A cautionary tale

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Executive Summary

- Entrepreneurship has become a critical part of regional economic development policies. As regional policies such as entrepreneurial ecosystems continue to be developed, academic research looks to provide a few cautionary details to policymakers.
- While high-growth firms must be differentiated from other small businesses, focusing exclusively on these firms may backfire on a region. A portfolio approach that supports all types of ventures will help sustain economic growth while mitigating negative externalities.
- Initiatives must be in place to retain firms as they begin to expand. This can be done through providing adequate financial support while cultivating and retaining quality talent.

Building entrepreneurial ecosystems

Since the rise of Silicon Valley, entrepreneurship has taken on a crucial role in creating more jobs and wealth for regions.[1] More recently, creating entrepreneurial ecosystems where multiple economic players contribute to create an environment conducive to entrepreneurship has become a popular approach for policymakers. Specifically, an entrepreneurial ecosystem involves the public sector, financial institutions, academic institutions, the private sector, the entrepreneurial culture and infrastructure to support new business formation.[2] This ecosystem is expected to build entrepreneurship clusters that can increase new firm founding and startup employment.[3] As the popularity of this approach increases, academic research cautions against misinformed applications that may have unintended repercussions for the region.

Take a comprehensive approach toward sectors

High-growth firms continue to be systematically grouped together with other small businesses, which has deprived them from receiving enough support. As much as 85 percent of ventures of “survival and lifestyle” businesses do not seek expansion or growth, and the small number of high-growth firms contribute disproportionately to job and revenue creation for regions.[4] Policies that properly differentiate among small businesses are pivotal to the success of growing an entrepreneurship cluster.[5] However, focusing exclusively on high-growth sectors may backfire on the region. Inequality may be exacerbated as the number of specialized and local jobs grow due to in-migration, while other jobs that create middle-class workers are pushed out.[6] In addition, industries that are not direct or indirect beneficiaries of such growth may get pushed out, leaving the region vulnerable to industry-specific shocks.[7]

The entrepreneurial ecosystem model stresses the symbiotic relationship among all types of actors, with one high-growth platform supporting the growth of the others, leading to an increase in overall socioeconomic well-being. This should expand to include all types of ventures as well, with policymaking taking on a portfolio approach to entrepreneurship.[8] This may protect the region against unexpected shocks. In addition, it will create room for the growth of region-specific industries, rather than duplicating the technology clusters of other regions.[9] Locally embedded entrepreneurs will then sustain economic growth in the region while mitigating inequality.[10]

Provide adequate financial support to expanding businesses

Researchers warn that policy initiatives that prioritize the creation of new businesses over the growth of such businesses may also pose a problem to the region.[11] As businesses expand, their needs evolve as well. Without the necessary resources, these firms will have to migrate to other regions that can support their expansion. Morris, Neumeyer and Kuratko and Isenberg and Onyemah suggest that proper incentives should be provided to keep these businesses in the region.[12] Tax policies and government-backed loans for small businesses can financially support the expansion while also creating an avenue for external funds to reach businesses in less popular regions. Relieving the burden of regulatory costs associated with the cost of employees could also support employment expansion for small businesses.

Cultivate and retain talent

Finding quality workers is another major problem for small businesses as they grow.[13] Without a sufficient supply of talent in the region, firms cannot expand at their preferred speed and size. Brown and Mason highlight the role of large corporations on this particular issue.[14] Not only do large, established companies serve as initial consumers for startups' products and services, they also spin off talented entrepreneurs and attract talent to the region.

However, large companies are undoubtedly a complicated player within the ecosystem. Spigel and Harrison caution that larger companies may not be the best source of startup founders and employees, as the skill set necessary to run a successful small firm is not always equivalent to the one needed by larger firms.[15] In fact, large firms could instead tie up resources that could be flowing into ventures while also promoting policies that defend their own positions while endangering the smaller firms.[16]

In addition, local governments must be judicious about their reward structure for firms within the ecosystem. Adequate regulation of monopoly power will balance the coexistence of larger firms and startups.[17] Prudent choices in imposing NDAs could sustain the talent flow between firms (Stiglitz, 2015).[18] Liberal bankruptcy laws that forgive losses or minimize exit penalties will sustain an entrepreneurial culture that remains favorable to smaller businesses.[19]

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Practitioner Takeways

- Differentiate between high-growth firms and "survival and lifestyle" businesses, but continue to provide support for all sectors.
- Provide adequate financial resources to support the expansion of small businesses, not just their initial creation.
- Cultivate and retain talent in the region through utilizing large, established companies, but be cognizant of the reward structures set up for these firms.

Contributing Experts

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