

# Good for Growth

## Refocusing Entrepreneurship Policy

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### The need to look at types of entrepreneurship

UK economic growth has been weak since the financial crisis, with output still below its pre-crisis peak. Despite signs of a recovery in recent months, there is nonetheless still a risk of permanent loss of productive capacity,<sup>1</sup> limiting the UK's future prosperity. This creates a strong rationale for looking afresh at the drivers of long-term productivity growth and innovation. As a vital driver of new innovation and productivity growth,<sup>2</sup> entrepreneurship could have a major role in revitalising the UK economy.

There are a plethora of different Government initiatives designed to incentivise start-ups and entrepreneurs, including funding schemes, tax reliefs, advice and mentoring. But research suggests that different types of entrepreneurship contribute differently to economic growth, employment and innovation. This means that we can maximise the economic benefits of entrepreneurship policy by focusing on encouraging the types of entrepreneurship that deliver the greatest economic gains.

This paper sets out a framework for analysing the benefits of different types of entrepreneurship, based on existing research and evidence. It goes on to show how the UK performs compared to other countries, and concludes by looking at where we should focus efforts to encourage more of the kind of entrepreneurship that is good for growth. We define entrepreneurship as activity that involves an individual or small group of individuals identifying and exploiting a new commercial opportunity. Our focus specifically excludes:

- **commercial opportunities** exploited collaboratively within a firm: whilst the economic benefits of this activity are likely to be similar to that of entrepreneurship, the incentives and barriers are likely to be different, requiring different public policy approaches.
- **social entrepreneurship**, where part of the opportunity is seen as non-monetary. For simplicity we only consider commercial opportunities, although there may be psychological similarities between the motivations of social and purely commercial entrepreneurs that can yield useful insights in the research.

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<sup>1</sup> International Monetary Fund, "United Kingdom—2013 Article IV Consultation Concluding Statement of the Mission", <http://www.imf.org/external/np/ms/2013/052213.htm>

<sup>2</sup> Zoltán J. Ács & László Szerb, "The global entrepreneurship index (GEINDEX)," Jena Economic Research Papers 2009-028, Friedrich-Schiller-University Jena, Max-Planck-Institute of Economics (2009)

## The benefits of types of entrepreneurship

Entrepreneurship can increase innovation, employment and growth. This section sets out the benefits of entrepreneurship, and then discusses how these benefits are likely to vary across different types of sector and activity, and across different types of entrepreneurs.

### Benefits of entrepreneurship

The main economic benefit of entrepreneurship comes from its effect on innovation. Long-term economic growth is driven by rises in productivity – the ability to create more or better quality outputs with fewer inputs. Across the economy as a whole, 51% of UK annual labour productivity growth from 2000 to 2008 was the result of innovation.<sup>3</sup> Entrepreneurial activity contributes to this in two main ways: direct innovation and general competition and spillover effects.

#### Direct innovation

Entrepreneurs can provide an avenue for new ideas to be tested on a small scale and brought to market,<sup>4</sup> driving structural change and job creation in an economy<sup>5</sup> as resources are reallocated to more productive areas. More specifically, entrepreneurship could involve the following types of direct innovation:

- Introducing a new product or service that previously had not been available on the market, for example, commercialising a new invention.
- Introducing a new process which reduces costs or raises productivity compared to existing firms, and which therefore allows an existing product or service to be provided more cheaply.
- Introducing a new way of delivering an existing product or service that creates value, for example, offering products online that were previously only available offline.

In terms of direct innovation, research shows that new firms do not necessarily invest more in, or produce more innovation compared to larger existing firms. But once size is taken into account, new firms perform better, with more innovations per employee in small and young firms. The quality of their innovations is also higher, and entrepreneurs tend to derive greater revenue from the commercialisation of innovations compared to existing firms.

On the down-side, entrepreneurs also destroy more value compared to existing firms by pursuing innovations that fail for too long.<sup>6</sup> This suggests that the role of the entrepreneur is complementary to that of existing firms in terms of bringing new and different innovations to market. In addition, the skills, ability and incentives of individual entrepreneurs will have a strong impact on the amount of net value created, in terms of striking the right balance

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<sup>3</sup> Department for Business, Innovation and Skills, *Annual Innovation Report 2012* (London: HMSO, 2012)

<sup>4</sup> Amar Bhide, *The Origin and Evolution of New Businesses* (Oxford: Oxford University Press, 2000)

<sup>5</sup> Erik Stam, Kashifa Suddle, Jolanda Hessels and André van Stel, "High Growth Entrepreneurship, Public Policies and Economic Growth", *International Studies in Entrepreneurship*, Volume 22, Part 1, 91-110 (2009)

<sup>6</sup> Mirjam van Praag and Peter Versloot, "The economic benefits and costs of entrepreneurship: a review of the research", *Foundations and Trends in Entrepreneurship*, 4 (2008), 65-154

between pursuing potential new innovations and knowing when to make the decision to end a venture that is likely to fail.

### **General competition and spillover effects**

Additional competition in the market can drive down prices and increase consumer choice (static benefits). But perhaps more importantly, increased competition can spur on direct innovation by other firms in the market, or firms in related markets (dynamic benefits). Entry by new firms encourages innovation by incumbent firms – especially in cases where incumbents are already technologically advanced – and thereby increases sector productivity.<sup>7</sup> The spillover effects of innovation can far outstrip direct innovation benefits, with some research suggesting that the spillover benefits associated with research and development investment can be double the private benefit to the investing firm.<sup>8</sup>

In addition to contributing positively to economic growth through innovation, entrepreneurial activity also has the potential to create jobs. Evidence shows positive links between start-up rates and self-employment, and total employment levels – both in the short term and in the longer-term, although this varies by type of entrepreneurship as explored later in this paper. The jobs created by entrepreneurs tend to be less secure and lower paid, although employees in these firms tend to report higher levels of job satisfaction.<sup>9</sup> The majority of job creation comes from a small number of high growth firms: for example, in the UK, high growth businesses generated half of new jobs created by firms of ten or more employees between 2007 and 2010.<sup>10</sup> But entrepreneurs and new entrants do not have to create jobs directly for there to be a positive impact on employment: research finds that the larger, longer-term effects of new entry come from the impact on the market as a whole, as increased competitiveness drives up total labour demand – not just from entrant firms.<sup>11</sup>

The net economic benefit to society of a person or group of people engaging in entrepreneurial activity also depends on what their alternative employment options are. For some individuals, with fewer other employment options, starting a new business or self-employment may be a net gain to the economy if their previous role was a poor job match, was less productive, or if they would otherwise be unemployed.

### **How do benefits vary by sector and type of activity?**

The impacts of entrepreneurship set out above are highly dependent on the specific type of activity involved. Overall, benefits are likely to depend on market size, the type of innovation and competition in the market. In particular, the benefits of entrepreneurship are likely to be larger in the following circumstances:

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<sup>7</sup> Philippe Aghion, Richard Blundell, Rachel Griffith, Peter Howitt, Susanne Prantl, “The Effects of Entry on Incumbent Innovation and Productivity”, *The Review of Economics and Statistics*, 91(1) (2009), 20-32

<sup>8</sup> Nesta, *The Innovation Index*, (London: Nesta, 2009)

<sup>9</sup> Mirjam van Praag and Peter Versloot, “The economic benefits and costs of entrepreneurship: a review of the research”, *Foundations and Trends in Entrepreneurship*, 4 (2008), 65-154

<sup>10</sup> Nesta, *Vital Growth* (London: Nesta, 2011)

<sup>11</sup> Mirjam van Praag and Peter Versloot, “The economic benefits and costs of entrepreneurship: a review of the research”, *Foundations and Trends in Entrepreneurship*, 4 (2008), 65-154

- There is a large potential market of consumers that could benefit from the innovation. There may already be a large market, or the innovation itself may increase the addressable market. It could involve a new way of delivering the service that means that more consumers can be reached, or it could create demand that did not previously exist, for example for something that people did not know they wanted until it was there. If the new entry is at the wholesale level, the number of consumers who will benefit will depend on the size of the consumer retail market that wholesale products and services feed into.
- The innovation is scalable and/or replicable (by the entrepreneur or an existing firm) so that the benefits can actually be realised across a large market of consumers. This may be more likely if it is a capital or knowledge-based innovation, for example, new equipment or a new product idea, or if it is a labour-based innovation that can be replicated, for example, if it is a skill that can be taught or a new way of working or structuring a business.
- The innovation is likely to give rise to spillovers and spin-off innovations. This may be more likely in some sectors (e.g. capital intensive, high tech) and where there are likely to be complementary products, or if it is a “platform” or enabling product (e.g. a new broadband service could allow further innovation in the services or products delivered over it).
- In the case of general competition benefits, the benefits of a new entrant are likely to be higher when there is currently little competition in the market.

This suggests that the benefits of entrepreneurship activity are likely to be especially large when it involves entry into sectors that have potential for high productivity growth due to spin-off innovations and the ability to scale up new innovations. In addition, a larger market size – or potential for growth in the size of the addressable market - is likely to result in larger benefits as it increases the number of consumers who benefit from any innovations.

For benefits to be realised, the firm itself does not have to be high growth, but the sector it is in should be. For example, other firms might replicate the innovation, resulting in benefits across the market. However, it is likely that higher growth firms are likely to result in greater benefits because they are more likely to pose a competitive threat to existing firms and so have a wider effect on competition and innovation. The relationship between economic growth and entrepreneurship per se is mixed, but the evidence shows that there is a strong link between “growth oriented entrepreneurship” and economic growth. “Growth-oriented entrepreneurs” are defined as entrepreneurs who expect to increase the number of individuals they employ in future years.<sup>12</sup>

The box below sets out examples of entrepreneurship and whether they could be considered low or high value on the basis of the benefits set out above.

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<sup>12</sup> Erik Stam and Andre van Stel, “Types of entrepreneurship and economic growth”, UNU-MERIT Working Paper Series 49, United Nations University, Maastricht Economic and social Research and training centre on Innovation and Technology (2009)

### Box 1.1: Examples of entrepreneurship: high or low value?

*Setting up Pret a Manger:* Pret a Manger could be viewed as filling a niche for high quality food in the fast-food market<sup>1</sup>, i.e. a new method of delivering high quality food. The potential size of the consumer base would – and indeed turned out to be - large, and the idea of delivering high quality food in a fast-food environment could be replicated across shops in other locations. So this entrepreneurship venture would score high on those two factors. But the nature of the sector is less likely to result in spin-off innovations.

*A new window-cleaning business:* If this involved the introduction of a new replicable skill or technology in cleaning windows that had a dramatic impact on the service itself, this might be a “direct innovation” with large benefits. But more likely it would only entail “general competition benefits”. These benefits are likely to be relatively small, since there is already competition in the window-cleaning business and the nature of the sector is less likely to give rise to spin-off innovations.

*Setting up eBay:* eBay – an online shopping and auction site - was one of the first of its type. This involved direct innovation benefits (a new service), with a large potential market of buyers and sellers. As a platform for buyers and sellers, it had the potential to allow innovation and development of new business models in a range of retail sectors. Overall this type of entrepreneurship would deliver large economic benefits.

*Self-employment:* Self-employment could have high or low benefits depending on the sector and product or service – for example, the potential of the commercial opportunity that is being exploited, the available growth opportunities, and the ability of the entrepreneur - or other firms in the market - to exploit these growth opportunities. Self-employment is often split up into those who are themselves employers, and those who are “own account self-employed” and do not employ any other individuals, for example freelancers. If having employees is an indication of growth, then own account self-employed individuals may be less likely to be involved in high value activity compared to those who are – or at least plan to be – employers in the future.

<sup>1</sup> Edgar Whitley, “Understanding participation in the entrepreneurial organisations: some hermeneutic readings”, *Journal of Information Technology*, 14 (1999), 193 -202

## How do benefits vary by types of entrepreneur?

Entrepreneurship involves identifying and exploiting a new commercial opportunity. The motivations and background of an individual becoming an entrepreneur will influence how well they are able to do this. In particular, some entrepreneurs, who are “necessity-driven” because they have few other employment options are, almost by definition, less likely to become involved in entrepreneurship to exploit an opportunity. In fact, the opportunities exploited by

individuals who say they have become entrepreneurs to take advantage of an opportunity are more profitable compared to those exploited by necessity-driven entrepreneurs.<sup>13</sup>

Most of this advantage is related to the fact that many opportunity-driven entrepreneurs start their ventures in sectors that they have expertise in.<sup>14</sup> So previous sector experience can help entrepreneurs spot and exploit more profitable opportunities. More specific research finds that prior knowledge of markets and customer problems in those markets is likely to help individuals spot where there is a gap to be exploited,<sup>15</sup> and that between 50% and 90% of start-up ideas come from prior work experience.<sup>16</sup>

At the wider economy level, empirical analysis shows that there is a link between opportunity-based entrepreneurship and growth, but not between necessity-driven entrepreneurship and growth.<sup>17</sup> This means that public policies to encourage entrepreneurship are likely to have only a limited effect on economic growth if they only incentivise necessity-driven entrepreneurs with few other employment options, and lower skill levels.<sup>18</sup>

### **Box 1.2: Summary of factors influencing the benefits of entrepreneurship**

In summary, the main factors driving benefits from entrepreneurship are: firstly, the sector and the scope that the sector offers for growth; and secondly, the extent to which entrepreneurship is driven by the identification of an opportunity, rather than by necessity.

The scope that the sector offers for growth, and therefore the benefits of entrepreneurship will be higher when:

- the size of the addressable consumer market is large
- the innovation introduced by the entrepreneur is scalable and/or replicable
- the sector is the type where spin-off innovations are likely
- there is little competition in the market

<sup>13</sup> Joern Block and Marcus Wagner, "Necessity and Opportunity Entrepreneurs in Germany: characteristics and earnings differentials", *Schmalenbach Business Review*, 62 (2010), 154-174

<sup>14</sup> Joern Block and Philipp Sandner, "Necessity and Opportunity Entrepreneurs and their Duration in Self-employment". *Journal of Industry, Competition and Trade*, 9 (2009), 117-137

<sup>15</sup> Alexander Ardichvili, Richard Cardozo and Sourav Ray, "A theory of entrepreneurial opportunity identification and development", *Journal of Business Venturing*, 18 (2003), 105-123

<sup>16</sup> Gerald Hills, Rodney Shrader, G.T. Lumpkin, "Opportunity recognition as a creative process", *Frontiers of Entrepreneurship Research*. (1999), 105-117. See also John Park, "Opportunity recognition and product innovation in entrepreneurial hi-tech start-ups: a new perspective and supporting case study", *Technovation*, 25 (2005), 739-752

<sup>17</sup> Zoltan Acs, "How is entrepreneurship good for economic growth?", *Innovations: Technology, Governance, Globalization*, 1 (2006), 97-107

<sup>18</sup> Pamela Mueller, Andre van Stel and D.J. Storey, "The Effects of new firm formation on regional development over time: the case of Great Britain", *Small Business Economics*, 30 (2008), 59-71. The authors look at the impact of public policy to encourage entrepreneurship across the UK, and find that the impact on job creation is positive in regions that are already prosperous. The long-term impact is zero and even negative in some other areas. The authors attribute this to firms in less prosperous areas being started by individuals with low skills and poor market prospects.

Figure 1.1 below shows how the potential benefits of entrepreneurship differ by type of entrepreneur and type of sector.

**Figure 1.1: Benefits of entrepreneurship**



## What would high and low value entrepreneurship look like in practice?

### Can we distinguish between sectors with different growth potential?

As set out earlier, sectors that are more likely to give rise to large benefits from entrepreneurship are those which offer more growth – firstly in terms of the number of consumers who could benefit from new innovations, and secondly, through the potential for further productivity growth driven by spin-off innovations. There are also competition benefits that are likely to be greater in markets where there is currently little competition.

It is relatively straightforward to distinguish between sectors by the size of the market in terms of numbers of consumers addressed – although the size of the potential addressable market is clearly more uncertain. It is also possible to distinguish sectors by the level of existing competition by looking at indicators such as market shares and

profitability. For example, recent studies have found on-going high concentration in parts of the retail financial services market with poor consumer outcomes. At the same time, the size of the consumer base for a product such as a current account is very wide. So entry in a sector such as this could result in widespread benefits if it results in increased competition driving better prices and products for consumers.

Moving onto the potential for innovation, data is available on sectors that have – historically – been innovative. Previous research suggests that in the UK, a large proportion of innovation takes place in the manufacturing, distribution and communications, business services and finance sectors. Of these, manufacturing has an especially large contribution, accounting for around 46% of innovation in the UK.<sup>19</sup> Given the capital-intensiveness of manufacturing, it is likely to be particularly conducive to the adoption of innovation across firms. Other research finds that high-growth firms in the UK are found across the range of sectors, but are particularly likely to be in business services.<sup>20</sup> More generally, international evidence suggests that high tech industries such as telecoms, aerospace and pharmaceutical firms are likely to be especially innovative.<sup>21</sup>

However, the overall economic contribution of some industries will not necessarily show up in figures for productivity by sector because of their ability to increase productivity in other sectors. For example, innovations in “enabling technologies” such as ICT, electronics and biosciences are likely to have beneficial impacts across several different sectors,<sup>22</sup> creating spin-off innovations that are difficult to measure and predict.

In practice, the extent to which opportunities for replication and spin-off activities are realised will depend on a complex interplay of the structure of markets, links between businesses and the strength of intellectual property rights. For example, the link between competition and innovation is not straightforward. In a competitive market, other firms may be more likely to respond to new innovations by attempting to further innovate to escape competition. But if there is “too much” competition, firms may not have sufficient resources to invest in research and development, and may be disincentivised by the lack of return on innovation. This typically leads to an “inverted U-shaped” link between the level of competition and innovation. Very high levels of competition may mean returns from innovation are competed away too quickly to make it worthwhile investing. At very low levels of competition, companies may not need to innovate very much to retain market share. So some competition, but not “too much” is needed to drive innovation in a market.<sup>23</sup>

A strong intellectual property rights regime provides incentives to create new ideas, but limits the extent to which they can be replicated, thereby limiting the overall benefits to consumers – at least in the short-term. But in a very competitive market, a strong intellectual property rights regime can bolster the incentive to innovate to escape competition.

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<sup>19</sup> Peter Goodridge, Jonathan Haskel and Gavin Wallis, “UK Innovation Index: Productivity and Growth in UK industries”, Nesta Working Paper 12/09, July 2012

<sup>20</sup> Nesta, “Geography of Growth”, [http://www.nesta.org.uk/home1/assets/features/geography\\_of\\_growth](http://www.nesta.org.uk/home1/assets/features/geography_of_growth)

<sup>21</sup> Nizar Becheikh, Rejean Landry, Nabil Amara, “Lessons from innovation in empirical studies in the manufacturing sector: a systematic review of the literature from 1993-2003”, University of Illinois at Urbana-Champaign’s Academy for Entrepreneurial Leadership Historical Research Reference in Entrepreneurship (2006)

<sup>22</sup> See, for example, Technology Strategy Board, *Concept to Commercialisation* (TSB, 2013)

<sup>23</sup> Phillippe Aghion, Nick Bloom, Richard Blundell, Rachel Griffith and Peter Howitt, “Competition and Innovation: an inverted-U relationship”, *The Quarterly Journal of Economics*, 120 (2005), 701-728

## Can we distinguish between opportunity versus necessity driven entrepreneurs?

As set out in the previous section, opportunity-driven entrepreneurs – those who make an active choice to start a new enterprise to exploit a business opportunity – are more likely to engage in high value entrepreneurship. So what do we know about these types of entrepreneurs?

Evidence suggests that compared to necessity-driven entrepreneurs, opportunity-driven entrepreneurs do have different characteristics, as set out below.<sup>24</sup>

- **Background:** Opportunity-driven entrepreneurs are more likely to have a high level of education and have had entrepreneurship education or training (although the latter is most likely explained by the fact that those who are interested in entrepreneurship are more likely to obtain training).<sup>25</sup> Alternative employment options also mean that opportunity-driven entrepreneurs are more likely to have had time to develop specific work experience to help them plan their ventures.<sup>26</sup> They are also more likely to progress if they have self-employed parents, potentially indicating the value of entrepreneurship experience and advice. Opportunity-driven entrepreneurs are more likely to be men than women, perhaps reflecting the fact that men are less likely to fear failure and more likely to think that they have the skills needed to start a business.<sup>27</sup>
- **Attitudes:** Opportunity-driven entrepreneurs are more likely to be willing to risk failure – which could explain why they would be willing to forgo more stable employment opportunities. As a group, they are less likely to see lack of financial support as a difficulty. But in comparison to necessity-driven entrepreneurs, opportunity-driven entrepreneurs have alternative employment prospects, so may be more discouraged by some obstacles. For example, those would-be opportunity driven entrepreneurs who do see lack of financial support as a difficulty are less likely to engage in entrepreneurial activities. They are also more likely to be put off by administrative complexities.

As set out earlier, high growth firms are more closely associated with driving economic growth than entrepreneurship per se. Evidence suggests that in fact entrepreneurs who set up high growth firms – or “gazelles” - are more likely to have started their business to increase their incomes and exploit a perceived opportunity, rather than being driven by necessity. So there is substantial overlap in the characteristics of opportunity-driven entrepreneurs and entrepreneurs who go on to create high growth firms – especially in attitudes to failure and levels of education. But there also are

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<sup>24</sup> Reena Bhola, Ingrid Verheul, Roy Thurik and Isabel Grilo, “Explaining engagement levels of opportunity and necessity entrepreneurs”, EIM and SCALES Research Paper (2006); Ingrid Verheul, Roy Thurik, Jolanda Hesseks, Peter van der Zwan, “Factors influencing the entrepreneurial engagement of opportunity and necessity entrepreneurs”, EIM and SCALES Research Report (2010)

<sup>25</sup> Entrepreneurship specific education is also positively linked to opportunity-based entrepreneurship and reduces the odds of failure. But this may be explained by the fact that those who are attracted to entrepreneurship tend to be more likely to undertake these programmes. One study which attempts to control for this finds that entrepreneurship education does not have a significant impact on intentions to become an entrepreneur. See, for example, Hessel Oosterbeek, Mirjam van Praag, Auke Ijsselstein, “The impact of entrepreneurship education on entrepreneurship skills and motivation”, *European Economic Review*, 54 (2010), 442-454

<sup>26</sup> Joern Block and Marcus Wagner, “Necessity and Opportunity Entrepreneurs in Germany: characteristics and earnings differentials”, *Schmalenbach Business Review*, 62 (2010), 154-174

<sup>27</sup> Jonathan Levie and Mark Hart, *Global Entrepreneurship Monitor, United Kingdom 2011 Monitoring Report* (2012)

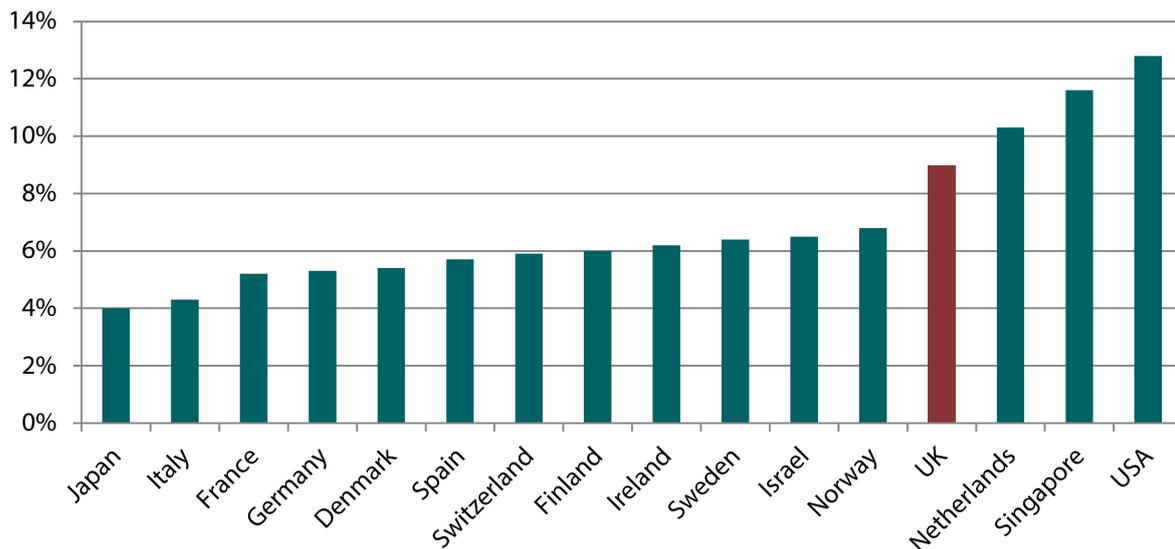
some specific characteristics common among high growth firms in particular. These include high responsiveness to demand and having a global outlook.<sup>28</sup>

The next section looks at how the UK compares to other countries on available measures of types of entrepreneurship.

## What does entrepreneurship in the UK look like?

The UK compares well to other countries in terms of the proportion of individuals in the process of starting up new businesses or having recently started up a new business, as shown in Chart 1.1. In fact, this proportion has been growing in the UK, from around 6% in 2006 to 9% in 2012.

**Chart 1.1: Proportion of 18-64 population who are either a nascent entrepreneur or owner-manager of a new business**



Source: Global Entrepreneurship Monitor, 2012

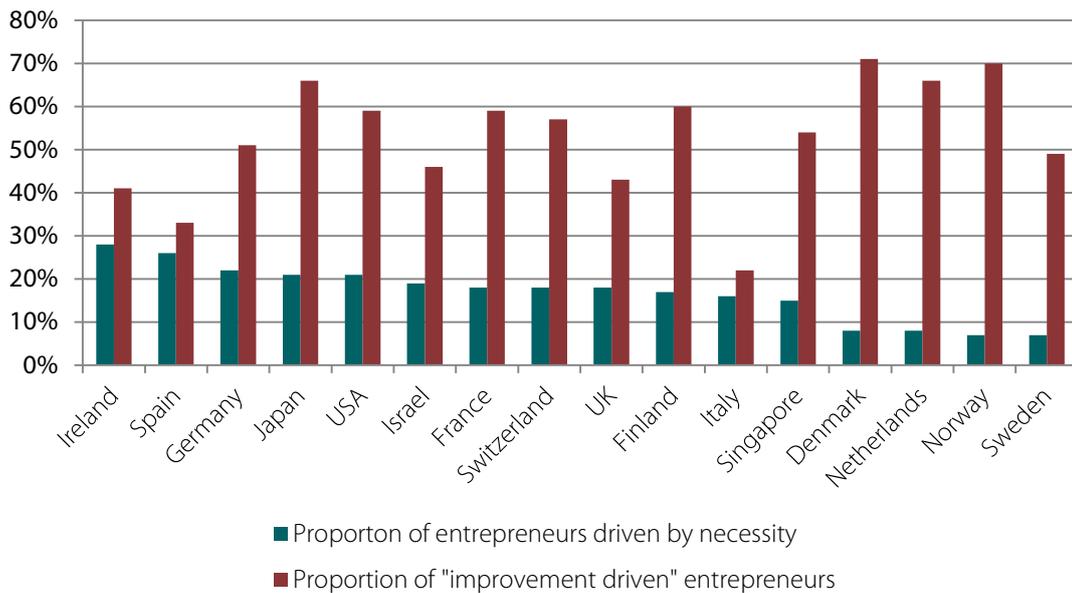
However, over the same period, the proportion of those involved in early entrepreneurship activity out of necessity also grew – from 15% to 18%. This suggests that a substantial part of the recent increase may be made up of individuals going into entrepreneurship because they have fewer other options during the recent economic downturn. And of the remaining 82% of entrepreneurs, some will be involved in entrepreneurship because of lifestyle benefits rather than because they have spotted a profitable opportunity to exploit.

<sup>28</sup> Shannon Wells and Geordie Hungerford, "High Growth Entrepreneurship: The Key to Canada's Future Economic Success", *Policy Options*, September 2011; Centre for High Impact Entrepreneurship and GEM, *2011 High-Impact Entrepreneurship Global Report* (2011)

A closer measure of opportunity-driven entrepreneurship provided by the Global Entrepreneurship Monitor is “improvement-driven opportunity entrepreneurship”, which measures the number of individuals motivated by opportunity and the ability to be more independent and increase their incomes, rather than simply maintain their incomes at current levels. On this measure, 43% of those involved in early stage entrepreneurship in the UK reported that they were involved in “improvement-driven opportunity entrepreneurship”.

The graph below shows the proportion of those engaged in early entrepreneurship doing so because they had no other option for work across different countries, and the proportion engaged in “improvement-driven opportunity entrepreneurship”. The UK has a relatively high rate of necessity-driven entrepreneurship and a relatively low rate of improvement-driven opportunity entrepreneurship. This suggests that a relatively large proportion of UK entrepreneurs are engaged in early stage entrepreneurship just to maintain their incomes, rather than to improve their incomes or to achieve greater job independence. Several other countries appear to be better at incentivising higher value entrepreneurship. For example, the Netherlands, Singapore, Norway and Sweden all combine relatively high rates of total entrepreneurship activity with lower rates of necessity driven entrepreneurship and higher rates of improvement-driven opportunity entrepreneurship compared to the UK.

**Chart 1.2 Proportion of early stage entrepreneurs split by driver**



Source: Global Entrepreneurship Monitor, 2012

As set out in the last section, the type of sector and activity that an entrepreneur engages in is also a crucial determinant of the overall economic benefits. A recent piece of international comparative research finds that the percentage of early stage entrepreneurs in the UK who are active in high tech or medium tech sectors was around 11%

and 12% respectively, a similar proportion to that in other benchmark countries.<sup>29</sup> The same study found that 39% of early stage entrepreneurs reported that they operated in new product markets – a similar level to France and the US.

However, other research has found that the UK underperforms other European countries in terms of the proportions of entrepreneurs in the high tech sector and making use of new technology. The same research found that the UK's small businesses have a lower capacity to innovate, grow beyond a certain size and expand internationally.<sup>30</sup> Clearly, the current economic conditions are likely to influence new firms' expectations of growth and ability to grow. But more generally, cross-country comparisons indicate that the UK's small businesses tend to have lower aspirations to grow, especially compared to the US, suggesting a more long-standing problem.<sup>31</sup>

In summary, the UK could generate more high value entrepreneurship if it had a higher number of opportunity-driven entrepreneurs in sectors with high growth opportunities. So how can we create more entrepreneurs of this type? The potential sources are other types of entrepreneurs, employees, the unemployed and those who are yet to choose a career path (i.e. graduates and school-leavers).

## Where could high value entrepreneurs come from?

Having set out what high value entrepreneurship looks like, and how the UK is currently performing, this section looks at potential routes into high value entrepreneurship, with the aim of understanding whether levels can be boosted.

Figure 1.2 below shows the potential flows into high value entrepreneurship from other types of entrepreneurship, unemployment and employment.

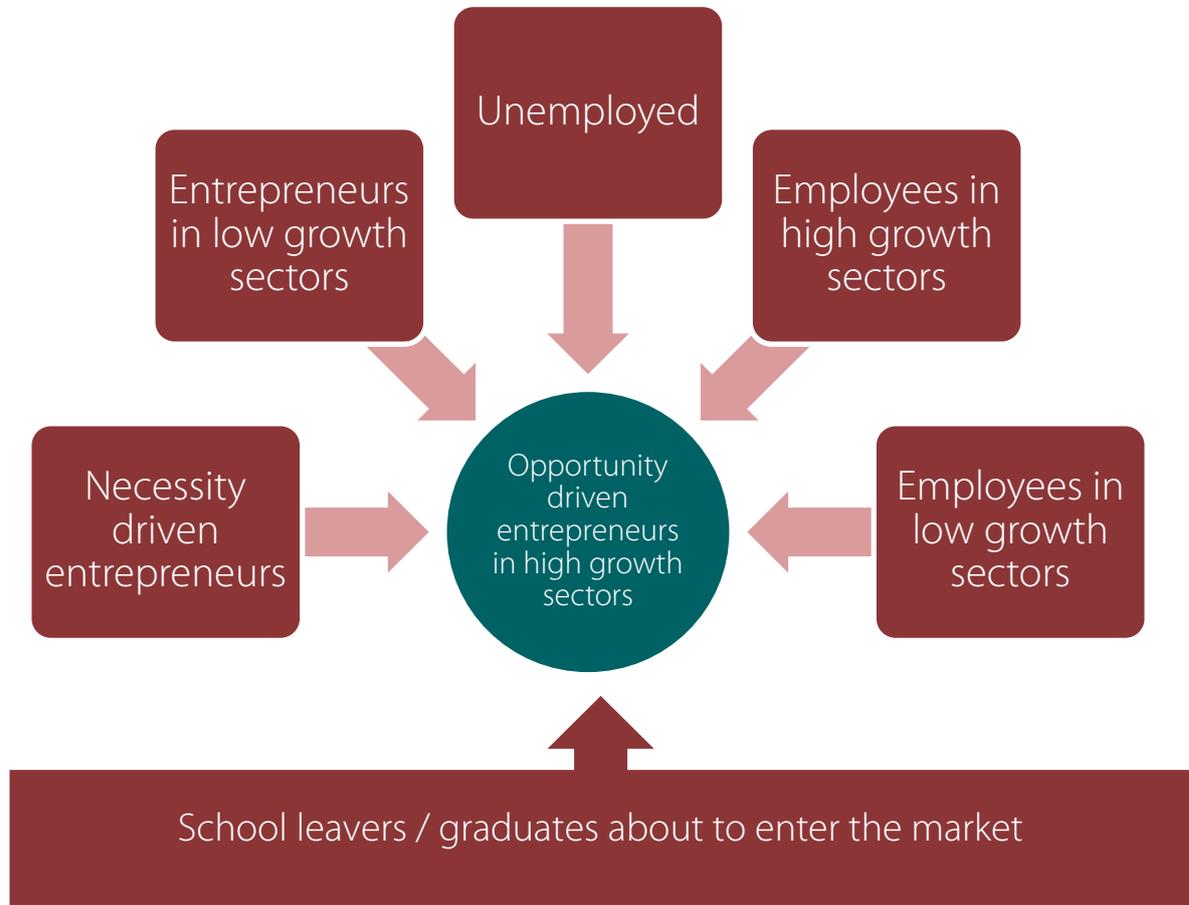
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<sup>29</sup> Jonathan Levie and Mark Hart, *Global Entrepreneurship Monitor, United Kingdom 2011 Monitoring Report* (2012). OECD definitions are based on R&D intensity and are available here: <http://www.oecd.org/sti/ind/48350231.pdf>.

<sup>30</sup> Saul Estrin & Carol Gaddun, *The Global Entrepreneurship and Development Index for the United Kingdom: The analysis of the United Kingdom's entrepreneurial position*, (2010)

<sup>31</sup> Estrin & Gaddun, 2010

**Figure 1.2: Routes into high value entrepreneurship**



**Necessity-driven entrepreneurs**

Opportunity-driven entrepreneurs – those who make an active choice to exploit a new business opportunity – are more likely to engage in high value entrepreneurship. But it is possible that some entrepreneurs who start off as necessity-driven could become high-value entrepreneurs at a later point in their careers.

Some research suggests that many entrepreneurs are driven by both necessity and opportunity, and can switch between the two. In particular, some necessity-driven entrepreneurs become opportunity-driven entrepreneurs once their ventures become more established.<sup>32</sup> As necessity-based entrepreneurs in a sector gain further skills and experience, they may become better able to spot other valuable commercial opportunities. So in some cases, necessity-

<sup>32</sup> Colin Williams, “Beyond necessity-driven versus opportunity-driven entrepreneurship: a study of informal entrepreneurs in England, Russia and Ukraine”, *The International Journal of Entrepreneurship and Innovation*, 9 (2008), 157-165

based entrepreneurship could be a “gateway” to more valuable types of entrepreneurship – particularly if these necessity-based entrepreneurs start out and gain experience in sectors with high growth opportunities.

Around 18% of those in UK who are involved in early stage entrepreneurial activity are doing so because they have no other option for work. This suggests that the pool of necessity entrepreneurs who could be shifted into high value entrepreneurship is relatively small. But of the remaining 82% of entrepreneurs, some will be involved in entrepreneurship because of lifestyle benefits rather than because they have spotted an opportunity to exploit. These “lifestyle” entrepreneurs may also have the ability and experience to go on to spot opportunities in the future, although they may be less likely to make this transition, given their original reasons for engaging in entrepreneurship activity.

### **Entrepreneurs in low growth sectors**

Sector-specific skills and experience can increase the likelihood that an individual will be able to spot and exploit a potential commercial opportunity. But this also means that it may be more difficult for entrepreneurs to shift from one sector to another. This places some limitations on the benefits of encouraging entrepreneurs in one sector to start up new ventures in other sectors with greater growth potential.

But some innovations are applicable across sectors, and especially across related sectors. For example, business models could be replicated in a different sector, as could the benefits of “enabling technologies” such as IT systems. So provided that there are links between businesses and entrepreneurs in different sectors to allow learning across sectors, it may be possible for entrepreneurs to deliver economic benefits by moving into sectors with higher growth opportunities.

### **Unemployed individuals**

Given the importance of skills, education and experience, it is likely that those who would deliver large economic benefits as entrepreneurs will also have other attractive employment opportunities available to them. Further encouraging those who are unemployed to become entrepreneurs will not necessarily create high value entrepreneurship, as such individuals are more likely to be driven by necessity, rather than the identification of a potentially profitable business opportunity.

There may be potential for such necessity-driven entrepreneurs to move into higher value entrepreneurship later on in their careers, if initial entrepreneurial activity allows them to gain skills and experience. However, broader investment in skills and education may be more beneficial, and widen the opportunities available to these individuals – whether employment or entrepreneurship.

### **Employees**

Opportunity-driven entrepreneurs in sectors with high growth opportunities are most likely to deliver large economic benefits. If skills and industry experience make it easier to spot and exploit commercial opportunities, then experienced and highly skilled employees in sectors with high growth opportunities could deliver large economic benefits by becoming entrepreneurs – although they may be less likely to have specific entrepreneurial skills related to starting up and managing a business. As set out earlier, a high number of start-up ideas come from previous work experience.

Those with fewer skills and less experience in high growth sectors are likely to deliver fewer economic benefits by shifting into entrepreneurship, although as set out above, there may be potential to move into higher value entrepreneurship later on in their careers.

### **Graduates and school-leavers**

There is a correlation between skills and education and high value entrepreneurship. So, depending on skill levels, it may be more beneficial for a higher number of individuals to become entrepreneurs rather than employees. But even high-skilled individuals may lack the industry experience helpful to identifying gaps in the market and potential commercial opportunities, especially in business to business markets which these individuals are less likely to have been exposed to, even as consumers.

## **Conclusions: can we better focus public policy on driving high value entrepreneurship?**

In summary, the evidence shows that there are differences in the value that different types of entrepreneurship create, with higher value likely to come from opportunity-driven entrepreneurship in sectors with high growth opportunities. This creates a rationale for public policy to focus on expanding the numbers of these types of entrepreneurs. The pools that these individuals could come from include employees in high growth sectors, entrepreneurs who were originally driven by necessity but have gone on to gain valuable skills and experience in high growth sectors, and high skilled graduates – although the latter may find it difficult to spot potential commercial opportunities if they have limited experience of specific sectors.

Currently, most public policy relating to entrepreneurship falls into two broad categories: financial incentives and access to finance; and support, advice and education. There are a wide range of schemes designed to increase incentives for investment in new and small businesses. The Enterprise Finance Guarantee scheme is designed to boost bank lending. Schemes such as the Enterprise Investment Scheme and Seed Enterprise Investment Scheme provides tax reliefs for investors. And there are other tax reliefs that entrepreneurs themselves can benefit from, such as Entrepreneurs' Relief.

The Government has supported initiatives such as "Start Up Britain" – designed to encourage and support start-ups. It has also tried to provide more focused support to firms that already have a track-record and have the potential to grow further, for example, the GrowthAccelerator programme. There are also policies to create further links between research and business, to help universities to commercialise their research.

But most support is not targeted at specific groups of potential entrepreneurs, and as such risks encouraging too much low value entrepreneurship and not enough high value entrepreneurship. There is a need to better understand the differing routes into high value entrepreneurship, the factors that affect choices to become an entrepreneur and the barriers to entrepreneurship across different groups. Doing this will allow public policy to focus in on the specific factors holding back people with the potential to become high value entrepreneurs and boost the benefits of entrepreneurship to the UK economy.

***This piece of research was kindly supported by Stephen Barclay***

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