

The complexities of encouraging Welsh enterprise

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It has been pointed out on many occasions that a fundamental weakness of the Welsh economy has been its inability to generate entrepreneurs (Jones-Evans 2001, Bryan and Jones 2000). Wales remains among the least entrepreneurial nations in Europe, perhaps even the western world. Although accurate evidence is difficult to obtain and invariably contradictory, Wales has the lowest rate of new firm formation in the UK (Local Futures 2003). Global Entrepreneurship Monitor data generated over the years has confirmed this poor state of affairs (GEM 2000 – 2004). VAT data further confirm a poor level of new firm formation, notwithstanding concerns about accuracy and relevance (Ball 2006), with only the North east registering fewer new firms. In terms of competitiveness – a fundamental driver of economic well-being in which entrepreneurship plays a major part – Wales lags behind the whole of Europe, bettering only Portugal and Hungary (Huggins 2004).

So what has led to this state of affairs? Misplaced regional policy has reinforced an employee culture that militates against entrepreneurship (Storey 2002). Since its beginnings with the Assisted Areas Acts of the 1930s, regional policy in the UK has had two clear objectives; *the creation of employment and the diversification of the inherited industrial structure to create self-sustaining growth*. In practice, policy instruments were directed far more at the creation of employment to the detriment of self-sustaining growth (George and Mainwaring 1988), resulting in policy being driven by the idea that employment creation (and consequently diversification) comes about principally through inward investment by large firms. There is no question that success in employment creation over the years would not have come about without a regional policy (Armstrong and Taylor 2003). However, policy has been successful in diversifying the industrial base but has done little to encourage the technical, managerial or skill base (Storey 1983); a criticism that now applies to a new wave of inward investment by large retailers and call centres.

The heritage of size and external ownership is illustrated by 2003 data from the Office of National Statistics. Of the 211,000 employed in production

industries in Wales, 57% were employed in the largest size band of 250+ employees. This size band represents just 3% of all production firms in Wales. In Wales' largest employment sector, Distribution, Hotels and Catering, 47% were employed in the largest size band, which represents just 1.5% of the firms in this sector. VAT registration data further illustrate the extent to which the Welsh economy remains very much a "branch plant economy." Of the 171,000 business firms which provide employment in Wales, just 43% are registered within Wales for VAT. While care should be taken with interpreting such data, it is a requirement of HM Revenue & Customs that VAT registration occurs at a firm's head office.

Why then is entrepreneurship such an important issue, exercising academics and politicians alike? Entrepreneurship and new firms provide dynamism, choice, innovation and employment (Gavron *et al* 1998) especially in the regions of the UK (Armstrong and Taylor 2003). Entrepreneurship describes firms offering new capacity, dynamism, innovation, flexibility, a culture that prizes enterprise and thus economic and social benefits (Carter and Jones-Evans 2000, Bridge *et al* 2003). The Bolton Report (CMND 4811 1971) noted the role of new firms as a 'source of dynamic competition' and that a healthy economy 'requires the birth of new enterprises in substantial numbers'. The Birch Report (1979) showed that employment creation was actually occurring in new and small firms, contrary to the received academic and political understanding of the time. There is evidence of a *causal link* between the rate of new firm formation and economic well-being (The Economist 1998). Van Stel *et al* (2005) have argued that entrepreneurship accounts for as much as 5% difference in national GDP – an interesting and challenging statistic given the present poor position of the Welsh economy.

Research in this most interesting area of social science suggests that there are two forces at work. The first is that entrepreneurship is an innate trait possessed by some individuals. De Vries (1997) adopted this psychological approach to entrepreneurship in the USA which generates many times more new firms as the UK (and Wales). However, it is unlikely that these

differences can be accounted for solely on psychological grounds. It is more likely that entrepreneurship is a function of the wider environment, and that it is the cultural, social but above all the economic environment – developed over time - which dictates the rate at which founders of new firms will emerge (Cooper 1973, Porter 1990, Storey 2002). Actively developing a more entrepreneurial society is exceptionally difficult and requires an explicit recognition of the dynamic and complex processes involved. New firm formation is an intricate system of interlocking parts, reflecting individual, structural and environmental influences that combine to either promote or discourage the entrepreneurial process. Missing elements will then suppress entrepreneurship.

A number of potentially predictive characteristics have emerged from established literature concerning entrepreneurs and new firm formation. While Storey (2002) urges caution arguing that these factors are descriptive rather than predictive, they do nonetheless present a research-based foundation which should inform policy-making.

The Founder of the New Firm

The founders of new firms very often come from a family business background, the experience from which provides stimulus and support (Bolton 1971, Bridge *et al* 2003). It follows that the local business environment will benefit from the existence of small businesses and in some numbers.

High levels of educational attainment characterise new firm founders (Storey 2002). They are often graduates, holders of higher education qualifications or have received some form of technical training. This underlines the more advanced and complicated nature of modern day business. The mid thirties is the most common age for founding a firm (Birley and Westhead 1992, Storey and Strange 1992, Carter and Jones-Evans 2000), although other research has suggested that the founders of new technologically based firms may be even younger (Carter and Jones-Evans 2000). Relevant career experience will have been obtained throughout the founders working life. Operating a business on a part-time basis prior to founding has provided a valuable contribution to new

firm formation, notably in manufacturing (Ball 1995, Legge and Hindle 2004). Experience gained through changes in employment is a characteristic of founders, many of whom have held a number of separate jobs with different employers. Successful new firm formation is largely a phenomenon of groups of founders with a set of different skills but similar backgrounds to those noted above, although single founders are not uncommon in the services sector (Storey 2002, Bridge *et al* 2003).

The Incubator

The organisation in which the founder worked immediately prior to founding the new firm is known as an incubator. Its role is fundamental to understanding the founding process. Its characteristics influence the location, nature and the likelihood of the new firm spin-offs, and influence regional entrepreneurship through its ownership, labour force, training and motivation, but above all size (Bridge *et al* 2003). This is where the greatest error of past policy lies. Traditional location theory suggests a search and least cost option. The reality is that since most individuals live near their existing place of work this location will invariably be the place to set up. Large employers in areas such as Wales established as a result of past and present regional policy play a major, and essentially negative, part. Such employers (whether in manufacturing or services) are usually externally owned and, as a result of lack of local management opportunity and training, are poor incubators. The age of the incubator organisation also has a bearing on likely founders; younger firms are likely to be smaller, reflect newer industries and develop better managers (Bloom *et al* 2005). Older incubators are invariably involved with products at the end of the life cycle.

Of all factors associated with the role of the incubator, *size* is the important determinant of new firm formation. Barclays Bank (2000) sought to identify regions with greater entrepreneurial potential. Their research confirmed that the number of small firms in an area is a fundamental determinant of new firm formation. The relationship between the incubator and the effect of size cannot be over emphasised; incubator size and the size distribution of incubators in any economy is *the main influence* on the rate at which new firms are set up (Mason 1991). Unheeded by Wales' policy makers, the Bolton Committee (1971) warned *'that an economy dominated by large plants cannot for long avoid ossification and decay'*.

Large employers do not make good incubators because their mechanistic

structures and the need for specialist and often product specific skills are of little use to employees considering establishing a new firm. Hence larger incubators (in employment terms) are less likely to spawn new firm founders. The number of individuals leaving to start a new firm will decline as incubator size increases (Mason 1991). There is consistent evidence that small firms lead to successful development of an indigenous business sector. Small organisations need and develop many skills while large employers develop individuals with non-transferable product specific skills. Checkland (1976) likened the one large, single employer in an area to the legendary Upas tree of Java. This tree was reputed to grow to a mile across, killing everything that attempted to grow in its shadow. Growth in new firms is also related to the amount of turbulence within an economy and it follows that if any economy is static and dominated by one or a few employers, the rate of new firm formation is likely to be small. Mention has already been made of the causal link between new firms and economic well being. New firms invariably spin out from other, existing *small* firms in the geographic area in a chain that commences with these existing small firms. The problem at the beginning of the twenty first century is that while large manufacturing plants are disappearing, the same mistakes are being repeated. Large manufacturing establishments employing hundreds of basic, product specific skill employees are now being replaced by call centres, supermarkets and a large public sector.

The work history of the founder is the most important influence in providing relevant skills. The local occupational structure and especially the number of non-manual workers, is a specific contributor to differences in new firm formation. In general, firm founders have management experience or have reached management positions, not an easy task in externally owned, large employers (Storey 2002). The motivation of founders is important and very often overlooked. The decision to establish a new firm is based upon a number of motivational factors, which can be regarded as either pushing or pulling the founder. Potential founders working in large externally owned incubators might have no inclination at all, even though they may have the ability. Some may be pushed into founding by recession, unemployment or frustration, factors upon which the incubator will have a direct bearing. Some are drawn by the chance to increase income, achieve independence or by market opportunity. A great deal of entrepreneurial activity that has taken place in Wales has been a

consequence of being pushed into entrepreneurship as a result of recession, although current research suggests that the opportunities presented by enterprise are beginning to become more important (GEM 2004).

The External Environment

Complex external factors play a key role in determining entrepreneurship (Storey 2002, Legge and Hindle 2004). Such factors often differ substantially from one area to another. Information and advice is a necessary first step, especially if founding is a new experience. Research evidence also shows that founders who do seek advice contact professional advisors in preference to public sector agencies, and the role and relevance of such agencies must therefore be questioned (Storey 2002). A new firm will usually require finance to commence trading. Research and indeed policy continues to devote more attention to the question of finance than to any other aspect of entrepreneurship, yet start-up finance is not necessarily the problem that agencies and potential funders appear to think it is (Deakins and Freel 2003). Research has shown that personal funds provide a substantial contribution to start up capital, though sometimes in combination with other sources of funds. The provision of funds from the founders' own resources is a reflection of the amount of start-up capital required, and many new firms require very little initial finance (Carter and Jones-Evans 2000, Deakins and Freel 2003).

However, the availability of start-up funds does reflect a wider economic context; a wealthy economy will have individuals with sufficient personal capital to start the new firm. Research has also revealed an important link between high levels of disposable income and high rates of new firm formation (Carree *et al* 2002). Culture is important. In Wales entrepreneurship is simply not the norm; working for others in traditional businesses, industry and the public sector is seen as the way to a stable and predictable career. The past 'success' of inward investment is owed in part to selling the notion that the Welsh make good employees; perpetuating an employee mentality that militates against entrepreneurship.

Finally, new firms begin in a specific economic environment, the structure of which will influence the sectoral activity of the new firm. Founders inevitably seek to establish in the sectors with which they are familiar or originate from (Armstrong and Taylor 2003). Change across sectors is not unknown, and the extent to which source and destination industries differ is significant for

regional change and diversification. This again illustrates the problems with the present policy of inward investment, large employers, external ownership and the public sector.

Conclusions

In future, the role of government and its agencies must be to assist the creation of a favourable economic, social and cultural environment within which enterprise is the norm and not the exception. There has to be a clear and long term strategy aimed at a fundamental change in thinking at all levels. This article suggests that the continuing policy of economic development in Wales based on externally owned inward investing organisations and the sole concern with employment creation as the only measure of success will continue to depress the very factors needed to develop an entrepreneurial society. The current enterprise policy based on simple exhortation "to be your own boss" is misguided, misplaced and doomed to failure in the present economic environment.

Note

It is recognised that there is a debate on the meaning of the terms *entrepreneurship* and *new firm formation*. For some (Schumpeter 1934 for example) entrepreneurship is specifically associated with innovation. New firms may not necessarily be "enterprising" according to this definition; indeed many new firms are established in existing products, sectors and markets. Their importance lies in the capacity brought to the economy and the potential for growth and change (Storey 2002). Thus the terms are used interchangeably in this article but have the same meaning.

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