SWP 1/90 DEVELOPING A NEW VENTURES STRATEGY

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Contributing Editor's Note

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The "Small Business Business" is now a world-wide industry. Governments of all political persuasions now accept that a healthy supply of new and small firms is key to a healthy economy. Over the past few years, I have participated in seminars with Government policy makers from countries as philosophically diverse as, for example, Hungary, India, China, Australia, Sweden, Italy, the Sudan, and Oman. All have been concerned about the depressed regions of their economies. Many have tried to market these regions to multi-national and international firms in an attempt to generate inward investment, and have found themselves in a highly competitive business with the associated high costs of creating and marketing incentive packages. Indeed, many have discovered that competition is so great that commercial incentives are taken for granted and executives are more concerned with local life style factors of schools, housing, and pleasant countryside. Consequently, all have now turned inwards to the community itself and are seeking new ideas, new ways to stimulate the people in these communities to create jobs for themselves.

Despite often being accepted as the home of the entrepreneur this phenomenon can also be found in the United States. When I lived in South Bend, Indiana, in the early 1980s community leaders throughout the "rust-belt" of the Mid-West were concerned to stem both rising unemployment, and the flow of businesses to the southern "sun-belt". Major marketing campaigns were launched in an attempt to persuade established firms to relocate part of their activity in these communities. The results were, and are, mixed, and in many places the emphasis has now returned to the stimulation of indigenous business.

It has long been my view that academics and researchers primarily concerned with working with, and studying, the entrepreneur cannot ignore these major issues. More importantly, nor can we ignore the consequent responsibility to respond to the many requests for advice and help in creating new venture strategies, both at home and abroad. Indeed, it is a field in which we can exert significant leverage. We simply cannot leave it entirely to the economists. I was interested, therefore to read the Spring 1989 edition of ET&P which arrived as I was writing this. In his editorial Frank Hoy discusses the Audiences for Entrepreneurship Research. He notes the three "obvious" ones of colleagues, students, and practitioners, but calls to our attention a fourth, the public policy formulators. Clearly, I endorse his view!

In the United Kingdom, the exchange of research results, ideas and experience between academics and policy-makers is well established, particularly in the realm of the small firm. This paper is the result of such relationships. The authors are both academics and practitioners, and the paper is based upon a strong base of current practical experience in advising Government and Government agencies, both regionally and nationally, on policies for new ventures. However, whilst parochial in its roots, the issues are universal.

DEVELOPING A NEW VENTURES STRATEGY

Manning, Birley and Norburn

The recent accelerated decline of most western economies has focussed the attention of both Government and Industry upon the need for industrial regeneration. This has been reflected in the call for a new "enterprise economy", for the encouragement of new firms and small firms, and for the development of new, "high tech" industries. In an attempt to foster these sunrise activities, new methods of economic intervention - systems, structures and schemes - have been devised. The United Kingdom has seen the rapid growth of the Enterprise Agency Movement and of Business in the Community; in the United States, Small Business Development Centres; in France, the Boutiques de Gestion; in Italy, FORMAPER. The fundamental aim has been to create new economic "hot spots" in the areas of high unemployment. Typically, these areas have been either the "rust-belts" of the Mid-West of America and the West Midlands of the United Kingdon, or the peripheral regions of the north of Scotland and the South of Italy. In each case, the goal has been to replicate the economic role models of London and the South East, Silicon Valley, or Milan.

This paper argues that these current modes of intervention are inappropriate; that they interfere in the system and so divert attention from the creation of local interdependence; that they should be initiating new systems and structures not managing them; and that the whole aim of commercial assistance agencies should be either towards their own extinction, or absorption into the local economic community. It starts from the premise that economic regeneration must be rooted at the local level, that strategies must be regional in design and delivery, not national.

New firms and new industries, whatever their size, draw many of their resources from the local community - premises, skilled employees, sub-contracted services, money and professional advice, as well as customers and suppliers. In implicit recognition, most Government strategies have had two main aims:

A. A focus upon the small firm sector by -

* increasing the rate of creation of new firms.

* encouraging and assisting existing small firms to grow by "picking winners".

B. The provision of incentives to attract the inward investment of large, multinational firms to economically distressed areas.

Clearly, both of these are important elements of a strategy for economic regeneration. However, they do not take account of six fundamental issues:

1. They ignore the essential complexity of creating new economic infrastructures. Historically, most of the inward investment has been in the form of branch plants which have had no real commercial ties to the local community, other than as an employer. As a result, and unlike the traditional local large employer, they have failed to serve as a focus for new firm activity through, for example, spin-offs, or sub-contracting, or local purchase. Moreover, senior management has been remote and uncommitted to local issues. Consequently, strategic decisions have been made at a global level rather than a local or even national level.

2. They ignore many of the basic motivations of the owner-manager, whose raison d'etre is often to stay small, and to avoid significant growth, particularly if growth implies increasing employment levels.

3. There is ample evidence that it is very difficult, if not impossible, constantly to pick winners [Hakim 1989]. Indeed, even the investment portfolios of many of the venture capital funds include only a small percentage of start-ups, relying more upon the proven track record of

development capital investments and management buy-outs.

4. There is an implicit assumption that all new firms are small firms, and that size is measured in terms of direct employment. Accordingly, policies have been directed at the owner-manager or the self-employed, and have been judged on the basis of "jobs created".

5. Time horizons ignore the natural time scales needed for new, small firms to develop and grow. A recent survey of the largest owner-managed firms in the United Kingdom showed corporate average age to be 21 years. Whilst some had certainly reached significant size in a relatively short period of time, it is clear that many of the potentially large firms of the year 2000, despite being established, are still small firms in the initial, often slow, growth stages [Birley and Watson 1988].

6. Too often it is the new small firms which are expected to be the source of exports, even before they have established in their own local markets. Yet the overwhelming majority of new firms draw their first customers from the local region. Very few ever export <u>directly</u>, even to the next region.

As a consequence, there is often an economic hiatus as branch factories leave the region, or reduce their activity, and the new high flyers have still to emerge from the small firm sector. This is not to suggest that new firms are not important. Indeed, they are crucial. They contribute to a balanced local economy and are the engine of economic growth. What is missing is a theme which builds upon the strengths of ALL new ventures, whatever their genesis or size and develops a group of firms with local, committed ownership, and critical mass. The aim should be to build a set of truly indigenous businesses in which all members of the community have the potential to have some form of ownership of the venture, not only as employees but also as customers, suppliers or investors. Moreover, whilst the majority are likely to continue to rely solely upon the community for their customers, a significant number must become "community exporters".

Community exporters have a significance far beyond their role of job creation. They are the community economic lynch-pin -

* They provide significant economic additionality through the local purchasing power released.

* They contribute, both directly and indirectly, to the demand for local supplies and services which, in turn, generates a new, small business community.

* They provide critical role models, and often critical resource, for the aspiring entrepreneur.

CREATING FERTILE GROUND FOR NEW VENTURES

The commonly held model of the entrepreneurial process centres upon a single-minded, inventive, individual with a clear vision of his new business. This is essentially a linear model of an individual who has an idea, then identifies a market opportunity, then assembles the necessary resources, and finally begins operations. IT IS A MYTH. Available evidence regarding the new venture process suggests the following:

* Firm founders often have only an ill-formed intention to start a business, which in many cases is tentatively started at home and evolves slowly [Lloyd 1980].

* The actual creation is invariably triggered by an unforseen event such as the possibility of an enforced geographic move, or a chance conversation with an eventual partner [Gudgin 1984, Atkin, Binks and Vale 1983, Binks and Coyne 1983, Westhead 1988].

* Most businesses are started by teams rather than one individual [Cooper 1971, Cross 1981].

* Many entrepreneurial teams start businesses in the industries in which they were previously employed, offering the same or an improved service [Gudgin 1978, Mason 1982]

* A high proportion of new ventures change direction significantly, perhaps several times, during the first 24 months [Lloyd 1980].

* Only a small minority of new ventures seek assistance or advice from the agencies established to assist them [Gould and Keeble 1984, Birley and Westhead 1988].

Essentially, the creation of new firms is not linear but rather a random process. There are very few totally new ideas, or new products; most new firms are variations upon existing products and markets; and, try as we might, entrepreneurs constantly refuse to fit any identi-kit picture. The more generalisations are made, the more exceptions to the rules emerge. Consequently, if policy initiatives are to improve the rate of new venture creation, they must mirror the reality of the venture process.

A MODEL OF NEW VENTURE CREATION

A number of studies have demonstrated the relationship between local economic factors and the rate of new firm formation [Cross 1981, Gudgin and Fothergill 1984, Lloyd and Mason 1984, O'Farrell and Crouchley 1984, Westhead 1988]. For example, evidence exists that rising levels of unemployment are associated with increased rates of firm formation, but that there is a local plateau [Hamilton 1989]. By contrast, high levels of industrial concentration, with a small number of large plants, tend to depress the rate of firm formation. Clearly in any local economy such factors may be effectively fixed - they establish the overall framework within which the venture creation process operates. However, ths paper agrues that the rate of conversion from potential to actual new ventures is determined by three factors which <u>are</u> susceptible to policy initiatives.

* <u>determinants</u> in the community which increase the propensity for the formation of new ventures.

* <u>linkages</u> throughout the resource network to facilitate new venture formation.

* individual new venture <u>characteristics</u> which determine their eventual success or failure.

These factors are linked by the model illustrated in figure 1 below. It assumes that new venture creation will occur only when the necessary determinants are linked together to entrepreneurs in Northern Ireland often display an island mentality; small communities in Scandinavian countries understand that to survive they must export.

* The availability of, and experience in, a wide range of new technologies, often evidenced by the presence of a number of high quality Universities and Polytechnics, as in the case of Cambridge or Stanford.

* The clear presence of market opportunities. For example, large local organisations, whether they be public or private, which do not purchase locally severely limit the market opportunities for the new venture.

* The availability of all types of resources - space, skilled employees, raw materials, training, information - which are both appropriate and affordable.

Since the nature of the entrepreneurial process is essentially random, implicit in all of these determinants are two critical conditions -

QUANTITY - the determinant base must be high.

ACCESSIBILITY - they must be easily accessible, and must be seen to be so.

Having large amounts of money available locally is unlikely to stimulate new venture creation if there is an inadequate local supply of human resources or suitable premises. Equally, it is no use having large local markets which have restrictive barriers around them, or new technologies being developed in inaccessible institutions.

2. LINKAGES

* The informal and formal network of catalytic agents bringing together the necessary components of the venture creation process.

It is being recognised increasingly that the most important factor in the success of a new venture is the nature of the entrepreneurs personal network, and his willingness to use it [Aldrich and Zimmer 1986, Johannisson 1986, Wetzel 1987, Birley and Cromie 1988]. Communities which have very closed networks are also communities in which new venture activity is small. Indeed, the culture of a community can be characterised by the types of informal networks which flourish. The reason is simple. Starting a new venture involves a process of assembling all the resources necessary for a viable market entry. In the absence of any comprehensive track record the entrepreneur draws upon the contacts in his own personal network of family, friends and acquaintances to establish his credibility, and to develop new opportunities. An active network provides four essential ingredients to the entrepreneur -

* Support and motivation
* Examples and role models
* Expert opinion and counselling
* Access to opportunities, informations and resources

For the venture to be successful, these networks must span a large number of individuals [DENSITY], whose own networks should be varied and wide [DIVERSITY]. Clearly, often by chance, some members of this informal network will also be part of the formal network of advice and assistance and so have appropriate skills and knowledge, but by no means all will be . Therefore, strong linkages between the personal, social network, and the formal, professional system of advice and assistance are crucial. Moreover, if the entrepreneur is adequately to be served, members of the formal system must also be part of their own diverse set of interlinked networks.

3. CHARACTERISTICS

Each new venture is a unique combination of skills and resources, but to gain entry to a market-place already served by other firms, there are four universal key characteristics for success:

* Specific competence in the products or markets.

* An appropriate market-entry strategy.

* Resources which are appropriate to the chosen market-entry strategy.

* Managerial systems which are appropriate to the size and structure of the firm.

These characteristics are essentially market driven, requiring that the firm display some clear sustainable COMPETITIVE ADVANTAGE over other competitors in the market-place.

NEW VENTURES POLICIES

The arguement presented above suggests that economic policies which are aimed at stimulating new ventures must take account of the particular character of the three factors of determinants, linkages, and characteristics. In order to identify and analyse the current state of play - the types of new ventures strategies adopted by various Governments - schemes in operation in 23 countries world-wide which are aimed at assisting the new and small firm were studied. The results are summarised in Table 1 below.

Insert Table 1 About Here

Quite clearly even in countries as geographically diverse as Australia, Singapore, India, America, as well as Europe, Governments have taken the lead in initiating schemes. Moreover, in the majority of cases, once created, the schemes have continued to be managed directly by Government rather than through other agencies such as Universities or private corporations. Indeed, of the few the private sector schemes in operation, almost all are found in the United States and Switzerland. Moreover, most of the schemes are evaluated on their ability to "pick winners" through assisting only those firms which promise, for example, significant jobs created or a high level of exports. They are schemes of <u>direct interference</u> and, as such, are at best marginal, and at worst counter-productive. It is the contention of this paper that the aim of any strategy should be enhance the random process, to find the conditions which create increased activity and from which firms of <u>all sizes</u> emerge.

Further, it is clear from the arguement presented in this paper that intervention in the natural process of new firm formation can take three forms -

* Determinant Enhancement
* Linkage Development
* Characteristic Improvement

The study of schemes in the 23 countries highlights a clear bias towards the two ends of the process - determinant enhancement at the beginning, and characteristic improvement of emerging new firms, the main focus of the latter being a bias towards training in the development of business plans. Only limited attention would appear to be paid to linkage development [See Table 2 below]. Moreover, from the evidence available, very few of the schemes appear to have been subject to rigorous evaluation, partly because many have only recently been introduced. Where evaluations have been conducted, they have usually been on the basis of either jobs created or simply the level of activity.

Insert Table 2 About Here

Overall, the schemes can be characterised in the following way -

* Determinant Enhancement: primarily government, often regional, relatively industry unspecific, and a considerable number of grants and subsidies.

* Linkage Development: mainly government or state agencies substituting for inadequate private sector involvement.

* Characteristic Improvement: almost all business development, principally advice and counselling, little differentiation made between new ventures and small businesses.

Further examination of the nature of the schemes shows a bias towards direct intervention through finance and assistance [See Table 3 below].

Insert Table 3 About Here

A NEW APPROACH

The starting point for most policy initiatives has been the development of an adequate supply of the determinants, the assumption being that there are inadequacies in the local environment inhibiting the creation of new ventures. The overwhelming majority of initiatives seek to redress these inadequacies by the direct supply from federal or state government of resources, subsidies, and facilities. However, whilst this may be an appropriate strategy in developing economies, there are few real shortages of determinants in advanced economies. Indeed, in these latter countries, the emphasis is shifting towards a general provision of business development support for small businesses, and of training for would-be entrepreneurs. This focus on small business is unlikely to enhance the creation of new venture creation. Indeed, it is rarely the stated objective.

New ventures are the life blood of any economy. They provide the fuel of economic growth and, in the long term, of job creation. Consequently the aim of any initiative should be to encourage and enhance the self-sustaining process of venture creation at the local level. Policy-makers should not interfere in the process, but rather facilitate it.

This paper has demonstrated a clear gap in policy initiatives, even at the macro-level. It is now well accepted that the most common characteristic of successful local entrepreneurial economies is an active system of formal and informal networks. Yet in attempting to replicate these economies, there is almost no attention paid by policy-makers to the need to develop a networking culture, to create active linkages between the entrepreneur and the resource base. A change in approach and in emphasis is necessary [See Table 4 below].

Insert Table 4 About Here

This approach is aimed at creating the right <u>environment</u> for new ventures to flourish. Inherently it accepts the random process of new venture creation, and recognises that growth firms often emerge in "un-planned" industries. The focus is upon facilitation and partnership with the existing business community, upon catalytic investment to close gaps in the commercial environment, and upon the development of strong formal and informal networks. The aim is to increase the critical mass of new firms, and to allow natural market forces to pick the winners.

Table 1: <u>Source of Intervention</u>

Source of Intervention	Percentage of Schemes
Government	57
Non-Government Public e.g. Universities	32
Private	11

Table 2: <u>Percentage of Total Schemes by Method of Intervention</u>

	Determinant Enhancement (DE)	Linkage Development (LD)	Characteristic Improvement (CI)
Government	30	5	20
Non-Government	16	4	11
Private	5	1	6

Table 3: Percentage of Schemes by Type of Aid

	Advice	Assistance	Training	Finance
DE	8	11	9	13
LD	3	4	2	3
CI	11	12	7	15
TOTAL	22	27	18	31

Table 4: Proposed Change in Strategic Orientation

PAST	PROPOSED
Determinant Focussed	Linkage Focussed
Direct Action	Facilitation and Partnership
Direct Expenditure	Catalytic Investment
Focus upon short term [1-3 years]	Focus upon longer term [7-10 years]

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