

Startup nation—the rhetoric and the reality

September 29 2015, by Tim Mazzarol

If recent statements from both the government and opposition are any guide, then entrepreneurship may be a key battleground for the next federal election. For example, Australia's youngest federal Assistant Minister for Innovation Wyatt Roy has [flagged an interest](#) in fostering growth in the number of entrepreneurial startups across Australia. He apparently has the backing of the new Prime Minister, Malcolm Turnbull.

Roy's focus, based on his [comments so far](#), appears to be on wooing back to Australia successful entrepreneurs who have moved to California's Silicon Valley. He has flagged the idea of issuing special visas for people in "innovation industries", which appear to be largely in the field of software and information technology.

Not to be outdone, opposition leader Bill Shorten has announced the idea of offering [special visas](#) to attract up to 2,000 entrepreneurs willing to start up new businesses in Australia. In addition, a further 2,000 international students would be granted a further year on their study visas if they can demonstrate they have a "credible startup idea" upon graduation.

While I would be the first to welcome a competition between the major political parties over the fostering of more entrepreneurship and innovation, it is important to put these proposals into context and separate the rhetoric from the reality.

Is investment in startups good policy?

[Professor Scott Shane](#), of Case Western Reserve University, is a notable academic in the field of entrepreneurship. In a 2008 [report to the World Economic Forum](#) he famously argued that encouraging more people to become entrepreneurs is bad public policy.

Shane's argument was based on the recognition that the number of new business startups generated is a poor metric. As he states in his paper:

Encouraging startups in general is lousy public policy because we have no evidence that people create too few or the wrong businesses in the absence of government intervention, and a lot of evidence that these policies lead people to start marginal businesses that are likely to fail, have little economic impact, and generate little employment.

This suggests it is not the number of new business startups that matters but the quality of these businesses. Shane also notes that the investment of money and time in the creation of a new business venture is a worse investment than if these resources were put into the expansion of an average existing business.

He also argues that the creation of new jobs among a cohort of [new businesses](#) occurs mostly in the first year or so, and that as that same cohort of [firms](#) age, more jobs are lost due to companies ceasing to trade than from those that grow. Further, the pay and conditions in most startups is poorer than in established firms.

Gazelles versus Muppets

Politicians' interest in entrepreneurship and startups is driven by the assumption that such firms will provide jobs and become an engine of growth. This is a belief that is shared by governments around the world. However, the scepticism of Shane is shared by others such as Paul

Nightingale and Alex Coad from the University of Sussex.

In a 2013 study published in the journal [Industrial and Corporate Change](#), they questioned the assumption that entrepreneurial activity was a major driving force of the economy.

Nightingale and Coad's view was based on the relative paucity of hard evidence validating rhetoric surrounding entrepreneurial startups as the driver of economic growth and job creation. Part of the problem is the lack of reliable data, and the tendency for a handful of highly successful companies to skew the statistics.

One of the issues here is that much of the growth and job creation is generated by a very small number of high growth young firms generally referred to as "Gazelles". Such a business is younger than five years, and has experienced an annual average rate of growth of more than 20% over a consecutive three-year period. Such firms are rare. For example, the OECD suggests that they represent less than 1% of all firms by employment and less than 2% by turnover.

If they survive their first three to five years and successfully grow into larger businesses, they contribute significantly to employment and economic growth. They are distinguished from the majority of small to medium firms that choose not to grow, or to grow more modestly. Such firms are dismissed by Nightingale and Coad as "Muppets".

However, unlike the Muppets, the Gazelle firms are also highly risky. This is because the startup phase is relatively easy, but the scale up or growth phase is very difficult. There is no "magic sauce" that can be applied to them to guarantee their success. From a policy perspective trying to build economic and employment growth by seeking to pick winners is fraught with risk.

Don't try to replicate Silicon Valley

Roy's apparent fascination with attracting Silicon Valley entrepreneurs to Australia is also open to challenge. For example, Professor Daniel Isenberg, from Babson College, suggests that government policy should [avoid trying to replicate Silicon Valley](#). The conditions that created that well known hub of entrepreneurial activity are unique to that area.

Instead, governments should focus on building on local conditions that favour the "Gazelles" and other high growth firms emerging from existing industries. Many of these are to be found in the low- to mid-tech sectors and, as such, all the attention should not be directed at high-tech or information technology ventures.

In 2010 the OECD issued a [report](#) on high-growth firms and what governments might do to facilitate them. This report recommended policy to improve the overall conditions for startups and small firms through reforms of competition policy, regulation and infrastructure.

It also suggested more development of training and management skills for the people running such firms, as well as making it easier for such companies to access finance and credit. It also highlighted the importance of intellectual property.

Finally, there were recommendations for assistance in helping such firms gain access to international markets by plugging into global supply chains, as well as encouraging innovation and entrepreneurial attitudes.

Does Australia need more startup activity?

In assessing the need for more entrepreneurial startup activity in Australia, it is important to note that it is already very easy to start a new

business in this country. According to the World Bank Australia ranks 7th out of 143 nations as the [easiest place to startup a business](#), with New Zealand ranking number one.

A [study](#) published this year by the Australian Bureau of Statistics and the Department of Industry and Science suggests that Australia already has a high rate of new business creation. However, this has been declining and the rate of employment generated per startup is relatively low compared with other advanced economies.

This study points to the significant contribution of a relatively small proportion of "Gazelle" firms to the overall job creation in the economy. Over the time period 2001 to 2013 such firms employed around 15% of the total workforce but contributed about 40% of all new job creation.

This research highlights the importance of a small number of high-growth "Gazelles" and that such firms are found not just in high-tech or software, but across all industries. A feature of such firms is that they are innovative and can generate above average levels of profit, which are essential ingredients for successful growth.

So Australia doesn't need more startup activity in total terms. But it does need more startups that are potentially scalable into larger firms. Yet the challenge for policy makers is how to identify the winners.

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