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ENTREPRENEURSHIP

What an Entrepreneurship Ecosystem Actually Is

by Daniel Isenberg

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Fostering entrepreneurship has become a core component of economic development in cities and countries around the world. The predominant metaphor for fostering entrepreneurship as an economic development strategy is the "entrepreneurship ecosystem." It should come as no surprise, however, that as any innovative idea spreads, so do the misconceptions and mythology. Here is a quick true-false test that will serve as a reality check on entrepreneurship ecosystems, and on the connection between entrepreneurship and development more generally. It's important to get this right, because the emergence of entrepreneurship as a policy priority has paralleled (and is at least partly in response to) disappointment with dictated industrial policy, barren "cluster" strategies, and the failure of a limited focus on a set of macroeconomic framework conditions (the so-called "Washington Consensus"). If we're to prevent the enthusiasm for entrepreneurial ecosystems from also fizzling out, we need to get a better grip on what the term really means.

You know that you have a strong entrepreneurship ecosystem when there are more and more startups.

False. There is no evidence that increasing the number of startups *per se* or new businesses formation stimulates economic development. There is some evidence that it goes the other way around, that is, economic growth stimulates new business creation and startups. There is also some reason to believe that the number of small businesses is negatively related to national economic health and the Kauffman Foundation recently reported that as the US economy is improving and good jobs are increasing, the number of startups is decreasing. In fact, encouraging startups may be bad policy.

Offering financial incentives (e.g. angel investment tax credits) for early stage, risky investments in entrepreneurs clearly stimulates the entrepreneurship ecosystem.

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False. There are actually few, if any, good evaluations of the impact of near-ubiquitous angel tax credits. One study of one of the oldest such schemes, the Entreprise Investment Scheme, started in England in 1994, suggests that it stimulated a significant increase of small investments (less than $10,000) by inexperienced investors who believed they received worse returns than the alternatives. In fact, the majority of venture capital investments are in California, New York, Massachusetts, and Israel, with no direct financial incentives other than fully-taxable profits.

Job creation is not the primary objective of fostering an entrepreneurship ecosystem.

True. Because no one owns or represents an entrepreneurship ecosystem, there can be no one objective that motivates all of the actors. The motivation for fostering entrepreneurship entirely depends on who the actor or stakeholder is. For public officials, job creation and tax revenues (fiscal health) may be the primary objectives. For banks, a larger and more profitable loan portfolio may be the benefit. For universities, knowledge generation, reputation, and endowments from donations may be the benefits. For entrepreneurs and investors, wealth creation may be the benefit. For corporations, innovation, product acquisition, talent retention, and supply change development may be the benefits. Many stakeholders must benefit in order for an entrepreneurship ecosystem to be self-sustaining.

In order to strengthen your regional entrepreneurship ecosystem, it is necessary to establish co-working spaces, incubators and the like.

False. There is no systematic evidence that co-working spaces contribute significantly to growing ventures. There are many anecdotes of high-growth ventures in all segments which got their starts in incubators, but there are also many more examples, less visible perhaps, of very success ventures that made no use of co-working space. Some entrepreneurs find that co-working spaces diminish their creativity or distract them from their focus. Others feel that the network gives them access to information and ideas. Whether they are a help or a hindrance, these types of intentionally created support mechanisms are at most just a small sliver of the entire entrepreneurship ecosystem, and whereas they may be helpful, they are not necessary.

If we want strong entrepreneurship ecosystems we need strong entrepreneurship education.

False. Surprisingly, there is no reason to believe that formal education in entrepreneurship leads to more, or more successful, entrepreneurship; there is, however, some evidence that it is irrelevant. Well-known entrepreneurial hotspots such as Israel, Route 128, Silicon Valley, Austin, Iceland and others, had significant entrepreneurship long before there were courses in it. These arose organically, first and foremost due to access to customers and employable talent, as well as access to capital. I taught the first masters course on technological entrepreneurship in Israel at the Technion in 1987, 15 years after Israel's first tech IPO on NASDAQ and when the entrepreneurial revolution in Israel was well underway. This is not to say that entrepreneurship education is not helpful, rather that it is probably not on the critical path to a regional entrepreneurship ecosystem.

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Entrepreneurs drive the entrepreneurship ecosystem.

False. This is an oft-heard statement, but there is a critical difference between being one essential element out of many — which entrepreneurs clearly are — and being *the* driver. There is no one driver of an entrepreneurship ecosystem because by definition an ecosystem is a dynamic, self-regulating network of many different types of actors. In every entrepreneurship hotspot, there are important connectors and influencers who may not be entrepreneurs themselves. In Boston several bankers and professors were crucial catalysts in the 1970s and 1980s. In Israel there were three or four investors involved in many of the early successes. In emerging markets, NGOs such as Endeavor and Wamda have been key catalysts.

Large corporations stultify entrepreneurship ecosystems because they prey on entrepreneurs and their ventures.

False. Of course, many large corporations do indeed take defensive action against entrepreneurs who challenge their markets. But it is not possible to have a vibrant entrepreneurship ecosystem without a broad spectrum of business "flora and fauna." This is true for a variety of reasons, two of which are: (1) corporations are important customers and market channels for entrepreneurs, not just competitors, and (2) flows of talented executives to and from larger corporations feed entrepreneurial success. Entrepreneurs and entrepreneurship definitely do not occur in a business vacuum.

According to entrepreneurs the top three challenges everywhere are access to talent, excessive bureaucracy, and scarce early stage capital.

True. But this does not mean that they are right. Whether in Boston, Tel-Aviv, Reykjavik, Milwaukee, St. Petersburg, Johannesburg, Buenos Aires, Rio or Bogota (all places where I have conducted workshops and have conducted informal surveys on the question) raising capital, finding talent, and overcoming bureaucracy are three of the top challenges entrepreneurs ascribe to their environments. As I have argued, this is such a ubiquitous phenomenon that it probably reflects something fundamental about the generic process of entrepreneurship, rather than a deficiency of the ecosystem. The process of entrepreneurship intrinsically generates a feeling that risk capital is difficult to raise and in short supply.

Banks are irrelevant for the entrepreneurship ecosystem because they don't lend to startups.

False. Yes, it is true that banks don't, and shouldn't lend to startups. That is not the business they are in. Yet banks, even if they never directly engage or interact with entrepreneurs, help financial markets mature and indirectly impact the entire value chain of investing. In fact, bankers have made a lot of money investing in somewhat later stage technology companies, which in turn increased the confidence of early stage investors that if their investments grew, they would find the capital to fuel their expansion.

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Family businesses squash entrepreneurial initiative in order to protect their "franchise."

False. I have heard it said by well-known promoters of entrepreneurship that family businesses achieve scale or maximize their contribution to open markets while remaining family businesses because they, for the most part, achieve their growth through special connections and protections. Yet experience in even the most advanced economies (e.g. Denmark) suggests that corporations with ownership structures from family to public to cooperative are essential to, and highly facilitative of, the entrepreneurship ecosystem.

How well did you score? If you got over 50% correct, then you are in very exclusive company. The above reality check is just a starting point. Entrepreneurship does indeed create many positive economic and social spillovers, yet the only way that policymakers, civil society, corporate leaders, and entrepreneurs themselves can truly set the context for successful economic development is to separate myth from reality and shake free from the many misconceptions that exist. Only then will we be able to accelerate the formation of entrepreneurship ecosystems. They are too important to leave to chance.

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