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NPRU Policy Briefing

Innovative entrepreneurship in the UK

Innovative entrepreneurs create ideas and have the ambition to build them into high-growth enterprises. Fostering innovative entrepreneurship is critical to the UK's future competitiveness

The UK must increase its focus on innovative entrepreneurs

While the UK has been successful at increasing the number of businesses, it is apparent that some entrepreneurs are more innovative than others.

It is these innovative entrepreneurs who are more likely to seek growth, create the majority of jobs and wealth, and therefore contribute to closing the UK's productivity gap.

The UK should therefore develop a policy framework that supports these entrepreneurs. However, with limited information available about them, more evidence is needed to identify their characteristics and the barriers that they face.

Entrepreneurship has important economic and social benefits

Entrepreneurship is an important driver of productivity

Improvements in productivity – how well an economy uses the resources it has available – are crucial to raising long-term economic performance and increasing living standards.¹ However, productivity in the UK has continued to lag behind its competitors.²

Dynamic economies have long been associated with a flow of innovative ideas from entrepreneurs, evaluated by a mature financial community and subject to demand-led scrutiny in a free market.³

Entrepreneurship – the creation of new businesses – applies competitive pressure to existing markets and thereby reduces costs and provides higher quality products and services to consumers.

An enterprising population has an impact beyond driving up the number of business start-ups

Driving up levels of entrepreneurship requires a more enterprising population – individuals with the skills, attitudes and ambition to develop new ideas and take informed risks. However, the positive impact of a more enterprising population goes beyond increasing the number of start-ups.

Enterprising individuals are more likely to start social enterprises, and enterprising employees can help to deliver further productivity gains in both the private and public sectors, whether they lead their own businesses or exercise leadership within those owned by other people.

The UK has policies to boost entrepreneurship, but current levels remain disappointing

The government has implemented several policies to boost levels of entrepreneurship

The government has recognised that entrepreneurship is an important driver of productivity.⁴ The Department of Trade and Industry (DTI) has a Public Service Agreement target to “build an enterprise society”.⁵ One of the components of this target is to increase the number of people considering entrepreneurship.

In response, the UK government has provided an extra £60m a year to schools for enterprise education. It has also supported ‘Enterprise Week’ to raise awareness of enterprise amongst young people. Such initiatives are welcome, although their success can only be properly judged over the longer-term.

A number of schemes have also been developed to support entrepreneurs

“Innovative entrepreneurs actively seek to develop and exploit new ideas, markets and products”

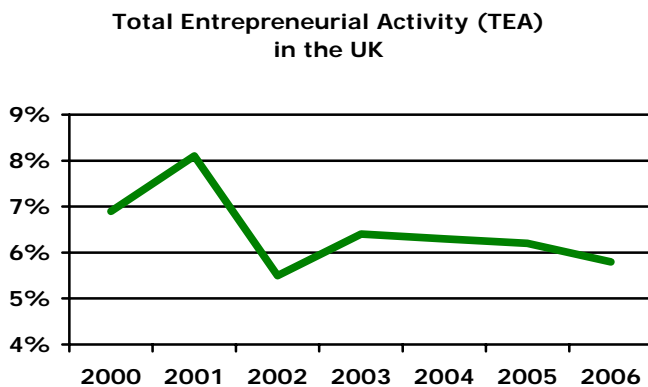
seeking guidance and finance to start a business.⁶ And, the UK government has acted to reduce the ‘red tape’ associated with starting up a business.

The Welsh Assembly, Scottish Parliament and Northern Ireland Executive have developed targeted initiatives to boost entrepreneurship. For example, the Scottish Executive have developed the ‘Business Gateway’ as a ‘one stop shop’ to help entrepreneurs to start and grow a business, whilst the Welsh Assembly Government are working on the ‘Dynamo Project’ which has put ‘entrepreneurship champions’ in most further and higher education institutions in Wales.

But levels of entrepreneurship in the UK remain disappointing

Despite these efforts, the number of people thinking about starting a business remains disappointing⁷ and has fallen short of the government’s target of 14%.⁸

Figures from the Global Entrepreneurship Monitor (GEM) suggest that the number of people involved in either setting up or running an early stage business has experienced a slight fall over recent years (see graph below), and the UK



Source: Global Entrepreneurship Monitor 2006

remains consistently behind countries in North America and Southern Europe.⁹

While the total number of businesses has continued to rise, this can be largely attributed to a growth in the number of sole traders and partnerships. Since 2000, the number of businesses in the UK has increased by 600,000, but the number of employers has only

increased by 50,000.¹⁰ This partly reflects a change in the mode of work, as people move from employment to self-employment, but continue to do broadly similar work.

Only a small minority of these ‘non-employer businesses’ go on to employ others in the future, and their overall economic contribution is relatively small.¹¹

Innovative entrepreneurs are especially important in driving economic growth

Some entrepreneurs are more innovative than others

During 2005, there were approximately 390,000 business start-ups.¹² However, many of these businesses are ‘lifestyle’ businesses – set up and run with limited ambitions for growth.¹³ Others are intent from the beginning on becoming the next Google or Zara, and have ambitious business plans to match.

Start-ups display a similar variation when it comes to the novelty of the ideas on which their businesses rest. Some entrepreneurs largely replicate what others do whereas others are more innovative.

While ‘replicative’ entrepreneurs can provide a valuable contribution to the economy, the growth of their enterprises tends to be linear and limited by population growth or their target market.¹⁴ In addition, in an increasingly globalised world, such firms are more susceptible to new entrants, disruptive business models, and alternative products and services.

By comparison, ‘innovative’ entrepreneurs actively seek to develop and exploit new ideas, markets and products to survive, thrive and grow. However, these innovative entrepreneurs are in the minority.¹⁵

Innovative firms display greater growth potential than non-innovative firms

One of the best identifiers of those firms with the greatest growth potential is the degree to which they are based on an innovative business

model or have significant innovative capacity. Simply put, greater innovation is associated with higher growth.¹⁶

A 2005 survey by the Small Business Service shows that two thirds of small businesses looking to grow do so by introducing new products or services.¹⁷ The most innovative businesses – sometimes referred to as ‘gazelles’ – are frequently the source of the disruptive innovations that characterise the birth of new industries.

Innovative start-ups have stronger potential for wealth creation and employment within the economy

Due to their greater growth potential, innovative entrepreneurs serve as a major source of new employment and wealth creation. In a review of the US start-up market, although ‘gazelles’ represented only 5% of new ventures, they produced 87% of new jobs.¹⁸ In another study, only 4% of the new firms born in any particular year accounted for half of all the jobs created by the surviving firms after 10 years had elapsed.¹⁹

The UK should concentrate on generating more innovative start-ups

The UK should place less focus on the total number of start-ups and more on boosting the number of innovative start-ups

GEM data suggests that only 0.7% of people in the UK are high expectation entrepreneurs, less than half of the 1.6% in the US.²⁰ Increasing this level in the UK would generate more employment and wealth, and contribute to closing the productivity gap.

More innovators need to be entrepreneurial, and more entrepreneurs need to be innovative

Nearly one in three (29%) people have what they thought was a great business idea or invention. However, eight out of 10 of those don’t do anything about it.²¹

On the other hand, many UK entrepreneurs are not currently fully

developing and exploiting their innovations.²² A number do not recognise the innovations taking place in their business, and the value that they have. Others are not innovating at all, and may therefore lose competitiveness as other more innovative entrepreneurs (perhaps from overseas) enter their market.

More knowledge and action is needed to boost levels of innovative entrepreneurship

The UK needs a framework that encourages, identifies and supports innovative entrepreneurs

The words ‘enterprise’ and ‘innovation’ are often used interchangeably, and the government’s enterprise and innovation agendas, while distinct, are frequently conflated.

However, if the UK is to develop more innovative entrepreneurs, these areas of policy need to be distinct but complementary, and tightly focused on encouraging, identifying and supporting innovative entrepreneurs.

The UK must minimise the specific challenges that face innovative entrepreneurs

Innovative entrepreneurs are likely to face distinct barriers to starting and then growing a business. Because of their high growth trajectory they will have specific pressures on their finances and require a different management style and leadership skills.

Necessarily, innovative new businesses (for instance in the biotech and digital media sectors) strain existing boundaries, whether economic, ethical or technological. As such, they are especially susceptible to aggressive action by incumbents and frustrating engagements with policymakers, the media and sometimes the legal status quo. This can cause significant challenges to effective business planning and to the raising of risk capital.

They are also more likely to seek venture capital rather than debt finance,²³ and depend

“More innovators need to be entrepreneurial, and more entrepreneurs need to be innovative”

proportionately more on the creation, protection and management of intellectual property than replicative businesses.

NESTA is working to understand more about the unique contributions, characteristics, and challenges of innovative entrepreneurs

NESTA Investments invests directly in UK-based, early-stage companies with innovative technologies and ambitions for high growth. As a result, NESTA has developed and is continuing to refine and disseminate several models for efficient early-stage investment.

NESTA Policy & Research Unit (NPRU) is developing a substantive concentration on innovative entrepreneurs. Over the next 12 months, the NPRU will establish research partnerships to develop new statistics that identify innovative entrepreneurs, as well as look at the specific barriers that face disruptive innovators in the area of low-carbon technologies.

Future Innovators aims to develop new ways to support and prepare the UK's next generation of entrepreneurs. The programme will develop effective approaches to nurturing the skills, attitudes and knowledge needed by young people to innovate in a rapidly changing world.

NESTA, the National Endowment for Science, Technology and the Arts, is working to transform the UK's capacity for innovation. Our endowed funds of over £300m allow us to be a genuine risk-funder, to take a longer-term view and invest in the most promising new ideas and ventures. Underpinning our work is the fundamental view that successful innovation fuels long-term economic and social progress, and is an essential ingredient to the UK maintaining its competitive edge in the global market place.

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⁶ These include the Small Firms Loan Guarantee scheme, Regional Venture Capital Funds, Enterprise Capital Funds, Enterprise Investment Schemes and Venture Capital Trusts.

⁷ SBS (2006) SBS Household Survey 2005, DTI, London shows that 11.6 per cent of people are thinking about starting a business or becoming self-employed - a similar figure to that in 2001 and 2003.

⁸ The PSA 2002 target was to increase the number of adults in England considering going into business to 14% by 2005.

⁹ Rebecca Harding (2007) Global Entrepreneurship Monitor 2006, London Business School, London.

¹⁰ Small Business Service (2006), SME Statistics 2005, London.

¹¹ SBS (2006) SME Statistics 2005, DTI, London show that out of the 4.3million enterprises in the private sector, 3.2 million have no employees. These enterprises provide just 7.2% of total turnover generated by all private sector enterprises.

¹² Barclays PLC (2006), London. (figures for England and Wales only).

¹³ SBS (2006) Annual Small Business Survey 2005, DTI, London shows that 61% of businesses with no employees do not aim to grow their business over the next two to three years.

¹⁴ W.P. Carey School of Business (2006) The Two Faces of Entrepreneurship, Part 1: Replicative Entrepreneurs Serve Growing Population available at <http://knowledge.wpcarey.asu.edu/index.cfm?fa=viewfeature&id=1275>.

¹⁵ Erkkö Autio (2005) GEM 2005 Report on High-Expectation Entrepreneurship defines high expectation entrepreneurs as those involved in setting up or are an owner-manager of a new firm that expects to employ over 20 people within five years.

¹⁶ HM Treasury (2000) Productivity in the UK: The Evidence and the Government's Approach, HM Treasury, London.

¹⁷ SBS (2006) Annual Small Business Survey 2005, DTI, London.

¹⁸ Birch (1987) Job Creation in America, The Free Press, New York.

¹⁹ Storey, D. (1994). Understanding the Small Business Sector, Routledge, London.

²⁰ See Footnote 15..

²¹ NESTA (2006). Survey of UK attitudes towards innovation and failure. Unpublished.

²² DTI (2003) Innovation Report – Competing in the global economy: the innovation challenge, DTI, London.

²³ SBS (2006) Annual Small Business Survey, DTI, London shows that those businesses proposing growth were more likely than those not proposing growth to have considered, or used, equity finance.

¹ HM Treasury (2006) Productivity in the UK 6: Progress and new evidence, HM Treasury, London.

² Ibid.

³ Phelps, E. (2004). Entrepreneurship and Innovation in Capitalist Systems, quoted in Understanding Entrepreneurship: A Research and Policy Report, Ewing Marion Kauffman Foundation.

⁴ SBS (2004) A government action plan for small business, DTI, London.

⁵ DTI Public Service Agreement Number 6: Build an enterprise society in which small firms of all kinds thrive and achieve their potential, with (i) an increase in the number of people considering going into business, (ii) an improvement in the overall productivity of small firms, and (iii) more enterprise in disadvantaged communities.