The Effect of Market Economies on the Development of Entrepreneurial Ecosystems.

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1.0 Introduction

Since it was first proposed, the variety of capital approach has given a foundation for a diverse study of many aspects of business activity in different economies. (Casper, 2010.) This paper seeks to use this approach to analyse how entrepreneurship is supported in each of the two ideal types of economies presented by Hall & Soskice (2001.), the liberal and coordinated market economies. There are already several studies on how levels of entrepreneurship vary from region to region. These studies tend to focus on areas in typical liberal market economies (LME). One of the central tenets to the varieties of capital approach is that the ideal types, while different, are both competitive in the international market. It follows that the coordinated market economy must also be able to support entrepreneurship in a way that is competitive. When the two ideal market economies are compared to the entrepreneurial ecosystems approach it is found that, as is expected, the liberal market economy shows high support for entrepreneurship and the development of entrepreneurial ecosystems, especially in high tech industries. The most important findings were the broad and deep talent pool that the liberal market provides, as well as the financial strength given by venture capital organisations. While the coordinated market economy does not line up as well with the description of an ideal ecosystem and is especially lacking in the area of a talent pool, there is a potential for both financing and support from government and business networks in the industries that are already established in those countries.

2.0 Theory

2.1 Varieties of Capital

The Varieties of Capital approach is an approach to analyzing different national and regional economies through the lense of how businesses interact with different spheres of influence in that nation or region. There are five spheres of influence identified by this approach: Corporate governance, where firms go to for financing and how investors are assured of a return on their investment. Industrial relations, is how firms interact with the labour market in regards to wage bargaining and working conditions. Vocational training and education, the coordination of how firms secure a skilled workforce and how workers choose how much to invest in which skills. Inter-firm relations is the sphere of the relationships that firms have with other firms, most notably suppliers and customers. This defines how much firms work together and how much standardisation and shared technology there is in an industry. The last sphere of influence is the employees of firms, how leadership within firms interacts with their employees and other actors. (Halls & Soskice, 2001) These implementations are said to be complementary; this means that a nation's market is strengthened the more the five spheres line up together. When institutions within the spheres of influence are congruent with each other they create a complementarity.

These five spheres are instituted in different ways in two ideal types presented in the VoC approach. These are the liberal market economy (LME) and the Coordinated Market Economy (CME) These two market economies are defined by the driving force that coordinates firms through the five spheres of influence in that nation. In the LME, the five spheres are coordinated through market forces. The firms and other actors relate to one another at arms length through market transactions. In the CME, it is non-market forces that coordinate the five spheres of influence. Firms and other actors create close relationships with each other seeking to benefit the whole industry and nation. These forces affect each of the five spheres. (Halls pg 8) The two ideal economies are presented as diametrically opposed, but both competitive. Though they act and work differently, the one is not superior to the other on the whole, but they excel in different industries and forms of innovation. The liberal market economy is focused on flexibility and taking advantage of short term opportunities. Businesses will typically advance through radical innovation. The coordinated market, on the other hand, is focused on long term investments and commitments. Businesses compete through advances done through incremental innovation (Knudsen, 2016).

2.2 The five spheres in coordinated market economies

Corporate governance generally allows firms access to financing that is not entirely dependant on public data or current returns. Private data is provided to investors through close connections with other firms in their industry and third party organisations that have an intimate knowledge of the industry. This allows for investment capital that survives downturns. This helps businesses focus on long term investment that may not be profitable in the short term, and to keep their workforce

The internal structure of the firm in CMEs support this network monitoring. Top leaders have a difficulty in taking unilateral action. They must instead gather agreement from supervisory boards that include employee representatives and stockholders as well as suppliers and customers. Long term employment contracts lead managers to focus on their reputations as opposed to short term profitability.

Industrial relations in CMEs are shaped by the strategies of firms there. Many firms rely on highly skilled labor force with a substantial work autonomy that shares information acquired to continuously improve production lines and processes. These strategies require long term commitments from their employees. This is attained through industry level bargains between trade unions and employer associations. Standardized wages across an industry removes incentives for employees to change employers and instead commit deeply in one business. This also leads to restrictions on business against arbitrary layoffs and changes to working conditions.

Because labour in CMEs is focused on business and industry specific skills, they depend on vocational training and education systems that can provide workers with those skills. Workers must believe an apprenticeship will lead to employment, whilst assuring businesses that their investment in apprentices will give them usable skills that will not be poached by other

firms. This is achieved through unions monitoring a potentially publicly subsidized training system. The skills learned are standardized so that apprentices are guaranteed to learn important competencies regardless of which business they began at.

Lastly, because firms rely on long term employment contracts, they cannot rely on a knowledge exchange between firms through the the movement of personnel. Instead, they cultivate inter-firm relations that facilitate the diffusion of technology and knowledge across the economy. This is supported through publicly subsidized programs to improve specific competencies and joint research programs between several firms and research facilities. Firms collaborate beyond tightly written contracts with employees and knowledge sharing that build upon and establish industry standards for inter-firm relations.

2.3 The five spheres in liberal market economies

The liberal market economy is described using the United States as an example. In America, the five spheres are coordinated in a different fashion. The five spheres complement each other to build an economy that specializes in radical innovation and flexibility.

The corporate governance sphere encourages firms to focus on current earnings and the value of company shares. Regulatory organisation allow acquisitions that can be hostile. The ability for large firms to secure finance is heavily dependant on their valuation in equity markets and publicly available information. Top management is often rewarded for net income and stock increases. Because of arm's length corporate networks, investors do not have access to inside information must rely on public information such as quarterly balance sheets. Some exceptions of this are firms in high technology industries that rely on venture capital companies that can monitor performance within the company, as well as companies with easily assessable assets connected to forward income.

The industrial relations sphere is influenced by the market relationship between individual workers and employers to organize the labor force. There is little protection given to employees, and management is given freedom to hire and fire. Trade unions are generally weaker than in CMEs. Wages are therefore controlled through policy and market competition rather than organizational coordination. Highly fluid labour markets push firms toward flexible strategies rather than strategies that require long term employee investment.

The education and trainings systems complement the highly fluid labour markets. Education institutions focus on general skills because firms will not invest in industry-specific skills that can easily be poached by other firms. Workers focus on acquiring general skills that can be used in many different firms. In-house training tends to build on general skills. The workforce tends to be suited to the service sector whilst it is lacking in industries that require highly specialized or company-specific skills.

Inter-company relations are generally based on standard market relationship and formal contracts. In the USA, there are also rigorous antitrust regulations designed to prevent colluding to control prices and markets. Technology transfer happens through the movement of workers from one company or research institution to another. LMEs also rely on the sale of innovation to

affect technology transfer. Standard setting is done through market races that allow the winner to license their technology to many users. This rewards venture capital firms where one success can pay for many failures.

The internal structure of firms concentrate authority in top management that focuses on flexibility. Labour can easily be released and strategies changed to take advantage of new opportunities or to avoid crisis. (Halls & Soskice 2001)

2.3 Entrepreneurial Ecosystems

Entrepreneurial Ecosystems are regional systems that support and enable entrepreneurship. (Stam & Spigel) These ecosystems are provide the rational behind why certain regions experience more entrepreneurial activity than others. Several factors which contribute to a successful ecosystem have been identified. The word ecosystem is used to emphasis the focus on interdependent actors that the system consists of. It is a living system with actors in the centre rather than institutions. Entrepreneurship is defined as activity in which opportunities for creating new goods and services are explored, evaluated and exploited. This is the process where individuals create opportunities for innovation. This activity does not include common statistical indicators of entrepreneurship, such as self-employment or small businesses but instead focuses on innovative and high-growth startups and entrepreneurial employees. (Stam & Spigel, 2016)

Stam and Spigel (2016) present a model for entrepreneurial ecosystems that divides the elements that support entrepreneurial activity into framework and systemic conditions. Framework conditions are those which exist as predecessors to the ecosystem, while systemic conditions are the heart of the ecosystem that fuel activity. The framework conditions are the fundamental causes to entrepreneurial activity found in a region. These are made up formal and informal institutions, physical infrastructure, and demand for new goods and services. A successful entrepreneurial ecosystem needs institutions that support the formation of systemic conditions as well as an entrepreneurial culture. An entrepreneurial culture can be defined as a culture where entrepreneurship is viewed in a positive light, as something to be desired (Sorensen, 2017) The ecosystem also requires physical infrastructure that facilitates entrepreneurship and demand from outside the ecosystem for its goods and services. The systemic condition are the heart of the ecosystem; they are the actors and resources in the ecosystem that drive activity. The systemic conditions are networks, leadership, finance, talent, knowledge, and support services/intermediaries. The entrepreneurial ecosystem needs social networks of entrepreneurs to provide an information flow, as well visible entrepreneurial leaders that are committed to the region. It also requires a source of financing for entrepreneurial projects, preferably from investors with entrepreneurial knowledge. Perhaps the most important element of a successful ecosystem is a broad and deep talent pool, available groups of skilled workers from diverse backgrounds. There must be sources of knowledge, both public and private, that provide opportunities for entrepreneurship, and there must be a supply of support

services catering to entrepreneurs to lower entry barriers and speed up innovation. (Stam & Spigel, 2016)

The entrepreneurial ecosystem is unique among system approaches to regional innovation in its focus on entrepreneurship. It is, however, not without its critique. The most obvious is the lack of geographical distinction. It is unsure at what levels of size the ecosystem approach applies, whether the conditions of the ecosystem apply at a city, region, or national level. Another critique that is especially apparent in this paper comparing entrepreneurial ecosystem with VoC is that much of the entrepreneurial empirical studies have been conducted in the USA, an LME country. While the USA is known to have a strong entrepreneurial culture, an approach that included other regions could bring new insights into alternative ways to support entrepreneurship. Opportunities for further study are finding examples of entrepreneurial ecosystems in a typical CME country like Germany or Japan to observe how these arise and are sustained.

3.0 Discussion

Entrepreneurship is found all across the world. Even the largest businesses were once entrepreneurial start-ups and new firms are still created in all regions. Yet there is an impression from entrepreneurial studies that entrepreneurship is a distinctly American phenomenon. This paper seeks to explore how entrepreneurship is supported in different regions using the varieties of capitalism approach as a framework for comparison, and the entrepreneurial ecosystem approach to define the prerequisites of regional entrepreneurial activity. This discussion will cover the ways that entrepreneurship is affected in general, how the description of each of the ideal market economies affects the framework and system conditions of the entrepreneurial ecosystem.

Not every part of the entrepreneurial ecosystem that can be compared with the Varieties of Capital approach. There are some aspects of the entrepreneurial ecosystem that are social in nature and deal with networks of individuals. The VoC approach groups countries of varying cultures such as Germany and Japan or the USA and England in the same market economies. Because the social rules of these countries differ, it weakens the ability of the VoC approach to describe how these market economy ideal types support social networks. Other aspects of the ecosystem are defined by the local physical conditions. These will vary from city to city and are not controlled by a country's institutions. The social and physical aspects of an entrepreneurial ecosystem are outside the scope of this paper, since it seeks to analyse the effect of VoC more generally. Another condition that this paper does not analyse is demand. This is said to be a largely exogenous value in the ecosystem approach, defined by the industry and end consumers. This can be affected by the industries that would tend to arise in each of the market economies. Because the opposing market economies are said to be equally competitive, it means that the level of innovation and demand for new products and services are expected to be equal.

3.1 The Entrepreneurial Ecosystem in the CME Country

The entrepreneurial ecosystem in coordinated market economies are shaped the long term focus that the five spheres of influence have. The education and industrial relations spheres in CME countries complement each other to lead individuals toward long term commitments in firms. When this is the norm, it creates a culture of investing in stable careers within large businesses. It is said of Germany that they have a culture of building upon the previous generation (Todd, 1989) This is in opposition to a culture of entrepreneurship, a culture of branching out and starting something new. This implies that entrepreneurship would not be seen as the ideal for many and stands as a hinder for the development of entrepreneurial ecosystems. These spheres also have a negative impact on the talent pool available for entrepreneurs. The education is specialized, meaning that while workers have high skill it is not easily redirected and is both industry and firm specific. Workers are also incentivized to commit to their career in one business and not leave to start something new.

Financing that is based on non-market information is positive for entrepreneurs since start-ups are not able to share market information anyway. (Hall & Soskice, 2001) However, financing from banks and long term investors tend to be risk averse. The institutions in CME countries tend to not facilitate venture capital firms in the same way as in LME countries. However, this is counteracted by an increased connection between organizations in CME countries. Because there is a focus on the country innovating as a whole, large businesses and the state are incentivized to invest in entrepreneurship as a vehicle for innovation. This means that there will be other interests involved in financing than monetary ones, while that allows for more long term investment, in limits the direction that the ecosystem can grow, because business networks and the state want to invest in start-ups that will meet their needs in their industries. When entrepreneurs are situated to use the financing and knowledge from business networks and from the state, they are also positioned to receive other forms of support. Both large businesses and government are motivated to invest in support services for entrepreneurs that serve their interests.

The knowledge flow is simple and open in the CME, because competencies and technologies are shared in business networks and with the government; the challenges that the market faces are easily apparent and can be seen as opportunities for entrepreneurs. There is also less need to start from scratch in each start-up. However, the focus of CME countries on incremental innovation narrows the field of what the entrepreneur can start. The knowledge available is expected to surround established industries and this limits the support for start-ups developing in other directions.

These effects paint the picture of a potentially successful entrepreneurial ecosystem built around business networks and industries that already exist in the market economy. There is a narrower window for which industries the entrepreneurial ecosystem can work with, but the inter-firm relations especially allow for strong partnerships between large businesses and business networks and symbiotic entrepreneurial ecosystems.

3.2 The Entrepreneurial Ecosystem in the LME Country

The liberal market economy supports the entrepreneurial ecosystem as it is described by Stam & Spigel (2016) This is not surprising, given that entrepreneurial studies are often based in LME countries such as the USA. The focus of the LME country on flexibility and short term exploitation of opportunity easily supports entrepreneurial projects and ecosystems. The norm in LME countries is for individuals to invest in careers that span several different jobs, potentially in different fields. This means that it is seen as a positive thing for individuals to leave one job to start something new and there is a potential for entrepreneurship to be idealized in local culture. The norm of rewarding top leaders for performance also supports a culture for entrepreneurship, because it creates a cultural aspiration for individuals to become top leaders. The focus on stock market and public information for financing does not benefit entrepreneurship directly because startups are by their nature not publicly accessible. However, the combination with patent laws allows for venture capital firms to arise that specialize in high growth startups, especially those in technology. This is the ideal for entrepreneurial ecosystems. The existence of venture capitalists supports the creation of of support services as well. This is because venture capitalists get a closer look into startups and have a vested interest in seeing entrepreneurs prosper. It can be inferred that they will lead to support services because venture capitalist businesses have motivation and opportunity to do so. They have motivation to build businesses that offer support services to entrepreneurs so that their investments will pay off and they have opportunity through existing capital and connection with previously supported entrepreneurs that are willing and able to start these services.

The industrial relations sphere and the education sphere have a positive effect on the talent pool available for entrepreneurship, both in depth and in breadth. The industrial relations sphere creates an uncertain environment for workers in established firms. Because of this they are more willing to change jobs to look for new opportunities because they are not sure they will be able to keep the job they have in the future. The education sphere encourages workers to acquire a broad set of skills; this in turn broadens the talent pool. The knowledge flow that gives entrepreneurs opportunities for innovation come from these employees that have learned from other jobs, just as in the rest of the inter-firm sphere.

4.0 Conclusion

The varieties of capitalism approach gave opportunity for researchers to analyse market economies without the need to use traditional economic theory. The idea that there is more than one way to establish a competitive economy allows for new looks at the building blocks of these economies and how they act differently in different contexts. This paper has analysed how entrepreneurship is supported differently in the coordinated and liberal market economies. It finds that in liberal market economies there is much support for entrepreneurial ecosystems to develop as described in entrepreneurial theory. Because of the availability of a diverse and

skilled workforce, and formal institutions that incentivize entrepreneurial investment, entrepreneurial ecosystems have the potential to develop independently and in many directions. Although the coordinated market economy does not offer as much support for entrepreneurial ecosystems, the formal and informal institutions that support close relations between businesses and organisation allow for the potential that entrepreneurial ecosystems may arise in a symbiotic relationship with larger organisations. Whilst the flexibility of such an ecosystem is lower than in the liberal market economy, it can also be a strong source for entrepreneurial activity. This paper provides opportunity for future empirical studies. These finding suggest that one would expect to find clusters of entrepreneurial suppliers and clients around larger businesses. An analysis of these clusters could improve the entrepreneurial ecosystems approach by adding new perspectives on what is required for entrepreneurial activity.

5.0 References

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