

Financing high-potential entrepreneurship

Government should create an enabling environment—for entrepreneurs and investors—rather than try to pick “winners”

Keywords: entrepreneurial finance, small business finance, high-potential entrepreneurship, banks, venture capital

ELEVATOR PITCH

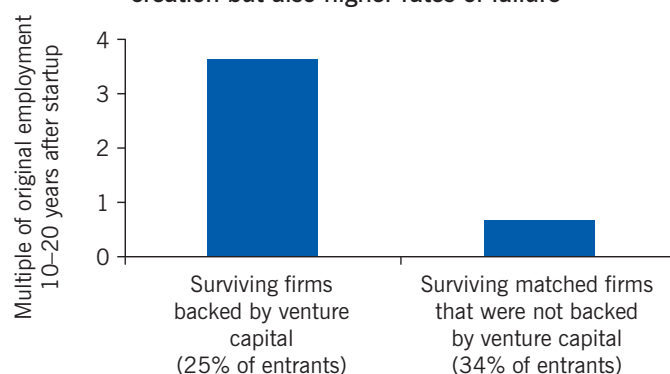
Entrepreneurship is essential to job creation and to productivity growth and therefore is an important matter for government policy. However, policymakers face a difficult challenge because successful growth for a few firms—which cannot easily be identified in advance—is accompanied by widespread failure for most other new firms. Predicting which firms will fail and which will succeed is nearly impossible. Instead of futilely trying to pick winners, governments can play a useful role in facilitating the growth of the most promising firms by setting the conditions for efficient trial-and-error experimentation across firms.

KEY FINDINGS

Pros

- ⊕ Because a few, typically young firms grow rapidly and account for much of job creation, finding an effective way to support their growth is important.
- ⊕ Predicting which firms will fail and which will succeed is virtually impossible, so policymakers are better off striving for the more modest goal of helping high-growth-potential firms.
- ⊕ Policies that make it easier to engage in trial-and-error experimentation are typically more effective than trying to pick winners.
- ⊕ An enabling environment for entrepreneurs, banks, and investors can support high-growth-potential firms and weed out failures.

Venture capital-backed US firms had higher rates of job creation but also higher rates of failure



Source: Calculations based on data from [1].

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Cons

- ⊖ Some support will inevitably go to failing start-ups and lead to considerable job destruction.
- ⊖ A focus on complementary institutions to support high-growth-potential firms requires changes across multiple fronts (from bankruptcy to employment protection legislation), which can be challenging to implement.
- ⊖ Collecting comprehensive data on entrepreneurship is difficult.
- ⊖ Predicting which firms will fail and which will succeed is virtually impossible.

AUTHOR'S MAIN MESSAGE

New firms account for a disproportionate share of aggregate job creation in advanced economies. Yet most firms fail, and it is immensely difficult to predict which firms will succeed. Policymakers can set the right conditions so that capital and other resources flow to firms with high growth *potential*, even if this implies initially supporting firms that ultimately fail. Policy can focus on supporting complementary institutions that promote trial-and-error experimentation both by increasing the chances that promising firms get further funding and by facilitating the efficient shutting down of firms when they do not meet their potential.