

**A Tale of Two Entrepreneurs:  
Understanding Differences in the Types of Entrepreneurship in the Economy**

Policymakers and pundits who use entrepreneurship as a “catch-all” phase to capture a single economic activity make an important mistake. There are two distinct types of entrepreneurship with different economic roles, requiring individually tailored policies to support each.

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Steve decided it was time to follow his dream and set up a pizza restaurant. He would specialize in organic ingredients, a painstakingly designed recipe for the crust, and an overall commitment to the environment. For Steve, the restaurant was an opportunity to work again after a three-year period of lacking full-time employment.

Excited by the possibilities of her recent research results, Karen, a chemical engineering professor, decided it was time to file for patents on her new surface chemistry technology and to create a business with a faculty colleague and two graduate students. Their strategic intent was to develop paper-thin solar sheets for a wide range of applications.

These two individuals have something important in common – they are entrepreneurs who have identified a new opportunity and are pursuing that opportunity regardless of the resources they currently have available.<sup>1</sup> There the similarities end.

**Why Entrepreneurs Can Be Different from One Another**

Steve and Karen differ in their ultimate aspirations. Steve considers success to be a thriving local restaurant, but Karen hopes to serve many customers in global markets. Steve is innovating in his ingredients, the unique composition of his pizza crust, and his recipes, but his pizza is still recognizably a pizza. By contrast, Karen will bring newly conceived features and functionality to customers; if all goes well, the team’s paper-thin solar sheets will transform how soldiers operate in the field, how rural communities charge their cell phones, and how medicine is practiced in remote communities.

Steve and Karen also differ in the resources they will need and in how they will go about organizing their entrepreneurial activities. While Steve will mostly work alone in a sole proprietorship, Karen already has a founding team and will soon have a board and investors to answer to.

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<sup>1</sup> Stevenson H 1983, “A Perspective on Entrepreneurship,” Harvard Business School Working Paper #9-384-131.

Most important of all, Steve and Karen differ in their potential impact on the economy. Steve has a high chance of modest success and will very likely create a small number of jobs – mainly for wait staff and kitchen workers. In contrast, Karen’s business is highly risky and chances are that (like so many high-tech entrepreneurial startups) she will fail, creating no jobs at all. On the other hand, if she succeeds, she will create tens to hundreds of jobs for Ph.D.s and Master’s-level graduates in chemistry, engineering and business. She might also create manufacturing jobs and sales jobs around the world.

### **Different Types of Entrepreneurship – IBE versus SME**

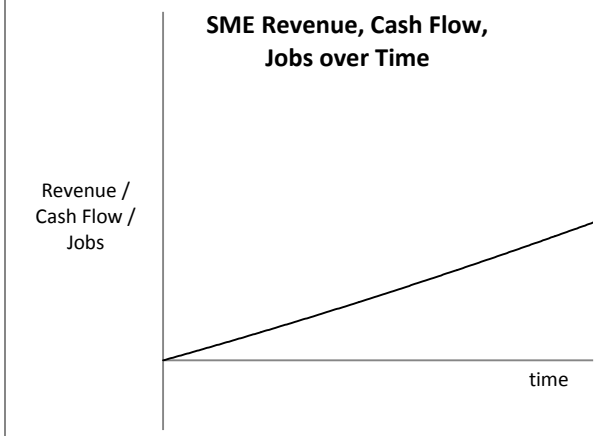
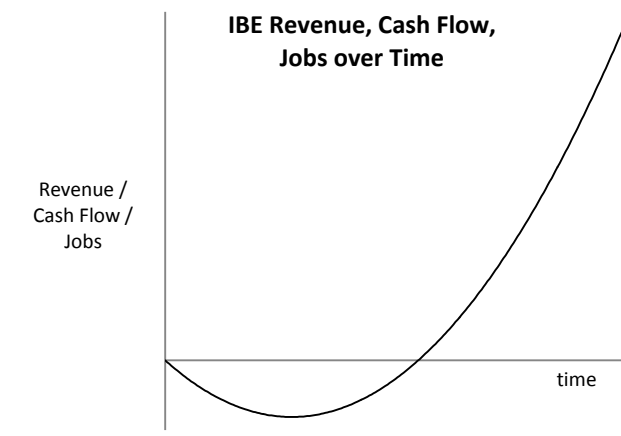
Karen’s activities exemplify a type of entrepreneurship we refer to as innovation-based entrepreneurship – the creation of “innovation-based enterprises” (IBEs) which pursue global opportunities based on bringing to customers new innovations that have a clear competitive advantage and high growth *potential*. Steve’s activities we think of as small business entrepreneurship – the creation of “small and medium enterprises” (SME), serving local markets with traditional business ideas and limited competitive advantage.

Although our daily work at the Trust Center for MIT Entrepreneurship puts us in contact with entrepreneurs building IBEs on a daily basis, we do not assume that this is the only type of entrepreneurship that matters. SMEs are the life blood of many economies. In some countries and regions, such as Andalucía in Spain, they form the majority of employment. These jobs are particularly important for individuals with relatively low levels of education and skills. A form of self-employment, SMEs give people the opportunity to work independently and to use their skills, particularly in times when large, established companies are laying off workers. On the other hand, SMEs are, as their name suggests, small! Many SMEs in the United States and Europe employ only a founder and a spouse, or just a handful of workers (the average European SME has four employees). These companies generally provide lower-than-average wages and poor benefits.

Contrast SMEs with the IBEs we advise and nurture in the Massachusetts entrepreneurial ecosystem. IBEs are focused from the beginning on addressing global markets. IBE entrepreneurs might well start out with a focus on a regional market, but only as a test bed for broader deployment of their strategy for a company that is likely to produce high levels of exports for the region. The entrepreneur is often part of a larger team and has some underlying innovation (e.g., technology, process, business model) that the team feels will give them competitive advantage as they enter new markets. The entrepreneurs from the beginning value control less than being successful on a bigger stage – which could well mean that they make more money while having less control. The business very likely will require some investment to develop its competitive advantage, which will allow it to scale. The jobs created by this type of entrepreneurship are for the most part “tradable jobs,” meaning that they could be moved to another region without killing the business.

IBEs generally (but not necessarily) require individuals with much higher levels of education and training. Biotechnology IBEs are usually founded, led and staffed by individuals with PhDs in molecular biology, MDs (physicians), and MBAs. Of course, as IBEs grow and succeed, they also create a wealth of auxiliary employment for those with lower skills – laboratory technicians, manufacturing staff, clinical trial managers, hospital workers, etc. Indeed, in Massachusetts, the governor’s office has calculated that for

every biotechnology job created directly by a biotech-focused IBE, five auxiliary jobs are created.<sup>2</sup> The same is true for the clean energy cluster that is emerging in Colorado, or the digital business cluster in London’s Shoreditch area, which is being transformed by the direct and indirect job creation of digital IBEs. Of course, there are many challenges in job creation through IBE growth. These companies are highly risky – they have a high chance of failure (a high chance of using resources but at the end of the day creating no jobs at all). On the other hand, they have a small chance of being an overwhelming success and being the next Google or Genzyme or A123 Systems, creating hundreds of exciting high-skilled jobs and many thousands of auxiliary jobs.

<b>SME Entrepreneurship</b>	<b>IBE Entrepreneurship</b>
Focus on addressing regional markets only	Focus on global markets. The company is based on some sort of innovation (tech, business process, model) where they can go global or across regions.
“Non-tradable jobs” – jobs that must be performed locally, e.g. restaurants, dry cleaners, service industry.	“Tradable jobs” – jobs that do not have to be performed locally.
Most often family businesses. People who start them seek to maintain control, not to create high growth.	More diverse ownership base as the focus of founders is on high growth and getting rich.
The company grows at a linear rate. When you put money into the company, the system (revenue, cash flow, jobs, etc.) will respond quickly in a positive manner.	The company starts by losing money, but will have exponential growth. Requires investment. When you put money into the company, the revenue/cash flow/jobs numbers do not respond quickly.
	

<sup>2</sup> “President Obama, the 111<sup>th</sup> Congress, and Biotechnology: Working Together Today to Ensure a Healthy Tomorrow,” Massachusetts Biotechnology Council, 2009, [http://www.massbio.org/writable/files/Policy/mbc\\_white\\_paper\\_2009.pdf](http://www.massbio.org/writable/files/Policy/mbc_white_paper_2009.pdf).

### **Why the Difference Matters**

The distinctions between IBE creation and SME creation are important for entrepreneurs. Let's take a third entrepreneur who founded a business at the same time as Karen and Steve: Joe, an immigrant engineer with over 30 years of technical experience, who lost his job in a large industrial company and later decided to start his own company. He joined forces with another former colleague and together they developed a small technical consulting business. Joe's business could be created with the aim of building either an SME or an IBE, but the two paths are completely different. Joe has a much better chance of succeeding if he defines his goals and then builds his business accordingly.

If he wants to build an SME, Joe can focus on using his technical skills as a consultant on a project-by-project basis. He might hire one partner but only for certain projects. If he has any product ideas, he will probably try and license them to large companies – even his former employer. To succeed, he should focus on minimizing his overhead and ensuring a steady stream of small contracts.

On the other hand, Joe could try to build an IBE. This would require him to really understand the *unique* technical skills he brings to the table. Perhaps he could build a strong database of projects throughout his industry, drawing on his own knowledge and public documents, using this as the basis for high-value-adding consulting. Or he could develop a *unique* new product design that meets the needs of a large or expanding market, file for patents, and lease some lab space to initiate proof-of-concept experiments. His capital expenditures (and risks) would be higher and he would probably need some initial capital – from an angel investor, perhaps.

One key step Joe would take along the IBE path is to build a team of individuals with complementary skills and passion for the business. If the idea looks promising, Joe and his team could approach risk capital providers and raise funds to grow aggressively and work with key customers.

These are two very different views of Joe's future. Again, neither is inherently better for Joe – it really depends on what he wants, his tolerance for risk, his personal situation, and his vision for himself. The critical factor is clarity of vision and the appropriate pursuit of the vision and the opportunity.

### **Why Governments Must Care about the IBE-SME Distinction**

For governments looking to create jobs by promoting entrepreneurship, clarity on the different types of entrepreneurship is necessary but often lacking. Since governments are fundamentally not entrepreneurial organizations, and are staffed by people who often lack entrepreneurial experience of either the IBE or SME type, policies often “lump” both sorts of entrepreneurs together, even though their needs are substantially different. From training programs and tax incentives to business accelerators and mentoring activities, entrepreneurial support programs must be designed differently for IBE-building entrepreneurs than for SME entrepreneurs.

We have seen that around the world, various organizations' enthusiastic efforts to support entrepreneurship fail to achieve the results they desire, precisely because they try to address both SME and IBE entrepreneurship through a singular organization. It is better for an individual organization to choose one focus and perform well, rather than choose both SME and IBE, leaving the organization unfocused and less successful. There need to be two separate support structures for these two types (SME and IBE) that have different support personnel, programs, mindsets and metrics for success.

Furthermore, an organization addressing both SME and IBE entrepreneurship often tends to disproportionately focus on short-term job creation, which does little to address long-term strategies for economic growth. SME, which is regional and provides a short-term payback, can be more attractive to politicians looking to please their constituents.<sup>3</sup> (Consider the term “shovel ready,” which connotes the political will to have quick unambiguous impact in exchange for providing resources.) Investment in supporting SMEs is also attractive because it can be geographically targeted, so a politician can more easily directly support his geographically assigned constituents. As a result, organizations that combine SME and IBE entrepreneurship tend to allocate proportionally more resources to SME at the expense of IBE. Yes, IBE entrepreneurship is more challenging, but it offers much greater potential upside in the long term.

Take Italy as an example of the shortcomings of a SME-centric strategy, as the *Wall Street Journal* described in November 2011. In Italy, entrepreneurs stay small, in trusted regional markets, because government policies discourage their aspirations for growth. Italy’s economic woes are partly due to the entrepreneurs who do not aspire for IBE, but instead stay content with SME.<sup>4</sup>

If job creation and economic prosperity are the goals for a government, IBE entrepreneurship must be a major element of government strategy and policymaking. IBE generates many more new jobs and much more exports than SME. And to ensure that IBE entrepreneurship has the right support structures, separate and equitable organizations will need to be set up, with different programs and mindsets, for each SME and IBE entrepreneurship.

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<sup>3</sup> However, note that a “small business” is not necessarily a job producer. The Kauffman Foundation found that *new* companies, that is, companies that are five years old or less, produced all 40 million net new jobs seen by the American economy between 1980 and 2005. See: Friedman, Thomas, “Start-ups, not bailouts,” *The New York Times*, 3 April 2010.

<sup>4</sup> Meichtry, Stacy, and Deborah Ball, “Culture Built on Family Firms Tests Italy’s Plan for Growth,” *The Wall Street Journal*, 14 November 2011.