Executive summary

Iñaki Peña Legazkue et al.
Basque Entrepreneurial Activity with Major Growth Potential (2000-2005)

Team Leader
Iñaki Peña Legazkue

Research Team:
Orkestra-Basque Institute of Competitiveness
José Luis González Pernía
Aloña Martiarena Arrizabalaga
Mikel Navarro Arancegui

University of the Basque Country
Iñaki Heras Saizarbitoria

Public University of Navarre
Martín Larraza Kintana

Simon Fraser University
Nahikari Irastorza Arandia

Mondragon University
Saioa Arando Lasagabaster

2009
Orkestra - Basque Institute of Competitiveness
Deusto Foundation
Basque Entrepreneurial Activity with Major Growth Potential: Innovation, Internationalization and Rapid Growth

Executive summary

1. Introduction

At the beginning of the current decade, an emerging global economy and the latest technological revolution marked the onset of a transformation. Europe responded by setting itself a strategic goal for 2010: “to become the most competitive and dynamic knowledge-based economy in the world, capable of sustainable economic growth with more and better jobs and greater social cohesion”1. Since then, the economic and social transformation toward a structure based on innovation and knowledge has become the main work agenda for national and regional governments throughout Europe.

The effects of this transformation have been felt in the Spanish region of the Basque Country (BC), so much so that it is now a model region, with its sights firmly set on achieving the common European goal for 2010. Nevertheless, despite the efforts made so far, the region is still in a period of transition from a traditional industrial society to a new, innovation- and knowledge-based society. We have yet to converge with Europe in terms of innovation and need urgently to acquire the necessary tools for completing the transformation.

Entrepreneurial activity is a major factor in the race for innovation within the economy and society. Public policy in the BC accordingly supports entrepreneurial projects. Over the past few years, both the Business Competitiveness and Social Innovation Plan 2006/09 and the Science, Technology and Innovation Plan 2010 provide firm backing for technology- and knowledge-based innovative projects that stimulate the capacity for rapid business growth and the ability to compete globally.

In response to the firmly held conviction that entrepreneurial activity is one of the drivers of a knowledge-based production structure, this paper presents research illustrating the current situation of companies deserving of regional society’s support. The project concentrates on identifying and describing such companies and their entrepreneurs, to give us an understanding of the forces that foster more innovative companies and help them to grow and internationalize rapidly.

---

1.1. Entrepreneurial activity as a Driver: A key factor in the bid for a Knowledge Society

With the endogenous growth theories emerging in the mid-1980s, entrepreneurial activity came to be seen as a major factor in long-term economic growth\(^2\). Since then, a number of empirical studies have verified the relationship between entrepreneurial capacity and economic growth, showing it to be positive in more developed countries and regions\(^3\).

In addition to the entrepreneurial phenomenon, the innovative capacity of a country or region is also a cornerstone of its economy’s competitive level\(^4\). This is why in recent years public business start-up policies implemented at virtually every administrative level from the European Union down have targeted new innovative companies.

This interest in new innovative companies is based on the fact that not all entrepreneurial activity contributes to economic growth with the same intensity. Several studies have shown that new innovative companies with potential for rapid growth\(^5\) and the capacity for internationalization\(^6\) are a decisive factor for economic growth, in both developing and developed countries.

Although new, rapid-growth companies account for a relatively small percentage of overall entrepreneurial activity, they make a greater contribution in terms of job creation than other businesses. The existence of this type of company is related to the quality of the business environment (e.g. infrastructures, technologies, the presence of venture capital, etc.) and the entrepreneur’s educational and income levels (human capital and welfare standards in society). A greater inclination toward rapid-growth entrepreneurial activity is to be found in high-income countries and regions.\(^7\)

Quality environments and greater technological development enables companies in advanced countries and regions to specialize in technology based-sectors. In those sectors, growth and internationalization are not only more viable (e.g. greater chances of entering new foreign markets where the product is new and few competitors exist), but are occasionally the *sine qua non* for survival (e.g. need to reach economies of scale to amortize R&D spending). Nevertheless, while tech-based companies are most prominent in this respect, the factors that drive other types of companies toward rapid growth and early internationalization also need to be promoted.

---

\(^2\) These theories enhanced models of economic growth by the addition of two new factors enabling the economy to experience continuous growth without relying on exogenous factors. One was the development of new technology and the other human capital. In the latter case, the entrepreneur is a factor in human capital on which economic growth depends.

\(^3\) Among the primary contributions to the analysis of regional and national entrepreneurial activity and economic growth are the findings of reports by the GEM project over the past few years. These reports suggest entrepreneurial activity in low-income countries is negatively related to per capita income, whereas in high-income countries this relationship is positive. While it may be true that in low-income countries the overall rates of entrepreneurial activity among the adult population exceed those of high-income countries, the percentage of people engaging in this activity out of necessity in the former group of countries is also higher. Consequently, most new companies started in low-income countries never reach consolidation and, in many cases, stagnate and fail to grow. For a more detailed explanation of the dynamics of this relationship, see: Stel, A. van; Carree, M. and Thurik, R. (2005). “The Effect of Entrepreneurial Activity on National Economic Growth.” *Small Business Economics*, Vol. 24, No. 3, pp. 311-321.


\(^7\) Within the framework of the GEM project, further details about this type of company can be found in the global report on rapid-growth entrepreneurial activity by Autio (2007)
The knowledge society requires new companies that are not only innovative, but also capable of rapid growth and internationalization. Besides creating jobs, new companies that grow also generate other benefits related to knowledge and innovation capacity. Meanwhile, internationalization enables new businesses to increase their resources and skills by accessing cutting-edge knowledge and technology worldwide. So a study enabling a diagnosis in the BC about the possible existence and functionality of this specific entrepreneurial framework is particularly pertinent.

1.2. How to approach the future

At the beginning of this paper, we described the BC as going through a period of transition. We are heading toward a knowledge society, and along the way entrepreneurial activity could play an important role as a driver. This idea is shown in Fig. 1.1, and provides the point of departure for this paper.

Fig. 1.1 The role of entrepreneurial activity

According to the literature, entrepreneurial activity that is innovative and has potential for growth and internationalization, requires some specific environmental conditions. Basically, the environment must have an entrepreneur support network, which orchestrates the components that foster the spirit of entrepreneurship and innovation.
Fig. 1.2 shows this network starts with the entrepreneur (human capital, both local and foreign); next come the venture capitalists and business angels (financing for new entrepreneurial projects), followed by consolidated companies capable of entrepreneuring (intrapreneurship or entrepreneurial activity within companies). After that comes the University and research centres (creators of business and technological knowledge), followed by the other elements of social capital (as creators of a culture of risk and acceptance of business failure). The final factor involves government institutions (responsible for equipping the environment with infrastructures, laws, educational system, etc.).

In line with the diagnosis performed for the study, there is a shortage of innovative companies that undergo a process of rapid growth and internationalization in the BC business structure. Although a considerable percentage of companies conduct innovation activities, they largely fail to transform their innovation efforts into new products. And even if new technology companies are founded, the potential for internationalization could be much greater than it is at present.
Fig. 1.3 is a pyramid representing the framework of new companies in the BC. The graph shows that, despite having a broad base of new companies (Zone “a”), the peak comprises a low percentage of innovative companies that continue growing and competing at the global level (Zone “c”). Close to the top of the pyramid is a group of innovative companies that need to grow and enter new markets (Zone “b”).

To be competitive in the knowledge society, the upper half of the pyramid representing innovative companies, particularly the peak, needs to expand. The Basque regional government Science, Technology and Innovation Plan 2010 acknowledges this need, opting for the creation of new technology-based companies with a strong global presence. The intention is for the BC “to become a benchmark for innovation in Europe,” which explains the target of R&D expenditure equivalent to 2.25% of the GDP in 2010.

Although the vast majority of firms conducting R&D activities are large companies, this size relationship does not appear to be linear. The Basque entrepreneurial knowledge-based society should consist of companies with strong potential for growth and internationalization. Innovative and technological companies eager to grow and internationalize allocate a large part of their income to the creation of new products through R&D expenditure. The challenge of this project is to show how key entrepreneurial behaviour occurs in Basque society.

---
