SME POLICY FACED WITH DEVELOPMENT OF FINANCIAL TECHNOLOGY

Promoting Investment in Human Capital and Labor Mobility: Making the Entrepreneurial Economy Work

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Abstract

Many economies face structural labor constraints largely derived from the 20th century managerial economy. How can sufficiently high levels of investments in human capital and organizational knowledge be achieved while ensuring an optimal level of worker mobility between and within organizations? Making the entrepreneurial economy work necessitates changing labor regulations and organization of work. Public policies can stimulate worker mobility between established organizations, new ventures, and young growing firms by loosening employment protections and making social security portable over all occupations. Businesses can change their work organization to enable worker mobility and bottom-up innovation initiatives.

Challenge

In the last few decades we have witnessed a shift from a managed to an entrepreneurial economy in many developed economies (Audretsch and Thurik 2001). This involves a shift from an economic system in which top-down governance, command-and-control, routine tasks, and scale economies dominated to an economic system in which there are more bottom-up initiatives, flexible governance arrangements, non-routine (creative) tasks, and network economies (Thurik et al. 2013). In the last few decades this transition has accelerated due to the twin forces of technological change and globalization, which has automated or moved these routine tasks to low-wage economies, making creative tasks more dominant in developed economies (Autor et al. 2003; Brynjolfsson and McAfee 2014).

This shift from a managerial to an entrepreneurial economy necessitates a shift in policy thinking from policy for large firms and SMEs to policy for an entrepreneurial economy, or entrepreneurial ecosystems (Thurik et al. 2013; Stam 2015). The core activity in an entrepreneurial economy is the recombination of resources to create new value. The bottom-up new value creation processes central to the entrepreneurial economy take place in start-ups, in networks of organizations ('open innovation'), in young growing firms, and within established organizations. From a social welfare perspective, new value creation via entrepreneurial initiatives should largely outperform value capture activities (Mazzucato 2018).

To create new value in entrepreneurial economies, investments in new knowledge are necessary, both in individuals and between organizations. Investment in individuals is often referred to as an investment in human capital, while investments in organizations contribute to the improvement of organizational practices, routines, and processes: organizational knowledge (Nonaka 1994), organizational capital (Prescott and Visscher 1980). To make these investments productive, complementary assets are often needed within or between organizations (Teece 1986). Private investments in new knowledge and the combination of assets are often performed at suboptimal levels from a social welfare perspective.

Investments in human capital, organizational knowledge, and the (re)combination of assets for new value creation needs optimal flexibility (Nooteboom and Stam 2008). On one hand there must be long-term investments in human capital, organizational knowledge, and in relations for complementary assets. On the other hand, for new recombination to take place, sufficient mobility of workers is needed.

The challenge is how to achieve sufficiently high levels of investment in human capital and organizational knowledge while providing an optimal level of worker mobility, either between or within organizations. In many countries there is little mobility between organizations due to strict employee and employer protections, and within organizations due to inhibiting organizational structures and cultures. However, there is also the danger of too much mobility, which leads to underinvestment in human capital, organizational knowledge, and in relations.

Proposal

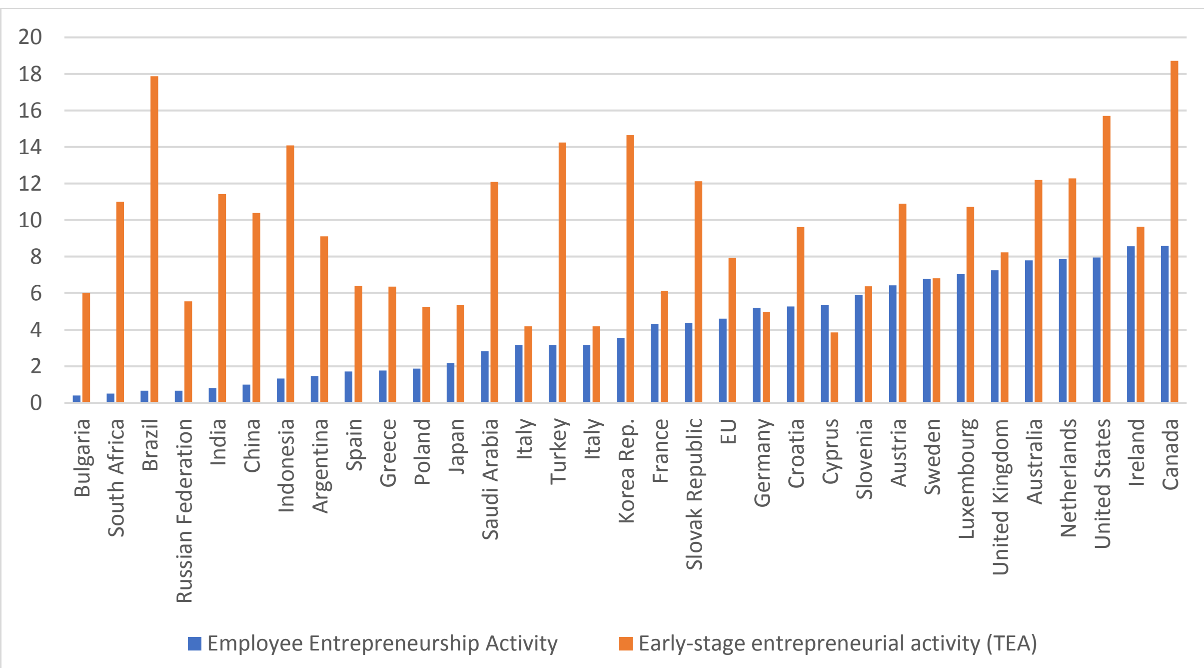
How to achieve sufficiently high levels of investments in human capital and organizational knowledge, and an optimal level of worker mobility, either between or within organizations? This proposal calls for established firms to change their work organization to enable worker mobility and innovation, and public policies to stimulate worker mobility by loosening employment and employer protections. It also makes a plea for a social security and pension scheme that is portable over different organizations. We illustrate our proposal with the current levels of (growth-oriented) early-stage independent entrepreneurship and levels of entrepreneurial employee activity in the group of G20 countries in 2018.

Change the Work Organization

Large and medium-sized firms solve underinvestment problems to some degree by offering long term contracts, investing in employees, and by organizing complementary assets internally. Micro and small firms cannot afford such investments. However, the organizational structures and the cultures of large firms often constrain entrepreneurial initiatives by employees, while they could be stimulated by internal worker mobility. Our first proposal is directed towards businesses to change their work organization to enable worker mobility (either internally or externally), and bottom-up innovation initiatives (entrepreneurial employee activity). External mobility could be stimulated by so-called “entrepreneurial leave,” which allows employees to experiment with an outside venture while still giving the employee the right to return within a reasonable amount of time (just like a maternity leave). Government policy has no direct role to play in this organization of work, it can only disseminate knowledge to inform business that these changes in work organization are likely to pay off the costs, and how to change work organization (Kochan and Osterman 1994).

The solution is that established (large and medium-sized) organizations create organizational structures and cultures that stimulate entrepreneurial initiatives by their employees. Entrepreneurial employee activity is relatively high in countries like Sweden, United Kingdom, the Netherlands, the United States, Australia, and Canada, but very low in countries like Brazil, Argentina, Russia, India, China, Indonesia, Japan, and Italy (Bosma and Kelley 2019; see Figure 1).

Figure 1. Entrepreneurial Employee Activity and Total early-stage Entrepreneurial Activity (TEA) Rates among Adults (aged 18-64)



Source: Global Entrepreneurship Monitor 2018/2019
Note: data from Australia and South Africa are from 2017

If these entrepreneurial initiatives cannot be pursued within established organizations, employees should be able and willing to experiment in start-ups.

One way to take away the barriers for start-ups by employees is to abolish non-compete agreements: legal contracts that prevent employees from entering markets or professions considered to be in direct competition with the employer (Marx 2018; Stam 2019). These non-compete agreements are a means of employer protection and hinder labor mobility in general, and labor mobility from established firms to start-ups in particular.

In some countries, both types of entrepreneurial initiatives (in established organizations and in start-ups) are very prevalent (Australia, The Netherlands, United States and Canada). Many others lack entrepreneurial employee activity, or lack employment options in general, but seem to be compensated by start-up activities (India, China, Indonesia, Brazil). Some countries face low levels of both types of entrepreneurial activity: Japan, Italy, Argentina (see Figure 1).

Labor Regulation, Established Organizations and Dependent Self-Employed

Public policy can stimulate worker mobility by loosening employment protections, which frees up resources for recombination outside (large) established organizations. Strict employment protection provides double trouble for innovation. It locks up assets in large established organizations and stimulates dependent self-employment (Pissarides 2001; Roman et al. 2011). Valuable assets in large established organizations will not be recombined in growth-oriented ventures, and independent entrepreneurs lack the ambition and ability to grow their venture (Bosma et al. 2009; Autio 2010). However, increasing employment protection, especially the notice period for employers, might also enhance entrepreneurial employee activity, as a notice period provides time for employees to continue their entrepreneurial activities in other organizations (Liebregts and Stam 2019).

Dependent self-employed persons often do not make the necessary investments in human capital and organizational knowledge and have limited ability to develop alliances with other organizations. Less strict labor regulations makes it more attractive for new ventures and (especially small) established organizations to hire workers (Bauernschuster 2013; Millán et al. 2013), and in this way to invest in human capital and organizational knowledge, that might not have occurred when these workers remain dependent self-employed.

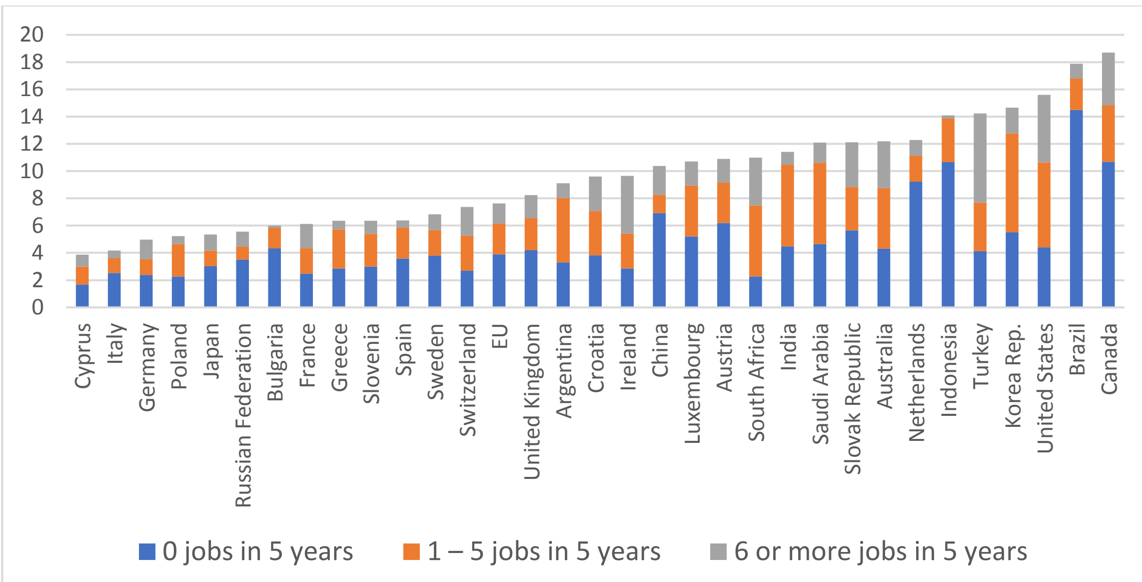
Worker Mobility and the Emergence of Medium-Sized Firms

Start-ups could grow to become new, dynamic medium-sized firms. These medium-sized firms would be large enough to realize economies of scale and scope (internally or in alliances with other organizations), and dynamic enough to let employees be entrepreneurial. However, start-ups do not often become medium-sized firms, partly due to the low mobility of workers (including company leaders) from established larger firms (Sørensen and Sharkey 2014). This low mobility can be explained by workers unwilling to risk leaving safe jobs with social security and pension entitlements to move to uncertain start-ups, and the relatively high wages established larger firms provide. What is needed is a labor regulation that allows worker mobility by making employment protections less strict and abolishing non-compete agreements. Next to these changes in labor regulation, we also propose a social security and pension scheme that is portable over different organizations (Andersen and Svarer 2007; Elert et al. 2017).

Once entrepreneurial ventures turn out to be successful, it should be easy for them to hire and possibly fire employees when they face growth problems.

When a venture is unsustainable, it should be easy for workers to re-enter established organizations. If worker mobility is (perceived to be) low, young firms are unlikely to grow. Countries showing high rates of growth-oriented start-ups are Ireland, Turkey, United States and Canada, while Japan, India, Italy, Germany, the Netherlands, Argentina and Brazil show low rates (Bosma and Kelley 2019; see Figure 2).

Figure 2. Self-reported Growth Expectations in early-stage Entrepreneurial Activity



Source: Global Entrepreneurship Monitor 2018/2019
Note: data from Australia and South Africa are from 2017

Conclusion

Public policy and the private sector share a joint responsibility to assure that sufficiently high levels of investments in human capital and organizational knowledge are achieved. This must be matched with an optimal level of worker mobility, either between or within organizations. In practice this means a balancing act towards optimal worker flexibility--sufficiently flexible so that new combinations of resources are made, and sufficiently stable so that investments in human capital, organizational knowledge, and relations are made. It calls for intensive interaction between public and private sector in order to determine the appropriate mix of public policies and firm strategies.

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