



Policy Brief on Entrepreneurship, industrial diversification and economic growth in EU regions

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Policy Brief on Entrepreneurship, Industrial Diversification and Economic Growth in EU Regions

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Abstract

To foster job creation and economic growth in EU regions, policy makers are increasingly focused on the promotion of entrepreneurship and the creation of new economic activities. Analysing newly constructed pan-European datasets, we obtain a set of findings that show that both the degrees of relatedness and un-relatedness of existing portfolios of economic activities of regions influence new firm creation and new industry specialisations. In particular, entrepreneurship is fostered by related variety, whereas new industry specialisations are linked to both related and unrelated variety. Policies that aim to promote a further diversification of regional economies in the EU need to account for and exploit these effects of the composition of existing portfolios of activities.

Introduction

Two of the central goals of the European Commission are the generation of new jobs and the creation of new economic activities. Within the context of promoting economic growth in EU regions, these goals relate to the important underlying issue whether policies should aim to promote regional diversification by supporting new businesses and industries that are unrelated to existing portfolios of activities or develop new firms and activities that build upon and extend existing industries.

The limited amount of available evidence indicates that both related variety and unrelated variety of the existing regional portfolios of activities can exercise positive effects on regional employment growth (Content and Frenken, 2016; Fritsch and Kublina, 2017; Boschma, 2017).

The deliverables 3.3-3.4 report empirical analyses on the relative importance of related and unrelated variety as drivers of new economic activities in EU regions. One key issue that this research addressed concerns the relationship between the composition of regional portfolios of activities and new





business formation. Examining the relations between related/unrelated variety and regional entrepreneurship provides indications whether newly founded businesses are mainly active in fields that are closely related to existing portfolios of activities (related variety), or if portfolios characterised by unrelated variety are more conducive to new business formation.

A second issue that the research examined is the link between related and unrelated variety of activities of regional economies and the creation of new industry specialisations. This research also investigated the role of regional knowledge intensive business services (KIBS), involvement of regional firms in global value chains (GVCs) and regional expenditures in research and development (R&D).

Methodology

In order to investigate the effects of related and unrelated variety on regional economic performance, new comprehensive pan-European datasets at the NUTS 2 regional level were created. Indicators of average total entrepreneurial activity as well as opportunity and necessity entrepreneurship¹ for the period 2007-2014 were taken from the Global Entrepreneurship Monitor (GEM). Information from the ORBIS database (Bureau van Dijk) was used to calculate indicators of regional related and unrelated variety and indicators of the occurrence of new regional industry specialisations. Other variables include gross regional product, population density, human capital and regional unemployment levels (Eurostat).

Main results

The empirical analysis of the drivers of entrepreneurship shows a significantly negative relationship between unrelated variety and all types of regional

entrepreneurship, indicating that most new businesses emerge in related industries. Regions with high levels of related variety have relatively high rates of opportunity entrepreneurship, indicating that regional economies that are characterized by a high degree of relatedness provide more opportunities for entrepreneurs to benefit from knowledge spillovers and to start new business activities. The analysis also shows that the institutional framework matters for entrepreneurship. In particular, the findings indicate that levels of entrepreneurship are significantly higher in regions located in countries that can be characterized as liberal market economies compared to regions in countries that are commonly classified as coordinated market economies (Hall & Soskice, 2001).

The findings from the empirical study of drivers of new industry specializations indicate that both related and unrelated variety are important for regional diversification. Related variety is positively associated with the degree that regions create new industries, indicating that such new activities are more easily created when related industries already exist. Furthermore, the presence of knowledge intensive business services (KIBS), regional involvement in GVCs and, to a lesser extent, also R&D expenditures are positively related to the number of new industry specializations, confirming that regional knowledge spillovers foster the creation of new economic activities. Importantly, there is also evidence of a moderating effect of the presence of KIBS and involvement in GVCs on the effect of related variety on new industry creation. This indicates that regions with high levels of KIBS and/or GVC participation are better able to also diversify into more unrelated activities, thereby avoiding or overcoming negative lock-in effects due to path-dependency of regional

¹ Opportunity driven entrepreneurs start new firms to pursue new business opportunities, whereas necessity-

driven entrepreneurs start businesses due to a lack of other employment options.





diversification based on related variety. Higher levels of unrelated variety also improve the resilience of regions with regard to industry-specific shocks.

Policy Implications

The research results have a number of important policy implications. First, the nature of the portfolio of existing activities in terms of related and unrelated variety will influence the effectiveness of policies that aim to promote new business formation in EU regions. The empirical evidence suggests that such policies need to be of a larger scale in regions that are characterised by a relative high degree of unrelatedness between economic activities.

Second, regional entrepreneurship is affected by the institutional framework. This implies that, given the variety of institutional frameworks in the EU, uniform 'one size fits all' policies to stimulate entrepreneurship are not likely to be very effective. Instead, policies need to be flexibly designed to be tailored to country- and region-specific institutional settings.

Third, since the creation of new industry specialisations is facilitated by the pre-existence of related industries, policies that aim to enhance regional levels of new business formation may try to benefit from this positive effect by promoting new activities that are closely linked to existing regional portfolios of activities. This is in line with the smart specialisation philosophy as advanced by the EU.

Finally, our findings on the positive effects of KIBS, GVC involvement and R&D activities reflect the positive impact of regional knowledge spillovers on new industry specializations. This indicates the need for flexibility of regional policy making to allow for the effects of characteristics of individual

regions on the impacts of regional diversification policies.

Concluding Remarks

Regional policy making in the EU is increasingly concerned with the promotion of economic growth by fostering the creation of new firms and new economic activities. The research summarized above clearly shows that existing regional portfolios of activities affect the economic outcomes of such policies. Therefore, to increase their effectiveness, regional policies need to account for the effects of related and unrelated variety on the creation of new firms and industries.

The research findings also indicate the need for flexibility in policy making. As regions differ in their portfolios of activities, policies need to be tailored to these individual portfolios in order to maximize the positive effects of related and unrelated variety on entrepreneurship and new industry specializations.

Sources or further reading

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