

PART II

KEY POLICY ISSUES IN ENTREPRENEURSHIP AND SME DEVELOPMENT

Part II of this report is structured in six thematic chapters. Each chapter starts with a summary of main findings from the local case study areas by the OECD. In the following paper, both theoretical and practical aspects of policy action are discussed in light of new policy approaches and options. References are made to good practice initiatives in East Germany and other regions in OECD member countries. A chapter concludes with the OECD policy recommendations presented as a 'Checklist'. Along with a selection of international learning models and good practice examples in East Germany, this final section of each thematic chapter aims to inspire policy innovation and the development of local approaches to strengthen entrepreneurship.

CHAPTER 5

RURAL ENTREPRENEURSHIP

FOSTERING ENTREPRENEURSHIP IN RURAL AREAS

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Introduction

Aims in context

This chapter is concerned with the distinctive challenges and opportunities of developing entrepreneurship in rural locations, in order to contribute to the development of policies to regenerate rural areas in East Germany. The chapter is based on a review of international literature and good policy practice in OECD countries.

A recent OECD report (2005) identified three specific *challenges* currently affecting rural areas, which have implications for entrepreneurship, namely:

- Declining employment opportunities in primary industries (mainly agriculture), as a result of structural change, intensified by changes in policy resulting from reviews of the EU's CAP and the GATT. This emphasises the need to take steps to stimulate economic activity with employment-generating potential in rural areas;
- An aging population, associated with an outmigration of young people and an in-migration of retired people, in some cases, which in combination affects the supply of potential entrepreneurs;
- Difficulties in maintaining a critical mass of facilities to support economic development, including a range of business services.

New *opportunities* identified in the same report (OECD, op cit) included:

- Increased demand for rural amenities on the part of urban residents;
- Sources of economic success, such as dynamic SME clusters; and
- Development of diversified agro-industries and rural tourism.

In addition, developments in communications technology offer potential opportunities to businesses in peripheral rural areas, in particular, to overcome some of the barrier effects of distance. Other positive attributes include evidence that shows the adaptive capability of some small firms in rural localities to overcome external environmental constraints (Smallbone et al, 1999; Vaessen and Keeble, 1995); and opportunities related to products that project traditions of quality and craftsmanship, connectedness with nature and a sense of place and culture (Dabson, 2001).

The heterogeneity of rural environments

In identifying policy issues and challenges facing rural areas, it is important to recognise the heterogeneity of such areas, both internationally and within the same country. Some of this heterogeneity reflects variations in the locational characteristics of rural regions within their national economies (e.g. central or peripheral), while others are related to national and regional differences and the implications for rural development paths. Peripheral rural areas are characterised by remoteness from major markets; depopulation; infrastructural deficiencies; and high dependence on land-based activities. Accessible or more central rural areas, by contrast, typically have higher population densities; closer proximity to markets; less dependency on agriculture; and a more diversified economic base. (Meccheri and Pelloni, 2006).

As a consequence, urban-rural contrasts do not always show rural areas to be disadvantaged in comparison with their urban counterparts, as far as entrepreneurship is concerned. Indeed, there are wide differences in economic performance between rural areas, since in more than a third of OECD countries, it is reported that the region with the highest rate of employment creation is a rural area (OECD, 2006a). Easier commuting over longer distances and a growth in home-based working has enabled people to combine living in rural regions with gainful employment. This, together with an increase in demand for rural assets, including natural heritage, has attracted workers and investment into some rural areas. Such factors have contributed to a reversal of the outmigration trend from rural areas in countries, such as France, England and the Netherlands.

Definitional issues: entrepreneurship and rurality

These variations between rural areas raise the definitional issue of what constitutes ‘rurality’. Indeed, in Europe, some authors have questioned whether it continues to make sense to speak of distinctly ‘rural’ societies, in view of the changes that have occurred in recent decades (e.g. Perrier-Cornet and Hervieu, 2002). At the same time, other authors have emphasised the remaining shared characteristics of Europe’s rural areas, in terms of low population density and the economic, social and symbolic significance of natural resources (Ferrao and Lopes, 2004). Whilst recognising the arguments behind the first view, this chapter is premised on the second, although there are still variations in definitions of what constitutes a ‘rural’ area.

Referring to the USA, Shields (2005) defined rural areas as ‘non metropolitan areas, exhibiting low population density’ and low densities are commonly incorporated into most statistical definitions of rural areas. Nevertheless, the size thresholds for excluding settlements vary widely between countries, ranging in Europe from less than 5,000 in Slovakia to less than 30,000 inhabitants in Bulgaria (Mandl et al, 2007).

The OECD itself has developed a typology of urban and rural areas based on three criteria: population density; percentage of people living in rural communities; and the size of urban centres, which are used to identify three regional types:

- *Predominantly rural regions*, in which more than 50% of the population live in communities with a density below 150 inhabitants per sq. km.
- *Significantly rural/intermediate regions*, in which between 15-50% of the population live in communities with a density below 150 inhabitants per sq. km., or the existence of an urban centre of 200,000 or more, representing 25% or more of the population is found in an otherwise predominantly rural region.

- *Predominantly urban regions*, in which less than 15% of the population live in communities with less than 150 inhabitants per sq km.

Numerous definitions of “entrepreneurship” can also be found in the literature. In this chapter, the broad definition used in the Global Entrepreneurship Monitor is used, namely “any attempt to create a new business enterprise or to expand an existing business by an individual, a team of individuals, or an established business” (Zacharis et al, 2000). Narrower definitions tend to focus on the creation of newness (e.g. Wennekers and Thurik, 1999), epitomised in high growth potential entrepreneurs that have a particularly strong potential contribution to make to economic development. However, as some authors have previously emphasised, in many rural and disadvantaged areas, “small businesses of all types are needed—those with high growth potential and also those formed for life style purposes, or self sufficiency that primarily serves local needs” (Dabson, 2001, p. 36). This chapter shares the latter view, since the sustainability of rural communities requires such a mix.

The rest of the chapter is divided into three main sections: The first identifies the main policy issues and challenges to entrepreneurship development in rural areas; the second describes the various approaches to rural enterprise policy in OECD countries; and the third section considers the implications for entrepreneurship policy in the rural regions of East Germany.

Policy issues and challenges facing entrepreneurship development in rural areas

Rural distinctiveness

A key question running through the chapter is the extent to which rural locations are distinctive from urban locations, from an entrepreneurship perspective. Referring to the US, for example, it has been suggested that rural settings have characteristics which present a unique context for small businesses. For example, the results of a study of 76 rural enterprises in a rural county in the mid-Atlantic region of the US strongly supported the hypothesis that rural small business owners manage their businesses in ways that are consistent with rural socio-cultural values, demonstrating the considerable influence of rurality on small business activities (Shields, 2005, p. 59). Examples include the importance that rural small business owners place on word of mouth reputation and on the primacy of relations with family, friends and neighbours to the successful operation of their businesses. Shields suggests these results indicate that formal sources of business advice take a backseat to family, friends and neighbours, thereby illustrating the role of embeddedness (i.e. where an individual is integrated with and helps to maintain the community structure) in the entrepreneurial process (Jack and Anderson, 2002).

Other studies undertaken in the USA point to low population density (Drabenstott, 1999), consumer income and educational levels below those found in metropolitan areas (Economic Research Service of the US Department of Agriculture 2003) and socio-cultural values (Allen and Dillman, 1994), as distinctive issues faced by small businesses located in rural areas.

Policy initiatives aimed at encouraging the formation and growth of enterprises in rural areas need to take into account of the distinctive challenges facing these areas, which are associated with three main aspects: characteristics of the business environment; characteristics of rural populations; and aspects of the existing economic structure.

Characteristics of the business environment in rural areas

Distinctive characteristics of the rural environment include: the small size of local markets; characteristics of rural labour markets; the availability of business premises; transport and

communications infrastructure; access to information, advice and business services; access to finance; and the institutional environment. The evidence base in relation to each of these is reviewed below:

Small size of local markets

Clearly, one of the potential disadvantages faced by rural firms in comparison with their urban-based counterparts is the small size of the local market that is typical, associated with low population densities, together with low per capita and household incomes, in some cases (Economic Research Service of the US Department of Agriculture, 2003). At the same time, the extent to which rural SMEs depend on local markets typically varies between sectors (North and Smallbone, 1996). As a consequence, differences have been identified between manufacturing and service/retail businesses in the extent of their dependence on the rural setting. Manufacturing enterprises typically make substantially fewer sales to permanent residents and as a result, show less concern than other rural business owners towards duplicating other local products (which some authors describe as an implicit co-operation strategy) (Shields, 2005, p. 60). Clearly, policy interventions need to be sensitive to the different implications of rurality on manufacturing and service enterprises.

One of the consequences of small local markets is that growth-oriented enterprises, located in peripheral rural areas particularly; typically have to penetrate non-local markets at an earlier stage of their development than comparable urban-based enterprises. This has implications for the external support they are likely to need (Smallbone et al, 1993a ; 2003), which in the case of high growth firms, this is likely to be from their inception. At the same time, the falling cost of transport (and improved communications technology) has contributed to a substantial expansion of potential market areas for rural businesses over time (Freshwater, 2000), although small enterprises often need help to take full advantage of this potential.

One of the ways that small firms have been shown to adapt to peripheral rural locations is by focusing on specialised niche markets, reflected in a lower average number of competitors being reported than by firms in other types of location (Keeble 1993; Cosh and Hughes, 1998). Indeed, as far as geographic market scope is concerned, research evidence from both sides of the Atlantic shows that rural firms appear to be able to access export markets at similar rates to metropolitan firms (Gale 1998). This is supported by evidence from a longitudinal study in the UK, which investigated the export behaviour and methods of 621 rural and urban-based firms, showing that a larger proportion of rural firms reported exporting goods and services, compared with their urban counterparts. At the same time, rural firms were reported to be markedly more likely to have entered foreign markets by reacting to unsolicited enquiries from foreign clients than urban firms, who tended to have been more proactive in their export marketing. One of the policy-related conclusions drawn by the authors is the need for improved access to market information by rural firms that can be used to increase their competitiveness (Westhead et al, 2001), although their results suggest there is a need to provide help in developing a more strategic approach to foreign markets (Wyer and Smallbone, 1999).

Rural labour market characteristics

The limited scope of local product markets is often paralleled by the small size and narrow occupational composition of rural labour markets, which can impose constraints on rapidly growing SMEs. Evidence from a survey of innovative small enterprises in rural locations in Devon and Cornwall in the UK, for example, found 'access to skilled labour' to be one of the most frequently mentioned constraints on rural enterprises, reflecting the small size and scope of rural labour markets (Smallbone et al, 2003).

Freshwater (2000) characterised the rural labour force in terms of lower levels of educational attainment and formal skills than those found in urban areas. However, he suggests that historically this has not been a major impediment to rural development, because the activities located in rural areas enabled lower formal skills to be offset, by either location or occupation specific experience and/or from informal training provided within the family or community. High rates of occupational succession reinforced this process, as did a more limited set of occupational choices. However, as traditional employment opportunities are becoming increasingly scarce, and employment opportunities created in emerging sectors, such as business services and IT, typically require more formal approaches to training than traditional activities. In this context, the skills base of the rural workforce may act as more of a constraint on rural enterprise development. In addition, in areas where business and population densities are low, access to training can be more costly.

Availability of business premises

Whereas urban areas are generally characterised by a wide range of business property of different sizes, this is invariably not the case in rural areas. Evidence suggests that whilst the cost of premises in rural locations may be less than in urban areas (e.g. Welsh Assembly Government, 2002), growing businesses may face space constraints resulting from larger premises not being available within a short distance of their existing location (Keeble et al, 1992). In some rural areas, the supply of business premises can also be affected by planning controls, designed to protect an area's environmental quality. However, enterprise policy responses to increase the supply of business premises without the potentially negative environmental effects associated with new buildings have included Redundant Buildings Grants Schemes to convert existing buildings to business use. More generally, a limited supply of business premises may reflect poor economic returns for private sector developers in localities where low levels of entrepreneurial activity depress the level of demand for business property. In such circumstances, there is a case for public policy intervention to stimulate the market for business premises.

Transport and communications infrastructure

The remoteness of many rural places presents transportation challenges to small businesses; because the population is widely scattered (Barkema and Drabescott, 2000) and distances to large national markets may be considerable. In some countries, distances between nodes in sparsely populated regions, or between rural and urban areas, exacerbates the effect of terrain and harsh climatic conditions. Infrastructure is particularly important in this context, as it affects the ability of a region to retain and attract people as well as businesses (OECD, 2006a).

At the same time, the effective use of ICT potentially offers a means for rural and peripherally located enterprises to overcome some of the barrier effects of distance, provided that the infrastructure is available. However, peripheral rural areas are often disadvantaged in terms of investment in the telecommunications infrastructure, because of the relatively low and dispersed nature of the demand (Warren, 2000). As a result, it is reported that in the USA for example, rural communities have lagged behind urban areas in terms of investment in infrastructure and bandwidth capacity (Leatherman, 2000), which has been attributed to a combination of distance and low population density. At the same time, there is some evidence that broadband providers are not deterred from investing in remote rural regions by dispersed demand and relatively high costs, nor that prices charged to consumers are necessarily higher (OECD, 2003). Perhaps the issue varies, to some extent, between countries reflecting differences in market and regulatory conditions.

Another communications infrastructure issue concerns Cellnet telephone coverage, since in the UK for example, none of the license holders have so far managed to provide universal coverage across

the country (Cabinet Office, 1999). This can be a particular problem for self-employed people and micro business owners in some peripheral rural areas, particularly those engaged in service activities that involve spending long periods away from the office, in situations where the businesses are too small to justify full-time office staff. For them, reliable Cellnet access is essential in enabling contact from potential customers.

Access to information, advice and business services

Another potential disadvantage faced by businesses located in rural areas is a greater average distance from business advice and support services provided through the market, such as from banks, accountants and consultants, compared with urban-based enterprises. In addition, some evidence suggests that rural businesses may be disadvantaged as a result of the poor quality of the business services provided through market mechanisms, since where they do exist such services may be more attuned to the needs of farmers than those of other types of entrepreneur within rural areas (Hitchens, 1997). In such situations, the provision of public sector forms of support to rural businesses becomes particularly important to overcome the various gaps and limitations in the market for business support.

Results from a survey of small businesses drawn from 5 representative locations in Britain, emphasise the influence of distance on the propensity of small firms to access business advice (Bennett et al, 2000). The study showed that the dominant factors were search and information costs on the demand side and constraints emerging from the locational structure of businesses on the supply side. Both sets of factors favour large agglomeration centres rather than smaller ones, thereby emphasising the disadvantages of businesses in rural (and particularly peripheral rural) areas in this respect (Bennett and Smith, 2002). It was suggested that the results provided strong support for public sector interventions to be focused on locations where SMEs have difficulty in accessing major sources of advisory support by virtue of their location i.e. on rural, and particularly, the more peripheral rural areas (Bennett and Smith, op cit).

Access to finance

Although finance is a commonly reported constraint on small businesses, wherever they are located, it has been suggested that historically at least, in the USA, rural businesses have lacked sufficient access to finance because the types of enterprise that investors tend to seek out (e.g. those with high growth potential, larger firms) are thin on the ground in rural areas (Drabenshott and Meeker, 1999). As a result, Drabenshott and Henderson (2006) refer to the need to increase the availability of equity finance in rural areas, pointing to innovative examples, such as the Nebraska Community Foundation and other community development funds, which channel charitable foundations into equity funds, measuring performance in terms of local economic benefits as well as financial performance. Whilst access to equity finance is only important for a small minority of potential high growth enterprises, the small percentage of firms that seek, or will accept, equity, means it is not a dominant issue in practice.

At the same time, relatively few studies have explicitly focused on access to finance by rural firms. An exception was a study undertaken in the UK by Mason and Harrison (1993), which was also focused on access to external equity by small rural firms; in this case, those located in Rural Development Areas, compared with other assisted and non-assisted areas. Although the main finding was to confirm the small proportion of SMEs (in all areas) that had sought external equity, there was no evidence that firms in remote rural areas were disadvantaged in comparison with other firms. Similarly, in a matched pair's comparison of new owner-managed businesses, Westhead (1995) found rural firms to have similar financial bases to their urban counterparts, with no evidence that they were disadvantaged with respect to equity. At the same time, there was some evidence of a need to improve

the dissemination of information about access to finance in rural areas, since Westhead found that business founders in urban areas perceived a wider availability of capital to be available from financial institutions than their matched rural counterparts.

Institutional environment

One of the key external factors influencing the nature and extent of entrepreneurship is the behaviour and orientation of local institutions. Moreover, it can be argued that such factors are particularly important in post-socialist economies (e.g. Smallbone and Welter, 2006), including the former East German *Länder* [states]. This is supported by evidence from neighbouring rural regions in Poland, where Piasecki and Rogut (2004) refer to the need to pay special attention to education and training provision; market institutions; and the banking system. Based on the Polish study, it was also argued that such developments need to go hand in hand with greater local self governance, in order to encourage greater innovation by local authorities and communities, which is a theme developed later in the chapter with respect to the East German *Länder*. The creation of an appropriate education and training infrastructure to support entrepreneurship has also been identified as a key policy priority in rural regions of Portugal, where a lack of an enterprise culture has been identified (North and Smallbone, 2006).

Characteristics of rural populations

The second group of factors influencing the propensity of an area to generate entrepreneurship refers to the characteristics of its population, in terms of the implications of their attributes for firstly, the development of an enterprise culture; secondly, the nature and extent of social capital, which can be an important potential resource for enterprise development; and thirdly, the role of in-migration.

Entrepreneurial culture and attitudes

Enterprise culture is widely recognised as an important influence on entrepreneurship development, yet it is a concept that is notoriously difficult to define and to measure. Morgan (1997) has defined culture as ‘an ongoing process of reality construction that leads people to see actions and situations in a distinctive way’. In this regard, some authors have referred to an identifiable culture associated with rural locations in the US that may influence business practice and entrepreneurship (Westhead and Wright, 1998). However, Shields (2005) emphasises that this is based more on assumption than evidence, referring to the lack of quantitative empirical research on the relationship between the prevailing socio-cultural features of everyday life in rural areas and business operations.

At the time, Shields (2005, op cit) recognises, on the basis of literature, that rural settings are characterised by distinctive socio-cultural values and preferences that can affect small business development, through its influence on gender roles, co-operation, communications and network composition. Gender attitudes, for example, are said to be less egalitarian than in urban areas and traditional notions about gender roles may act as barriers to women as business owners (Tigges and Green, 1994). At the same time, Shields finds no evidence that gender stereotypes have significantly affected women entrepreneurs in rural areas.

The local case studies undertaken in East Germany emphasise the effect of ‘path dependency’ on attitudes towards enterprise and the propensity to start businesses, which is a feature of enterprise development in post-socialist economies in general, rather than being exclusively confined to rural areas. This limits the capacity of rural places to generate dynamic entrepreneurs able to create new entrepreneurial ventures. In these circumstances, rurality combines with the effects of transition from

central planning, thereby demonstrating how rural development issues interact with place specific factors.

Social capital

In terms of social capital, close or strong ties are said to be characteristics of rural communities where people rely on long-term, smaller, denser kinship and neighbour-centred relationships than their counterparts in urban areas (Beggs et al, 1996), which may represent a resource for entrepreneurship. More specifically, social capital in rural areas is based on the interaction between individuals in formal and informal networks. It involves social trust and sometimes a cultural dimension, reflected in higher levels of engagement in voluntary activities by people in rural than in urban areas (Mandl et al, 2007).

In terms of new member states of the EU specifically, Valentinov (2003) finds that social capital is a critical determinant of socio-economic welfare of rural communities going through the transition to a market-oriented economy. At the same time, it has been suggested that social capital seems to be less employed for economic purposes in rural than in urban areas, representing a specific challenge for rural policy makers. Another factor influencing the extent to which personal networks are a real resource for business development purposes is their composition. In situations where entrepreneurship is underdeveloped, there is less chance of a potential entrepreneur's personal networks containing individuals with knowledge, skills and/or contacts that can offer practical inputs for the entrepreneur.

Local development partnerships that include representatives of government, local authorities, development agencies, businesses, professional associations and voluntary and community organisations would seem to represent one way of capitalising on the underlying social capital that exists in rural communities for economic benefit (OECD, 1990). In practical terms, the EU's Leader and Leader+ programmes aims to establish local action groups, raising awareness for rural development action and initiating a long term learning process, representing a strong 'bottom-up' community-based approach to rural development (Shucksmith et al, 2006).

Although various studies refer to social capital as one of the potential assets for rural enterprises, the empirical evidence available to support this is limited. Meccheri and Pelloni (2006) have suggested that since rural businesses show a strong preference for local access to business support, this suggests that mobilising any resources (e.g. venture capital) that are potentially available for entrepreneurship development in the local community should be important targets for institutional policies. Rural support networks sponsored by local institutions represent one possible response to linking rural entrepreneurs to new sources of capital, employees, partnerships and business services (Dabson, 2001). Such networks can take different forms, including angel investor networks; non-traditional venture capital funds; and incubator networks, reflecting local needs and conditions.

The role of in-migrants

In some countries, the quality of life and environmental appeal of many rural communities is attracting in-migration into rural areas, which includes some people with entrepreneurial or business experience (Dabson, 2001). Where such a trend is occurring, immigration can contribute to increasing the entrepreneurial capacity of a rural region; directly if immigrants start up new ventures themselves; but also indirectly, if they make their experience available to other entrepreneurs (and/or social enterprises), acting as mentors or advisers.

Some survey evidence from the UK has shown in-migrants to a rural region to be concentrated in the more externally orientated sectors, whereas those born locally are more likely to be concentrated in local service activities. The same study also showed in-migrant entrepreneurs to display a greater level

of informal business contacts outside the region, as well as a greater proportion of sales (Centre for Rural Economy, 2000). At the same time, caution must be used when interpreting the policy implications from this finding, since many in-migrants move in to rural areas at or near retirement. Whilst some of this group may engage in entrepreneurial activity, this may not be on a full-time basis, and/or with any intention of growing their business to employ others.

In a similar vein, some US studies have identified behavioural differences between small businesses owned by short-term residents compared with their longer established counterparts, in terms of their customer base and affinity for strong ties, with diminishing importance placed by them on relations with family, friends and neighbours. However, whether this reflects difficulties in becoming accepted by the community or a more positive use of wider networks by newcomers has not been clearly demonstrated. Anderson and McAuley (1999) suggest this reflects differences in the types of business founded by members of the two groups.

Characteristics of rural enterprises and the economic structure of rural areas

The entrepreneurial performance of a region and its capacity to change is also affected by the structure and performance of its existing enterprises. In this section, the evidence base is reviewed with regards to the size composition, sector mix, and innovation and growth performance of rural enterprise.

Size

Businesses in rural areas tend to be smaller than their urban counterparts, with a higher proportion of micro and one-person businesses, which suggests that they may be able to meet their needs from their own internal resources. Not only are micro businesses predominant numerically, but in some regions they mostly consist of solo owner/managers i.e. without formal labour (Centre for Rural Economy, 2000). The small average firm size, combined with their sparse distribution and remoteness, makes the delivery of business support services to rural firms more difficult and potentially more costly than in urban areas. In addition, micro enterprises are a notoriously “difficult to reach” group by external agencies, because of the limited management time available within the firms for seeking and making use of external help, as well as attitudinal barriers on the part of business owners, with regard to the value of external assistance.

Sectoral mix

Traditionally, sectoral differences have existed in the economic structure of urban and rural areas that have potential implications for entrepreneurship development. However, this is an aspect of the rural environment that has been changing in mature market economies in recent years and continues to evolve. In the USA, for example, the traditional agriculture-based rural economy now depends on a diverse mix of manufacturing services, recreation and non-farm activities (Whitener and McGranahan, 2003). Traditional industries such as farming and mining are no longer the major sources of employment, because new economic activity has moved in to rural areas, so that manufacturing and particularly services have increasingly provided more jobs. At the same time, in some rural areas, a lack of economic diversification may involve dependence on a single manufacturing plant, with most local institutions geared to serving that enterprise and its employees (Dabson, 2001). The negative effects of large plant dominance on levels of entrepreneurship in a local economy is long established in the entrepreneurship literature, because of the so-called ‘upas tree’ effect (e.g. Fothergill and Gudgin, 1982).

Despite these structural changes, agriculture remains a key sector in many rural economies. Even where there has been a dramatic decline in the percentage of the rural workforce employed in agriculture, agriculture continues to have an important influence on the rural economy. A productive agricultural base can be a major purchaser of local inputs, including business services; and agriculture also provides outputs for local processing. At the same time, reductions in agricultural support, combined with changing market trends have increased the pressure on farmers to adapt by diversifying their activities. As farmers face greater levels of market competition and agricultural support is reduced, one of the policy challenges is to encourage farmers to look for new business opportunities.

Farm diversification can take a number of forms, including retailing (e.g. farm shops, craft centres, 'pick your own', direct sales, and food processing); sports and recreation (e.g. indoor, outdoor, informal, water-based, and equestrian activities); services (e.g. agricultural, non-agricultural, and industrial workspace; and tourism (e.g. leisure centres and accommodation). Diversification offers considerable scope for improving the economic viability of businesses related to agriculture, as well as contributing to the local rural economy as a whole (MAFF, 2000). At the same time, diversification is not a universal panacea and farmers often need good advice if they are to succeed. In addition, the opportunities for profitable diversification are affected by location; with access to large urban centres a key factor.

Innovation performance

Innovation is at the heart of a region's ability to compete internationally. Entrepreneurs have a key role to play in contributing to a region's competitiveness by creating new products and services and bringing them to market and keeping one step ahead of their competitors. As a consequence, the performance of (rural) regions with regards to both innovation and entrepreneurship becomes critical to their future development. Referring to the US, it has been suggested that the dilemma for rural regions is that they appear to be lagging in terms of innovation and entrepreneurship (Drabenstott and Henderson, 2006).

Several studies in the UK in the 1980s and early 1990s suggested that rural SMEs were more innovative than their urban counterparts (University of Cambridge, 1992). At the same time, high levels of product innovation were often not reflected in process innovation, particularly in manufacturing SMEs in remote rural areas (Keeble et al, 1992; Smallbone et al, 1993), where both the adoption of and intensity of use of computer technology was relatively low (North et al, 1997). Keeble et al (op cit) found firms located in accessible rural areas stood out as exceptionally innovative. However, by the mid- to late 1990s, the urban-rural contrast with respect to innovation had disappeared from the Cambridge studies (Cosh and Hughes, 2003), which were consistent in the methodology employed over time and also repeated at regular intervals.

One of the indicators of process technology relates to the adoption of and use of ICT. Although the effective use of ICT is potentially one of the ways that rural businesses can overcome some of the disadvantages with respect to distance from major markets and sources of supply, research evidence has suggested that rural businesses typically lag behind their urban counterparts in the use of ICT. For example, in a European cross-national study of ICT use, it was shown that the main barriers to the further use of ICT was a lack of time for training and direct use of ICT, a lack of appropriate personal skills and the cost of the equipment (Gray and Juhler, 2000). Although rapid communication through the Internet and other forms of telecommunications may represent a new 'Industrial Revolution', it has been suggested that changes brought by the Internet provide mixed blessings for rural areas. In this regard, Freshwater (2000) has suggested that many of the changes in the new information based economy are not likely to benefit rural areas in practice, because the labour force lacks many of the basic skills necessary to take advantage of them.

Approaches to rural enterprise policy in OECD countries

A variety of types of policy response to the promotion of rural enterprise may be identified, some of which are territorially specific; some targeted at economic sectors that are prominent in rural areas; whilst others involve adapting national or regional policies to make them more appropriate to the needs of rural enterprises. However, a shift has been taking place in most OECD countries over time, away from traditional sectoral policies (focused particularly on agricultural subsidies) to place-based policies, which is evident in policies addressing economic development in rural areas (OECD, 2005). Three factors have been identified as having particular influences on recent changes in rural policy making across OECD countries:

- An increased focus on amenities, such as antiquities, historical sites and other recreational amenities;
- Pressures to reform agricultural policy, to reduce distortions to international trade, as well as for budgetary reasons; and,
- And decentralisation trends in regional policy, with the aim of mobilising local assets, involving a more ‘bottom-up’ approach to policy and negotiated forms of governance (OECD, 2006a).

Referring specifically to policies related to entrepreneurship and enterprise development in rural areas, North and Smallbone (2006) have previously distinguished between policies to encourage and support venture creation, including policies to promote an enterprise culture; entrepreneurship education and policies to help individuals through the nascent and initial stages of starting a business; and ‘more traditional enterprise support policies’ concerned with the growth, survival and competitiveness of existing SMEs. Essentially, entrepreneurship policies are directly concerned with building the capacity of rural regions to generate new entrepreneurial businesses, while enterprise support policies aim to promote and support the modernisation and upgrading of existing firms through some combination of financial assistance, advice and consultancy, training and infrastructural improvements.

Referring specifically to high growth potential entrepreneurs, Henderson (2002) identifies three types of entrepreneurship policy intervention in the US. While not specifically designed for rural areas, Henderson suggests they address the challenges that rural areas face in delivering support to high-growth entrepreneurs.

- Those that aim to improve the skills of individual entrepreneurs, such as through management or technical skills programmes. In the US, these are typically delivered through the SBDCs, often working in collaboration with universities and colleges.
- Those that seek to strengthen community resources for entrepreneurs, especially mobilising potential sources of venture capital and measures designed to contribute to building an enterprise culture.
- Those that seek to create support networks to help entrepreneurs capture the resources they need, which often include some form of incubator programme.

Many of the programmes that provide funding for entrepreneurship and enterprise development in rural areas are not solely focused on rural enterprise, but include other aspects of economic and social development in rural areas as well. Territorial or area based policies, such as the EU Leader

programme, come into this category, characterised by a holistic approach to rural development. They typically include investment in infrastructure, but frequently also measures to promote new venture creation and small business development.

In this context, an analysis of existing policies for rural enterprise in a diverse set of 10 European regions, led to the identification of five programme types: territorial or area-based; sectoral; economic development; business support and employment/labour market focused interventions (North and Smallbone, 2006). Four key policy lessons with respect to either policy processes or policy priorities were also identified in the same study. These were: the need to make policies appropriate to local circumstances, which can influence the nature and extent of policy transfer; the need to improve the internal and external coherence of policy interventions; the need to encourage diversification in agriculture and land-based sectors; and the importance of overcoming barriers to the adoption of new technologies in rural areas.

Despite the heterogeneity of the 10 case study areas and their emphasis on ensuring that policies are appropriate to the needs of local rural economies, North and Smallbone (1996) highlighted two main policy priorities. On the demand side, they refer to a need to develop potential sources of entrepreneurship in Europe's peripheral rural areas, targeting young people; immigrants; and key existing entrepreneurs who can act as animators and role models. On the supply side, they point to the need to develop the infrastructure to support entrepreneurship, emphasising education and training; as well as the physical and social infrastructure; and measures aimed at overcoming barriers to innovation and enterprise development. Institutional development is central to the successful implementation of all these suggestions.

An alternative typology of rural enterprise policy interventions was presented by Smallbone et al (2003c), based on an analysis of rural policy practice in the UK:

- *Farm and land-based initiatives*, such as farm diversification schemes, local sustainable development programmes; and the activities of Farm Business Advisers, in seeking to integrate business support for farmers into mainstream programmes;
- *Other rural sector initiatives, focusing on non-land based activities*, such as a Village Shop Scheme and tourism initiatives;
- *General business advice/training programmes targeted at small firms*, such as rural outreach for start-ups;
- *Initiatives targeted at minority or disadvantaged groups in rural areas*, such as the long-term unemployed or women; and,
- *Strategic initiatives for rural regeneration*, in which enterprise support was part of a wider economic regeneration programme.

Whilst emphasising the varied nature of the 24 case study projects, the authors identified a number of recurrent and interrelated *good practice* features, based on the appropriateness of the interventions to the distinctive needs of rural enterprises and/or rural areas. These were:

- An integrated approach, in which enterprise support is, integrated into a wider rural development strategy, such as for inward investment, housing, transport and social issues, emphasising the interdependencies within the rural economy;

- Partnership, which can help to mobilise scarce resources, avoid duplication and increase the utilisation of the existing rural infrastructure;
- Contribution to capacity building, which helps to ensure there are long-term benefits from the intervention and increased social capital to act as a future resource for development;
- A bottom-up approach, involving some initial ‘research’ on the part of the community, which helps to encourage community ownership and a grounded approach to rural development, with benefits in terms of adding to social capital;
- A proactive approach to delivery, since experience over a number of years in the UK has emphasised the need for outreach activity and peripatetic advisors to deliver business support in rural areas, particularly since many rural enterprises (e.g. farms and micro enterprises) have been outside the target groups of mainstream business support agencies in the recent past;
- Effective co-ordination of sector specific support with generic business support services;
- Encouraging co-operation and networking between enterprises, which can reduce purchasing costs, involve joint marketing to boost sales and share knowledge; and,
- ‘One stop shops’, involving a common entry point through which all initial enquiries for assistance from entrepreneurs are channelled. This reduces fragmentation and facilitates more effective service delivery.

These features provide a potentially transferable set of policy principles that may be used to guide rural policy development elsewhere with two provisos. The first is that in regions where there is little or no culture of enterprise, a more explicit emphasis needs to be given to links with educational institutions, which are essential if attitudes and behaviour towards entrepreneurship are to change. The second is that a more explicit emphasis on institutional capacity building is likely to be essential, to encourage more entrepreneurial behaviour from institutions serving rural regions.

Areas for policy intervention

This final section of the chapter focuses particularly on the challenges and opportunities facing entrepreneurship development in rural regions in East Germany and the implications for public policy intervention. Rural regions in East Germany share many of the characteristics of, and challenges facing, rural regions in other countries, as well as features that reflect their transition from a socialist planned to a market-based economy. Although varying in detail, all the East German rural case study regions retain a high level of dependence on employment in land-based industries; high levels of outmigration, particularly of young people; and depressed local market conditions for goods and services.

Significantly, federal public policy interventions with respect to entrepreneurship hitherto, which have been applied in these rural areas amongst others, have tended to fuel the pre-existing perception amongst the population that entrepreneurship is essentially an alternative to unemployment. The three-year living allowance offered to unemployed people who start up businesses is an example of this. It is also reported that the better-educated and highly skilled sections of the population that remain in the regions rarely favour entrepreneurship, if employment opportunities are available.

The dominant culture appears to be one of a dependency on state funds and intervention, which may be viewed as the antithesis of an entrepreneurial culture. Moreover, entrepreneurship that is primarily driven by a lack of employment opportunities, rather than pulled by the identification of business opportunities tends to encourage people to set up businesses in activities where entry barriers are low, leading over time to increasingly crowded markets and low returns for business owners. Clearly, in such a context, a major shift in attitudes and behaviour is required, on the part of policy makers and local institutions as well as by the local population, if entrepreneurship is to become a driving force behind future economic development.

Detailed analysis of the East German case study regions (Dabson, 2006) leads to the identification of a number of priorities for entrepreneurship development policy, which may be generalised to other rural regions in East Germany. In the rest of this section, potentially relevant rural policy initiatives drawn from OECD countries are presented in relation to each of these priorities, together with the implications for policies to promote entrepreneurship in rural East Germany.

Promoting an enterprise culture in rural areas where previously it has been low

Changing the culture of rural regions is undoubtedly the biggest challenge facing policy makers in East Germany and one which requires a number of co-ordinated policy actions, if it is to be achieved. At the same time, a fundamental change in attitudes towards entrepreneurship may take at least a generation, suggesting that a successful strategy needs to have both long and short-term objectives and outputs. Educational programmes are an example of the first; targeted support for new business support an example of the second.

The aim is to raise awareness of the entrepreneurship option and demonstrate what can be achieved through the active dissemination of the experiences of entrepreneurial role models. Policy actions designed to achieve this need to engage with different target groups, including young people of secondary school age, as well as those in higher education. The policy initiatives described below illustrate how this might be achieved. The case of REAL (Rural Entrepreneurship through Action Learning) in the US is a potentially relevant example, providing entrepreneurial learning through experience for students, through school-based community development corporations.¹

Within Europe, North and Smallbone (2004) describe an innovative attempt to develop entrepreneurial awareness amongst children of school age in Waldshut in Germany within the School for Commercial Education. It is a junior enterprise scheme involving students from the School, acting as an incorporated enterprise, with marketable products and services on real markets. Participants learn to think entrepreneurially and how to come to a managerial decision, thereby sensitising them to entrepreneurial concerns and opportunities.

Other authors have emphasised the need for an emphasis on programmes which support ‘on-the-job’ training and ‘learning-by-doing’ in the rural workforce, as well as skill acquisition through placements in existing enterprises (e.g. Meccheri and Pelloni, 2006). At the same time, a ‘learning by doing’ approach is difficult in areas where the level of entrepreneurship is low and few dynamic enterprises exist. In such conditions, the introduction of entrepreneurship into primary, secondary and tertiary curricula is a key element in a longer term strategy. However, to achieve this requires a strong commitment to ‘training the trainers’ in the short term to ensure the quality of the student experience is high. Programmes such as the new Masters in International Entrepreneurship Education and Training (IMEET), led by the University of Aarhus, is an example of a programme that can help train

¹ See overview of international learning models and good practice examples in East Germany in the Annex.

staff to lead such an initiative. An example of a potentially relevant start-up initiative is the Leader+ project in the Kellerswald-Dersee region of Germany.²

Active promotion of role models of successful rural entrepreneurs is a key element in raising awareness in the local population of what is achievable, particularly among younger people. In this regard, a recent publication by the Australian government represents a particularly relevant initiative (Kenyon, 2005). The report contains the stories of 20 dynamic rural enterprises, including six that are community-owned. Whilst they are very heterogeneous group, a number of common themes were identified:

- Passion and persistence, without which success in business is impossible;
- Core values and vision, which go beyond the maximisation of profits;
- Community connectedness and involvement, which community and privately owned businesses alike stressed needed to be nurtured;
- Quality customer service, which in all cases involved customer feedback mechanisms;
- Idea obsession, innovation and continuous improvement, stressing the need to stay ahead;
- Leadership and skilled management practices, including knowing when to seek outside expertise;
- Staff pride and involvement, which is typically linked to a strong commitment to staff training and keeping staff fully informed;
- Product differentiation and quality, which in some cases was focused on aspects of the rural environment;
- Collaboration, networking and strategic partnerships, including key players in the community; and innovative marketing.

Whilst many of these are generic entrepreneurial attributes, a number are more specifically tuned to the rural context. One of the main target groups is intermediaries working with young people living in remote rural communities areas in Australia, as part of programmes designed to promote entrepreneurship and the self employment option.

The following policy recommendations can be put forward in light of the OECD findings and key recommendations from the local case studies:

- Actively promote entrepreneurship as ‘a career option’ to young people in secondary schools and in higher education institutions serving rural areas, using a combination of experiential learning through student placements, ‘junior enterprise’ schemes and the active dissemination of entrepreneurial role models;

² See overview of international learning models and good practice examples in East Germany in the Annex.

- Provide support to enable teachers and lecturers in secondary schools, further and higher education institutions serving rural areas, to receive specialist training in entrepreneurship education;
- Prioritise the establishment of support programmes in rural areas to facilitate new business start up, that incorporate pre-start up as well as post start-up support;
- Take steps to actively promote successful rural entrepreneurs in the various regional media; and,
- Establish a portfolio of enterprise awards for successful entrepreneurs, and aspiring entrepreneurs from rural regions, including ‘Young Entrepreneur of the Year’.

Encouraging farmers to diversify into non-farming activities

The pressure on farmers in mature market economies to diversify is almost universal and many governments have introduced policies to encourage and facilitate this process. It has been necessary for farmers to become more entrepreneurial in diversifying into other land-based activities (e.g. organic production, unconventional livestock production, as well as into the formation of non-farm based enterprises (Carter and Rosa, 1998). Farming is not only a business sector in its own right, but also an integral part of a wider supply chain and a vital contributor to rural tourism through its management of the rural landscape. In this context, it is important that farm-related rural enterprises have access to business support, as well as measures to encourage farmers to become more integrated into the mainstream business community (Rural Affairs Forum for England, 2002). The Land Management Initiatives of the Countryside Agency in England was an attempt to apply these principles.³

Research in New Zealand has highlighted the role of farmers’ markets as a launching pad for opportunity entrepreneurs who produce value added goods, as well as necessity entrepreneurs, who may have been squeezed out of the food supply chain (Cameron and de Vries, 2006). A farmers’ market is a common facility where farmers, growers and producers gather regularly to sell fresh fruit, vegetables and other farm products direct to consumers (Payne, 2002).

Farmers’ markets can play an incubator function by allowing new businesses to become established at low cost and minimum risk (Feenstra et al, 2003). They can provide an opportunity for farmers to ‘test the water’ with an entrepreneurial endeavour that involves selling to the final consumer directly. Moreover the concept can be extended to include local craft and related activities, which has been tried with some success in East Lancashire as part of an attempt of the local Business Link to increase its penetration of rural businesses and nascent entrepreneurs (Smallbone et al, 2005, 49).

The following policy recommendations can be put forward in light of the OECD findings and key recommendations from the local case studies:

- Provide access to high-quality business advice and support for farmers interested in diversifying into non-agricultural activities; and,

³ See overview of international learning models and good practice examples in East Germany in the Annex.

- Promote the use of farmers' markets as a means of encouraging farmers to 'market test' new enterprise ideas and activities.

Promoting and implementing an integrated approach to rural development

The shift from a managerial to an innovative entrepreneurial economy (Audretsch and Thurik, 2000) presents particular challenges for rural regions. According to Drabenstott and Henderson (2006), it requires rural communities to engage in partnerships across jurisdictional lines, as well as leadership capacity, which is not always present. In the face of the development challenges facing rural regions in the USA, the same authors identify three main priorities for federal policy:

- Helping rural communities craft new competitiveness strategies, following Italy's example of allocating 15% of regional development funds to train regional officials in 'competitiveness skills';
- Linking federal research instruments (that previously were narrowly focused on agriculture) to rural strategies for innovation in the new economy; and,
- Building a more effective support system for rural entrepreneurs, focused particularly on rural start-ups develop into high-growth businesses.

It has been suggested that in the US, one of the more focused public sector efforts to stimulate and support rural entrepreneurship has been made by the Appalachian Regional Commission (ARC), which highlights the importance of institutional capacity building.⁴

A similar emphasis on capacity building and leadership can be found in the Rural Leadership Programme 2007 of Scottish Enterprise (http://www.scottish-enterprise.com/sedotcom_home/services-to-the-community/rural), which seeks to enhance the leadership skills of agricultural and rural leaders to explain, motivate, influence, promote and defend their sector to ensure its future in the Scottish economy. The aim is to draw participants from the rural sector as part of a countrywide recruitment campaign and the operation of the scheme is designed to build up the necessary awareness of rural policy issues among participants, as well as the network of contacts to maximise their future impact.

An emphasis on an integrated approach to rural development, involving capacity building is central to the EU's Leader programme, which also has the merit of being very adaptable to local conditions. Leader II (1994-99) and Leader+ (2000-6) are concerned with encouraging rural development in local communities, via local action groups, providing funds for a wide range of projects, which involve community-based entrepreneurial actions (North and Smallbone, 2004). Various evaluations have found Leader programmes to be tailored to specific localities, with a high degree of local ownership (e.g. Midmore, 1998). The programme has contributed to the diversification of rural economies, facilitated local capacity building and actively promoted good practice. An emphasis on the dissemination of good practice includes a Website of Leader+ 'good practice' initiatives, drawn from the 25 pre-enlargement members states (<http://intranet.leaderplus.org>). The identification of 'good practice' was linked to the seven Leader+ characteristics, namely area-based; bottom-up; partnership and local Action Group structure; innovation; integrated approach; networking and co-operation between areas; and local financing and management; to which transferability and

⁴ See overview of international learning models and good practice examples in East Germany in the Annex.

sustainability were added. Examples of Leader+ initiatives that are particularly relevant to case study regions are described in the Annex.⁵

The following policy recommendations can be put forward in light of the OECD findings and key recommendations from the local case studies:

- Actively promote the EU's LEADER programme throughout the rural regions and offer workshops to help interested parties to prepare proposals;
- Consider establishing an additional fund to support integrated rural development projects based on LEADER principles; and,
- Provide support for leadership development programmes, based on the Scottish Enterprise model, to enable community leaders in rural areas to develop the knowledge, skills and contacts to promote and lead entrepreneurship development within their localities.

Promoting networking activities between entrepreneurs, potential entrepreneurs and key institutions in rural areas

Because rural entrepreneurs tend to be more isolated physically and have less immediate access to markets and other resources, various types of networking, resources and risk pooling can be especially helpful to them. It may be argued that the limited resources available for businesses in rural areas (e.g. insufficient local markets, distance from major markets, and limited access to capital) require an approach that is systemic in nature.

In this context, the promotion of entrepreneurial networks is a key element in a strategy to develop the entrepreneurial potential of rural areas, contributing to building social capital for economic purposes. Although the empirical evidence base is limited, Lyons (2002) considers an approach to rural social capital building for enterprise development, based on three case studies drawn from the US: a rural business incubation system in NE Alabama; a business incubation programme serving rural Humboldt County in California; and a community-based economic development programme in the Central Appalachian region. Lyons' analysis of the three cases identifies a number of key characteristics associated with successful rural social capital building, including:

- Multiple linkages between numerous participants to develop a networking culture.
- A process-oriented approach to business incubation linked to networking activities, although the approach is process-oriented rather than focused on the implementation of new physical structures.
- A sector-focused enterprise development strategy e.g. food processing, furniture and computer services.
- Social capital building practices that are closely linked to specific barriers to entrepreneurship presented by the rural environment e.g. links to sources of capital; links to external markets.
- Service providers that are willing and able to behave entrepreneurially.

⁵ See overview of international learning models and good practice examples in East Germany in the Annex.

- A combination of formal and informal linkages.
- A need for long-term commitment to maintaining networks over time.

A focus on developing entrepreneurial business support organisations has been identified as a key ingredient in the creation of an entrepreneurial environment in rural America (Centre for Rural Entrepreneurship, 2003). Attributes of entrepreneurial support organisations that are emphasised include a focus on entrepreneurs rather than on the associated businesses; building entrepreneurial support systems that nurture entrepreneurs throughout the entrepreneurial process, from the development of business ideas into viable enterprises; building entrepreneurial environments with the support of both private and public sectors; being strategic, comprehensive and customised in meeting the needs of entrepreneurs in the locality.

Entrepreneurial support organisations may be organised as networks, intermediary organisations or sectoral clusters. Specific activities include: identifying, engaging with and supporting local individuals with the motivation and drive to create successful enterprises; facilitating support networks that include access to mentors and role models; helping entrepreneurs to access capital to support different stages of business development; helping entrepreneurs to access distant markets, such as through participation in trade shows; providing access to technical assistance of various types; engaging in some form of entrepreneurial facilitation, which goes beyond point-in-time training and skills development programmes towards developing long-term partnerships with entrepreneurs.

A common focus for co-operation and networking between entrepreneurs takes the form of joint marketing initiatives, which in the case of food-related activities may benefit from joint branding, as well as from external economies of scale. An example is the Clyde Valley Tomato Growers Initiative in Scotland.⁶

At a European level, Mandl et al (2007) describe a number of case studies involving specific activities designed to foster social capital in rural areas for economic purposes. These include the creation and support of traditional business clusters in areas where companies have no history of collaboration, the creation of business networks for joint distribution of products, and strengthening local tourism. A Spanish example of a traditional business cluster is described in the Annex of this report.⁷

An emphasis on social capital leads to a consideration of the role of social enterprises, which the UK government recognises can contribute to the success of rural communities (Defra, 2005). Social enterprises are defined as ‘businesses with primarily social objectives, whose surpluses are principally re-invested for that purpose in the business or in the community, rather than being driven by the need to maximise profits for shareholders and owners (www.sbs.gov.uk). Detailed investigation of a group of social enterprises in rural Devon emphasised the contribution of certain types of social enterprise to rural service provision to increased social inclusion and community involvement, whilst operating to environmentally sustainable standards (Smallbone et al, 2003b). In the UK, social enterprises are contributing to providing services from community transport, village shops and post offices to childcare provision, where neither the private nor public sectors find it economic to provide. Certain

⁶ See overview of international learning models and good practice examples in East Germany in the Annex.

⁷ See overview of international learning models and good practice examples in East Germany in the Annex.

forms of social enterprise would appear to have a particular contribution to make in building entrepreneurial capacity in rural areas with low entrepreneurial capacity currently.⁸

An example of a social enterprise from rural Dorset in southern England illustrates the contribution that social enterprises can make to a sustainable farming and food industry, particularly through direct sales to the consumer. One way this is being achieved is through farmers' markets, which help farmers reconnect with consumers and also meet the growing demand for local food. Other ways include food co-operatives that aim to bring direct access and greater awareness of the health benefits of fresh fruit and vegetables to those on lower incomes.

The following policy recommendations can be put forward in light of the OECD findings and key recommendations from the local case studies:

- Prioritise support for network development in rural areas, which link nascent and new entrepreneurs to their more experienced counterparts and to relevant institutions;
- Promote and support the development of latent clusters of business activity in rural areas;
- Promote the social enterprise option to rural communities, as a means of generating enterprise activity to improve rural service provision, for businesses and/or rural people;
- Ensure that rural social enterprises have access to high-quality business advice and support; and,
- Prioritise the provision of marketing support for new and small rural firms, such as through joint marketing initiatives and meet-the-buyer events.

Finding innovative ways of increasing access to business services for new and existing entrepreneurs in areas of low population density

One of the key principles in the design of a business support infrastructure to provide advice, training, technical assistance and access to capital for entrepreneurs is client focus, reflected in services being easy to access and tuned in to the needs of clients rather than funders. There is no shortage of examples in North America and Europe, where critics have identified a fragmentation of service provision, a lack of continuity and strategic vision, which is often associated with short-term funding regimes and a lack of embeddedness of delivery agencies. The Entrepreneurship Development Systems in Rural Development project, described by Lichenstein and Lyons (2001) was an attempt to avoid such problems, through a process of competitive bidding for funding by multi-county rural regions, where collaboration and partnership were key criteria used in evaluating competing bids for the funds provided by a private foundation. The principle of competitive bidding for public funds is commonplace in Europe and, as the Leader and Leader+ programmes demonstrate, provides a mechanism for encouraging co-operation between individual and organisations that may have little previous history of co-operation.

Business incubation centres can be particularly appropriate to those rural regions where there is a lack of local advice and business services, although low population and business densities can represent a challenge to their viability. An innovative approach to this problem is the Outreach

⁸ See overview of international learning models and good practice examples in East Germany in the Annex.

Incubator, which is an extension of the Greenhouse Incubator established in Inverness, Scotland in 1999.⁹

Easy access to business services, which helps to avoid creating an impression of fragmentation, can be facilitated by some form of single entry point or ‘gateway’ to the business support system.¹⁰

The following policy recommendations can be put forward in light with the OECD findings and key recommendations from the local case studies:

- Create a fund for projects to find innovative ways of delivering support to rural businesses, which business support agencies and other institutions serving rural areas could bid for on a competitive basis, thereby encouraging them to demonstrate entrepreneurial behaviour; and,
- Promote the active involvement of higher education institutions in entrepreneurship development in rural regions, by establishing a higher education rural enterprise fund to support the development of links between HE institutions and entrepreneurs.

Promoting innovation in rural businesses

Universities have a particular role to play in contributing to innovation in a rural economy, working in close partnership with other institutions. The important potential role that higher education institutions can play in local economic development is increasingly recognised in mature market economies, although achieving significant results in practice requires strong institutional commitment and leadership. The case of the Innovation Group in the state of Kentucky illustrates what can be achieved in a rural context in this regard.¹¹

Rural Kentucky has scenic beauty but also contains some of the economically depressed counties in the US, as traditional sources of employment are no longer able to sustain the regional economy. Barriers to competitiveness include outmigration, a poorly educated workforce, unemployment and an inadequate infrastructure.

The following policy recommendations can be put forward in light of the OECD findings and key recommendations from the local case studies:

- Provide support for a programme of rural business incubators that emphasises the process of business incubation and the active participation of key actors in rural localities as partners; and,
- Provide funds for universities to establish Innovation and Commercial Centres, focused on increasing their capacity to effectively support new and small rural businesses.

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⁹ See overview of international learning models and good practice examples in East Germany in the Annex.

¹⁰ See overview of international learning models and good practice examples in East Germany in the Annex.

¹¹ See overview of international learning models and good practice examples in East Germany in the Annex.

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FINDINGS AND POLICY RECOMMENDATIONS FROM LOCAL CASE STUDIES

OECD

Rural regions tend to be challenging environments for the promotion of entrepreneurship. The seriousness of these challenges obviously varies from region to region, but the main obstacles derive from the small size and low population densities of rural communities, their social and economic composition, and the nature of internal and external linkages. Delivery of public support tends to be more fragmented, and access to banks, suitable premises, high-speed internet access, and specialised technical advice is more difficult. Networking activity between entrepreneurs is limited or has a focus on agricultural activities. The latter often results from the tendency for rural economies to be less diversified than urban ones. Consequently, labour forces tend to suffer from low skill levels, low skill diversity, and a structural mismatch in the local labour market, caused also by outward migration of the young, professionals, and well-educated people.

Experience from other OECD countries demonstrates that a crucial factor for the success of entrepreneurship development programmes lies in convincing farmers, or dependent workers in the agricultural industry, of their ability to become entrepreneurs in terms of seeking to capitalise on new and profitable endeavours by bringing forward new initiatives and not hesitating to take risks. Farmers tend to be an attractive group for entrepreneurial activities because by running their farm, they have already acquired a number of skills necessary for successfully operating a business. However, modernising and diversifying actual entrepreneurial activities is often not amongst the first thoughts of an agricultural entrepreneur. In the districts of Uckermark and Parchim, the former in Brandenburg and the latter in Mecklenburg-Western Pomerania, which composed the local case study area with emphasis on rural entrepreneurship, substantial progress has been made in pursuing this approach. Various initiatives within the framework of LEADER and LEADER+ are aiming to increase partnership building, co-operation and synergies amongst different actors through the establishment of Local Action Groups, as well as to further link different initiatives in diversifying the rural economies in the two districts with wider local economic development strategies that promote entrepreneurship as a motor for job creation and economic growth. The initiatives include group activities that aim to promote the local tourism and health industries, as well as activities that enhance modernising and diversifying existing ventures in commercial agriculture. Both districts are close to the metropolitan centres of Berlin and Hamburg. This offers great opportunities to develop leisure and weekend tourism activities, together with housing for retired city dwellers. The second area of intervention supports entrepreneurs entering alternative business directions, such as organic production of agricultural commodities, producing and marketing for local food systems, and the whole field of biomass and renewable energy. For both groups, policy actions address skill development needs of rural entrepreneurs in professional techniques, as well as business skills, including investment assessment and wider financing issues concerning equity capital and external financing.

The partly rural character of the two districts and their proximity to economic development centres within and outside *Land* [State] borders further underlines a general need for the increased integration of different policy programmes and initiatives and their joining up in local development strategies that can frame entrepreneurship and job creation. Further, the territories regional diversities make the local tailoring of policies and programmes designed at *Land* level a prerequisite for their effectiveness. In terms of integrating policies, it is important that programmes and initiatives undertaken, e.g. in the fields of modernising existing SMEs, general workforce development, strengthening the local and regional science

industry base, and supporting entrepreneurship amongst groups with limited business ownership representation, are clearly linked to each other and are also part of an overall strategy. A number of good practice examples to overcome these barriers to entrepreneurship development in rural areas can be found in the local case study areas. Integrated rural development strategies have been drafted and are implemented. The development of local rural development concepts, so called *Integrierte Ländliche Entwicklungskonzepte*, and the establishment of regional management agencies, *Regionalmanagement*, aim at outlining new economic development perspectives for rural areas. A continued synergy building at *Land* level between the Ministry of Agriculture, leading rural development efforts, and line ministries for entrepreneurship development will also help to further minimise co-ordination problems at local level that may derive from a translation of different priority setting into different strategies implemented by different agencies at local and/or *Land* level. This allows for synergy-building between agricultural production and key economic areas, like renewable energy generation and tourism, and provides a solid local pillar for an effective rural entrepreneurship policy.

A further development of entrepreneurial activity and economic development might be hampered by the demographic challenges posed by an aging population and an ongoing out-migration of young and skilled persons. It is important that new opportunities for rural areas – such as increased demand for rural amenities from urban dwellers, unused resources for economic development through a diversified agricultural industry, the growing interest for rural tourism, and the settlement of firms that select rural areas as new business locations – are recognised by policy and translated into actions. Starting one's own business is, however, only in very few cases an alternative to a migration elsewhere with better job opportunities. Migration can be temporary and policy can influence this. Often, migrants would wish to return after a certain period of time to make use of the newly gained skills and experiences. Providing the right framework conditions for starting one's own business, for business succession, or matchmaking with business's needs for skilled and high-skilled labour are well-piloted approaches developed in OECD regions elsewhere.

What can policy do and what could be activities that foster rural entrepreneurship? The partly rural character of wider parts of East Germany and the proximity of rural areas to economic development centres within and outside *Land* borders further underscores the above-mentioned principle of co-ordinating between and integrating different policies, programmes and initiatives and their joining up at regional and local levels to frame entrepreneurship and job creation. Further, the regional diversity of territories make the local tailoring of policies and programmes designed at *Land* level a prerequisite for their effectiveness. Local actors will be requested to identify local and regional assets and convert them, with the help of government programmes, into entrepreneurial activity. The probability of success in reaching wider markets is often linked to the entrepreneur's or the business's capacity to understand and make use of the opportunities resulting from ICT application in sourcing production means and selling products and services. In peripheral areas especially, a greater usage of e-commerce can help modernise and diversify existing companies by offering ways to overcome the barrier of insufficient local market capacity.

The local case studies in East Germany brought to light several policy recommendations that despite their local provenance, still have certain relevance for other localities in East Germany and elsewhere. Hence, the following list of recommendations should be considered and consulted as check list for policy makers and local organisations when innovating entrepreneurship policy and developing new local initiatives to enhance and strengthen rural entrepreneurship and to diversify rural economies through new and innovative entrepreneurial activities.

Policy recommendations to enhance rural entrepreneurship

- Make regions attractive.* Initiatives should be developed to attract entrepreneurial people from other areas to set up businesses, using marketing and promotion of the districts to a targeted entrepreneurial audience and taking advantage of the local contacts they may have. Local people currently living outside of the districts but who maintain family linkages should be a particular target group for such measures, because they will find it easier to recognise the quality of life and business opportunities the districts have to offer (e.g. lower living costs, access to grants, natural beauty) and may also have social reasons to return.
- Focus on identifying local and regional assets and converting them into entrepreneurial activity.* There is a tendency in economically challenged communities, including those in rural areas, to emphasise their problems and deficiencies, often as a means of attracting public sector investment and support. As a consequence, it becomes difficult to see opportunities that may translate into economic advantage. An intentional mapping of local and regional assets – even the poorest rural communities have some assets, whether human, social, physical, or financial – can yield possibilities that might attract entrepreneurial interest and help improve economic competitiveness.
- Embed entrepreneurship education into the school and college curricula, and into workforce training programs.* Broadening education and career preparation to increase creating and growing businesses is potentially a powerful way to retain young people in rural communities. It also opens up new possibilities for dependent employees in trades and other professions, as well as those in agriculture and forestry, to consider how they can create their own business, particularly when they are not getting adequate rewards from their current employment and do not want to move away to the cities for better prospects.
- Generate local community support for entrepreneurship to increase the chances that entrepreneurs will be successful in their ventures.* If people trying to start and expand their businesses are treated with suspicion or are not valued in the community, they will either abandon their venture or move elsewhere. Rural entrepreneurship has to be embraced by community leaders as an effective alternative to attracting companies to relocate from other places.
- Organise support services for entrepreneurs into effective networked systems for providing resources such as technical assistance and training, access to capital, land and buildings, and regulatory guidance.* The aim should be to bring in ways that increase efficiency and reduce transaction costs while maintaining or improving quality outreach to dispersed rural entrepreneurs. Relationships and networks will be critical in ensuring that integrated and comprehensive support is available for those entrepreneurs with the motivation to create jobs and wealth in rural communities. Particular attention will have to be paid to regulatory frameworks and the time it takes to obtain regulatory approvals.
- Connect rural entrepreneurs to external markets, regionally, nationally, and internationally so that they are not dependent upon stagnant local markets for their goods and services.* Strategies are likely to include the use of information and communication technologies for e-commerce, collaborative marketing strategies that might be sectoral, geographic, or both, and the fostering of networks and exchanges between entrepreneurs across regional and national boundaries. Technical assistance and training will need to be retooled to emphasise the importance of accessing broader markets for products and services. With the right support, good ideas and people can be nurtured through commercialisation to the point at which they can attract venture capital investment. Using the appropriate networks, rural-based entrepreneurs can be connected to resources and markets outside their own region to create successful businesses.
- Foster grass roots innovation.* More should be done to encourage innovation in agricultural and food industries, basic industries and services and in smaller, less capital-intensive companies.
- Expand technology support and activities.* The establishment and further development of external R&D services could help SMEs in rural areas to innovate. It might be that a district perceives itself as too small to create by themselves the innovation support infrastructures necessary for SMEs. In this case, collaboration with neighbouring Districts or thematically related higher education institutions should be sought.

Box 1. Being inspired from good practice in enhancing rural entrepreneurship

[Enterprise Facilitation@ in Rural Kansas – United States of America](#): Fostering an understanding where rural entrepreneurship is considered an effective alternative to attracting companies to relocate from other places.

[Dundalk's integrated development strategy – Ireland](#): Facilitating access to finance through partnerships with banks and venture capital organisations.

[Entrepreneurship Development Systems in Rural America – United States of America](#): Building a comprehensive entrepreneurship development system that combines financial incentives and technical assistance and joins the efforts of public, private, and non-profit actors.

[Talent Attraction – Scotland – United Kingdom](#): Revitalising a primarily rural, sparsely populated and extremely peripheral area, such as the Highlands and Islands region of Scotland.

[Innovation and Entrepreneurship in rural Kentucky – United States of America](#): Supporting the tapping of external markets through regional cluster development in rural areas.

[Energy Cluster Initiative for North East Brandenburg - Germany](#): Innovative ways in renewable energy generation and usage.

[Rural Entrepreneurship through action learning \(REAL\) in rural North Carolina – United States of America](#): Fostering entrepreneurial activity amongst school students in rural areas.

[Strategies for a sustainable entrepreneurship in Appalachia – United States of America](#): Building regional markets for rural entrepreneurs.