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Barrier to entry or barrier to growth

The research of Adam Fremeth suggests it's not easy for policymakers to get banks to lend to new entrepreneurs

President Barack Obama recently talked tough to the banks, telling them they owed it to the country to lend more to small business. He said that the banks, as recipients of billions in bailout money, had a responsibility to get credit flowing again.

Despite the extraordinary circumstances, banks may be reluctant to make major changes to their lending practices. "Banks don't always do what the government wants them to," says Ivey Professor Adam Fremeth, who studies the interaction between the public and private sectors. "Governments create policies with clear intentions, but what actually happens is sometimes quite different."

In a recent paper Fremeth studied the effects of the liberalization of the U.S. banking sector that took place during the early 90s. At the time policymakers were looking to stimulate more lending by easing restrictions. Their goals were two-fold: to grow the economy and give entrepreneurs more access to credit.

Policymakers recognized that entrepreneurs were a key driver of economic growth, and were concerned that banks weren't giving them much help. Research showed then, as it does now, that entrepreneurs have to look outside the traditional banking sector to raise capital. They tended to rely on informal networks, such as family and friends, with some occasional help from angel investors. Policymakers felt that the existing financial system acted as a barrier that prevented entrepreneurs from starting new businesses, and they wanted to change that.

In 1994 the Clinton administration passed the Riegle-Neal Act, which repealed interstate banking restrictions and allowed banks to lend to borrowers outside their local markets. The idea behind the legislation was that increased competition would lead to growth in overall lending, and result in more entrepreneurial activity.

Scholars have generally believed that the Riegle-Neal Act achieved its objectives, but Fremeth was not convinced that it actually helped entrepreneurs. Using information from the U.S. Census Bureau, he did a statistical analysis to find out exactly what happened.

He focused on the five years following the full implementation of the Act, from 1998 to 2002. During this period, the number of interstate bank branches increased from about 15,000 to 25,000, a dramatic increase. To measure overall growth in the economy, Fremeth measured the number of firms and the

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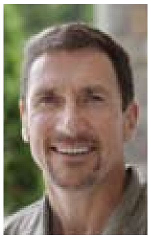


Institute Buzz

By Stewart Thornhill, Executive Director, Pierre L. Morrissette Institute for Entrepreneurship

If entrepreneurship were a season, it would have to be spring – the season of new growth, new beginnings, and endless possibilities.

In a few weeks, the class of 2010 will emerge from Ivey's hallowed halls and be transformed into Ivey alumni. While many new grads will pursue careers in finance and consulting, others will launch their own new ventures, having been introduced to a world of possibilities through the Ivey New Venture Project and Certificate in Entrepreneurship programs, and inspired by entrepreneurial alumni who shared their experiences and expertise with the next generation of Ivey Entrepreneurs.

Spring is also the season for business plan competitions. The Wes Nicol HBA Competition and the IBK Capital – Ivey Business Plan Competition for graduate students are highlights of the academic year, at which students present their business plans to panels of A-list of entrepreneurs and investors who serve as judges.

The theme of new beginnings extends to academic research, as well. In this issue of *Ivey Entrepreneur*, we present Adam Fremeth's research on the impact of banking policy on early stage and start up new ventures, and congratulate Simon Parker on the publication of his latest book, *The Economics of Entrepreneurship*.

We are delighted to welcome three new members to the Advisory Council of the Pierre L. Morrissette Institute for Entrepreneurship: Ian Aiken, HBA '87, Melinda Lehman, MBA '94 and Larry Rosen, MBA '81 will add their entrepreneurial expertise, ideas and energy to our dynamic team of leaders and mentors.

Rounding out the roster of new beginnings are a number of outreach and networking events, including a Business Families Leadership Summit, Alumni Association Chapter events in Ottawa and Toronto, and the 6th annual Quantum Shift Program for Canada's top entrepreneurs

It's a new year. It's spring. Let's go Ivey Entrepreneurs!

CONTINUED FROM PAGE 1

size of the firms. He based firm size on the average number of employees.

Fremeth found first that the increase in interstate banks resulted in the growth of existing firms. In this respect the policymakers achieved their goal of growing the economy.

He also found that all the growth took place among small to mid-sized firms that were already established. The data showed a significant increase in the number of firms with 20 to 100 employees. Entrepreneurial activity, on the other hand, remained unchanged. Fremeth's analysis showed an overall reduction of firms with five to 19 employees. The number of firms with less than five employees stayed the same. "What we see happening from the data is a transition from small to mid-sized firms," he says. "If liberalization had resulted in more entrepreneurs, then you would see growth in the number of those smaller firms."

Fremeth's research establishes that the clear beneficiaries of liberalization were firms that already had established relationships with banks. The banks, rather than seeking out new opportunities among budding entrepreneurs, helped existing clients take advantage of opportunities to expand. Despite the new regulations and increased competition, banks continued to rely on strategies and core competencies that they had already developed. These tended to exclude lending to entrepreneurial ventures because they failed to meet standard loan requirements. "The entrepreneurial firms lost out to the incumbent firms," says Fremeth. "Basically, the goals and objectives of the policymakers did not come to fruition."

The lesson from Fremeth's study is that the traditional banking sector basically exists to help businesses that are already on a solid financial footing. Bank procedures and lending practices are well entrenched. If policymakers want to change banking behaviour, they need to think carefully about how banks are going to respond to policy and regulatory initiatives. "They have to find ways to actually change bank strategy," he says. "Policy initiatives need to be much more targeted and focused on the entrepreneur."

Fremeth's paper also has an important message for entrepreneurs: don't count on the government to develop policy to help you start your business. "During the startup and early stages of your business you need to rely on your social networks and what you are able to bring to the table," says Fremeth. "You then have to lift yourself to a position where the bank will see you as a customer they're willing to lend money to."

Even though it may not result in immediate financing, Fremeth suggests it's a good idea to try to develop a relationship with a bank as early as possible. This relationship will help you access capital once you've established a solid financial track record.

Fremeth's research also advances an ongoing debate in academic and policy circles: does enterprise lead finance, or does finance lead enterprise? His findings give weight to the former. "Good opportunities and innovation seek out finance, not the other way around," he says. "Despite the hopes of policymakers, banks will tend to follow the strategies and lending practices they already have in place. Banks will not rush in and start lending to every entrepreneur who has a good opportunity."

about the author

Adam Fremeth

Assistant Professor

Business, Economics and Public Policy

Alumni Spotlight | Congratulations

Ivey Entrepreneur salutes Ivey alumni and supporters who have been recognized for their entrepreneurial accomplishments by industry associations and peers. Please join us in congratulating fellow Ivey Entrepreneurs:

Canada's 50 Best Managed Companies (2009)

- Harry Rosen Inc: Larry Rosen, MBA '81, Chairman & CEO
- Pelmorex Media Inc: Pierre Morrissette, MBA '72, President & CEO
- Sifton Properties Ltd: Founding Sponsor, Ivey Business Families Centre

Profit W100 – Canada's Top Women Entrepreneurs (2009)

- Kelsey Ramsden, MBA '04, Project Manager, Tallus Development LTD
- Madeleine Paquin, HBA '84, President & CEO, Logistic Corp

Ernst & Young Entrepreneur of the Year (2009)

- Emerging Entrepreneur (Ontario)
  Robert Deluce, HBA '01, MBA '05, Executive Vice-President, Porter Airlines Inc
- Business-to-Consumer Products and Services (Ontario)
  Anton Rabie, HBA '94, Co-Founder & President and Ben Varadi, HBA '94, Executive Vice President, Spin Master Ltd
- Business-to-Consumer Products and Services (Atlantic)
  David Wilson, MBA '65, President, The Wilson Group of Companies
- Business-to-Business Products and Services (Pacific)
  Brett Hodson, MBA '02, President, The Corix Group

Upcoming Events 2010

Quantum Shift Program	Sponsored by Ivey & KPMG Enterprise	May 3-8, 2010	Spencer Leadership Centre, London
Quantum Shift Fellows Conference	Sponsored by Ivey & KPMG Enterprise	May 12-14, 2010	Spencer Leadership Centre, London
Fireside Chat with alumni entrepreneur	Hosted by IAA Ottawa Chapter	May 12, 2010	
Buying and Selling Private Ventures	Hosted by IAA Toronto Chapter	May 13, 2010	First Canadian Place Gallery, Toronto
Entrepreneur 1.0: The Ultimate Bootcamp	Hosted by Ivey & TechAlliance	Tuesdays, October 5 – December 7, 2010	London, Ontario
3rd Annual Ivey Venture Forum	Hosted by Ivey and IAA Toronto Chapter	November 2010	Toronto, Ontario
2nd Annual Ivey Venture Forum	Hosted by Ivey and IAA BC Chapter	November 2010	Vancouver, BC

An economist-eye view

Simon Parker's new book will be a valuable resource for anyone with an interest in entrepreneurship

"Economists have discovered that you can't really understand the creation and evolution of wealth without an understanding of the economic impact of entrepreneurs."

That's Simon Parker, talking about his new book, *The Economics of Entrepreneurship*, recently launched by Cambridge University Press. Parker is the Director of Ivey's Centre for Driving Growth through Entrepreneurship and Innovation. Parker's new book follows its predecessor, *The Economics of Self-employment and Entrepreneurship* (Cambridge University Press 2004), regarded as an essential reference for academics.

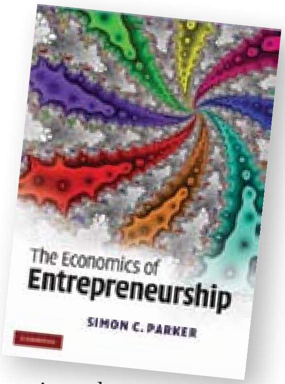
The Economics of Entrepreneurship brings together a complete overview of the literature on entrepreneurship from an economic perspective. "The economics of entrepreneurship explains how economic incentives influence entrepreneurs and how entrepreneurial behaviour affects the broader economy," says Parker.

The statistics tell a compelling story. Entrepreneurs in the United States, for example, account for less than 9 percent of households, yet hold 40 percent of the nation's net worth. One-half of the richest families in America are business owners. Of the 400 wealthiest Americans, about 60 to 80 percent are entrepreneurs, and nearly all the rest inherited their wealth from entrepreneurs.

Parker's new book has something for everyone with an interest in entrepreneurship. It's written in an engaging and direct style, so it's easy to follow for those who don't have a technical background. In addition to being a valuable reference for researchers, it's a broad-based resource for graduate students and undergraduates. Policy makers are also a key audience for the book. "You can't create good public policy toward entrepreneurs without an understanding of economic concepts," says Parker.

The book is also an important guide for entrepreneurs, including groups that are underrepresented in North America, such as women and ethnic entrepreneurs. "There is a lot of detail in the book that would be helpful to anyone configuring their own business," says Parker. "There are various lessons we've learned and insights we've gained that should make entrepreneurs stop and think."

The book is divided into four parts. The first part, "Selection," describes the people who become entrepreneurs, and the economic incentives and influences that shape them. The second part, "Financing," explores the issues of raising capital, and looks at intriguing questions such as whether potential entrepreneurs are constrained by credit restraints (buy the book to find out!). The third part, "Performance," focuses on how entrepreneurs contribute to job creation, innovation and growth. The fourth part, "Public Policy," examines the principles of policy and evaluates specific policy initiatives designed to promote entrepreneurship.



The Economics of Entrepreneurship is designed to serve as a comprehensive guide to entrepreneurship for those in a variety of disciplines, not just economics. "It will help researchers, students, and entrepreneurs cover all the literature quickly, or get up to speed on a particular topic," says Parker. "The biggest contribution of the book is that it really organizes the field for the first time."

The Economics of Entrepreneurship by Simon Parker can be purchased online from either Cambridge University Press or Amazon.

about the author

Simon Parker

Associate Professor

Director, Driving Growth Through Entrepreneurship & Innovation Cross-Enterprise Leadership Research Centre

MBA '80 Professor in Entrepreneurship

Student Watch | 2010 scholarships & awards

Each year, the Institute delights in bestowing scholarships and awards on Ivey students who embody an entrepreneurial spirit and drive along with outstanding academic achievement and proven leadership skills. We could not recognize these stellar individuals without the dedicated support of donors who provide nearly $200,000 in entrepreneurial scholarships and awards.

On January 28, 2010, donors and recipients attended an awards banquet celebrating Entrepreneurship at Ivey. The Institute extends heartfelt thanks to our award donors and congratulations to our 2010 student recipients:

ACE HBA Award in Entrepreneurship

Donor: Ian Aikten, HBA '87

Recipients: Nick Yang, HBA '11; Jordan Peckham, HBA '11; Johnathon Quinn, HBA '10

Benjamin D. Anyon MBA Award in Entrepreneurship

Donor: David Anyon, EMBA '97

Recipient: Neha Agrawal, MBA '10

John R. Currie HBA Award in Entrepreneurship

Donor: John R. Currie, HBA '60

Recipient: Kim Wallace, HBA '10

Nelson M. Davis Scholarship

Donor: Nelson M Davis Trust Fund, c/o Bruce Lloyd

Recipients: Andrew Baines, MBA '10; Patrick Smith, MBA '10

Gudewill Scholarships

Donor: Gudewill Family

Recipients: Becky Carlin, HBA, '10; William Richman, HBA '11

Hydrogenics MBA Award in Entrepreneurship

Donor: Pierre Rivard, MBA '83

Recipient: James Pan, MBA '10

Pierre L. Morrissette Doctoral Scholarships

Donor: Pierre Morrissette, MBA '72

Recipients: Fei Zhu, PhD Candidate; Michael Sartor, PhD Candidate; Matthias Tietz, PhD Candidate

Pierre L. Morrissette HBA Award in Entrepreneurship

Donor: Pierre Morrissette, MBA '72

Recipient: Laurie Anne King, HBA '10

Tevya Rosenberg HBA Scholarship in Entrepreneurship

Donor: Teddy Rosenberg, HBA '73

Recipient: Ellen Zhu, HBA '11

Schulich Award for Entrepreneurship

Donor: Seymour Schulich

Recipients: Ryan Hall, MBA '10; Piyush Sehgal, MBA '10

Bruce Lloyd with MBA students Andy Baines and Patrick Smith

Pierre Morrissette, MBA '72 with PhD students Fei Zhou and Matthias Tietz

Geoff Gudewill, MBA '83 with HBA students Will Richman and Becky Carlin

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This newsletter is published for individuals in business and academic life who have a particular interest in entrepreneurship. If you have any comments or questions please contact us. If you or your organization would like to obtain a copy of this newsletter, free-of-charge, please contact:
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