

Job and Enterprise Creation Schemes

David Ellerman
Economics Department
University of California at Riverside
www.ellerman.org
August 2005

Introduction

Every company has two products: its product and itself. By "itself" is meant the company as an organization of people trained in the systems necessary to run the business and in the technologies necessary to produce the products or services of the company. While some skills are already possessed by people when they join the organization, the company still has to have the training capacity to specialize those skills to the systems and technologies specific to the firm. And as people leave or retire, the company has to recreate those human capabilities within the firm.

While the company's ordinary products may be protected by patents and trademarks, there is generally no such exclusive rights over the human capabilities developed in the company. When those capabilities leave the company, then it is a positive externality. In A. C. Pigou's classic book on normative economics, he noted that the businesses in a country provided the positive externality (meaning their social product exceeded their private product) of training people in business:

One very important indirect service is rendered by the general economic organisation of a country in so far as, in addition to fulfilling its function as an instrument of production, it also acts, in greater or lesser degree, as a training ground of business capacities.¹

Modern economics texts seem to have lost sight of this fundamental point that existing businesses are major training grounds for entrepreneurial and managerial capability and major incubators for new businesses. Yet the conventional business sees this social product as no part of its corporate goals. Quite to the contrary, businesses want to grow by expansion rather than spin-offs and they want to retain their potential future managers rather than lose them to new businesses.

In a vibrant entrepreneurial environment, such as Silicon Valley in California or Silicon Gulch in Taiwan, people routinely leave companies, often together with some colleagues, to start new companies. But this tends not to happen in poorer business environments—a fact that may be both cause and effect of the underdeveloped environment.

In biological terms, there are two ways in which the biomass is increased: existing life getting bigger or existing life having offspring. Diminishing returns set in as companies get bigger and the same happens to biological organisms. The limits of increasing

¹ Pigou, A. C. 1920. *The Economics of Welfare*. (4th ed.) London: Macmillan, p. 204.

biomass by existing creatures getting larger in size are soon reached. Most of the biomass that covers the globe comes from the second strategy of having offspring. Indeed, biology gives little choice. While organisms can grow larger within certain limits, the organism must eventually die and so the DNA can only survive by having offspring.

Corporations are subject to various forms of diminishing returns to increased size but they have no natural limitation on lifetime. Hence the first tendency of companies is preserve their "business DNA" by growing bigger rather than fostering offspring. In this sense, the company's "second product" (its trained people) is sterile—particularly in a less-than-vibrant business environment; the company may grow but it does not breed. Hence there is relatively little increase in the "economic mass" and the business environment stagnates. That is the conundrum.

This conundrum pointed out by Pigou gives grounds for some public policy support to schemes that try to improve the social role of existing businesses as spawning new businesses. Pigou also recognized that some organizational forms more than others might lend themselves to this social role. In particular, "associations of workers combined together in small co-partnership workshops" would constitute the "first school in which this capacity can be developed" and thus such companies would contribute to the community not just "boots and shoes" but the second product of "well-trained competent" people [ibid., 205-6]. There are also examples where more conventionally organizations have promoted this role (see below on Thermo-Electron and 3M).

An appropriate role for a medium-to-large company in a developing country would be to structure itself in part as an incubator for spin-offs and break-aways of related but majority locally-owned (preferably cooperatively owned) companies to maximize local business development and job growth. How could this be done?

How might a company foster offspring? In the remainder of this note, four ways are described for a company to accelerate the production of its "second product" (trained people) to foster offspring.

1. Sheltered or associated spin-offs of routine products and services as separate companies.

Inside any medium to large-sized company, there are routines products or services provided for the company such as printing, graphics design, catering or food services, trucking, and cleaning services. These could be organized first as a separate profit-center and then as a 'sheltered spin-off' majority locally or cooperatively owned with a multi-year contract with the mother firm. But as a quasi-separate firm (associated with the original firm or group of firms), it would be free to do business with other companies to expand its market. There is only so much printing etc. that is needed by any one company. That will create job growth to serve the expanded market. Moreover, it will build entrepreneurial and managerial skills on the part of the people leading the spin-off.

This strategy should be differentiated from “out-sourcing” where the purpose is to reduce the payroll of the mother company and introduce competition in the supply of those services, not to expand the market and jobs in the business unit. The spin-off could remain associated with the original company perhaps even carrying part of its name, e.g., Acme Printing, Acme Food Services, or Acme Trucking as spin-offs from Acme Company. It should have a multi-year sole-source contract to counteract any suspicion that it was just an “out-sourcing” scheme.

Eventually a group of companies might form around the original mother company. The group might sponsor a second-tier organization to help spawn more offspring.²

A slight variation on this theme occurs when a production company wants to eventually upgrade machinery. Given limited space, they may scrap the old machinery and replace it with the new equipment. But there might be several years of effective operation in the old equipment which could be moved off-site to a more disadvantaged area as a job-creation scheme. Some workers in the factory might take that as an opportunity to start their own production shop with low start-up costs and some guaranteed sales but where they have the possibility to finance other machines and produce parts for other clients. This type of urban-to-rural spin-off helped to fuel the rural industrial development in township-village enterprises in China.

2. ‘Ad hoc’ or ‘Light Touch’ franchising: Seconding entrepreneurs to learn about a business

Most entrepreneurs do not start from scratch. They have worked in companies and learned how companies operate first hand before striking out on their own with some colleagues. But in many cases an entrepreneurial individual may not have had that relevant experience so an economic development agency could sponsor secondments in an existing company (e.g., by paying most of the salary of the seconded person). The seconded person would work with the manager and various departments to learn about their functions. Since the existing company would not want to be training new competition, the new company would have to commit to operate in a non-competing zone, e.g., in another city outside the business region of the original company. If the new company develops well, there might be future business partnerships with the original company where the entrepreneurial received the training.

This could be thought of as an ‘ad hoc’ or ‘light-touch’ franchise. A franchise also tries to replicate the business systems and procedures of an existing company and to insure that such clones will be in non-competing niches. But franchising requires a rather sophisticated legal system to enforce all the intellectual property rights. And franchising is a rather top-heavy system due to the large up-front fees and strict rules since all the franchisees will be advertising under the same name and should be enforcing the same

² See my case study of such a “factory factory” in the Mondragon cooperatives: *The Mondragon Cooperative Movement*. Case No. 1-384-270. Harvard Business School 1984, also available on my website: www.ellerman.org under the button “The Firm: Theory and Practice.”

quality standards. Hence this light touch franchising scheme tries to use as a development tool the enterprise multiplication or replication part of the franchise idea without all the other top-heavy parts of the system.

3. Spin-offs of new products using an existing technology

When a company learns or imports into a country the technology or know-how X to produce product A, then often with minor new knowledge, the technology can also be used to produce other products B and C. But those other products may have a different customer base, require different suppliers, and be outside of the original business focus of the company. Hence companies will not pursue those other feasible products in order not to confuse the strategy and dilute the managerial attention-span of the company. But a few individuals might very well spin off from the company to produce B or C. This is particularly feasible in the information technology industries where the capital requirements to produce the other products may be minimal. This sort of spin-off is commonplace in the business environment of Silicon Valley or Taiwan. In Taiwan, there is the saying that the people leading the spin-off would “rather be the head of a chicken than the tail of an ox.”

In an ordinary company, there might be some resistance to fostering spin-offs since talented and already-trained people will be leaving the original company. And, more to the point, it reduces the “empire” under the direct control of the management of the mother company.

In the case of the Thermo-Electron group (www.thermo.com), there is a rule that every new product must be produced in a new company. The mother company owns a portion of the “spin-out” to help alleviate the tendencies to resist spin-offs. Now the children have had children on the same principle so the Thermo group has some 80-odd companies. It is doubtful that such creativity and growth could have been released if it had been confined to one company. Yet this is the exception, not the rule, in conventional companies due to the desire to maintain the ownership and control of the “empire” and any hidden profit potential it might have. Think of how many companies there would be in the “MicroSoft Group” if every new product meant a new company.

Most companies would rather try to exploit such opportunities in a multi-divisional structure. Such a structure could facilitate some growth (e.g., the 3M company—now nicknamed the “Mutation Machine from Minnesota”—is a rare example) but it seems that the growth opportunities would be maximized from the social (job creation) viewpoint if the new products were produced in a new company that was not just a division or controlled subsidiary of the mother company.

4. Local procurement as an enterprise-creation strategy

Many companies routinely buy simple things from elsewhere (e.g., retail packaging for products that could be imported in bulk) that could be produced locally. Even where there is an established local producer, it might be better to use this demand to foster a start-up or new facility from the established local firm in a disadvantaged area.

This is also the strategy behind local content requirements for multinational companies using a country as a cheap-labor production platform. With some upgrading (e.g., ISO 9000), local companies might be able to produce components previously imported. Those programs eventually have to be extended back into the technical and vocational educational institutions of the country.

In starting or expanding a business, one of the basic concerns is the market for a product. Yet whenever something is being imported, then there is, *ipso facto*, some local market. Thus the idea is to scan the list of imports to see which could be produced locally—perhaps with some training and upgrading of skills. This idea might be combined with some of the other ideas. For instance, people from a disadvantaged area might be temporarily seconded to an established firm to learn the necessary skills and systems to set up the company where the jobs were needed. There could be incentives or acknowledged satisfaction of social responsibilities for the established firm.

Concluding Remarks

All of these schemes could be promoted by companies themselves or by development agencies or ministries with appropriate financial incentives. One theme running through these examples is that economics should imitate biology in the sense that existing businesses are the best sources and incubators for new businesses. Bio-mass expands primarily by old life spawning new life, not by old life getting bigger. The ideas broached above are ways to similarly increase the “economic-mass” in a country by getting old firms to spawn new firms. These ideas have been primarily inspired by the economic development thinking of Jane Jacobs in *The Economy of Cities* (1969) and in *Cities and the Wealth of Nations: Principles of Economic Life* (1984).³

Another underlying principle is to look at how desired outcomes happen spontaneously (e.g., Silicon Valley in California or Silicon Gulch in Taiwan) without deliberate programs—and then try to see how programs can deepen those channels so that streams can swell to become rivers. Too often, development agencies tend to think of isolated entrepreneurs creating new enterprises from scratch—yet that is rarely the way it actually happens. The challenge with the creation of more jobs and new enterprises is to figure out how to get existing businesses to more consciously and deliberately play that role as the generator and incubator of new businesses.

One of the big problems in implementing the above ideas is desire of managers and owners to maximize their empire and the “shareholder value” orientation of companies both of which conspire to keep any potential off-shoot under the ownership and control of the mother company—in other words, no new life, only the expansion of old life. Where companies are organized cooperatively like Pigou's worker co-partnerships or as in the Mondragon complex of 100 or so companies in the Basque country of northern Spain

³ For more of this background, see my paper: Jane Jacobs on Development. *Oxford Development Studies*. Vol. 32 (4 Dec. 2004), 507-21, or How Do We Grow?: Jane Jacobs on Diversification and Specialization. *Challenge*. 48 (5 May-June): 50-83; also on my website www.ellerman.org under the “Development Issues and Helping Theory” button.

[\[http://www.mcc.es/ing/index.asp\]](http://www.mcc.es/ing/index.asp), it is easy and natural for one democratic firm to expand by becoming two democratic firms each controlled by its staff or to have cooperative spin-offs.

With unitary “ownership,” the tendency is only to have new divisions or wholly-owned subsidiaries which have a rather different dynamics in (not) fostering local economic development. The challenge to economic policy in a non-cooperative context is to see how these tendencies of conventionally owned companies can be overcome to increase the role of existing businesses in creating new businesses—or to move the environment more in the direction of democratic businesses that can naturally spawn offspring.

In conclusion, the focus of economic policy for job creation should not be expecting jobless individuals to create jobs or expecting existing companies to expand their current businesses to create jobs. The focus should be to get existing companies to indirectly create jobs by fostering spin-offs of routine segments, as-if franchises, spin-offs putting existing technologies to new uses, and new segments to produce goods that are currently imported. Each company's second product, its production of a staff trained in doing business, has potentially significant positive externalities for the local economy so there are grounds for governments to create incentives to increase those positive spillover effects.