Tales of an early-stage entrepreneurial ecosystem for startups in Cyprus: Prolific, superficial and dysfunctional?



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Bernard Musyck and Dariia Robota, present research on the Cypriot entrepreneurial ecosystem for startups and highlight the need to create a system that inspires collaboration and re-investment from successful entrepreneurs, rather than the search for startup heroes.

:Introduction:

Startup companies have gained considerable attention in recent years as an effective tool for promoting innovation and job creation.

Startup companies remain fragile and often fail to survive during their first years of existence due to various reasons such as unfavorable business environments, lack of proper financial support and insufficient managerial skills of the founders.

There is ample literature focusing on exploring characteristics and success factors of large, well established innovation clusters like Silicon Valley, whilst smaller less developed regions remain relatively poorly understood.

Cyprus, with its liberal economy, low corporate taxation, affordable and attractive living conditions, has seen the emergence of an increasing number of startup companies. It is a small open service-based economy with tourism, financial and shipping services accounting for the lion's share of domestic wealth creation. The small Mediterranean island is dominated by small and medium-sized enterprises which account for 72% of value added compared to 57% in the rest of the EU (European Commission 2016:2, SBA Fact Sheet Cyprus). Cyprus boasts one of the lowest expenditures on Research and Development (R&D) activities (0.46% of GDP in 2015) when compared to the EU average (2,03%), along with Romania (0,49%), Latvia (0,63%) and Malta (0,77%) [Eurostat 2017, CyStat 2017 (Cyprus Statistical Services)]. According to the European Startup Monitor (European Startups Monitor 2016), Cyprus's startups are mainly concentrated in the service sector, serving business-to-business needs notably in the Information and Communication Technology (ICT) sector.

Cyprus's entrepreneurial ecosystem is characterised by the presence of the necessary basic framework conditions, including physical infrastructure, research institutions, as well as qualified human resources and supporting government initiatives. However, systemic conditions, including networks, leadership, finance and adequate support service were found to be underdeveloped.

Focus on early stage startups

Our study of the Cypriot entrepreneurial ecosystem indicates that there is a

strong belief within the community that a higher number of startups will benefit the ecosystem, whilst little consideration is given to the quality of those startups.

The issue of quantity versus quality of startup has been discussed by Isenberg (2014) who argues that there is no evidence to confirm that increasing the number of startups will stimulate economic growth. Similarly, Shane (2009) underlines that instead of focusing on the creation of startups, policymakers would gain from targeting resources towards innovative, growth oriented ventures.

Our own findings suggest that the Cypriot ecosystem is becoming overwhelmed with so-called startups that are actually just small businesses without much growth potential.

We have observed, mainly young local entrepreneurs, engaging simultaneously in several entrepreneurial ventures and neglecting those companies during their growth phase. The number of startups in Cyprus is growing each year, yet the value added of these companies remains usually relatively low; there are many startups in their early stage of development but few make it to the advanced stages of growth. In the words of a local entrepreneur, "… the ecosystem may become oversaturated with startups, programs, accelerators, incubators, and there will be no success stories… eventually good projects will be missed". Thus, initiatives and programs supporting the Cypriot ecosystem mainly serve early stage startups; the ecosystem's institutions work to motivate and attract an ever increasing number of new entrepreneurs into the community, yet there is no focus on later stage ventures and support for a sustainable entrepreneurial community.

Limited deal flow

Isenberg (2011) explains how investing extensively in the ecosystem will not necessarily lead to expected positive results since one of the most important tasks of policy actors is to provide venture capitalists with substantial and steady deal flows. This is not the case in Cyprus where the limited deal flow and low-quality of startups have seriously curtailed the development of venture capital funds. Although a number of initiatives were implemented to support investors' initiatives (notably tax incentives), these eventually have become meaningless because of the absence of high-quality innovative startups in the market. Instead,

early stage funding takes centre stage within the ecosystem: startup competitions, accelerators, incubators, business angels are offered to the community of entrepreneurs, who in the end, often need to rely on personal savings and support from family and friends to develop their venture.

Having said this, the role of venture capital in entrepreneurial ecosystems can also be overestimated and not all startups will rely on it to succeed (Feld, 2012). In other words, attracting more venture capital (by means of tax breaks) might not be a necessary condition for success. In the specific case of Cyprus, it might be more reasonable at first to activate and engage local resources: build and develop strong innovative ventures through support and proper mentorship, facilitate networking between local investors and entrepreneurs so that they can learn from each other and finally, and most importantly, educate local investors to make more informed decisions and become less risk averse. In the words of a local entrepreneur and mentor: "There's too much focus on trying to create investment funds … My point is that money is always there …, but what you really need to do is to put the environment in place that will allow these startups to begin to learn about their journey in the right way".

Lack of understanding and experience

Public and private actors alike create a lot of buzz around the idea of "entrepreneurship" and "startups", they "import" incentive programs and ready-made solutions seen abroad for immediate implementation on the island. These initiatives often fail because they do not sufficiently take into account the nature and needs of entrepreneurs in Cyprus.

Government initiated programs often come with excessive bureaucratic burden during the application process, huge delays during the assessment of proposals and the allocation of funds: "…the procedures for application were very difficult so we didn't bother to apply. This is not how startups work. Startups need to be flexible, they can't wait for so long and they need trust". One of the schemes on offer required a detailed business plan from the applicant and this was viewed by the community as simply absurd: "…startups don't operate with business plans, you can't tell a startup to plan 3 years in advance … they really don't know what they will be doing in six months… this is sending the wrong signal."

It is to be expected that mentors operating in incubators and accelerators have

background experience in private sector entrepreneurship (Motoyama, 2015). In Cyprus the reality is somewhat different; there are not enough experienced people engaged in the ecosystem, including successful serial or former startup founders, who really understand what entrepreneurship is and are able to validate ideas and provide proper support. When it comes to funding schemes, business competitions and incubators/accelerators programs, candidate entrepreneurs are evaluated and selected by people who themselves have rarely worked for a startup company. In the words of a local entrepreneur: "…my observation is that people involved [in the ecosystem] have a different agenda, they don't have entrepreneurial experience, so they can't evaluate or help… they have never been founders, they don't know the lessons".

No systemic functions

Cyprus boasts a high rate of entrepreneurs. Cypriots are often characterized as having a strong entrepreneurial spirit but this may have little to do with the existence of entrepreneurial skills. One can reasonably assume that this relative lack of entrepreneurship skills may explain why companies display a low survival rate and why startups often don't reach later stages of growth. However, one can hardly notice their presence in the ecosystem as mentors, investors or co-founders.

The practice of successful entrepreneurs reinvesting back their expertise and wealth into the ecosystem is still underdeveloped in Cyprus. Experienced entrepreneurs tend to shy away from joining new startup teams, it is not part of the local culture and it is perhaps perceived as a bad time investment. Yet, the Cyprus entrepreneurial ecosystem desperately needs the involvement of experienced entrepreneurs to act as mentors, private investors and/or co-founders.

Our study leads us to assume that there is no culture of sharing and support; what is described in the literature (Feld, 2012) as "give before you get" philosophy (i.e. the existence of non-zero-sum game in the ecosystem), seem to be absent in Cyprus. Instead, the system displays signs of fragmentation, competition seems to prevail over collaboration, and actors are disconnected from each other. Following an entrepreneur and mentor: "The problem is that the ecosystem is disconnected, people don't work together, everyone is trying to be a hero".

A superficial approach to entrepreneurship

There are a great deal of entrepreneurship competitions (business ideas contests. See Figures 1 and 2) that motivate would-be entrepreneurs to produce a continuous flow of new ideas. However, there is circumstantial evidence that leads us to believe that such events may have a negative impact on the entrepreneurial ecosystem. Entrepreneurs may overly concentrate on competing for cash rewards and fame, rather than focusing on the development of their business ideas. Often, people who are acting as judges for these competitions don't have suitable expertise and experience, they can't provide startups with the necessary validation, support and mentorship opportunities that are so crucial to take the process forward. The end-effect can be detrimental to the system as a whole, as described by the founder of a local incubator: "After startups win prizes, they start believing that their idea is great, however it is not always so… we are creating a culture of arrogance here in Cyprus…".



Many of the events described above are organised or sponsored by business consultancy organisations seeking to fulfil their corporate social responsibility obligations, but also aiming indirectly to involve more people into the world of

startups and extend their potential client base (the main corporates engaged with the Cyprus startup community include two telecom operators, CYTA and MTN and "the big four" KPMG, EY, PwC and Deloitte). When competitions become a vehicle for self-promotion, it is not surprising that a culture of collaboration and sharing proves difficult to develop. The above is not limited to startup competitions, the Cypriot ecosystem appears to be led by a myriad of local support organisations *"… there are so many of them* (support organisations)*,* there's just noise" says a local observer, such as incubators, accelerators, non-government organisations (NGOs) and corporations related to these organisation, including their main sponsors, the business service providers. Many events and initiatives tend to promote the organisers and their sponsors, attracting a large number of potential company creators, who in turn make up a pool of potential clients of these incubators, accelerators and other engaged professional service providers. Thus, startups increasingly become clients of these well-established corporations whilst there is little evidence of enhanced collaboration within the system.



Entrepreneurs and investors are risk averse

During the course of our study, we came across the following interesting issue:

Whilst Cyprus outperforms other EU countries in terms of company creation (number of newly registered companies, Global Innovation Index (GII) 2017, at the same time our own observations corroborated with other research confirm the

presence of risk averseness in the Cypriot culture. How could this be compatible with the emergence of startups in Cyprus?

One could assume that one of the drivers of entrepreneurship in Cyprus is the high unemployment rate, especially among youth, meaning that a great deal of founders are by necessity entrepreneurs. More importantly, according to Isenberg (2010), one must distinguish between self-employment and entrepreneurship, as these activities incorporate different degrees of risk and value creation. In Cyprus we have observed that only a small percentage of newly created companies incorporate real innovations and therefore higher risk. Thus, society may perceive entrepreneurship positively when it comes to opening a small family low-risk business, like a coffee shop or a fast-food restaurant. However, when riskier (innovative) business activities are involved, society may not be ready.

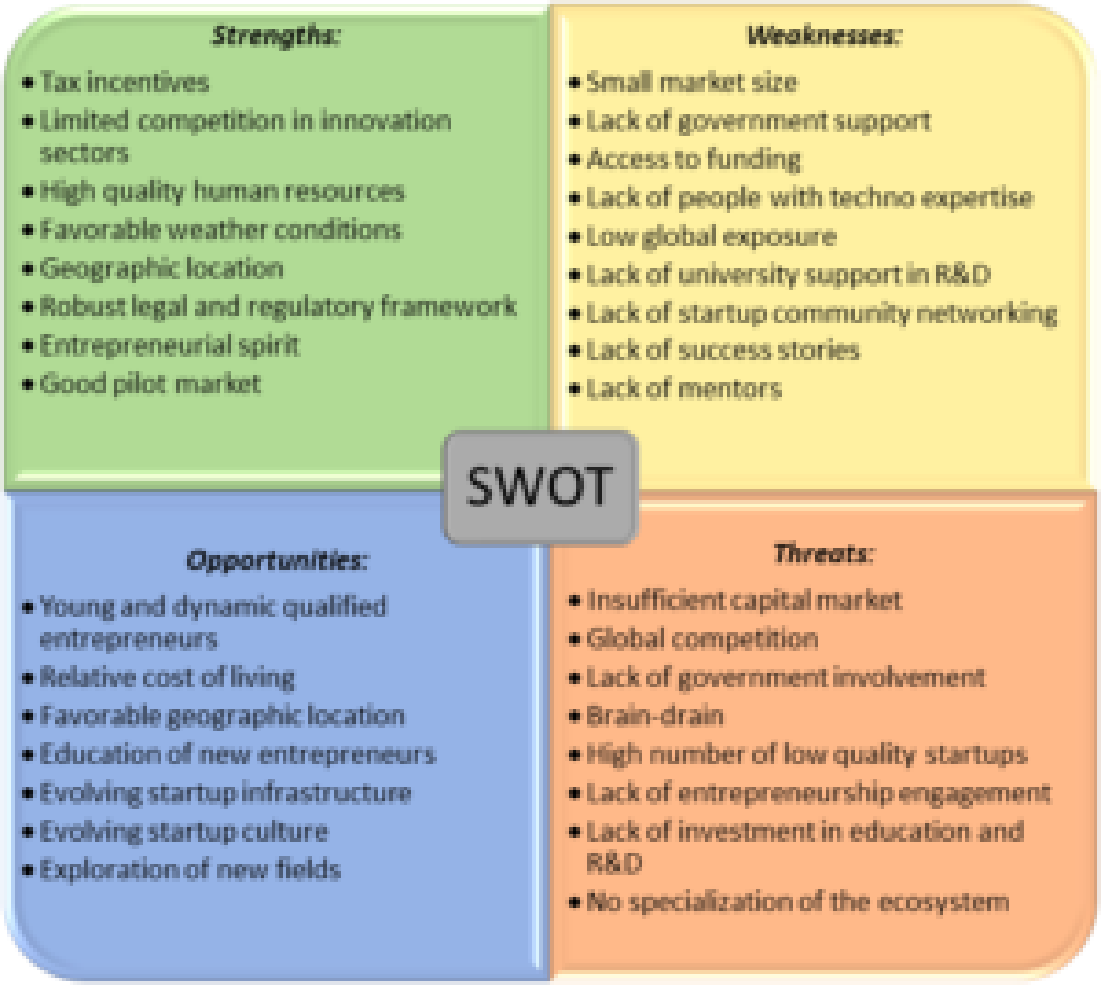
As explained before, our findings highlight that the investment culture is not well developed in Cyprus, especially when it comes to funding risky ventures. Investors on the island tend to prefer less risky projects like in the real estate business or well established companies that have reached large volumes of sales. However, the situation is different; surveyed actors indicate that local investors do not actually know how to select startups that are suitable for investment, they do not understand the needs and nature of innovative enterprises. Instead, investors end-up judging candidates on their potential for a quick financial return. A local -perhaps frustrated- entrepreneur summarized the situation as follows: "I wouldn't go and ask for money in Cyprus, I wouldn't talk to investors in Cyprus, they are not educated in technology, they want to make money in one day, but it doesn't work like that, what they can do, is just selling properties".

Going forward

A SWOT analysis was prepared (Figure 3) on the basis of a closed questionnaire addressed to entrepreneurs and other relevant actors to record their own perceptions of the system in which they operate. It complements our analysis and also highlights, amongst other things, the relative isolation or insular character of the ecosystem. The degree of openness of the system, i.e. its ability to attract highly qualified human resources, is of crucial importance. Searching for specialised skills beyond the shores of the island requires a smart migration policy, but according to stakeholders the government's attempt to address this issue (through the introduction of the "Startup Visa" program) does not seem to

have reached a satisfactory outcome, as many restrictions still remain in place.

As it stands today, the startup sector in Cyprus is made up of companies operating mostly in social media, marketing, education and e-commerce; other more country-specific opportunities don't seem to have developed. For instance, one could have expected the "clean-tech" sector to be better represented (Cyprus has lots of sun and little water) or other activities relevant for the island's economic structure like financial services, tourism and shipping. More research would be needed to better identify the links between startups and the local economy. In the same vein, our findings established the lack of engagement between entrepreneurs and between entrepreneurs and their environment. Going forward, we would need to improve our understanding of the subtle relations between all the stakeholders involved (including R&D providers), to assess how the ecosystem of startup companies in Cyprus could engage on a deeper, more sustainable and *meaningful* path of development.



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