When public agencies are free to decide, entrepreneurs are more likely to get a licence

It is well established that government regulation of markets can pose significant barriers to entry. Entrepreneurs are disproportionately burdened by regulation not only because they lack resources and familiarity to navigate regulatory hoops, but also because policies designed to regulate markets are often influenced by and for the benefit of incumbent firms.

However, despite this disadvantage, entrepreneurs do manage to enter regulated markets with some frequency. We sought to investigate under what conditions entrepreneurs could enter regulated markets in the absence of formal policy changes to reduce regulatory barriers. Taking a nuanced (pluralistic) view of government that looks not just at elected officials but also at regulatory agencies that implement laws, we examine regulatory discretion—the flexibility that agency bureaucrats have to interpret and implement policy—and explore its role in influencing market entry of new ventures.

Elected officials delegate varying amounts of discretion to agency bureaucrats to implement laws for a couple of reasons. First, policymakers are generally not well-versed in the subject matter of the new law, whereas agencies are staffed with technical experts who have more information. Second, because writing detailed policy requires much time and effort, elected officials would rather delegate discretion to regulators to fill in the details so they can spend their time on activities that facilitate re-election.

At the same time, agency bureaucrats and elected officials have differing motivations. Findings in the public administration literature suggest that the former is generally motivated to maximise social welfare and the agency's mission, whereas the latter is motivated to maximise the likelihood of reelection. The tension created by these differences manifests itself in how policies are implemented with respect to firms. When agency bureaucrats are given little discretion, incumbent firms benefit more from regulatory decisions than new ventures due to their political influence over elected officials and market power.

However, where discretion is high, agency bureaucrats can be guided more by a public service motivation that emphasises neutrality and equity in policy implementation and insulates them from pressure from elected officials, who may be lobbied on behalf of incumbent firms. As greater discretion decreases the political influence of incumbents, it levels the playing field for entrepreneurs and leads to more favourable regulatory decisions and market entry.

Empirically, we examine regulatory licensing decisions of new hydroelectric power facilities in the United States from 1978 through 2014. The results show that where discretion is high, entrepreneurs are 48% more likely to receive licensing relative to incumbents and 22.5% sooner, based on an average wait time of 4.5 years. These entrepreneurial hydro facilities can make up to $7740 per day, so that computes to $2.8 million in revenue gained through faster licensing.

This paper has a number of implications for entrepreneurs, incumbent firms, and public policy. For entrepreneurs, it informs how they might better navigate regulatory agency interactions by choosing to enter markets in states and regions in which regulators have greater discretion. For incumbent firms, because high discretion reduces the effectiveness of their financial lobbying—by 28 per cent according to our findings—they should pursue other forms of corporate political influence. For elected officials, the promotion of innovation, entrepreneurship, and environmentally sustainable business practices has become a key element of many state and federal policy agendas, yet studies have found mixed results of many of these laws. Instead of focusing on the policy, elected officials should first examine how regulatory agencies are structured and how the policies are implemented.

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Notes:

- *This blog post is based on the authors' paper "State Agency Discretion and Entrepreneurship in Regulated Markets" in Administrative Science Quarter, 2020.*
- *The post expresses the views of its author(s), not the position of LSE Business Review or the London School of Economics.*
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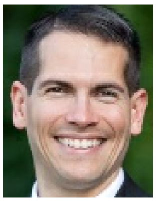

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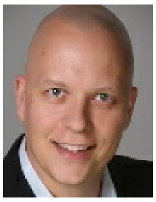

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