

Entrepreneurship Impact on Economic Growth in Emerging Countries

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Abstract

Productive entrepreneurship is generally assumed to be conducive to economic growth through exploiting new business opportunities and creating new jobs. Today, emerging countries, with their vast youth labour force and low or middle income level, are starting to direct their policies towards encouraging entrepreneurship. Moreover, international, regional and local media have also focused on entrepreneurship as a vehicle for growth. In this paper, a regression analysis has been conducted to investigate the impact of entrepreneurship on the economic growth in seven countries, representing emerging countries. Results have revealed a significant negative relationship between entrepreneurship and economic growth indicating the importance of the role of other factors such as: institutional framework and investing in "new economy" sectors, in affecting this relationship.

1. Introduction

Several tremendous changes have occurred in the last two or three decades, such as the rapid developments in communication and technology, the falling transportation cost and the free flow of trade and services, all of which are changing the world to become such a one small village. Moreover, these changes have put excessive pressure, on along with providing opportunities for the domestic firms in emerging countries to find out a way to compete with huge companies invading their markets through creating new ideas, innovating, and improving their competitive position. Moreover, the world had been shifting towards a knowledge based economy where success is mainly based on skills, knowledge and innovation that serve as a competitive advantage of such economy.

As governments in emerging countries perceived the importance of entrepreneurship in providing these new ideas and innovation capabilities, they started to support entrepreneurs, as being the engine of economic growth and sustainable development. Any meaningful talk about economic reform in emerging markets cannot dismiss the question of entrepreneurship and its ecosystem.

2. Entrepreneurship Definition

Entrepreneurship is a globally recognized phenomenon lacking a single agreed upon definition, as scholars have suggested various definitions for entrepreneurship. The following lines will present different definitions for entrepreneur and entrepreneurship.

An entrepreneur is "someone who specializes in taking responsibility for and making judgmental decisions that affect the location, form, and the use of goods, resources or institutions" (Hebert and Link, 1989). While Baumol (1990) defined entrepreneurs as 'persons who are ingenious and creative in finding ways that add to their own wealth, power, and prestige'. Kirzner (1973) defined entrepreneurship as "a process of discovery; the acting upon previously unnoticed and often marginal – profit opportunities."

Another definition of entrepreneurship proposed by the OECD:

“Entrepreneurs are agents of change and growth in a market economy and they can act to accelerate the generation, dissemination and application of innovative ideas... Entrepreneurs not only seek out and identify potentially profitable economic opportunities but are also willing to take risks to see if their hunches are right” (OECD, 1998, p. 11)

While Hart (2003: 5) defines entrepreneurship as the *“process of starting and continuing to expand new businesses”*

To sum up, productive entrepreneur has four roles: innovator, coordinator, bears risk and perceives profit opportunities.

3. Importance of Entrepreneurship

Audretsch, D.B., 2007 argued that Paul M. Romer’s (1986) critique of the Solow approach was not with the basic model of the neoclassical production function that considers labor and capital as its key factors, , but rather, what Romer perceived to be ignored is the knowledge factor. Many researchers, other than Romer, believed that knowledge was not a factor of production of less importance than the two traditional factors of labor and capital. (Robert E. Lucas (1988)). Audretsch, D.B., 2007 suggested that there is another important factor that has been dropped from the neoclassical production function, which is *entrepreneurship capital* defined as the capacity for economic agents to generate new firms.

Entrepreneurship capital can contribute to output and growth by acting as a conduit for knowledge spillovers, fostering competition through the increased number of enterprises, and by increasing diversity through providing enterprises with various and different activities, especially when taking into consideration the shift towards a knowledge based economy and the increasing importance of digital entrepreneurship. (Audretsch, D.B., 2007).

Moreover, entrepreneurship is identified as an important driver of job creation in both developed and developing economies (Audretsch, D., Fritsch, M., 2003; Decker, R., et al 2014). Additionally, entrepreneurship is viewed as a way for income flows, stabilization and profits augmentation for weak countries exposed to risk (Hermes and Lensink 2007; Karlan and Valdivia 2011). Constructive entrepreneurship helps in boosting innovation, variety, competition and selection as well as increasing the rate of growth of TFP (total factor productivity).

4. Literature Review

Many studies have been conducted to examine the relationship between entrepreneurship and economic development, however there has been little consensus about the effect of entrepreneurship on the economic growth of a country. Some studies have found a positive relationship between entrepreneurship and economic growth (Audretsch, D.B., 2007; Vázquez, E., et al 2010; Salman, D.M. & Badr, K., 2011), while other studies have argued that unless certain conditions prevail in the economy, entrepreneurship impact on economic growth would be undefined, these conditions are in the form of the institutional framework (including tax regimes, human capital, the level of economic development and many other factors). (Audretsch and Fritsch (2002); Van Stel, et al, 2005; Wennekers et al 2005; Urbano and Aparicio 2015). It was found that the impact of entrepreneurship on the economic growth depends on the stage of development. At the early stage of development, business owners, in emerging markets, invest heavily in traditional industries to benefit from economies of scale. Such industries do not boost effective entrepreneurial activities. In addition, as the economy starts enjoying higher levels of income and consequently higher wages, the opportunity cost of switching from employee to business owners (as a proxy for entrepreneurship) increases (Carree et al, 2002). Accordingly, studies have revealed that the effect of entrepreneurial activity on the economic growth depends on the per capita income level where a positive relationship exists between the

two variables for high income countries and a negative relationship exists for low income ones. (Van Stel, A et al, 2005 ; Stam, E. and van Stel, A., 2011).

Moreover, the results obtained from these studies depend on how entrepreneurship is defined and simultaneously the stage of economic development. (Klapper, L.F. and Love, I., 2011). As entrepreneurship can either be defined as “necessity entrepreneurship,” which is having to become an entrepreneur because you have no other better job opportunities (the refugee effect), or as “opportunity entrepreneurship,” which is an active deliberate choice to start a new enterprise based on the awareness that a business opportunity is left either unexploited or underexploited. (Acs, Z., 2006). Studies found that necessity entrepreneurship has no or even negative effect on economic development. (Acs and Varga 2005; Shane 2009). On the other hand, opportunity entrepreneurship has a positive and significant effect. (Acs, et al 2008; Valliere and Peterson, 2009). When Acs (2006) analyzed the effect of entrepreneurship on economic growth, Acs, Z, claimed that by creating new businesses, entrepreneurs will thus provide new jobs, strengthen competition, and surge productivity through technological change. Consequently high level of entrepreneurship will mean high economic growth rates, especially as developed economies have shifted away from traditional industries towards electronics, software, biotechnology and ICT sectors, where productive entrepreneurs play a great role in boosting growth. Also, a high level of economic development entails a higher level of income which widens the scope of market. Acs, Z argued that entrepreneurship may include informal self-employment which means either the existence of considerable bureaucratic obstacles to formally creating a new business, or merely that the economy provides too few reasonable wage-earning job opportunities which is meant to be necessity entrepreneurship.

5. Entrepreneurship in Emerging Countries

Emerging Countries are witnessing what is called a “youth bulge,” or a population dominated by young people. Governments of these countries should be aware of the importance of making the best benefit of this young population, otherwise it will be turned into a burden especially in the prevailing rising unemployment trend among most of the emerging countries. According to the World Bank (2013), unemployment in Egypt is 12.7%, while up to 38.9% among those aged 15-24 years old in 2013. According to the OECD (2014), this situation has placed a burden on Egypt’s labor market to absorb between 600000 and 700000 new entrants each year. According to the World Bank, both Hungary and Indonesia were suffering from youth unemployment of 27% and 21.8% in 2013 respectively, compared to an unemployment rate for the whole population of 10.2% and 6.3% respectively.

In the meanwhile, in their search for both a job opportunity and a source of income, this unemployed young population started to be self employed by starting up their new business and turning into entrepreneurs. This is clear from the increasing number of new business startups during the last decades in most of these countries.

In addition, some emerging economies are characterized by a gender entrepreneurial gap (biased towards male entrepreneurs) and a geographical gap (biased towards the capital city and some urban areas).

6. Research Objective

Given the economic recession prevailing in most of the emerging countries, and the high unemployment rate especially among the youth and women in some cases, it has been crucial to direct and allocate this vast population into its best and efficient use so as to turn its population into an engine for economic growth. Accordingly, the study objective is to examine the impact of entrepreneurship on the economic growth of emerging countries so as to provide policymakers with guidelines and recommendations concerning entrepreneurship policies. Emerging

economies, should create an enabling entrepreneurial ecosystem which consists of six components: markets, culture, regulatory framework and infrastructure, education and training, funding and finance and other support mechanisms (mentors, advisors, incubators and accelerators).

7. Methodology

This research is based on a cross sectional data for seven emerging countries (Egypt, Hungary, India, Mexico, Indonesia, Turkey and Romania) over the period 2004-2014. The selection of these countries was based on three criteria: First, these countries are from different regions as Mexico representing South America, Egypt representing North Africa, while Hungary, Turkey and Romania representing Eastern Europe and India and Indonesia representing east of Asia. The second criterion is that these countries are considered emerging according to different classifications such as those of: the IMF and the Economist, as well as the Financial Times Stock Exchange (FTSE), which is a British provider of stock market indices and associated data services, wholly owned by the London Stock Exchange. According to the IMF, the main criteria that distinguish advanced economies from emerging ones are their high per capita income and export diversification. While, FTSE distinguishes between Advanced and Secondary Emerging markets on the basis of their national income and the development of their market infrastructure. The Advanced Emerging markets are classified as such because they are upper or lower middle income countries with advanced market infrastructures or high income countries with lesser developed market infrastructures, while the Secondary Emerging markets include some low income, lower middle, upper middle and high income countries with reasonable market infrastructures and significant size and some upper middle income countries with lesser developed market infrastructures. The third criterion is that these countries are selected to have a global competitiveness index that varies from 3.6 to 4.6, as this index is an indicator of the set of institutions, policies, and factors that determine the level of productivity of a country. The level of productivity, in turn, sets the level of prosperity that can be reached by an economy. The productivity level also determines the rates of return obtained by investments in an economy, which in turn are the fundamental drivers of its growth rates.

A linear regression model has been formulated as follows:

$$Y_{ti} = \beta_0 + \beta_1 \text{LogGDP}_{(t-1)i} + \beta_2 \text{LogSTP}_{ti} + \beta_3 K_{ti} + \beta_4 L_{ti} + \beta_5 \text{RD}_{ti} + \beta_6 \text{Edu_Ter}_{ti}$$

Where:

Y represents GDP growth rate in year t in country i.

GDP represents GDP in year t-1 in country i.

STP represents new establishments as a proxy for entrepreneurship in year t in country i.

K represents physical capital measured as a % of GDP in year t in country i.

L represents growth in labor productivity in year t in country i.

RD represents research and development expenditure as % of GDP in year t in country i.

EDU _ TER represents tertiary school enrollment in year t in country i.

GDP with one time period lag is included in the model to control for historical effect of GDP that may cause current differences in the dependent variable and hard to account for in other ways. In other words, it has been estimated that current values of the GDP are a function of its prior values, so lagged GDP, following Yalta (2013), has been incorporated to eliminate serial correlation. GDP using PPP prices has been used. This research has used the World Bank data for GDP measures using PPP prices which was extrapolated from the 2011 International

Comparison Program (ICP) benchmark estimates. According to Solow growth model (1956), growth comes from adding more capital and labor inputs and also from ideas and new technology. The Solow model believes that a sustained rise in capital investment increases the growth rate in the short run. Consequently, it has been concluded that one of the important factors that may lead to economic growth is the physical capital. Moreover, Solow growth model has proved that the increase in labor productivity positively and significantly affects the economic growth and this was confirmed by many studies such as the one conducted by Sosa et al, (2013). Accordingly, physical capital, labor productivity have been incorporated in the model. The current study has used data for labor productivity available in the Conference Board Total Economy Database, whereas, data from the World Bank has been used for physical capital. While both the research and development expenditure and tertiary school enrollment are considered to be affecting the economic growth through promoting both the innovation capabilities and skills of the workforce as well as boosting the competitiveness of firms. (Coughlin and Segev 2000; Akcali, B.Y., Sismanoglu, E., 2015). Data for these two variables, as well as that concerning new establishments, as a proxy for entrepreneurship, have been obtained from the World Bank.

8. Results

After OLS assumptions have been tested and verified, relationships needed to be studied have been investigated. Table 1 summarizes the regression coefficients of each of the independent variables.

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.	Collinearity Statistics	
	B	Std. Error	Beta			Tolerance	VIF
1 (Constant)	-19.446	14.573		-1.334	.187		
Initial GDP	2.903	1.238	.344	2.345	.023	.309	3.237
New Establishments	-2.496	1.089	-.227	-2.292	.026	.680	1.470
Research & Development Expenditure	-1.774	1.232	-.153	-1.439	.156	.591	1.693
Tertiary Education	.025	.035	.116	.715	.478	.251	3.992
Labour Productivity	.781	.106	.786	7.349	.000	.581	1.722
Physical Capital	-.053	.078	-.083	-.680	.499	.444	2.252

Table 1: Summary of Regression Coefficients

Dependent Variable: GDP growth rate

It has been found that the only factors that significantly affect the economic growth in the emerging countries are the level of their initial GDP, entrepreneurship and the labour productivity. Whereas the research and development expenditure, tertiary education and the physical capital have not shown a significant effect on the economic growth. As expected, both

the level of economic development of the country- measured by its GDP level- and growth of its labour productivity are positively related to the economic growth.

A significant negative relationship has been detected between the numbers of new establishments, as a proxy of entrepreneurship, and economic growth. This result is consistent with those obtained by other studies which found that necessity entrepreneurship has no or even negative effect on economic development, as its marginal productivity is zero or even negative. (Acs and Varga 2005; Poh Kam Wong et al, 2005). This negative relationship can be attributed to many factors. First, many studies have argued that not all new businesses will have equal effects on the economic growth, as it is the fast growing firms that provide most of the new job opportunities, however, these firms represent less than 5% of new firms formed. (Henrekson and Johansson 2010)

Second, as emerging countries are suffering from high youth unemployment rate and low income levels, accompanied by an unenabling entrepreneurial ecosystem, in comparison to developed economies, it is expected that most of entrepreneurs will be necessity ones who are forced to be self-employed in traditional industries. Empirical studies found that such entrepreneurship has an adverse effect on economic growth in contrast to the "opportunity entrepreneurs" who demonstrate innovative capabilities and exploit unidentified opportunities in the non- traditional industries.

Third, emerging economies are facing severe market failures and many SMEs do not have easy access to information, markets and finance.

Fourth, the countries selected in the research sample are having a GCI (Global Competitiveness index) that ranges between 3.6 and 4.6. Generally the CGI can have a value between 1 and 7, this index reflects the set of institutions, policies, and factors that determines the level of productivity of a country which in turn, defines the ability of a country to grow. Accordingly, the countries in the research are having a moderate level of competitiveness and institutional framework that may not be providing the appropriate environment that helps new business to contribute to the country's economic growth.

The role of entrepreneurship in spurring economic growth is necessary but not sufficient, the type of entrepreneur and the sector in which he operates and the institutional setting are of vital importance regarding "the rules of the game".

9. Research Limitations

The present study has included some limitations that should be taken into consideration. Firstly, due to non - availability of comprehensive, comparable data concerning entrepreneurship measurement in the chosen emerging economies, the number of new registered business has been used, however, this proxy may not accurately reflect the level of entrepreneurship in these countries, as it may underestimate the real level of entrepreneurship due to the exclusion of the informal sector which is estimated to play a significant role in the economies of the selected countries as it employs more than one-half of non-agricultural employment in most regions of the developing countries.(Vanek, J et al, 2014). Secondly, a sectoral, geographical and gender division of the new registered businesses would have provided better policy implications. Thirdly, using total entrepreneurial activity rates (TEA), as a proxy for entrepreneurship, is highly recommended to focus on nascent entrepreneurs versus young business owners in different sectors. Fourthly, other countries may have been included for a better representation of emerging countries but have been dropped due to the non - availability of data.

10. Discussion and Summary

The goal of this paper was to examine the effect of entrepreneurship on economic growth in emerging countries, the results revealed that there is a significant negative relationship between entrepreneurship and the economic growth, while both the labour productivity and the level of economic development have shown a positive relationship with the economic growth. These results indicate that first of all emerging countries should focus more on investing in their human capital to be of high skills and thus augmenting their productivity. Concerning entrepreneurship, governments in these countries should be aware that encouraging increasing number of businesses to start up alone, without promoting and improving the business environment, will have an adverse effect on their growth. Governments should construct an infrastructure of high quality to serve business as well as create a business climate with a reasonable taxing system and business regulation.

In addition, as previously stated studies have proved, the opportunity entrepreneurship (especially in non- traditional sectors as knowledge based sectors, biotechnology, and alternative energy) is the one that will generate economic growth, therefore policies should be developed to make sure that entrepreneurs with innovative capabilities and who are exploiting promising opportunities are receiving adequate information and appropriate assistance and guidelines.

Furthermore, as long as youth unemployment and low level of income are prevailing in emerging countries, necessity entrepreneurs are unavoidable, therefore training programs should be directed to self-unemployed individuals so as to alleviate their managerial and innovative capabilities. Government led incubators and start-ups that are privately incubated are important mechanisms to boost productive entrepreneurial activities.

11. Direction for Future Research

Based on the results of the study, future research may replicate the same model using a different data set for different group of countries, to be able to generalize the findings on emerging countries. Further studies may be conducted using other indices for entrepreneurship to give more accurate results. Also, further research might be useful to compare entrepreneurship growth effect for each of the seven countries separately. This can be used as a guide to explain the economic growth resulted from new enterprises in each emerging country.

Moreover, it would be beneficial if further studies were conducted to study the factors that play an important role in shaping the relationship between entrepreneurship and economic growth and shedding the light on the causality paradox between them and focusing on the gender entrepreneurial gap and the geographical entrepreneurial gap.

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