

The role of the entrepreneur



Previous studies have highlighted the changes by OECD countries from large companies consisting of mass production to smaller companies focusing on ‘knowledge, initiative and flexibility’. According to Karlsson et al, this change appears to have taken place from the mid-1970s to the early 1990s.

(Karlsson et al., 2004; Acs, 1996 and 1999; Acs and Audretsch, 2001; Audretsch and Thurik, 1997 and 2001; Audretsch et al, 2002)

The large ‘managed economies’ invested in production, distribution and management. (Chandler, 1990) A large distributional network meant the products could reach large market.

The smaller ‘entrepreneurial economies’ focus on knowledge and flexibility as part of production. (Karlsson et al., 2004)

Karlsson et al highlights the factors that caused the change from a managed economy to an entrepreneurial economy such as ‘increased global competition, changes in demand and demographics, intensified uncertainty and new technologies’. (Karlsson et al., 2004)

Definition of Entrepreneurship

The name ‘Entrepreneur’ can be used very vaguely as it can cover a number of different roles. Thurik and Wennekers identified up to thirteen roles that the entrepreneur can be responsible for:

The person who assumes the risk associated with uncertainty

The supplier of financial capital

An innovator

A decision maker

An industrial leader

A manager

An organiser and coordinator of economic resources

The owner of an enterprise

An employer of factors of production

A contractor

An arbitrageur

An allocator of resources among alternative uses

The person who realises a start-up of a new business (Thurik & Wennekers, 1999)

After much studying regarding the history of entrepreneurship and the economy, Hébert and Link came up with the following definition for the entrepreneur:

‘ The entrepreneur is someone who specialises in taking responsibility for and making judgemental decisions that affect the location, form, and the use of goods, resources, or institutions.’

Thurik and Wennekers then came up with the following definition of entrepreneurship, with the help of Hébert and Link (1989), Bull and Willard (1993) and Lumpkin and Dess (1996):

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‘ Entrepreneurship is the manifest ability and willingness of individuals, on their own, in teams, within and outside existing organisations, to:

perceive and create new economic opportunities (new products, new production methods, new organisational schemes and new product market combinations) and to

introduce their ideas in the market, in the face of uncertainty and other obstacles, by making decisions on location, form and the use of resources and institutions.’ (Thurik and Wennekers, 1999)

The Global Entrepreneurship Monitor (GEM) defines entrepreneurship as:

‘ Any attempt at new business or venture creation, such as self employment, a new business organisation, or the expansion of an existing business organisation by an individual, teams of individuals, or established businesses.’ (GEM, 2002)

Invest NI simply defines entrepreneurship as:

‘ Someone who pursues business opportunities beyond known resources to create wealth.’ (Invest NI)

History of Entrepreneurship

Entrepreneurship and Economic Growth Theories

Thurik and Wennekers split the historical entrepreneurial theories into three traditions:

German tradition of von Thünen, Schumpeter and Baumol – ‘ Entrepreneur is the creator of instability and creative destruction’.

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(Neo-)classical tradition of Marshall, Knight and Schultz – Helps markets reach an equilibrium by carrying out entrepreneurial activities.

Austrian tradition of Menger, von Mises and Kirzner – The ability of the entrepreneur to realise opportunities for profit. Helps satisfy needs or improve market inefficiencies and deficiencies.

Thurik and Wennekers attribute economic growth through entrepreneurship to three main entrepreneurial activities, enhanced competition, innovations and employment growth through firm start-ups. The following table, created by Thurik and Wennekers, shows the various schools of growth theory with the role of entrepreneurship:

Growth Theories

Neo-Classical Growth Theories

Schumpeter/ Baumol Theory

Karlsson et al highlights that the German traditions of Schumpeter in 1934 and Baumol in 1968, shows the entrepreneur as ‘ an innovator and inspirer, the implementer of creative destruction, creating instability, disequilibria and economic development’. (Karlsson et al., 2004) A model by Aghion and Howitt tries to explain how ‘ creative destruction’ works. The Research and Development sector invents new production techniques, putting other techniques beyond use. As this new technique is used, the innovators are rewarded until a new technique superseeds his invention. (Aghion and Howitt, 1992; Thurik and Wennekers, 1999)

Neo-Classical Theory

While there have been a number of neoclassical growth models created over the years, the main one to have an impact has been that of Robert Solow in 1956. One of his main conclusions was that the accumulation of capital cannot account for historic growth per capita, nor the differences in international per capita output. Karlsson et al explains that the model is built where output is a function of capital and 'effective labour', where 'effective labour' includes the knowledge and effectiveness of the labour force. Output therefore increases if either capital or effective labour increase, and with given levels of capital and labour, the only way growth can occur is through the expansion of knowledge, being the advancement of technology. The economy will eventually reach equilibrium, where output, capital and effective labour will all grow at a constant rate. This rate of growth is determined by the advances in technology. With this theory by Solow, the entrepreneur does not exist.

Austrian Theory

The Austrian Theory is where the entrepreneur spots an area of disequilibrium and attempts to profit from this situation by improving on the inefficiencies and deficiencies in the market. (Kirzner, 1973) Holcombe (1998) and Minniti (1999) agree that in order for opportunities to become available, they have to have been created by other entrepreneurs. Quite simply put by Karlsson et al, 'entrepreneurship generates more entrepreneurship'. (Karlsson, 2004; Holcombe, 1998; Minniti, 1999)

Endogenous Growth Theories (New Growth Theory)

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The Endogenous Growth Theory or New Growth Theory was developed in the 1980s as a response to the basic Neoclassical Theory of Growth. Many believe that the problem with the Neoclassical theories is that as growth is determined through the levels of technological changes, there is very little relating to the factors that affect technological progress. Romer (1986, 1990) and Lucas (1988) were responsible for the early development of this concept. (Hoque)

It appears that generally within the endogenous models such as Romer (1986, 1990) and Lucas(1988), the entrepreneur does not hold a central role, however, Grossman and Helpman (1991) suggest that all Research and Development and investment decisions are made by ‘ forward-looking profit maximising entrepreneurs’. (Karlsson et al, 2004; Grossman and Helpman, 1991)

Hoque goes on to suggest that output and growth are dependent on the internal variable saving rate, which is converted into human capital investment used for innovating new ideas and methods. This variable saving rate allows for technological progress, resulting in the long-term growth of the economy.

The endogenous growth theory focuses on a number of factors, including education, knowledge, research, training and experience. These factors help for growth and lead to innovation. Hoque mentions two types of innovation:

Horizontal Innovation – The Research Sector develops a variety of goods leading to a spillover effect on the economy. These goods can be patented

and sold to the immediate goods sector who then have a monopoly power on each design and can therefore earn a monopoly return.

Vertical Innovation – This is where improvements are made to existing products, leading to a temporary increase in productivity and a sustainable increase in output growth.

East Asian Miracle: 1965 – 1990

Thurik and Wennekers (1999) refers to the economic growth of East Asian countries in the past decade. These eight countries are referred to as the High-Performing Asian Economies (HPAEs) and include the Republic of Korea, Taiwan, Singapore, Hong Kong, Japan, Indonesia, Malaysia and Thailand. During the period of 1965 to 1990, they experienced an average GNP growth rate per capita of 5.5%.

This growth can be taken from both exports of goods, as well as domestic demand. A number of public policies led to growing physical and human capital, the allocation of resources to productive investment and the gathering and perfecting of technology. Thurik and Wennekers, however, state that the innovation, private investment and marketing does not necessarily come from entrepreneurial activity and there is no obvious proof of an increase in entrepreneurship. Phelps commented on the paper by Mankiw (1995), claiming that with such an increase in human capital, entrepreneurship must be the reason, helped by the governments. Porter (1990) has also supported this view when writing about Emerging Korea in which he states two factors, being the willingness to take risks and the intensity of competition.

Entrepreneurship and the Competitive Advantage of Nations

An analysis by Porter (1990) was conducted in order to highlight the factors or conditions and determine the competitive strength of nations. Porter's model was made up of four sets of factors in what was called the 'diamond' model. Thurik and Wennekers describe these determinants below:

Factor Conditions – Porter distinguishes basic factors (e. g. natural resources and cheap, unskilled labour) from advanced factors (highly skilled personnel, modern networks infrastructure);

Demand Conditions – These have three main elements: the nature of buyer needs (e. g. sophisticated instead of basic), the size and the pattern of growth and the existence of mechanisms by which a nation's domestic preferences are transmitted to foreign markets;

Related and Supporting Industries – The presence of internationally competitive supplier and related industries stimulates rivalry and partial cooperation;

The Structure and Culture of Domestic Rivalry – This encompasses a wide scope such as opportunities provided to possible new entrants, the nature of competition between incumbent firms, dominant business strategies and management practices. (Thurik and Wennekers)

This diamond model is summed up by Porter (1990) as, 'Invention and entrepreneurship are at the heart of national advantage'. With this model, Porter suggests that innovation comes directly from entrepreneurship. As well as this, he claims that international competitiveness is a vital link

between entrepreneurship (innovation) and economic growth, with domestic rivalry being important in leading to international competitiveness. He also mentions that entrepreneurship is not a trait associated with smaller firms. (Thurik and Wennekers, 1999)

Evolutionary Economics

The concept of this theory is that each individual has a set of routines, which gradually evolve. These routines are tested in the market environment and due to natural selection, the most suitable one survives. (Karlsson et al., 2004) In this model, each individual has entrepreneurial spirit, human capital and venture capital. (Grebel et al., 2001)

Eliasson (1994) mentions that in order for a firm to survive, competence is the most important factor and that accumulation of competence is the determinant of success. This was also backed up by a study conducted by Eliasson and Braunerhjelm (1998), claiming that ' economic growth stems from human-embodied tacit competencies. (Karlsson et al., 2004)

Linking Entrepreneurial Activities to Economic Growth

Competition

Within the U. S., Acs (1996) suggests that employment growth is due to the increased competition. Geroski (1994) agrees that competition is important by stating that ' competition plays a significant role in stimulating productivity, with both new firms and new ideas provoking movements to, and outwards movements of, the production frontier which, the data suggest would not have occurred in their absence.'

Gort and Sung (1999) conclude that an increase in competition will lead to an increase in efficiency. This competition will affect efficiency in four ways:

Greater incentive to stimulate demand

Higher quality of capital inputs

Lower monitoring costs

Greater efficiency of firm-specific organisational capital and rivalry leading to innovation

Dennis (1995) mentions how competition stimulates some people, but not everyone. These people will try to find a better and more profitable way of doing things in order to maintain or improve their position in the market. These people have chosen innovation rather than working harder. (Dennis, 1995;

However, he also mentions how there are policy-imposed limits on competition which vary from country to country, giving the example that the U. S Postal Service who are owned by the government, are the only company allowed to deliver first class mail. This can allow a monopoly to form over a certain market and prevent competition occurring.

Innovation

The innovative activity of small firms has a different level of importance depending on the type of sector a firm is involved in. (Acs and Audretsch, 2001) Baldwin and Johnson (1999) mention a number of small firms in which innovation is important including electronics, instruments, medical

equipment, steel and biotechnology. Acs (1996) goes further than this by calculating the number of innovations per 1000 employees in different industry sectors. When this measure was carried out in 1982 in the U. S., it was found that firms with less than 500 employees produced more innovations in fields such as electronic computing equipment, process control instruments, electronic components, engineering and scientific instruments and plastic products. (Karlsson et al., 2004)

In studies conducted by Acs et al (1994), as well as Audretsch and Vivarelli (1996), it was found that innovations by small firms was greater if the firms were close to Universities. This shows the effect of education on innovation.

Other studies have found that small firms are more likely to innovate in unexplored areas of technology, with the larger companies focusing on more established areas. (Acs, 1999)

Rothwell and Zegveld found that all outputs from the UK which they studied were ‘ radical breakthroughs’, with only 27% of U. S. firms producing these ‘ radical breakthroughs’, 30% as ‘ major technological shifts’ and 37% as ‘ improvement type innovations’. (Rothwell and Zegveld, 1982; Karlsson, 2004)

Ernst and Young make a number of observations with regards innovation and entrepreneurship:

There’s no time like a downturn to take advantage of entrepreneurial thinking – A recent Ernst and Young survey found that the majority of entrepreneurs saw the economic slowdown as the perfect time to explore

new opportunities. ' More than half of the companies on the 2009 Fortune 500 list were founded during a recession or bear market'.

The market leaders of today are not necessary the market leaders of tomorrow – Entrepreneurial enterprises grow quickly, replacing the market share of many dominant corporations.

Innovation can, and often must be, disruptive – Disruptive innovation is often the turning point for business in an industry undergoing significant change.

(Christensen, 1997) Applegate states, ' Disruptions in the business environment cause economic shifts that destabilise industries, companies and even countries. They allow new entrants or forward thinking established players to introduce innovations – in products, markets, or processes – that transform the way companies do business and consumers behave.'

(Applegate, 2007) She goes on to mention a number of factors which companies must consider when faced with disruptive business conditions:

Technology – Important emerging technologies and how they are being used by others to help create an advantage.

Business Models – New business models need to be created or adapted to help improve how business is done.

Industry Dynamics – Fragmented industries where significant value can be delivered through consolidation.

Globalisation – Adapt to how companies in another part of the world perform.

Regulatory, macroeconomic, political and societal factors – Changes in regulations, political power and society that disrupt major companies, providing opportunities for new companies. (Applegate, 2007)

Never too big to be an entrepreneur – Large firms are often weighed down by institutional structures that may see unconventional ideas or strategies as impractical or threatening. However, they can still innovate successfully by building and sustaining ‘innovation-oriented cultures’. Large companies have found that in addition to internal research, they can seek innovation through partnerships, joint ventures, licensing and investing in up and coming companies.

Government policies that encourage entrepreneurship are most likely to result in increased innovation – A 2009 report from the Ernst and Young Conference Board states, ‘Policies that protect firms or industries can result in reduced incentives for entrepreneurs to invest in innovative ideas and for large firms to invest in Research and Development because they no longer face the competitive pressure to constantly improve their product in order to improve (or maintain) their market share. Ernst and Young highlight that the governments which are viewed as most effective when they stay out of the business sector’s way, play an important role in helping the engines of growth which are entrepreneurs. They also highlight some ways in which the government can help:

Strengthen and invest in education systems

Encourage businesses to connect with global, cross-border markets

Cultivate confidence in capital markets

Simplify procedures and requirements

Champion robust Research and Development programs

Allow for failure

Encourage sound public/private partnerships

Make the tax framework friendly to innovation (Ernst and Young, 2009)

Industrial Structure, Start-ups and Job Creation

When it comes to the differences between large and small firms, Carree and Thurik (1998), as well as Vosloo (1994) highlight a number of advantages in smaller firms. Mentioned is the fact that a greater number of smaller firms dispersed geographically allow for customers to cut travelling distances. As well as this, variety can only be created by small firms and the entrepreneur running the firm is more likely to be energetic and motivational. Vosloo highlights advantages of small firms in developing economies, such as less capital per worker on average, higher likelihood of innovation per employee, greater flexibility, higher growth and job creation rates, as well as being able to serve a more niche market.

Studies by both Audretsch et al (2002), as well as Carree and Thurik (1998), have found that on average, the employment share of large firms had a negative effect on growth of output and that smaller firms have helped economic growth. With regards to Germany, Wengenroth (1999) concluded that ' Small business was the catalyst of industrial growth in providing the

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background of skills and services which alone made possible the mass consumption of industrial product.'

Davis et al (1996) mentions that the entrepreneurship in start-ups makes a smaller contribution to job growth than expansion of existing firms in the U. S. This is also backed by a study conducted by Bednarzik (2000). It has to be noted however, that smaller firms have a higher gross job creation, with larger firms providing more in terms of net job creation. Carree and Klomp (1996) dispute this claim from Davis et al, arguing that relative to employment share, small firms created more net jobs relative to employment share. (Karlsson, 2004) What has regularly been found is that small firms can have a volatile job situation, with plenty of job growth, but also a lot of job destruction.

Investec, a UK asset management group, have predicted a large number of job losses within the public sector with the hope that entrepreneurship will offset this. Their research also found that two thirds of Britain's entrepreneurs expect to increase employment, with only 8% expecting job losses. (Investec, 2010) Ed Cottrell, from Investec Private Bank highlighted what is required by the new Coalition Government in the UK. ' With a new government formed, severe spending cuts will have to be enforced to help tackle the country's debts, and this could lead to job losses, especially in the public sector. We need to make sure that entrepreneurs, which are the lifeblood of our economy, are properly incentivised to grow their operations and therefore hire more people.' Philip Shaw, the chief economist at Investec Bank added, ' Entrepreneurs look for an environment that provides them with opportunity, reward and a flexible environment to operate in. They also

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look for stability and support, be that from the banks or the government, and it is in the best interest of the economy to provide this to them.’ (Investec, 2010)

Entrepreneurship and Large Firms

Entrepreneurial activity is not limited to small firms. Corporate entrepreneurship occurs in large organisations with Drucker (1985) claiming that they will not survive ‘ unless they acquire entrepreneurial competence’. Stopford and Baden-Fuller (1994) explain that there are three types of corporate entrepreneurship:

Creation of new businesses within an organisation – often referred to as intrapreneurship.

Transformation or strategic renewal of existing organisations.

Carrying out an innovation that essentially alters the industry. (Stopford and Baden-Fuller, 1994)

He also highlights five attributes common with corporate entrepreneurship:

Proactiveness

Aspirations beyond current ability

Team orientation

Capability to resolve dilemmas

Learning capacity

Stevenson and Jarillo (1990) refer to corporations acting entrepreneurially, 'pursuing opportunity, whether through specific company structures or not, constitutes the core of entrepreneurship, both individual and corporate'. They highlight how dependant management are on the individuals within a firm to create this corporate entrepreneurship.

Bridge et al (1998) highlight the difference between inventors and intrapreneurship. 'Inventors are usually individuals, but intrapreneurship is frequently carried out by groups or teams'.

Thurik and Wennekers (1999) concludes by stating that corporate entrepreneurship 'plays an essential role in the process of strategic renewal of large and incumbent firms'. In the short-term, corporate entrepreneurship can occur at the same time as downsizing and the loss of jobs, however, in the long-term, it enhances competitiveness and leads to sales growth. Thurik and Wennekers (1999) also mention how studies have shown that there seems to be a strong evidence to support a positive impact of corporate entrepreneurship on economic growth. They created a table to show the differences between individual and corporate entrepreneurship:

Figure 2 – Individual and Corporate Entrepreneurship

According to Cole and Neumayer (2003), neoclassical growth theory predicts that poor economies grow faster than rich economies. This is taken from the theory that if all economies are assumed to have the same steady state, then the only difference between countries is the initial level of capital and poor economies will grow faster as they are further away from their steady state.

Measuring Entrepreneurship

GEM (Global Entrepreneurship Monitor)

The Global Entrepreneurship Monitor is a global measure of entrepreneurial activity to assist in entrepreneurship policy research. The project has now been running for 12 years and covers over 34 countries worldwide. GEM aims to fulfil a number of research questions similar to this dissertation:

How much entrepreneurial activity is taking place in each country?

Why do levels of entrepreneurial activity differ between countries/regions?

What are the links between entrepreneurial activity and economic growth and productivity?

Surveys conducted by GEM are used to collect information on different types of businesses at a range of entrepreneurial activity. These three business types are:

Start-ups

Young businesses

Establishes businesses

Research from GEM continues to associate a positive correlation between start-up activity and economic development, highlighting key indicators of entrepreneurial capacity and tendencies.

A Background to Northern Ireland

Northern Ireland is one of four countries located in the United Kingdom. With a population of 1.7 million people as of 2004, it is the smallest of these countries. (UK Statistics Authority, 2004) Traditionally, Northern Ireland has been known for having an industrial economy, for example, in the shipbuilding and textiles businesses. This has since been replaced by the services industry. For example, Harland and Wolff, a shipbuilder located in Northern Ireland, once employed around 35,000 people. Nowadays, there are only around 500 employees focused on the repairing of oil platforms and the assembly of wind turbines.

Northern Ireland has for a long time suffered from a troubled past, with the most recent referred to as 'The Troubles'. This has been dated from the late 1960's to the signing of the Good Friday Agreement in 1998. (Aughey, 2005) During this time, threats of bombings, the high cost of security and the lack of a stable market, meant large companies were reluctant to invest. This also drove away many of the existing businesses. (Rowthorn & Wayne, 1988)

Confidence gradually built up within Northern Ireland since the mid 1990s, when many paramilitary groups initiated 'cease fires' and political parties began to work together. However, the signing of the Good Friday Agreement in 1998 proved to the rest of the world that the majority of Northern Ireland were willing to move on from the troubled past. Twelve years on and unemployment has fallen sharply, as well as many people immigrating to Northern Ireland from other EU countries. (BBC, 2008)

The current rate of unemployment stands at 6.8%, amongst one of the lowest of the regions in the United Kingdom, compared with a peak in 1986 of 17.2%. (DETINI, 2010) (BBC, 2001)

Entrepreneurship within Northern Ireland

Previous research into the effect of entrepreneurial activity on economic growth by organisations such as the Global Entrepreneurship Monitor (GEM) and the Organisation for Economic Co-operation and Development (OECD), have shown a direct correlation. (Hegarty, 2006) According to the GEM survey in 2009, Northern Ireland was ranked 9th out of 12 UK regions for Total Entrepreneurial Activity (TEA). There has still, however, been a rise in the TEA rate since 2002, despite the impact of the economic recession. (GEM, 2009) Figure 1 below shows the change in Total Entrepreneurial Activity since 2002:

Figure 3 – Total Entrepreneurial Activity in Northern Ireland and the UK (2002 – 2009) (GEM APS)

This TEA value is calculated using the percentage of early-stage entrepreneurial activity among the adult population, aged 18 – 64 years. (Pfeifer and Sarlija, 2010) In order to qualify and be included in the TEA value, respondents have to be involved in either:

Nascent Ventures – The firms generally referred to as start-ups. Any respondent actively involved in creating a new business that they would own or part of and had not paid any salaries or wages to anyone for more than three months.

Young Businesses – More established, owner-manager businesses but have not been paying salaries for more than 42 months.

Lee et al explains that there are two academic approaches to categorise entrepreneurship. The first way is to focus on the entrepreneurs and understand why they chose to start a new business and be an entrepreneur. The second way is to study regional variation in the formation of new businesses. (Lee et al., 2004) For this study, both approaches will be used.

A number of factors can be studied in order to determine how entrepreneurship affects economic growth. Storey (1994) focused on factors such as personality, human capital and ethnic origin whereas Evans and Leighton (1990) focused more on factors such as educational attainment and work experience. Previous research has linked a higher educational attainment with new business formation. (Evans and Leighton, 1990) Evans and Leighton also found that men with greater financial resources and greater confidence in their ability are likely to be self-employed. (Evans and Leighton, 1989)

Regional factors that affect birth rates of businesses include unemployment, population density, industrial clustering and the availability of financing. (Reynolds et al., 1994) Armington and Acs (2002) also highlighted factors such as income growth and population growth.

Factors Affecting Entrepreneurship

Gender

Female entrepreneurial activity within Northern Ireland between 2002 and 2009 has been significantly below the UK average. In 2009, 2.4% of females were engaged in early stage entrepreneurial activity compared to the UK average of 3.7%. This value is also under a third of male entrepreneurial activity within Northern Ireland, which stands at 8%. Figure 2 shows the female early-stage entrepreneurial activity for Northern Ireland compared with that of the UK average.

A report by Crimson Business Limited, highlighted possible reasons why women are less likely to be entrepreneurial than men:

Under-capitalisation of ventures

Low levels of self-confidence

Visibility of appropriate role models

The report indicates that these barriers to women becoming entrepreneurs needs to be overcome with greater support from the government. (Crimson Business Limited, 2006)

These barriers are not seen globally however, with different parts of the world having different cultures and customs with regards the participation of women in the economic growth of countries. For example, in countries such as Tonga and Guatemala, women are more likely to be involved in early-stage entrepreneurial activity than men. (Bosma and Levie, 2009)

Age

In 2009, total entrepreneurial activity for those aged 18 – 24 in Northern Ireland was 2.3% of the adult population. This is compared with a UK average of 3.4%. Northern Ireland remains, as it has done in recent years, with a peak in total entrepreneurial activity between the ages of 25 and 34.

A surprising decline in entrepreneurs between the ages of 35 and 44 has been seen in 2009, against the trend of the rest of the UK