

Entrepreneurship Development and Policy (Part 1)

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Reading List

- Naude, W. (2010), “Entrepreneurship, developing countries, and development economics: New approaches and insights”, *Small Business Economics* 34: 1-12.
- Mendez-Picazo, M-T., M-A Galindo-Martin, D. Ribeiro-Soriano (2012), “Governance, entrepreneurship and economic growth”, *Entrepreneurship & Regional Development* 24: no. 9-10: 865-877
- Banerjee, A. and E. Duflo (2011), *Poor Economics, A Radical Rethinking of the Way to Fight Global Poverty*, Public Affairs. Chapter 9: “Reluctant Entrepreneurs”
- Banerjee, A. and E. Duflo (2011), *Poor Economics, A Radical Rethinking of the Way to Fight Global Poverty*, Public Affairs. Chapter 7: “The Men from Kabul and the Eunuchs of India: The (Not So) Simple Economics of Lending to the Poor”

Entrepreneurship, Developing Countries, and Development Economics: New Approaches and Insights

Naude, W. (2010)

- Entrepreneurship scholars have increasingly been arguing that entrepreneurship is important for economic development.
- Thus it has been claimed that entrepreneurship is the main vehicle of economic development (Anokhin et al. 2008, p. 117), ...the more entrepreneurs there are in an economy, the faster it will grow (Dejardin 2000, p. 2), and that the engine of economic growth is the entrepreneur (Holcombe 1998, p. 60).

Entrepreneurship and Economic Development

- Entrepreneurship is considered to be an important mechanism for economic development through employment, innovation and welfare effects (Acs et al. 2008, p. 219).
- More than a billion people— described as the ‘bottom billion’ by Collier (2007)— still live in extreme poverty.
- How does entrepreneurship matter to the bottom billion and what does this imply for our understanding of the developmental role of the entrepreneur?

Measures of Entrepreneurship

- Self-employment measures from the International Labour Organization (ILO)
- Measures of opportunity entrepreneurship from the Global Entrepreneurship Monitor (GEM)
 - Entrepreneurship is already high in developing countries.
 - Start-up rates, self employment, and opportunity entrepreneurship are all much higher in India, for example, than in the Netherlands or Finland

Summary

- The early development economists were likely correct in that the lack of entrepreneurship or entrepreneurial talent may indeed not be the binding constraint on development.
- It may be that entrepreneurship is important for economic development because many of the most binding constraints are channeled through entrepreneurship.
- If the most pressing binding constraints are located in the institutional and policy environment of a particular country, then better understanding the role of the entrepreneur in economic development will amount to unpacking the 'black box' of institutional explanations.

Governance, Entrepreneurship and Economic Growth

Mendez-Picazo, M-T. et. al (2012)

- In recent decades, economists have focused their attention on determining the factors that promote economic growth.
- several factors have been considered in the analysis: income distribution, entrepreneurship and governance.

Definition of Governance

- Governance means how an organization is governed.
 - Communities of persons, firms, institutions, etc., are essential ingredients of good governance.
- The authors consider public governance and the channels through which it affects entrepreneurship activity.

Institutions (Acemoglu 2003, 27)

- They must enforce the property rights for a broad section of the society. Thanks to such behaviour, individuals have incentives to invest because their property is secured.
- They must constrain the actions of some pressure groups, elites as well as politicians, to avoid actions that could damage property rights (for instance to expropriate incomes).
- They must introduce degrees of equal opportunities for broad segments of the society, so more individuals can participate in productive economic activities. This goal is achieved by facilitating access to a better human capital formation as well as facilitating access to financial resources to increase investment activity.

Empirical Analysis

- Equation 1:

$$\ln(y)_{it} = \beta_0 + \beta_1 \ln(In)_{it} + \beta_2 \ln(\Phi)_{it} + \beta_3 \ln(I)_{it} + \varepsilon_{it}$$

- y is GDP measured in millions of USD.
- In is innovation which is measured by the proxy, patents, measured in number of patents issued.
- Φ is entrepreneurship which is measured by the proxy, Total Entrepreneurship Activity (TEA), created by Global Entrepreneurship Monitor (GEM).
- I is private investment measured in millions of USD

Empirical Analysis

Table 1. Equation (1) estimation.

Variable	Coefficient	Standard error (SE)	<i>t</i> -statistic	Probability
<i>C</i>	5.184542	0.249526	20.77760	0.0000
LOG(<i>In</i>)	0.118334	0.024502	4.829589	0.0000
LOG(ϕ)	0.008573	0.004148	2.066916	0.0475
LOG(<i>I</i>)	0.608518	0.034320	17.73052	0.0000
<i>Weighted statistics</i>				
R^2	0.999974	Mean-dependent variable		21.15168
Adjusted R^2	0.999962	SD-dependent variable		12.41969
SE of regression	0.014978	Sum squared resid		0.006730
<i>F</i> -statistic	87774.80	Durbin–Watson statistic		1.827272
Probability (<i>F</i> -statistic)	0.000000			
<i>Unweighted statistics</i>				
R^2	0.999903	Mean-dependent variable		13.86761
Sum squared resid	0.006988	Durbin–Watson statistic		1.312915

Empirical Analysis

- Equation 2 is the entrepreneurship equation ϕ :

$$\ln(\phi)_{it} = \beta_4 + \beta_5 \ln(\lambda)_{it} + \beta_6 \ln(PE)_{it} + \beta_7 \ln(GOV)_{it} + \beta_8 \ln(ms)_{it} + \varepsilon_{it}$$

- λ is the income distribution represented by the Gini index
- GOV is governance
- PE is public expenditure
- ms is the money supply, which could be considered as representative of the role of the monetary authority

Empirical Analysis

- Measures of Governance

World Bank (Kaufmann, Kraay, and Mastruzzi 2005):

- (1) Voice and accountability, which measures political, civil and human rights.
- (2) Government effectiveness, measuring the competence of bureaucracy.
- (3) Rule of law, measuring the quality of contract enforcement, the police and the courts.
- (4) Control of corruption, measuring the exercise of public power for private gain.

Empirical Analysis

Table 2. Equation (2) estimation.

Variable	Coefficient	SE	<i>t</i> -statistic	Probability
<i>C</i>	−3.920288	1.054111	−3.719045	0.0004
LOG(<i>GINI</i>)	1.294914	0.273285	4.738325	0.0000
LOG(<i>PE</i>)	0.100719	0.059271	1.699293	0.0944
LOG(<i>GOV</i>)	0.611223	0.202340	3.020772	0.0037
LOG(<i>MS</i>)	−0.101783	0.017288	−5.887576	0.0000
R^2	0.518623	Mean-dependent variable		1.639462
Adjusted R^2	0.487058	SD-dependent variable		0.487048
SE of regression	0.348824	Akaike info criterion		0.804236
Sum squared resid	7.422370	Schwarz criterion		0.970119
Log likelihood	−21.53979	Hannan–Quinn criterion		0.869784
<i>F</i> -statistic	16.42996	Durbin–Watson statistic		2.163523
Probability (<i>F</i> -statistic)	0.000000			

Conclusions

- The empirical analysis developed in the previous section shows that governance would have a significant indirect effect on economic growth.
- There is a positive relationship between governance and entrepreneurship that it is an economic growth-enhancing factor.

Chapter 9: “Reluctant Entrepreneurs”

Banerjee and Duflo (2011)

- Lots of entrepreneurship among the poor
 - Who is an entrepreneur?
 - Examples
 - 12% of people in the OECD describe themselves as self-employed
 - The corresponding fraction among the poor is much higher.
- What are disadvantages of the poor with the respect to entrepreneurship?
- What are advantages of the poor with respect to entrepreneurship?

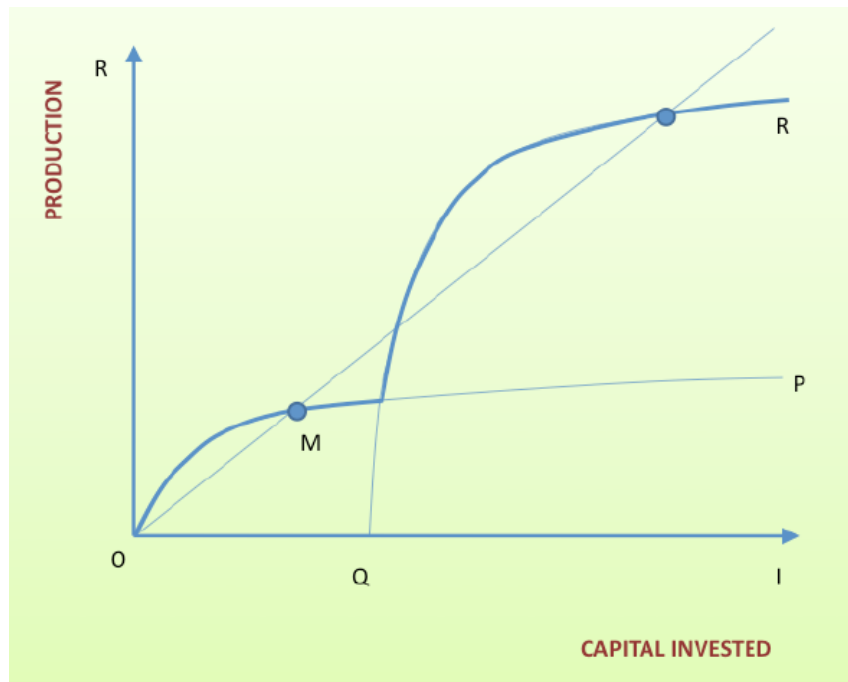
“Natural Entrepreneurs”

- Does this mean that the poor are natural entrepreneurs?
- What do we know about the businesses of the poor?
 - Size
 - Type
 - Multiplicity
 - Durability
 - Aspirations

Are these Profitable Businesses?

- In Hyderabad, when household labor was priced at minimum wages most businesses lost money.
- On the other hand they pay high interest rates—so marginal returns must be high.
- How do we square these facts?

Production Function for Entrepreneurs



- There is limited scope for growth.
- In Sri Lanka those who got \$250 in lottery got 60% or more return on their capital
- However many of those who got \$500 did not invest the second \$250.

Why Are They in Business

- Lack of good jobs: Almost nobody grows therefore no one creates good jobs
- Flexibility
- “Idle” women

Chapter 7: “The Men from Kabul and the Eunuchs of India: The (Not So) Simple Economics of Lending to the Poor”

Banerjee and Duflo (2011)

- After some fantastic years, where microcredit was considered to be the best way to solve poverty, it is now in the eye of the storm: attacked in India, in Bangladesh, in Latin America...

Some Facts About Credit Markets in Developing Countries

- Most of the poor do not have access to any form of formal credit (excluding microcredit, which reaches about 200 million people worldwide).
- Government sponsored formal lending programs have typically been failures, with high default rate, and have some times become political giveaway.

Some Facts About Microcredit

- In the informal market, lending rates are much higher than deposit rates.
- Yearly interest rate are in the 40%-200% range.
- Or some times much more: Fruit vendor in Chennai pay 5% per day!
- Study of money lenders in Pakistan (Aleem) found that average interest rate was 78.5% annually, and the average cost of capital was 32.5%.

Some Facts About Microcredit

- Extreme variability of interest rates even within the same economy (village or town).
- The rich have larger loans, and pay lower rates.
- Those who borrow more typically pay lower interest rates.
- The rates of default are quite low. People often borrow for investment, not because they are desperate.

Facts

Poor

- Poor cannot borrow from formal lenders
- Interest rates are high
- Interest rates are variables

Rich

- Rich borrow more
- People who borrow more pay lower interest rates
- Default rates are low

Why Are Formal Institutions Absent

- Formal institutions are far removed from the villagers: they have a high fixed cost, perhaps a high variable cost as well.
- They may also face an interest rate ceiling.
- They would be unable to lend to the poor (unless they accept that this is a subsidy program).

Why Are Money Lenders Thriving

- Money lenders are close to the people (in the same village)
- They may also be able to impose large penalty if the person tries to flee with the money: paradoxically this will lower the interest rates
- They can lend to the poor:
 - But their cost of fund will be high
 - So the interest rates they charge will be high

Conclusion

- These inherent difficulties in the credit market explain why the poor are largely shut off, and when they can borrow, must borrow at very high rate.
- The genius of microcredit was to introduce an institutional form that helped mitigating those problems.