Entrepreneurship and Economics

Manuel, Eduardo

26 August 2006

ENTREPRENEURSHIP AND ECONOMICS

EDUARDO G. MANUEL[1]

ABSTRACT

This paper has as objective to show the relationship between the Entrepreneurship and Economics and in this work we have the opportunity to verify the impact of entrepreneurial activity on competitiveness of a country, and I used as example whose countries considered for studies edited by Global Entrepreneurship Monitor (GEM).

We concluded that the relationship between Entrepreneurship and Economics is and will be always strong on measure that entrepreneurship is important to growth and development of the Nations, principally in the countries with strong necessities of that, to improve their life conditions, high their wealth, everything essential for their economic development.

Keywords: Entrepreneur, Entrepreneurship, Economics

JEL Classifications: A23, M13

Working Paper Series

[1] Eduardo Manuel is B.A in Economics at University Autonoma of Lisbon (UAL), Portugal and MSc in Management of Enterprises at same University. Economist and Investigator.
e-mail adress: edu.manuel@economista.com or eduardo_manuel@mail.pt

INTRODUCTION

According to Davidsson (2006), researching entrepreneurship is fun, fascinating, frustrating and important.

Entrepreneurship is a phenomenon of tremendous societal importance, and it has been referred much times in moment that we are living – globalization era, principally when we are speaking about immigration theme.

This paper has as objective to show the relationship between the Entrepreneurship and Economics and in this work we have the opportunity to verify the impact of entrepreneurial activity on competitiveness of a country, and I used as example whose countries considered for studies edited by Global Entrepreneurship Monitor (GEM).

1. ENTREPRENEURSHIP

1.1. Nature and Development of Entrepreneurship

According to OECD (1998), who first argued in a systematic way on the issue in the early 18th century was Richard Cantillon, and pointed to the entrepreneur as a prime agent in economic activity, by specific definitions have been difficult to agree on.

The development of theory of entrepreneurship parallels to a great extent the development of the term itself (see table 1.1). The word *entrepreneur* is French and literally translated means “between-taker” or “go-between” (Hissich and Peters, 2002).

TABLE 1.1

Development of Entrepreneurship Theory and the Term *Entrepreneur*

Stems from French: means between-taker or go-between	
Middle Ages	Actor and person in charge of large-scale production projects.
17th Century	Person bearing risks of profit (loss) in a fixed contract with government.
1725	Richard Cantillon – person bearing risks is different from one supplying capital.
1803	Jean Baptiste Say – separated profits of entrepreneur form profits of capital.
1876	Francis Walker – distinguished between those who supplied funds and received interest and those who received profit from managerial capabilities.
1934	Joseph Schumpeter – entrepreneur is an innovator and develops untried technology.
1961	David McClelland – entrepreneur is an energetic, moderate risk taker.
1964	Peter Drucker – entrepreneur maximizes opportunities.
1975	Albert Shapero – entrepreneur takes initiative, organizes some social and economic mechanisms, and accepts risks of failure.
1980	Karl Vesper – entrepreneur seen differently by economists, psychologists, businesspersons, and politicians.
1983	Gifford Pinchot – intrapreneur is an entrepreneur within an already established organization.
1985	Robert Hisrich – entrepreneurship is the process of creating something different with value by devoting the necessary time and effort; assuming the accompanying financial, psychological, and social risks; and receiving the resulting rewards of monetary and personal satisfaction.

Source: Adapted of Hissich and Peters, 2002

1.2. Notion of Entrepreneurship

According to Nafziger (1997 and 2006), the *entrepreneur* can be viewed in at least four ways: (1) as the coordinator of other production resources – land, and capital; (2) as the decision maker under uncertainly; (3) as the innovator; and (4) as the gap filler and input completer.

According to this author, an entrepreneur (an individual or groups of individuals) has the rare capability of making up for market deficiencies or filling gaps.

1.3. Function of the Entrepreneur

Kilby (1971) identifies thirteen entrepreneurial functions:

Exchange relationship

1. Seeing markets opportunities (novel or imitative);
2. Gaining command over resources;
3. Marketing the product and responding to competition;
4. Purchasing inputs.

Political administration

5. Dealing with the public bureaucracy (concessions, licenses, taxes, and so fourth);
6. Managing human relations in the firm;
7. Managing customer and supplier relations.

Management control

8. Managing finances;
9. Managing production (control by written records, supervision, coordinating input flows with customer orders, maintaining equipment);

Technological

10. Acquiring and overseeing plant assembly;
11. Minimizing inputs with a given production process – industrial engineering;
12. Upgrading processes and product quality;
13. Introducing new production techniques and products (Kilby 1971: pp. 27-28, as discussed by Nafziger 2006, p. 397). .

1.4. Characteristics of Entrepreneurship

According to Longeneeker, Moore et al (1994), a common stereotype of the entrepreneur emphasizes such characteristics as **high need for achievement,** a **willingness to take moderate risks,** and a **strong self-confidence.**

1) Need for achievement – a desire to succeed, where success is measured against a personal standard of excellence;

2) Willingness to take risk – the risk that entrepreneurs take in starting and/or operating their own business are varied. By investing their own money, they assume a financial risk. If they leave secure jobs, they risk their careers. The stress and time required in starting and running a business may also place their families at risk. And entrepreneurs who identify closely with particular business ventures assume psychic risk as they face the possibility of business failure.

3) Self-confidence – Individuals who possess self-confidence feel they can meet the challenges that confront them. They have a sense of mastery over the types of problems they might encounter. Studies show that successful entrepreneurs tend to be self-reliant individuals who see the problems in launching a new venture but believe in their own ability to overcome these problems.

Wheelen and Hunger (2000) identifie four entrepreneurial characteristics such as:

1) The ability to identify potential venture opportunities better than most people;

2) A sense of urgency that makes them action oriented;

3) A detailed knowledge of the keys to success in the industry and the physical stamina to make their work their lives;

4) Access to outside help to supplement their skills, knowledge and abilities.

1.5. Entrepreneurial strategy

Mintzberg (1973) contends that there are four chief characteristics of entrepreneurial strategy making (Thompson, 1993):

- Strategy making is dominated by the active search for new opportunities;
- In entrepreneurial organizations, power is centralized in the hands of the chief executive;

- Strategy change is characterized by dramatic leaps forward in the face of uncertainly;
- Growth is the dominant goal of the organization.

According to Drucker (1985), entrepreneurship consists on creation of a new market and a new customers, by applying management concepts and management techniques (asking, what's 'value' to the customer?),standardizing the product, designing process and tools, and by basing training on the analysis of the work to be done and setting the standards it required.

2. ENTREPRENEURSHIP AND ECONOMICS

2.1. Entrepreneurship as an economic function

According to Kinght (1921)[2], an entrepreneur is someone who calculates and then takes those risks and has to manage the uncertainties, and take responsibility for both good and bad outcomes. Hence as risk takers, entrepreneurs play an important role in the economy in ensuring that identified risks opportunities in taken up, and this may thus develop and improve efficiency of the economy.

Say stressed the function of entrepreneurship as bringing together and co-coordinating resources. Casson argued that the skill of an entrepreneur is to make judgmental decisions about the best allocation and use of resources and to coordinate scarce resources (Khong, 2002).

Schumpeter saw entrepreneurs as innovators, that is, those who wish to change things or do things differently. According to Schumpeter, entrepreneurs is someone who implements "new combinations of means of production". Curran argued the term entrepreneur should be reserved for those small business owners who are innovative and opportunistic in deploying resources or providing new products and services in pursuit of profit, and others that are not innovative and simply provide established and services to existing markets are simply small business owners.

[2] *Op cit of* Wah (2002) in *A Comparative Study: Entrepreneurship and Small Business Management in Hong Kong and Guangzhou*, p.10.

2.2. Entrepreneurship in Neoclassical economics

According to Wah (2002), in a general equilibrium system, in which there is perfect knowledge and decision making is routine and determined by the environment, there is little scope for entrepreneurship. In the partial equilibrium approach developed by Marshall, there is also little mention of entrepreneurship, although again an entrepreneurial function can be identified implicitly. Marshall differed from is neoclassical contemporaries in that he was more concerned with incorporating an element of realism into his analysis. The assumptions underlying Marshall's analysis are that change is slow and gradual and subsequently economic evolution is a predictable incremental process.

Knight was the first economist to explicitly identify a specific entrepreneurship function within a general equilibrium system, and he sought to adress the deficiences of early general equilibrium models in overcoming the problem of uncertainty by assuming perfect knowledge. Knight's contribution was consisted on distinction between the notions of risk and uncertainly, and he identified the entrepreneur as being ultimately in control of the venture, ultimately responsible for all receipts and all outlays, and thus subject to the uncertainty that surrounds the amount and the difference between them.

Kihlstrom and Laffont followed Knight and identify this ability as being the willingness to bear risk, which they take to mean uncertainty in common with Knight's distinction. Entrepreneurs play a key role in the general equilibrium system of bearing uncertainty but their reward is specifically associated with their entrepreneurial ability and not with the function of uncertainty per se as in Knight's analysis. Lucas identified the ability as being one of managerial coordination while Oi identified ability to manage time effectively as being the critical ability required to be an entrepreneur.

According to Holcombe (2001), in the competitive model of neoclassical economics, equilibrium exists when all prices are set such that they just clear the market, so for all markets the quantity supplied equals the quantity demanded, and competitive firms earn only normal profits.

2.3. Entrepreneurship and The Invisible Hand

According to Holcombe (2001), the invisible hand concept arises from the incentives that are provided in a market economy for welfare-enhancing actions, but those actions can be divided into two different categories. In one category are the maximizing actions that are part of neoclassical economics. The other category consists of entrepreneurial actions. In the neoclassical framework, individuals maximize utility by allocating their endowments (which in a production economy includes their labor and human capital) over a given opportunity set. Firms maximize profits by choosing the optimal quantity and mix of inputs that will be combined in a production function to generate output. Profit maximization for firms must be a shorthand description, because firms do not act as independent entities. Rather people act. According to this author, in a neoclassical setting, profit maximization means that the firm's decision-makers choose the optimal quantities of inputs and then produce the maximum possible amount of output given the inputs employed. In this neoclassical setting, people who run firms must be good managers, but there us no room for entrepreneurial activity. Good managers means choosing the right combination of inputs, and adjusting the mix when changes in relative prices dictate a different optimal combination. Good management also means eliminating waste so that workers do not shirk and so that other inputs are not under-utilized, and good management is not a trivial task, but the optimal course of action for the firm is always dictated by market conditions and by the firm's production function.

The role of the invisible hand in equilibrium is to keep economic actors from straying away from equilibrium. Even in a dynamic equilibrium model, the invisible hand merely keeps economic actors from straying away from the equilibrium path as the economy grows.

Entrepreneurship occurs when individuals act upon previously unnoticed profit opportunities, whereas management works to make the production process as efficient as possible by maximizing the amount of output that is produced by a given level of input, and it necessary to refer that in equilibrium there is no entrepreneurial activity, but management is still necessary to prevent shirking and other forms of resource waste. Following Smith's vision, the invisible hand is much more than this, and mainly consists of those forces that push individuals to seize entrepreneurial opportunities, and that foster economic progress. In this sense, the invisible hand may play a disequilibrating role as argued by Schumpeter, as entrepreneurial

discoveries upset the previous plans of those in the economy, by open up new opportunities for further entrepreneurship and further progress. Whether the invisible hand is equilibrating or disequilibrating is of secondary importance; the primary point is that Adam Smith was describing an invisible hand that leads people to engage in entrepreneurship and to promote economic progress, not an invisible hand that holds people close to equilibrium.

2.4. Entrepreneurship and Markets dynamics

The Australian school, in contrast to the neoclassical school, is concerned with the dynamic nature of the operations of market economies. Mises emphasied the importance of entrepreneurship in a market economy. He stated “Entrepreneurs means acting man in regard to the changes occurring in the data of the market”. While Mises discussed the importance of the entrepreneur in a market economy, he did not attempt to develop a theory of entrepreneurship. Baumol criticized neoclassical theory explicitly from an entrepreneurial viewpoint, and he argues that the neoclassical paradigm is non-entrepreneurial. Thus Baumol emphasized the importance of imitative entrepreneurs in economic development.

Leibenstein distinguished between two broad types of entrepreneurial activity: routine entrepreneurship and Schumpeterian or “innovational” entrepreneurship. For him, the roles of entrepreneurs in development are gap filling and input completer. Leibenstein had correctly identified the shortcoming of the conventional system and recognized the role of entrepreneurship in economic development. However, like Baumol, the distinction of Leibenstein between Schumpeterian entrepreneurship and the routine entrepreneur is still blurred.

Schumpeter’s concept of entrepreneurship introduced a new dimension into economics, and according to him, entrepreneurs were the economics agents who perform the service of innovating, of introducing changes that radically change the framework of the economic system. And furthermore, he recognized that entrepreneurial innovation is a difficult job, because it lies outside the routine framework and because the environment resist in many ways. Therefore, the entrepreneurial function does not essentially consist in either investing or creating the conditions, which the enterprise exploits. It consist “getting [new] things done”.

Kirzner's original theory of entrepreneurship, unlike Schumpeter, this theory was based on Mises's action theory, proposed that there is an entrepreneurial element present in all human action. Kirzner considered that this entrepreneurial element involves an alertness to perceive Mises's "end-means" framework, where maximizing behavior occurs. Alertness to profit opportunity implies arbitrage activities. Regarding the arbitrage theory of profit, Kirzner argued that the existence of disequilibrium situations in the market implies profit opportunity. The entrepreneur endeavor to exploit this opportunity, eliminate errors and move the economy toward equilibrium. Kirzner altered this original theory of entrepreneurship in response to criticism that time and uncertainty is important consequences in human decision-making, and the modified theory involves arbitrage and speculation and both theories describe entrepreneurship as bringing about a greater mutual consistency in market transactions. This author also criticized the equilibrium approach and the assumption of optimizing behavior in neoclassical economics. Similar to Leibenstein, he followed a microeconomic approach, and he builds his analysis of entrepreneurship on the notion of the market as an entrepreneurial driven discovery process, in a world where knowledge is unevenly dispersed between market participants and where there exists genuine ignorance on the part of some individuals.

Hayek also recognized that knowledge of the economic problem faced by society "does not exist in concentrated or integrated form, but solely as the dispersed bits of incomplete and frequently contradictory knowledge which all separate individuals possess".

2.5. Influence of Entrepreneurial Activity on Competitiveness of a Country

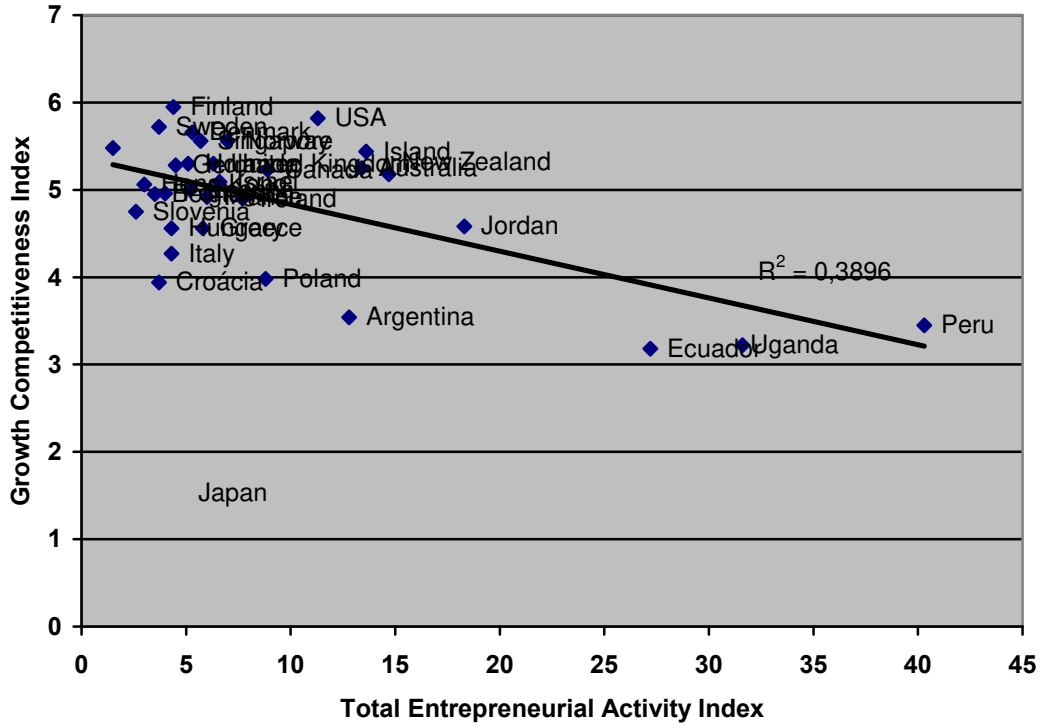
To determinate the influence of entrepreneurial activity on economic performance of a country, it was used as example of the countries that was showed by GEM Report (2005 and 2006), such as USA, Finland, New Zealand, Ecuador, Uganda, Peru, Italy, Slovenia, Jordan, Singapore, Sweden, Canada, Japan, Greece, Denmark, Australia, United Kingdom, etc.

The graphic 1.1 and 1.2 show us the influence of total activity entrepreneurial on competitiveness of their countries in 2004 and 2005.

We can see in the graphic 1.1, that countries more entrepreneurial are not countries that show highs competitiveness index, and we have as example, Peru,

Uganda and Ecuador case that was countries more entrepreneurial in 2004, according to table 1 (see annex).

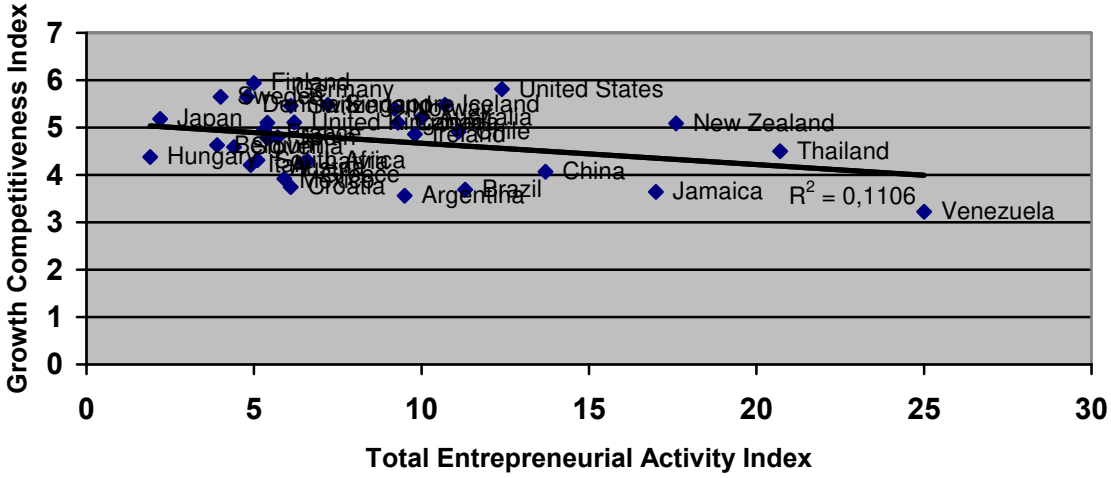
Graphic 1.1 – Total Activity Entrepreneurial Index versus Growth Competitiveness Index in 2004



Sources: GEM, 2005 e World Economic Forum, 2004

The same we can see in the graphic 1.2 for 2005, in that countries more entrepreneurial are not countries that show highs competitiveness index, and we have as example Jamaica, New Zealand, Thailand and Venezuela that showed most high total entrepreneurial activity index (TEA) (see annex – table 2).

Graphic 1.2 – Total Activity Entrepreneurial Index versus Growth Competitiveness Index in 2005



Sources: GEM, 2006 e World Economic Forum, 2005

So, we can say that countries more entrepreneurial are not necessarily countries more competitiveness, according to we saw above.

CONCLUSION

We saw the approach of ***Entrepreneurship*** as well their relationship with ***Economics*** where it was refereed the influence of entrepreneurial activity on competitiveness of a Country having as example whose countries studied by Global Entrepreneurship Monitor (2005 and 2006).

We concluded that the relationship between Entrepreneurship and Economics is and will be always strong on measure that entrepreneurship is important to growth and development of the Nations, principally in the countries with strong necessities of that, to improve their life conditions, high their wealth, everything essential for their economic development.

All approach about economics growth and development, about any country or region, at level of the science in general, where are used economic models it should try always to refer the paper of entrepreneurship on growth and development of a country.

The evolution of economics science should be linked with evolution of entrepreneurship, to take away mistakes at level of interpretation about how economic activity of new entreprises, for example, contributes for economics growth of a nation or region.

BIBLIOGRAPHICAL REFERENCES

1) DAVIDSSON, Per (2006), *Researching Entrepreneurship*, Springer, USA

2) DRUCKER, Peter F. (1985), *Innovation and Entrepreneurship – Practice and Principles*, First Published, Butterworth-Heinemann, Oxford

3) GLOBAL ENTREPRENEURSHIP MONITOR (2006), *2005 Executive Report*, Edited by Maria Minniti, William D. Bygrave and Erkko Autio, USA and UK

4) GLOBAL ENTREPRENEURSHIP MONITOR (2005), *2004 Executive Report*, Edited by Zoltan J. Acs, Pia Arenius, Michael Hay, Maria Minniti, USA and UK

5) HISSICH, Robert D. and PETERS, Michael (2002), *Entrepreneurship*, Fifth Edition, International Edition, New York

6) HOLCOMBE, Randall G. (2001), "The Invisible Hand and Economic Progress", *Entrepreneurial Inputs and Outcomes: New studies of Entrepreneurship in the United States*, edited by Gary D. Libecap, Advances in the study of Entrepreneurship, Innovation and Economic Growth, Volume 13, First Edition, Oxford

7) KILBY, Peter (1971), *Entrepreneurship and Economic Development,* New York: Free Press

8) LONGENECKER, Justin G, MOORE, Carlos W, et al (1994), *Small Business Management – An Entrepreneurial Emphasis*, 9th Edition, South Western Publishing, Ohio

9) NAFZIGER, E. Wayne (1997), *The Economics of Developing Countries*, Third Edition, Prentice-Hall, New Jersey

10) NAFZIGER, E. Wayne (2006), *Economic Development,* 4th edition, Cambridge University Press, Cambridge

11) OECD (1998), *Fostering Entrepreneurship*, The OECD Jobs Strategy, Organisation for Economic Co-operation and Development, France

12) WAH, Eva Khong Yueng (2002), *A Comparative Study: Entrepreneurship and Small Business Management in Hong Kong and Guangzhou*, Doctoral Dissertation in Management, Instituto Superior de Ciências do Trabalho e da Empresa (ISCTE), Lisboa

13) WHEELEN, Thomas C. and HUNGER, J. David (2000), *Strategic Management and Business Policy – Entering 21th Century Global Society*, 7th Edition, Prentice-Hall International, USA

14) WORLD ECONOMIC FORUM (2004), *The Global Competitiveness Report 2004-2005*, Edited by Michael E. Porter, Klaus Schwab, Xavier Sala-i-Martin and Augusto Lopez-Claros, Palgrave Macmillan, New York

15) WORLD ECONOMIC FORUM (2005), *The Global Competitiveness Report 2005-2006*, Edited by Michael E. Porter, Klaus Schwab, Xavier Sala-i-Martin and Augusto Lopez-Claros, Palgrave Macmillan, New York

ANNEX

Table 1 - Total Entrepreneurial Activity (TEA) by Country for 2004 and Growth Competitiveness Index (GCI) for 2004

Countries	Total Entrepreneurial Activity (TEA) 2004	Growth Competitiveness Index (GCI) 2004
United States	11.3	5.82
Brazil	13.5	4.05
Peru	40.3	3.78
Uganda	31.6	3.41
Argentina	12.8	3.54
Germany	4.5	5.28
United Kingdom	6.3	5.30
France	6.0	4.92
Poland	8.8	3.98
Ecuador	27.2	3.18
Canada	8.9	5.23
Australia	13.4	5.25
Italy	4.3	4.27
South Africa	5.4	4.53
Spain	5.2	5.00
Japan	1.5	5.48
Jordan	18.3	4.58
Netherlands	5.1	5.30
Greece	5.8	4.56
New Zealand	14.7	5.18
Hungary	4.3	4.56
Portugal	4.0	4.96
Israel	6.6	5.09
Belgium	3.5	4.95
Sweden	3.7	5.72
Norway	7.0	5.56
Ireland	7.7	4.90

Denmark	5.3	5.66
Singapore	5.7	5.56
Finland	4.4	5.95
Hong Kong	3.0	5.06
Croatia	3.7	3.94
Slovenia	2.6	4.75
Iceland	13.6	5.44

Sources: GEM, 2005 and World Economic Forum, 2004

Table 2 - Prevalence rate of Entrepreneurial Activity Across Countries for 2005 and Growth Competitiveness Index (GCI) for 2005

Countries	**Total Entrepreneurial Activity (TEA) 2005**	**Growth Competitiveness Index (GCI) 2005**
Argentina	9.50	3.56
Australia	10.00	5.21
Austria	5.30	4.95
Belgium	3.90	4.63
Brazil	11.30	3.69
Canada	9.30	5.10
Chile	11.10	4.91
China	13.70	4.07
Croatia	6.10	3.74
Denmark	4.80	5.65
Finland	5.00	5.94
France	5.40	4.78
Germany	5.40	5.10
Greece	6.50	4.26
Hungary	1.90	4.38
Iceland	10.70	5.48

Ireland	9.80	4.86
Italy	4.90	4.21
Jamaica	17.00	3.64
Japan	2.20	5.18
Latvia	6.60	4.29
Mexico	5.90	3.92
Netherlands	4.40	5.21
New Zealand	17.60	5.09
Norway	9.20	5.40
Singapore	7.20	5.48
Slovenia	4.40	4.59
South Africa	5.10	4.31
Spain	5.70	4.80
Sweden	4.00	5.65
Switzerland	6.10	5.46
Thailand	20.70	4.50
United kingdom	6.20	5.11
United States	12.40	5.81
Venezuela	25.00	3.22
Average	**8.40**	

Sources: GEM, 2006 and World Economic Forum, 2005