

ECONOMIC & MANAGEMENT ISSUES IN **RETROSPECT & PROSPECT**



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THE IMPACTS OF ENTREPRENEURSHIP ON THE ECONOMY FROM PAST TO PRESENT

Şükriü APAYDIN¹, Korhan KARACAOĞLU²

Introduction

The most important phenomenon in the last quarter of the twentieth century, no doubt, is globalization. The international competitive environment caused by economic globalization has affected the firm behaviors and the national economies in both micro and macro levels. As a result, increasing global competition has led all economic actors to search for alternative sources in terms of the continuity of the firms and the sustainability of the growth and development of national economies. In this context, the effects of entrepreneurship and innovation activities on the economy have begun to focus on both academic and economic policy interest.

Undoubtedly, the effects of entrepreneurship and innovation activities on the economy cannot be considered as a specific phenomenon contemporary. The history of entrepreneurship dates back to Richard Cantillon, who regarded the entrepreneurship as an economic actor. According to him, entrepreneurs are the ones who should be considered together with the landowners and the labor factor and benefit from profit opportunities created by the differences in supply and demand in the market (Wennekers and Thurik, 1999). Say, a prominent classical economist, is the first person to recognize entrepreneurs as an important factor of production in addition to labor, capital, and natural resources (Say, 1803). Another pioneer is J. Schumpeter, who identifies the entrepreneur as an innovative person. He integrates the concept of technology and enterprise that he defines. Thus, the entrepreneur, as in the traditional definitions³, is considered not only as a risk-taker or capital owner but also as an innovator and leader (Schumpeter, 1934; Praag, 1999).

However, Wennekers and Thurik (1999: 46-47) state that this way of addressing entrepreneurship is insufficient to examine the impacts of entrepreneurship on the economy. Because, according to them, the definition of entrepreneurship should take into account the competitive dynamics that make it possible to create and gain new profit opportunities. In addition, according to them, entrepreneurship does not qualify as a person or company but refers to the behavioral characteristics of individuals. Moreover, entrepreneurship should take into consideration both the firm and the industrial scale, as well as at the national level. In this framework, the entrepreneur must show the willingness and ability to create and gain new economic opportunities, such as introducing new products, new production methods, new institutional schemes, and new product-market combinations. In other words, analyzing the effects of entrepreneurship on the economy depends on a multidimensional evaluation of the concept (Wong, et al. 2005: 337-339).

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3 For more information, see the following: Herbert and Link (1989), Wennekers and Thurik (1999).

In this conceptual and historical development process, different aspects of entrepreneurship have discussed, and their effects on the economy have examined in various dimensions. While the theoretical literature emphasizes the relations between entrepreneurship and economic growth/development, cyclical fluctuations, unemployment, financial development, and similar issues, it is noteworthy that the empirical literature focuses on the relationship between entrepreneurship and business cycles and unemployment. In this study, the survey of the theoretical and empirical literature on the subject is conducted to determine new research areas. Thus, it is aimed to contribute to the richness and depth of the related literature with a holistic perspective on the effects of entrepreneurship on the economy.

Theoretical and Empirical Literature

Entrepreneurship plays a vital role in the development/growth of a country economy, as this is the key contributor to innovativeness, product improvement, reduction of unemployment, and poverty. In addition to this, as Schumpeter pointed out, entrepreneurship can be among the causes of cyclical fluctuations along with innovation activities. In this section, the relationship of entrepreneurship with economic growth/development, business cycle and unemployment is discussed.

First of all, the idea that there is a positive and close relationship between entrepreneurship and economic growth goes back to the early studies of Schumpeter. The main idea is that the increase in the number of entrepreneurs will increase economic growth. The main effect here is the increase in the entrepreneurial skills or, more accurately, the innovative entrepreneurial tendencies. However, according to Schumpeter, there is no economic growth without innovation, no innovation without entrepreneurs, and no entrepreneurs without credits. In short, the three factors that determine growth are innovation, entrepreneurship and credit (Schumpeter, 1934 and 1939).

Schumpeter described this innovative activity, “the carrying out of new combinations”, by distinguishing five cases. The introduction of a new good, the introduction of a new method of production, the opening of a new market, the conquest of a new source of supply of raw materials or half-manufactured goods and the carrying out of the new organization of an industry (Schumpeter, 1934: 66). In this definition, three aspects of the role played by the entrepreneur in the economy stand out. The first is the role of innovator. Matter of fact, Schumpeter was the economist who has most prominently drawn attention to the ‘innovating entrepreneur’. The second role is the perceiving profit opportunities. This role is expressed as Kirznerian (or neo-Austria) entrepreneurship. And finally, the third role that can treat as the Knightian entrepreneurship is the role of assuming the risk associated with uncertainty. In this way, when any individual produces a new product or establishes a new firm, it can be interpreted as an entrepreneurial act involving all three roles. Because the individual is innovating, he/she has (or supposed that he/she) perceived a hitherto unnoticed profit opportunity and he/she takes the risk of the failure (Carree and Thurik, 2003).

The literature suggests that when appropriate conditions (personal, cultural, institutional) for entrepreneurship are provided, it contributes to economic growth by introducing innovation, creating change and competition, and enhancing rivalry. Because, entrepreneurs create new firms and new firms create jobs. In short, the contributions of entrepreneurship to economic development, growth and sustainability can be listed as the employment generation, innovation, productivity and growth, and increasing individuals’ welfare. In other words, entrepreneurship can contribute positively to long-term growth by increasing employment and productivity (Acs, 2006; Praag and Versloot, 2007).

The existence of the relationship between entrepreneurship and economic growth points to another economic impact of self-entrepreneurship. This is the relationship between entrepreneurship and unemployment. If entrepreneurship affects economic growth by increasing employment, then entrepreneurship has a reducing effect on unemployment. However, there are several approaches and different findings about this relationship. The ambiguities found in the studies⁴ on the subject reflect two conflicting mainstream movements. On one hand, entrepreneurship may lead to a decrease in unemployment; on the other hand, unemployment may lead to an increase in entrepreneurship. While the first effect has been defined as Schumpeter entrepreneurial effect, the second effect has been referred to as refugee or desperation effect. The Schumpeter effect suggests a negative relation between unemployment and entrepreneurship, and that higher levels of entrepreneurship lead to lower levels of unemployment (Audretsch and Fritsch, 1994; Audretsch, et al., 2005; Garofoloi, 1994). In other words, higher levels of start-up activities result in employment increase. Contrary to the Schumpeter effect, the refugee effect claims a positive link between entrepreneurship and unemployment, and thus an increase in unemployment rate leads to higher levels of start-up activities (Blau, 1987; Evans and Leighton, 1990; Evans and Jovanovic, 1989; Blanchflower and Meyer, 1994).

An important aspect of the impact of entrepreneurship on the economy is its effect on the business cycles that Schumpeter first introduced in the analysis of growth. In his opinion, the capitalist form of production has an evolutionary character, and what gives it this characteristic is the innovations that entrepreneurs have carried out. And these innovations constantly destroying the old ones and replacing with new ones, thus creating an unstable structure of economic growth. This Creative Destruction Process is a fundamental fact of capitalism, and in such a system, “equilibrium” is rarely seen in historical time. The system passes through the conjectural phases which are called the neighborhoods of equilibrium (Schumpeter, 1935: 4; 1939: 63-64, 82-85, 140-141; 1943: 82-86). The reasons for the economy to pass through cyclical stages are that the innovations created internally in the economic process and their applications are non-continuity or clustered and focused in certain periods. The cyclical fluctuations arise as a result of innovation and disproportionate or recurring fluctuations in their intensity (Kuznets, 1940: 259; Schumpeter, 1935: 6; 1939: 82-84, 98-100).

In summary, the theoretical literature on the effects of entrepreneurship on the economy has been the subjects of entrepreneurship and economic growth/development, business cycles and unemployment in general. Hence, the empirical literature was largely focused on these subjects and it was observed that different results were obtained in various studies. Moreover, some studies have been conducted by classifications such as ‘corporate entrepreneurship’, ‘social entrepreneurship’, ‘opportunity entrepreneurship’ and ‘necessity entrepreneurship’, and the effects of entrepreneurship have been analyzed (Wong, et al. 2005; Gedeon, 2010).

For example, in some studies have found a positive relationship between entrepreneurship and growth, while other studies have argued that unless certain conditions (including tax regimes, human capital, the level of development and the other institutional factors) prevail in the economy, the impact of entrepreneurship on the economic growth would be uncertain. 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,

4 Some of the first group studies include Audretsch (2007), Vázquez-Rozas, et al. (2010), Salman and Badr (2011) and the second group studies can be listed as Audretsch and Fritsch (2002), Van Stel, et al. (2005), Wennekers, et al. (2005), Urbano and Aparicio (2015).

the opportunity cost of switching from employee to business owners (as a proxy for entrepreneurship) increases. 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, et al., 2005; Stam, et al. 2011).

On the other hand, the results obtained from these studies depend on how entrepreneurship is defined and simultaneously the stage of economic development (Klapper and Love, 2016). 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. Studies found that necessity entrepreneurship has no or even negative effect on economic development (Acs, 2006; Acs, et al., 2005; Shane, 2000). In addition, opportunity entrepreneurship has a positive and significant effect (Acs, et al. 2008, Valliere and Peterson, 2009). Acs (2006) 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. Furthermore, Acs (2006) 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.

Looking at the literature on the subject, the relations between economic growth and entrepreneurship have been examined by considering the development levels of countries. For example, according to the research by Zaki and Rashid (2016) on seven emerging countries (Egypt, Hungary, India, Mexico, Indonesia, Turkey and Romania) over the period 2004-2014 and other previous studies on entrepreneurship, necessity entrepreneurship is indicated to have no adverse effect on economic development as the marginal productivity is zero or even negative. Necessity entrepreneurship means having to become an entrepreneur because there are no other better job opportunities. Apparently, most emerging countries have more necessity entrepreneurs who are forced to be self-employed and fewer opportunity entrepreneurs because of the high youth unemployment rate, low income level and uneasy entrepreneurial environment. Opportunity entrepreneurs are entrepreneurs who make a deliberate choice to start a new enterprise, they demonstrate innovative capabilities and exploit unidentified opportunities (Acs, 2006: 97). However, the research concluded that there is a significant negative relationship between entrepreneurship and economic growth, while both labour productivity and level of economic development shows a positive relationship with economic growth. This statement implies that entrepreneurship has excellent benefits for the economy of the nation if the government can encourage business start-ups, improve the business environment, provide necessary infrastructure as well as create a fair taxing system and business regulation (Zaki and Rashid, 2016). According to Yusuf and Albanawi (2016), in developing countries, the entrepreneurial activities of the population are a determinant of economic growth. The well-planned and well-coordinated activities of entrepreneurs in a nation can bring about a high economic growth rate.

Van Stel, Carree and Thurik (2005), who stated that entrepreneurial activities have a positive effect on economic performance, believe that these activities in developed countries are related to the level of economic development.

These means that the entrepreneurial activities in such countries can contribute to the economic growth of such country which affirms the notion that the difference in economic growth rates of countries is due primarily to the quality of their entrepreneurs. Entrepreneurs in developed countries are mostly opportunity entrepreneurs who are highly creative and innovative. They employ all factors of production (land, labor and capital) for productive ventures and in most cases, their government provide an enabling environment for business to thrive as such most start-ups in no time become a more substantial corporation and enjoy economies of scale. China's explosive economic development over the past twenty-five years is as a result of the removal of bureaucracy, government encouragement, and support for the entrepreneurial activity of the people. In the United States, the world's biggest economy, seventy-five percent of the sixteen million businesses operate as a sole proprietorship with enormous support from the government and in turn, show how these 17 entrepreneurial activities have helped create jobs and moved the country out recession to growth. Also, at the heart of other rapidly growing economies such as India and Brazil are numerous SMEs manufacturing, retail, IT, technical, and financial firms who are providing jobs, creating products and services and bringing about competition, innovation and growth (Osolor, 2016).

Although there are a large number of cyclical fluctuation theories in the literature, there are few theoretical and empirical studies explicitly including entrepreneurship. For example, in the real conjuncture model theoretically considered by Rampini (2004) focusing on the relationship between entrepreneurs' share of total labor and business cycles. It is assumed that economic actors preferred to risk-averse and chooses between employment and entrepreneurship in which model entrepreneurship activities changed with cycles in the same direction.

Wong, et al. (2005) examined the effects of entrepreneurship and innovation on economic growth separately. In the study, it is carried out in the context of the neoclassical growth model using the cross-sectional data of 37 countries in 2002 and concluded that innovation is an important and significant determinant of economic growth. The rate of entrepreneurship is defined in four different ways such as general or total entrepreneurship, an opportunity of entrepreneurship, a necessity of entrepreneurship and potential entrepreneurship and it is stated that only potential entrepreneurship has a positive and significant effect on economic growth.

The literature review of Parker (2009) discussed whether new companies in the United States will be in the same direction with the cycle and it was indicated that reducing wages had encouraged opening new firms and entrepreneurship during the recession period.

Koellinger and Thurik (2012) had examined the relationship among entrepreneurship, unemployment and GDP cycles in a panel data analysis of for 22 OECD countries during the period of 1972-2007. For the 22 countries, the entrepreneurship was Granger causality of the business cycle even though it was not on the national level. In other words, entrepreneurship had increased in all countries when the conjuncture had entered the expansion period, but such a relationship had not seen at the country levels. Moreover, entrepreneurship at the national level was a reaction to unemployment fluctuations unlikely to cause unemployment.

Congregado, et al. (2012), it is questioned whether the entrepreneurship in Spain and the United States shows a hysteresis effect or not and the causality between business cycles and entrepreneurial ratios is investigated. According to the study, the entrepreneurship caused hysteresis effect in Spain, but not seen in the United States. In addition, it has been concluded that changes in business cycles in both countries have significant effects on future entrepreneurship rates. In other words, the existence of reverse causality between business cycles and entrepreneurship has been determined.

Fritsch, et al. (2013) examines the relationship among entrepreneurship, unemployment and business cycles in Germany. It is found that there was a positive relationship between unemployment and new firm start-up activities in the study and that establishment of the new firm was more during recession periods, in other words, the entrepreneurship was counter-cyclical. The authors also analyzed the periods of high and low unemployment and indicated that unemployment had a significant effect on entrepreneurship when entrepreneurship was below the trend value of unemployment.

Scholman, et al. (2014) analyzes the relationship among entrepreneurial activities in an open economy, business cycles and unemployment. In the study, using both quarterly and annual data for 1998-2007 of 19 OECD countries, if the business cycle in the country follows behind the world conjuncture, then in the short run the entrepreneurship in that country increases.

However, if the country's business cycle leads the world conjuncture, the entrepreneurial activity in that country has increased in the mid-term (a year or two years later). According to authors, the position of a business cycle in a country with regard to the cycles in the world creates different types of entrepreneurial opportunities depending on the time horizon. When this is interpreted for an open economy, the entrepreneurial opportunities relate to the conjectural performance of the outward-country.

The study of Faria (2015) asserts empirical results based on the theoretical model in which Koellinger and Thurik (2012) claimed that entrepreneurship was Granger causality of the cycles in the world economy and entrepreneurial cycles were positively affected by national unemployment rates. The study investigated the relation among entrepreneurship, unemployment and GDP based on Ramsey model, in that unemployed persons tend to be an entrepreneur and to enter the market by developing a technological innovation during periods of high unemployment. If unemployment declines during the expanding of the economy, the number of new entrepreneurs will decrease, and this reduction in entrepreneurial numbers will lead to decrease technological innovations and capital stock (Llopis, vd., 2015: 246).

On the other hand, in the related literature, it is expected that entrepreneurship improves economic performance by creating innovations and increasing competition (van Stel, Carree and Thurik, 2005). However, as the empirical studies have shown, the effects of entrepreneurship on economic growth and conjuncture can vary from country to country and the length or shortness of the period considered because of that there is an interesting relationship between the period of the conjuncture and entrepreneurship. This case emerges especially during the recession period of the conjuncture. The recession periods, on the one hand, the entrepreneurship may be reduced because the potential income and wealth of firms are decreasing, and on the other hand, the entrepreneurship can necessarily be increased due to the lack of employment opportunities or the lack of potential job opportunities. Moreover, as the unemployment increases and the labor is cheaper, the opportunity of entrepreneurship can also increase. The characteristic features of the recession period make the net effect on entrepreneurship uncertain (Farlie, 2011; Wong, et al., 2005).

When we look at the studies examining the effects of entrepreneurship on unemployment, while some studies have found that entrepreneurship reduces unemployment, some studies have concluded that the increase in unemployment reduces entrepreneurship. According to these studies, Unemployed people do not have the adequate knowledge and capital to build a business and therefore do not seek entrepreneurship (Johansson, 2000; Hurst and Lusardi, 2004). This phenomenon is explained by unstable economic growth in some studies (Audretsch,

1995; Audretsch, vd. 2005; Thurik, vd., 2008). Finally, there are studies suggesting that there is no relationship between entrepreneurship and unemployment and even that the interaction is bi-directional (Carree, 2002).⁵

These trends in the world literature on the relationship between entrepreneurship and unemployment are also observed in a small number of empirical studies for Turkey. While there is a negative relationship between unemployment and entrepreneurship in the study conducted by Kum and Karacaoğlu (2012), the causality is from unemployment to entrepreneurship. In the study carried out by Halicioğlu and Yolaç (2015), which takes into account different countries, the increase in unemployment in some countries increases entrepreneurship, while in some countries it decreases entrepreneurship. On the other hand, there was no long-term relationship between the two variables in some countries, including Turkey. Finally, Apaydın (2018a) found that the Schumpeter effect was valid while the refugee effect was invalid. In other words, when the rate of entrepreneurship increases. Unemployment decreases and causality is from entrepreneurship to unemployment. The only study in Turkey that examined the impact of entrepreneurship on Business Cycles was carried out by Apaydın (2018b) and it was found that the entrepreneurship activities were counter-cyclical. In other words, it has indicated that these activities increase in the recession periods and decreasing in the expansion period of the cycles.

Concluding Remarks

In this chapter, the effects of entrepreneurship on the economy have been historically studied and the issues that have been considered in the theoretical and empirical literature have been tried to be determined. In this context, it is determined that the effects of entrepreneurship on business cycles, unemployment and growth are examined both theoretically and empirically. In the studies, it is generally accepted that entrepreneurship will affect economic growth positively, reduce unemployment and increase economic prosperity. However, empirical studies have shown that the economic effects of entrepreneurship may vary according to country-to-country, applied method and the length or shortness of the period considered. For example, while in some countries there is a negative of positive relationship between entrepreneurship and unemployment, in some countries there is no relations between variables. A similar situation exists for the relations between entrepreneurship, business cycles and growth. Undoubtedly, factors such as the specific characteristics of the countries, the different analysis methods and how the variables used in the analysis can be defined can play a role in the emergence of different results.

Despite the fact that the relationships between the variables mentioned in entrepreneurship are examined in detail and the effects of entrepreneurship on economic development are emphasized, it is observed that the studies are considered as growth-oriented rather than development. In other words, the relationship between entrepreneurship and development has been neglected. Considering that entrepreneurship reflects the individual's behavioral characteristics, this aspect of the issue is particularly important. Therefore, while examining the effects of entrepreneurship on the economy, taking into account other development indicators (energy consumption, health expenditures, education expenditures, etc.) other than the growth rate will make the analyzes to be more meaningful and significant. In addition, when examining the effects of entrepreneurship, the analysis of entrepreneurship and innovation activities together will help to discuss the issue with a richer content.

⁵ Some of the studies covering different countries / regions and different methods are as follows: Evans ve Leighton (1990), Audretsch ve Fritsch (1994), Garafoloi (1994), Audretsch ve Thurik (2000), Audretsch, et al. (2002), Audretsch, et al. (2005), Caree, et al. (2007), Faria, et al. (2009), Faria, et al. (2010).

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