

**CHALIMBANA UNIVERSITY**

***Integrity. Service. Excellence*.**

**SCHOOL OF BUSINESS AND ENTREPRENEURSHIP**

**DEPARTMENT OF ENTREPRENEURSHIP**

THEORECTICAL PERSPECTIVES OF ENTREPRENEURSHIP

CODE: BTE 1101

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# RATIONALE

This is a learning module namelyTheorectical Perspectives ofEntrepreneurship composed throughProduct-Based Learning Approach to determine the effectiveness in improving the students’ learning outcomes. This module is expected to provide guidance to students with the goal of conducting lectures and make them have entrepreneurial spirit. According to Borg (1989), the implementation of the Research and Development (R&D) is an attempt to develop or produce and validate a production that is used in learning. According to Putra (2012), methods of Research and Development (R&D) is a research that deliberately and systematically aims to seek findings, formulate, refine, develop, produce, test the effectiveness of product, models, methods / strategies / ways, services, specific procedure which is superior, new, effective, efficient, productive and meaningful. Good or bad a learning process is mostly determined by the selection of instructional media. The learning media chosen should be relevant to make the learning process go well (Heinich, 2005; Smaldino, 2012). One of relevant medium in the teaching and learning process of entrepreneurship courses is a module. The module is a resource that contains materials, methods, limitations, and evaluation systematically arranged and attractive. (Dimopoulos). The definition explains that a product-based learning contains procedures or steps that need to be done by the educators to facilitate learners to actively learn, participate, and interact with competence-oriented in order to produce goods or services required. In addition, it is implemented collaboratively, production based learning should also be innovative, unique, and focused on solving problems related to the lives of the learners or the needs of the community or the local industry. The benefit of this module therefore is to support the existing teaching materials, to provide an opportunity for students to learn independently with the concepts described in the module, and can improve the students’ competencies, and to foster the students’ entrepreneurial spirit.

# AIM

This aim of this course is to introduce university students to theories of Entrepneurship, Innovation and Small Business Management, provide better innovation, development and research on entrepreneurship education and initiate efforts to improve the entrepreneurial spirit of students as an essential element which can help reduce the numbers of educated unemployment.

# BACKGROUND

Entrepreneurship module by using Product-Based Learning Approach aims to make the students be able to develop the potential, the creativity and the ability to produce products that are needed by the community and have a sale value (Ganefri and Hidayat, 2015; Kusumaningrum, Anori, & Dewy, 2016; Hidayat, Hendra, 2017; Mega Silfia Dewy and Sartika, 2017). Considering the particular characteristics of the learning process of entrepreneurial learning as unique and comprehensive characteristics, the development of the module is potential to meet the demands of the learning. This module will direct learners in a systematic and standard work procedures to make or complete a product (goods or service), through the production process / work indeed. The benefit of this module is based to support the existing teaching materials, provide an opportunity for students doing work practices oriented to the market, and to improve the competence of students as well as to foster their entrepreneurial spirit.

# LEARNING OUTCOMES:

By the end of this course, learners should be able to:

* Discuss the importance of co-operative strategic alliances and networks between firms.
* Justify the importance of theoretical perspectives frameworks
* Examine the importance of psychology in Entrepreneurship
* Explore the relationship between the society and Entrepreneurship
* Have first-hand experience of the selection and deployment of tools, techniques and theories for the identification, validation and structuring of Entrepreneurship.
* Understand strategies to confirm customer needs & test market demand
* Be able to define and test critical business model uncertainties
* Understand key principles that underpin theoretical perspectives

**ASSESSMENT**

1. **CONTINOUS ASSESSMENT**
2. PROJECT 20%
3. ASSIGNMENT 10%
4. TEST 20%
5. **FINAL EXAM 50%**

TOTAL **100%**

# 

## **HISTORY OF ENTREPRENEURSHIP**

Unit 1

**OBJECTIVES.**

‘At the end of this unit, learners should be able to:

* Explain the importance of Entrepreneurship
* Describe the how the past influenced entrepreneurial activities
* Discuss prominent people around the world who made an impact on entrepreneurship
* Justify the establishment of entrepreneurship in the past

### INTRODUCTION

History does matter. It has been said that he who controls the past controls the future. Our view of history shapes the way we view the present, and therefore it dictates what answers we offer for existing problems. When you go into a doctor’s office for the first time, you invariably have to fill out an information sheet that asks about your medical history. Some of these forms are very detailed, asking questions that require information from rarely accessed memory banks. Why does a doctor ask these questions? The doctor is trying to construct an accurate picture of your state of health. Your health is heavily influenced by the past. Your heredity, past behaviours, past experiences are all important determinants and clues to your present condition. Whenever you return to the doctor, he or she pulls out a file which contains all the notes from past visits. This file is a history of your health. Doctors understand very clearly that the past matters. “History is a story about the past that is significant and true.” This simple definition contains two words packed with meaning which must be understood in order to understand history. The past is fixed—no one can change what happened—but as the values of society change, the historians’ depiction of the past changes also. It has been argued that history tells us more about the time in which it is written than the time about which it is written.

### A Brief History of Entrepreneurship:

The Pioneers, Profiteers, and Racketeers Who Shaped Our World (Joe Carlen),2016.

Especially when it is guided by that rare combination of imagination, energy, and shrewdness, the entrepreneurial impulse can be the forerunner of momentous transformation, an instigator of significant changes that extend well beyond the realm of industry. As tantalizing as space tourism seems from a modern-day perspective, many of the entrepreneurs highlighted were involved in enterprises that, for their respective eras, were just as radically innovative and transformational as the work of Musk, Bezos, and company. In 1985, Peter Drucker, the late management expert, defined entrepreneurship as “the act that endows resources with a new capacity to create wealth,”¹ among the most specific and meaningful definitions of the term. More literally, the words “entrepreneurship” and “enterprise” both derive from the Old French word for “an undertaking,”entrependre. Yet even in French, the related word entrepreneur did not take on its current meaning until the economist Jean-Baptiste Say so imbued it in 1800.In the English language, until the mid-nineteenth century, when the French term entrepreneur began to enjoy common usage outside France, the termunder-taker (a...

### The Pirates of Phoenicia

In the Bible, there are several passages in which the term “Canaanite” is employed interchangeably with the words for “trader” and “merchant.” Evidently, among the writers of the Old Testament, the commercial skills of this rival Semitic nation were so impressive that a Canaanite was, by lineage, a cunning and effective merchant. This legendary flair for commerce was most apparent among the Canaanites who had settled north of the Hebrew kingdoms, on an unremarkable sliver of coastal land in modern-day Lebanon and Syria. From this inauspicious starting point, these northerly Canaanites, the Phoenicians, would remake the world of commerce.

### The Reluctant Romans

In the realm of entrepreneurship, the legacy of the ancient Romans stands in stark contrast to that of the enterprising Mesopotamians and Phoenicians. In fact, Rome bears the distinction of being among the least entrepreneurial civilizations not only of antiquity but of recorded history. This, of course, begs the question of why this civilization deserves an inclusion in a module chronicling the history of entrepreneurship. Part of the answer is that the entrepreneurial experience in Rome is an insightful illustration of enterprise as practiced under unfavourable and at times even hostile conditions. Some civilizations, past and present, have consciously fostered...

### An Enterprising Faith

The region of Arabia, or the Arabian Peninsula, encompasses modern-day Saudi Arabia, all of the smaller Persian Gulf States, Yemen, and to the east, portions of Iraq and Jordan. Situated between the great western powers of antiquity and the coveted spices and silk of the Indus valley, Arabia held considerable strategic value. Not surprisingly, many of the nomadic Arabs became involved in trade, and caravans of merchants were commonplace, Arab or otherwise. Due to the vast commerce that passed through the peninsula, at their respective peaks, the empires of Persia, Rome, and Byzantium all ensured a strong regional presence to...

### Flying Money and Capitalist Monks

The Middle East and Mediterranean Europe were the settings of most of the significant developments in the early history of entrepreneurship. However, by the medieval era, Chinese civilization had not only caught up with those regions commercially but in some respects surpassed both the Islamic world and Christian Europe. The diary entries of Marco Polo, the celebrated Venetian trader and explorer, express his breathless astonishment as he took in the sights of Hangzhou, capital of the Southern Song dynasty in medieval China.

### Captains of the Revolution

“Without innovation,” the Austrian economist Joseph Schumpeter wrote, “no entrepreneurs.” Of course, there are varying levels of innovation involved in different business endeavours. So an enterprise does not need to involve a radically new product or service to qualify as innovative. For example, while they were not in a technology-oriented business, the directors of the European merchant companies discussed in the previous chapter were, nonetheless, habitual innovators. From financing to the exploitation of profit-making opportunities, their creativity was legendary. In fact, considering that the Latin origin of the term “innovate” means “to make new,” the establishment of novel trade routes.

### The Land of (Entrepreneurial) Opportunity

The United States, particularly during the period from the Civil War until the end of the twentieth century, stands as the quintessential entrepreneurial society. Certainly, there have been few nations and epochs so moulded by entrepreneurship and its attendant marvels and perils as America was during that time. From John D. Rockefeller to Henry Ford and all the way to late twentieth-century Information Age pioneers like Bill Gates and Steve Jobs, America spawned one iconic and internationally renowned entrepreneur after another. Moreover, there were many other transformational American entrepreneurs during this period, some of whose stories may be less well...

## A Brief History of Entrepreneurship: In Between Centuries.

* Earliest Period
* middle Ages
* 17th Century
* 18th Century
* 19th Century
* & 20th Century

### Earliest Period

• Marco polo, as a go-between was an Italian.

• He wanted to trade routes to the Far East.

• As a go-between, He had to sign a contract with a money person to sell his goods. In the contract merchant adventurer took a loan at 22.5% rate including insurance. Capitalist was the passive risk bearer and merchant adventurer took the active role in trading, bearing all physical and emotional risks. When the merchant-adventurer successfully sold the goods and completed the trip, the profits were divided with the capitalist taking most of them (up to 75%), while the merchant-adventurer settled for the remaining 25 %.

### Middle Ages

• Entrepreneur used to describe both as an actor and a person who managed large production projects. Individuals did not take any risks because all the resources used to provide by the government of the country, all an entrepreneur should do is to manage it. A typical entrepreneur in the middle age was the priest.

• The person in charge of great architectural works used to build castles and fortifications, public buildings, abbeys, and cathedrals.

### 17th Century

The connection of the risk with entrepreneurship developed in the 17th century.

• An entrepreneur was a person who entered into a contract with the government to perform a service or to supply stipulated products.

• John law, a Frenchman was one of the entrepreneur in that period.

•The founder of the royal bank of France and the Mississippi Company, which had an exclusive franchise to trade between France and the new world.

• Monopoly on French trade eventually led to collapse of the company.

• Richard Cantillon, a well-known English economist at the beginning of the 17th century, understood Law’s mistake.

• He viewed the entrepreneur as a risk taker, observing that merchants, farmers, craftsmen, and others sole proprietors “buy at a certain price and sell at an uncertain price, therefore operating at a risk.”

### 18th Century

• In the 18th century, the person with capital was differentiated from the one who needed capital.

• The entrepreneur was distinguished from the capital provider.

• One reason for this differentiation was the industrialization occurring throughout the world.

• Eli Whitney was an American inventor best known for inventing the cotton gin. This was one of the key inventions of the industrial Revolution.

• Thomas Edison, the inventor of many inventions. He was developing new technologies and was unable to finance his inventions himself.

• Edison was a capital user (an entrepreneur), not a provider (a venture capitalist).

• In the late 19th and early 20th centuries, entrepreneurs were frequently not distinguished from managers and were viewed mostly from an economic perspective.

• The entrepreneur organizes and manages an enterprise for personal gain.

•The materials consumed in the business, for the use of the land, for the services he employs, and for the capital he requires.

### 19th & 20th Centuries

• Andrew Carnegie is one of the best examples of this definition.

• Carnegie, who descended from a poor Scottish family, made the American Steel Industry one of the wonders of the industrial world.

### In the middle of the 20th Century

• The function of the entrepreneurs is to recreate or revolutionize the pattern of production by introducing an invention.

• Innovation, the act of introducing some new ideas, is one of the most difficult tasks for the entrepreneur.

• Edward Harriman, who reorganized the railroad in the United States.

• John Morgan, who developed his large banking house by reorganizing and financing the nation’s industries.

• Traditional technologies innovations (translators, computers, lasers) that are usually associated with the word invention.

• The Egyptian who designed and built great pyramids out of stone blocks weighing many tons each, to laser beams, supersonic planes and space stations.( Sakhidari – TIM Review.)

## Historic background

One of the first entrepreneurs was Marco Polo. He had ideas of trading with Asia in the 13th century and was sure of how he could get there and the materials he could trade. His expeditions were financed by venture capitalists in Venice with an assurance that he would share his profits with them. These loose associations continued to flourish in Europe and other parts of the world where people with money were willing to back ideas and new schemes when they were convinced that there was some pecuniary advantage in the end. Entrepreneurship first took off when production levels exceeded local consumption and people were left with surpluses of the things they produced, whether in the form of agricultural produce, dairy products, livestock and quite a few manufactured items. This initially led to a barter system that allowed people exchanged things to satisfy their own requirements. This further led to the development of the market place where people gathered to barter or sell their excess production in order to profit themselves. This came about with the realization that they could not wait indefinitely for a coincidence of wants before they could barter their own products. Government agencies stepped into the act in the 17th century and made capital available to people to finance production ventures. The risk involved in such ventures was the sole responsibility of the entrepreneur and they had to make a fixed payment to the government, irrespective of any profit they made from the venture. Governments considered this as a source of revenue. The concept of entrepreneurship was first established in the 1700s. There are many concepts and theories about its genesis. However, based on its key features, there were three basic ideas that explain the appearance of entrepreneurial activity.

* The first focuses on the individual, in other words, entrepreneurial action is conceived as a human attribute, such as the willingness to face uncertainty, accepting risks, the need for achievement, which differentiate entrepreneurs from the rest of society.
* The second fundamental idea emphasizes economic and environmental factors that motivate and enable entrepreneurial activity, such as the dimension of markets, the dynamic of technological changes, the structure of the market or merely the industrial dynamic.
* The third factor is linked to the functioning of institutions, culture and societal values. This approach is not exclusive given that entrepreneurial activity is also a human activity and does not spontaneously occur solely due to the economic environment or technological, normative or demographic changes.

The present development of entrepreneurship started after the Second World War in the 1950’s when nations were looking to build up their economies from the ravages of the war. People had new ideas for business or jobs as individuals and started in small ways with limited capital to form businesses which went on to challenge the well established companies.

In the 20th century, economist Joseph Schumpeter (1883-1950) focused on how the entrepreneur’s drive for innovation and improvement creates upheaval and change. Schumpeter viewed entrepreneurship as a force of “creative destruction.” The entrepreneur carries out “new combinations,” thereby helping render old industries obsolete. Established ways of doing business are destroyed by the creation of new and better ways to do them. Business expert Peter Drucker (1909-2005) took this idea further, describing the entrepreneur as someone who actually searches for change, responds to it, and exploits change as an opportunity.

***Activity***

**The Envelope Exercise**  
In this exercise, you are asked to plan for a two-hour activity to increase an initial, unknown investment provided to you in an envelope. The amount of money in the envelope is very small – around $20 (K200.00). The students are usually surprised at how little money is in the envelope. You have been asked to increase the investment money provided to you. The exercise helps students realize how easy it is for them to make money. This exercise and realization is really eye-opening and thrilling for them. It is also a very rewarding experience for both students and lecturers.

Unit 2

# THEORIES OF ENTREPRENEURSHIP

# In this unit we discuss the theories in entrepreneurship.

OBJECTIVES:

As you study and work through this unit, you will be expected to:

* Identify different theories and hoe they are applied.
* Justify the general points to consider when applying these theories.
* Classify the theories according to activists.

## INTRODUCTION

Since the turn of the century, studies on entrepreneurship have been carried out within a number of other social sciences disciplines than economics – such as sociology, psychology, economic and business history and anthropology (Swedberg 2000). Most people who are not economists would probably expect that economics literature to be full of analyses of entrepreneurship, as economics is, in fact, the social science that deals most directly with contemporary economic reality. However, for long time economics literature had relatively little to say about entrepreneurship and it is often alleged that such neglect of the entrepreneur should be a source of embarrassment to economists (Cosgel 1996), as the importance of the entrepreneur in the real world became more and more difficult to ignore (Wennekers and Thurik 1999).

## What Are the Theories of Entrepreneurship?

An entrepreneur puts together a business and accepts the associated risk to make a profit. While this definition serves as a simple but accurate description of entrepreneurs, it fails to explain the phenomena of entrepreneurship itself. A number of theories exist, but all of them fall into one of five main categories.

### Economic Theories

Economic entrepreneurship theories date back to the first half of the 1700s with the work of Richard Cantillon, who introduced the idea of entrepreneurs as risk takers. The classic, neoclassical and Austrian Market process schools of thought all pose explanations for entrepreneurship that focus, for the most part, on economic conditions and the opportunities they create. Economic theories of entrepreneurship tend to receive significant criticism for failing to recognize the dynamic, open nature of market systems, ignoring the unique nature of entrepreneurial activity and downplaying the diverse contexts in which entrepreneurship occurs.

### Resource-Based Theories

Resource-based theories focus on the way individuals leverage different types of resources to get entrepreneurial efforts off the ground. Access to capital improves the chances of getting a new venture off the ground, but entrepreneurs often start ventures with little ready capital. Other types of resources entrepreneurs might leverage include social networks and the information they provide, as well as human resources, such as education. In some cases, the intangible elements of leadership the entrepreneur adds to the mix operate as resource that a business cannot replace.

### Psychological Theories

Psychological theories of entrepreneurship focus on the individual and the mental or emotional elements that drive entrepreneurial individuals. A theory put forward by psychologist David McClelland, a Harvard emeritus professor, offers that entrepreneurs possess a need for achievement that drives their activity. Julian Rotter, professor emeritus at the University of Connecticut, put forward a locus of control theory. Rotter’s theory holds that people with a strong internal locus of control believe their actions can influence the external world and research suggests most entrepreneurs possess trait. A final approach, though unsupported by research, suggests personality traits ranging from creativity and resilience to optimism drive entrepreneurial behaviour.

### Sociological/Anthropological Theories

The sociological theory centres its explanation for entrepreneurship on the various social contexts that enable the opportunities entrepreneurs leverage. Paul D. Reynolds, a George Washington University research professor, singles out four such contexts: social networks, a desire for a meaningful life, ethnic identification and social-political environment factors. The anthropological model approaches the question of entrepreneurship by placing it within the context of culture and examining how cultural forces, such as social attitudes, shape both the perception of entrepreneurship and the behaviours of entrepreneurs.

### **Opportunity-Based Theory**

Prolific business management author, professor and corporate consultant, Peter Drucker put forward an opportunity-based theory. Drucker contends that entrepreneurs excel at seeing and taking advantage of possibilities created by social, technological and cultural changes. For example, where a business that caters to senior citizens might view a sudden influx of younger residents to a neighbourhood as a potential death stroke, an entrepreneur might see it as a chance to open a new club.

## DEVELOPMENT

From an **economics** perspective, entrepreneurship is seen as a fourth factor of production (i.e. together with land, labour and capital). Joseph Schumpeter (1934) provided what has often been said to be the modern definition of an entrepreneur:

“*The person who destroys the existing economic order by introducing new products and services, by creating new forms of organization, or by exploiting new raw materials”*

In fact, it is from this perspective of business formation and the resultant economic benefits that entrepreneurship has been viewed as being important to overall economic development of a country, region and the world as a whole. It has been argued that whilst entrepreneurship as a whole does lack a clear theoretical framework, this does not necessarily apply when operating from an economics perspective. This is because it then benefits from well-developed theoretical frameworks and methodologies found in economics as a discipline. The methods used are often quantitative, incorporate models for optimizing behaviour under uncertainty, whilst also utilizing empirical approaches founded on econometric analysis of large and representative data samples. It is therefore small wonder that probably the more prominent entrepreneurship research works have been from the economics perspective. Does this necessarily make the other perspectives (e.g. psychological and sociological) any less important? We will observe from this chapter that whilst economics can provide important insights into the entrepreneurship, it does come up against aspects that are difficult to explain from this perspective. So rather than trying to decide which perspective should be utilized in entrepreneurship, the perspectivist view taken in this book is that it is through a well-reasoned combination of these different perspectives that we are able to arrive at a more complete picture. This approach is certainly more relevant for practitioners and policy makers who seek to move beyond mere concepts, theories and research and would want to work with practical and holistic models that can help in achieving tangible developmental results.

## **THEORETICAL MODELS ON THE ECONOMICS OF ENTREPRENEURSHIP**

Various economic theories have been advanced to answer the many questions that may be raised in connection with the economics of entrepreneurship. In this section, we will draw heavily on the work of Parker (2004) who provides a synthesis of some key and well-established categories of thought on the economics of entrepreneurship. The theories seek to explain the phenomenon of entrepreneurship from an economic perspective and also consider particular economic factors affecting it.

### Occupational Choice under Uncertainty

Occupational choice theories espouse the view that individuals make choices between entrepreneurship (understood to be self-employment) and alternatives (mainly taken to be either making safe investments or being employed), based on individual characteristics or abilities.

According to Lucas (1978), as utility maximization choices are made, the most entrepreneurial will run the largest firms whilst the least will be indifferent to either entrepreneurship or employment. As entrepreneurial firms get established and also grow, two things happen from an economics perspective: (1) wages will adjust as the firms mop up the labour market; and (2) interest rates will also adjust as they use up venture finance in the capital markets.

It is important to note that the above view does not necessarily recognise the effect of variations in wealth endowments arising from imperfections in capital markets (Banerjee & Newman, 1993), and also the possible differences in human productivity between the contexts of entrepreneurship and paid employment (Iyigun & Owen, 1998).

Rather than referring to entrepreneurial characteristics or abilities in general Kihlstrom & Laffont (1979) build on the work of Knight (1921) by focus on attitude towards risk as a basic determinant of occupational choice. From this perspective, the least risk-averse will therefore run the largest firms whilst those that are most risk averse will strongly opt for paid employment. There are three variables to keep in mind here: risk, return and risk profile of the agent. Parker (1996 & 1997) undertakes theoretical analyses that combines these variables to show how decisions are made. It is worth noting that an individual can combine occupations as a way of “risk management”, with greater time allocation to what may be perceived to provide a better risk-return profile based on the risk disposition of the individual.

Also particularly relevant to a developing country context is the possibility of ending up with a socially undesirable number and combination of entrepreneurs in an economy. For example, more efficient foreigners or a particular class of people may dominate as entrepreneurs, and possibly crowed out others. This can arise due to lack of risk sharing. Grossman (1984) points to the need for addressing this through devising risk-sharing mechanisms (e.g. at policy level).

### Credit Rationing

This category of theories focuses on access to venture finance. Information asymmetry (with entrepreneurs being better informed about their ventures than financiers) results in banks “pooling” their loan contracts as a way of managing risk exposure.

Stiglitz & Weiss (1981) and De Meza & Webb (1987) discuss the differences in risk profiles of loan applicants and applications, and how that these cannot be accurately ascertained at the application stage. Banks are therefore compelled to (1) set interest rates at lower than market clearing levels so as not to crowed out lower risk project (which will have a corresponding lower return and will therefore not be willing to pay high interest); and (2) to also ration out finance across a pool of different borrowers.

Important implication of the information asymmetry and inability to establish entrepreneurial ability is that:

1. In the case of the model by Stiglitz & Weiss (1981), banks will under-invest into entrepreneurship – an aspect of market failure clearly undesirable socially (and often politically too!).
2. In the case of De Meza and Webb (1987), rationing leads to the more than optimal resources being extended towards entrepreneurship, with the more efficient entrepreneurs subsidizing the less efficient.

### Innovation, entry, exit and industry evolution

The recognition of the important o innovation in the economics of entrepreneurship goes back to the contributions of Schumpeter (1934). Two influential theories have emerged in explaining the relationship between innovation on one hand and the birth/death of firms and also how industry evolves on the other hand.

Jovanovic (1982) provides a model based on the view that entrepreneurs are exposed to randomly-emerging information from the market, and that those that adequately adapt (through learning that enables them to innovate) survive, whilst the rest exit the market. This model enables us to therefore predict firm entry and exit, and how industries evolve in view of the effect of entrepreneurship (as here represented by innovation). The model has, for instance, been able to assist in establishing that *newer and the smaller firms are characterized by higher and more varied growth rates, and higher exit rates than larger older and larger firms* (from Parker 2004).

Klepper (1996) considers the relationship between innovation on one hand and product life cycle and industry evolution on the other. From this, we are able to learn that *different types of innovation are performed at different stages of firm maturity*. This has a bearing not only on firm exit or survival, but also on how industries evolve over time and across different phases. We also understand that *the rate of new firm entry and product innovation slows down as an industry matures, with innovation shifting towards process.*

It is important to mention that the nature and level of research and development (R&D) has important ramifications on demonstrating the impact of innovation on firm growth and overall economic development (Howitt, 1992; Aghion & Howitt, 1997).

## RECENT THEORETICAL AND METHODOLOGICAL CONTRIBUTIONS TO THE ECONOMICS OF ENTREPRENEURSHIP

### Social Entrepreneurship

The challenge to economists has to do with why entrepreneurs would go for social rather than profit maximizing enterprises. Altruism and tax relief have been unsatisfactory explanations. Glaeser and Shleifer (2001) explain the ability of social entrepreneurs to survive competitions from the fact that profits are non-distributable and investments cannot be cut back. They say that this ensures sufficient re-investment that can provide a competitive edge. Further, Social enterprises attract donations which in turn reduce the marginal utility of revenues, reducing incentives to compromise on quality.

### Linking Venture Capital, Entrepreneurship & Public Policy

Kieuschnigg & Nelsen (2005) have developed an occupational choice framework that helps to understand venture capital-backed entrepreneurship and how public policy can help improve competitive equilibrium outcomes and so increasing social welfare.

### Human Capital & Entrepreneurship

Lazear (2002, 2004) suggests that entrepreneurial selection and performance is guided by a mix of skills rather than specialization. Research by Wagner has contributed to this view. One possible effect from this view is that *more specialized fields (art, accounting, etc.) may with time suffer from lower number of entrepreneurs because of their demand for specialized competencies*.

Polkovnichenko (2003) attempt to answer a puzzle identified by Moskowitz & Vissing-Jorgensen (2002) as to why entrepreneurs, despite having higher risk, are willing to earn similar returns as publicly tradable equity (which are much safer due to risk diversification). Polkovnichenko (2003) assert that human capital is not put to risk and, combined with the entrepreneurial returns, provide a weightier option to the equity investment option.

Parker & Van Praag (2004) extend the work of Bernhartd (2000) by unifying the knowledge on human capital with that on borrowing constraints. They predict that more educated entrepreneurs will face lower barriers to borrowing. The rate of return on their education, coupled with greater productivity through access to finance, will continue to enhance the value of entrepreneurship compared to employment. Hence, they argue that highly educated individuals are well-placed to become successful entrepreneurs.

### Entrepreneurial Learning

Parker (2005) argues that learning and knowledge creation are the most important strategic activities of a firm in the modern day. He further states that entrepreneurs tend to rely heavily on their past beliefs of unobserved firm performance than responding to information about current market conditions – with biologically younger entrepreneurs responding more to current market information than their older counterparts.

Questions still remain with regard to how entrepreneurs learn, and also regarding the effectiveness of entrepreneurship education models currently in use.

## **APPLICATION OF THE ECONOMICS OF ENTREPRENEURSHIP**

To assist us in applying economic theory to entrepreneurship, we will use the following questions as a basis for discussing major aspects of the economics of entrepreneurship (Parker, undated):

* How many jobs do entrepreneurs create?
* Are small entrepreneurial firms more innovative than large corporations?
* Do tax cuts stimulate entrepreneurship?
* Why are blacks and females less likely to be entrepreneurs in Britain and America?
* Do banks ration credit to new enterprises, and do capital constraints impede entre into entrepreneurship?
* How successful are loan guarantee schemes in unlocking credit to new enterprises?
* Which entrepreneurial ventures are most likely to survive and grow?
* Why do entrepreneurs work hard for so little pay?
* Should government encourage or discourage entrepreneurship?

Let us briefly consider each of the above questions.

### Entrepreneurship, Job Creation & Economic Development

The argument that small firms have a significant impact on job creation is linked to the work of David Birch (1979) and is set in the context of the USA. ACS and Audretsch (1993) confirmed this with other developed countries. But Davis et al (1996) challenged these findings and questioned methodological flaws in earlier studies. Subsequent studies by Hart and Oulton (1996) and Davidson et al (1998) address key identified flaws but still reaffirm earlier findings by Birch (1979) and ACS and Audretsch (1993).

### Small Firms & Innovation

Whilst one may argue that measuring innovation and technological change is not an easy process (ACS and Audretsch, 2003), various studies have shown that small firms and younger firms are more innovative than the bigger and older ones (in terms of the number of innovations contributed per employee). Also important to mention is that innovation in small firms is closely related to availability of skills labour.

### Tax Cuts & Entrepreneurship Development

Carroll et al (2000a) show that income tax reductions for entrepreneurs have the effect of increasing the propensity of entrepreneurs to hire labour and to raise investments in general, but not necessarily to increase the numbers of those opting for self-employment.

Generally though, little is known about the effects on entrepreneurship of government regulation on small business development. There is need to undertake cost-benefit analysis of government policy positions with regard to entrepreneurship development.

### Ethnicity, Gender & Entrepreneurship

White Americans and Britons are 2 to 3 times more likely to participate in entrepreneurship that their black counterparts (Clark & Drinkwater, 1998; Fairlie, 1999), with a similar ratio applicable to males and females in the same countries (Devine, 1994; Ajayi-obe & Parker, 2005).

Despite major efforts to understand the ethnicity phenomenon, there remain unobserved factors that may very well lie in the social and/or psychological realms (e.g discrimination, culture, unobserved individual characteristics, etc.).

With regard to gender, greater success has been scored, with revelations that factors affecting female entrepreneurship include, marital status, having infant or school-going children, husband’s employment status, and husband experience with self-employment (MacPherson, 1998; Caputo & Dolinsky, 1998; and Bruce, 1999). This factors also apply to the incidence of home-based female entrepreneurial activity (Edwards & Field-Hendrey, 2002).

### Access to Finance & Entrepreneurship

Berger & Udell (1992) found that there was little evidence of capital rationing in the US financial sector, with finding that only about 2% of entrepreneurs failed to access finance (including those with proposals that may not have been viable!)

Whilst the above may hold, there is evidence that a larger proportion of entrepreneurs (as much as 20% in the Dutch case) obtain less financing than they require (Parker & Van Praag).It is also important to note that many options for financing exist in developed countries (including credit cards). In any case, most start-ups need little, if any, external financing from the onset (Hurst & Lusardi, 2004).

For the developed world at least, there is therefore little evidence that access to finance impedes entry into entrepreneurship. The scenario may be different with regard to accessing finance for firm growth, as is reported in Sub-Saharan Africa. Little is known on the economics of using alternative and less conventional sources of finance, such as family and friends, credit card, mutual guarantee schemes (ASCAs & ROSCAs), etc.

### How successful are Loan Guarantee Schemes in Improving Access to Entrepreneurial Finance?

LGS do enable finance to flow in a direction it may otherwise not have, therefore unlocking entrepreneurship and its resultant effects. But studies show the likelihood of poorer performance of loans extended in this way (Bosworth et al, 1988 in the case of the US; and KPMG 1999 in the case of the UK).

### What kinds of enterprises are likely to survive?

Those that are older and larger (turnover and/or capitalization); operated by an older entrepreneur with prior business experience; and are formed in a conducive economic climate (Parker 2004).

### Why do Entrepreneurs work so Hard for Less Than Employment?

Economic theory has confirmed that entrepreneurs in general earn less than if they were in employment (Hamilton, 2000) but has failed to explain this from an economics perspective.

Studies have also shown that the prospect of making more money typically ranks low in entrepreneurs’ stated motivations for founding their own firm (Bamberger, 1986; Cromie,1988; Hamilton, 1988) and especially much so in Scandinavian countries (Scheinberg & MacMillan, 1988). From Davidsson, 1995)Parker (2004) concedes that there should be other non-economic considerations that are factored into the choices made by entrepreneurs.

### Should Government encourage or discourage Entrepreneurship?

Whilst it would sound politically correct to respond in the affirmative, economists are suspicious of making unqualified normative claims about the benefits of entrepreneurship (Parker, undated). It is possible, from an economics perspective, to have too much entrepreneurship!

The benefits of entrepreneurship are well-known: promoting competition; innovation and job-creation; generating positive externalities with other enterprises; and, as a result, providing a pathway out of pervert and general underdevelopment. In such a context, government’s role would be to correct any market failures and enhance the investment climate and business environment.

There is still limited authoritative evidence of positive spill overs from entrepreneurship. There is evidence that uncontrolled entrepreneurship can result into greater social and economic costs than the benefits produced (Parker 2003b; Astebro, 2003; Coelho, 2004).

Evidence of the importance of human capital spill overs and industry clusters for entrepreneurial innovation is growing (Acs & Armington, 2004), but specific evidence of externalities is still lacking, i.e. on what these are, how they are generated, who generates them, their value, and how they can be nurtured (Parker, undated).

### How do economists attempt to explain regional variations in entrepreneurship?

* Role models derived in working in small businesses (Wargner, 2004).
* Knowledge spill overs concentrated in particular localities (ACS and Armington, 2004)
* Multiple equilibrium based on self-reinforcing human capital investment decisions (Parker 2005b)

## **THE ECONOMICS OF ENTREPRENEURSHIP AND CONTEXT**

Even though the economic perspective may tend to provide more robust and credible explanations regarding entrepreneurship, researchers (Low & Abrahamson, 1997; Thornton, 1999) have still argued that unless context is taken into account, the links between the various aspects of entrepreneurship and between the phenomenon and overall development are likely to remain elusive. It is with this in mind that Lingelbach et al (2001) suggest that entrepreneurs in developing countries face a different set of circumstances than their counterparts in developed economies, and that the difference is rooted in the underlying economies in which they operate. Many developing country economies are factor-driven, and any attempts to move beyond this (through enhancing entrepreneurship) continue to be hampered by inadequate attention being paid to areas such as institutions, infrastructure, macro-economic stability, health and education.

In fact, Rosa et al (2006) and Vares et al (2011) have gone as far as arguing that there is actually no direct relationship between entrepreneurship and economic development but that the form and nature of entrepreneurship (e.g. necessity or opportunity driven), within the context of pre-existing levels of national development, informs the type of economy (e.g. factor driven, efficiency driven, and innovative driven), which in turn dictates economic development. However controversial this view might appear, the point that comes out clearly is that an important starting point would need to be entrepreneurship development a point made by Muller et al (2010) regarding Sub-Saharan Africa.

Mainstream economics, particularly microeconomics and the theory of the firm, had great difficulty in fitting entrepreneurship into its theory and consequently tended to ignore the existence of the entrepreneur. This has led to an entrepreneur less theoretical firm for long time (e.g., Baumol 1968). Until most recent decades, economic models, mainly those on firm behaviour, were very often indifferent to the phenomenon of entrepreneurship. The theory’s failure to explain entrepreneurship was a consequence of the extreme simplifying assumptions in neoclassical economics, in particular relating to perfect competition and static market equilibrium, which assume, in turn, free and perfect information about markets and production processes (Montanye 2006). These assumptions, which reduce the economic process to clocklike mechanics, overlooked the need for specialized individuals to perform the discovery, coordination, promotion and risk-bearing functions that neoclassical economics takes for granted (Schumpeter 1911, 1934; Landström 2005). As a result, during long time, there was no possible room for the entrepreneur in economic theory.

Despite the attempts of Richard Cantillon to recognize the role of the entrepreneur to economic phenomena in the 18th century, the entrepreneur had virtually disappeared from the academic economic discussion by the late 19th century. However, from the early 20th century onwards, we identify a rebirth of this figure within economic theory. The entrepreneur has (re)entered into economics and academics started to look at the entrepreneurship phenomena through different perspectives. Almost all the branches of economic theory had something to say about the entrepreneur figure and his respective importance for some economic phenomenon. Actually, the history of economic analysis became replete with references to the entrepreneur and the essential role that he plays in the vitality of the market (Martin 1979). However, there is perhaps no other area of economic analysis where there exists less agreement than on the nature of the entrepreneurial function and the identification of the entrepreneur figure.

The evolution of entrepreneurship research within Economics was, actually, strongly intensified by the different roles that were attributed to the entrepreneur figure over the time by several economists and analysts. In economic thought literature, we already find valuable interpretations of the visions of particular economists about the entrepreneur figure (see, for instance, Martin 1979, Kanbur 1980, Santarelli and Pesciarelli 1990) or even about the reasons behind the entrepreneur’s disappearance from mainstream economic analysis (e.g., Cosgel 1996). However, a deeper knowledge about how the entrepreneur (re)entered into economic theory through the several Economics branches is still lacking in the literature. This paper thus aims at contributing to the current literature and economic though debates by analyzing the path through which the entrepreneur (re)entered into economic theory over the 20th century, leading to a growing research arena around the entrepreneurship topic within Economics. More than focusing on particular visions of specific authors or confronting similar or opposing views of different authors, this paper tries to provide a wider vision on the need that economic theory felt, over the last century, to include the entrepreneur figure as a potential explanatory agent of several economic phenomena.

The remainder of the paper is organized as follows. As a starting point, Section 2 pays particular attention to the most influential economists who helped to bring the entrepreneur back into economics over the 20th century, in order to identify and summarize the contributions of the main Heffalump hunters. Section 3 goes through the main Economics fields where the (re)discover of the entrepreneur figure was most remarkable – namely Labour Economics, Microeconomics and Industrial Organization, and Macroeconomics, more precisely Economic Growth and Development – searching for the rationality to include the entrepreneur figure into the analyses of economic phenomena. Section 4 provides some quantitative analysis based on the academic research on entrepreneurship over the last decades, supporting the evolution of this academic field – currently known as Economics of Entrepreneurship or Small Business Economics - within Economics.

The crucial roles of the entrepreneur in economic theory were first and foremost recognized by Richard Cantillon (1755, 1931), early in the 18th century, who became the progenitor of the ideas that subsequent economists explored. Cantillon recognized that discrepancies between demand and supply in a market create opportunities for buying cheaply and selling at a higher price and that this sort of arbitrage would bring equilibrium to competitive market. People who took advantage of these unrealized profit opportunities were called “entrepreneurs” (Landström 2005).

Since Cantillon, several economists such as Mill, Say and Marshall in the 19th century, in addition to Schumpeter, Knight, Kirzner and Baumol throughout the 20th century, were among the most influential contributors to the recognition of the merit of entrepreneurship and the entrepreneur himself within economic theory. In the writings of classical economists, the entrepreneur’s appearance was frequent, though he remained a shadowy entity without clearly defined form and function, so that for several times it was argued that there was no room for the entrepreneur in economic theory, particularly in the theoretical firm (Baumol 1968; Swedberg 2000). Actually, by the end of 19th century, the entrepreneur had virtually disappeared from the economic thought1, requiring a rebirth after that (Blaug 1998). Such reincarnation of the entrepreneur within the several branches of Economics was prompted by the recognition that entrepreneurial activity was marked by uncertainty and risk (Knight 1921), though being potentially innovative and important for economic development (Schumpeter 1911). Hébert and Link (1989) observe that the taxonomy of entrepreneurial theories can be condensed into three major intellectual traditions – Chicago, German and Austrian traditions – each one tracing its origin to Richard Cantillon. Within each of them, we emphasize the contributions of Frank Knight, Joseph Schumpeter and Israel Kirzner, respectively, in addition to other economists who have shared or opposed their opinions over time – in particular, William Baumol. We can suspect that without these contributions and confronts of ideas, entrepreneurship would have not get its deserved space within Economics.

### Joseph Schumpeter and the Creative Destruction

In the words of Reisman (2004: 3), “Schumpeter” means “entrepreneurship”. Schumpeter, and later Frank Knight, succeeded in infusing life to the entrepreneur (Baumol 1968), who had remained as an invisible man for economists for large decades. Schumpeter strongly contributed to the understanding of entrepreneurship, mainly from a development economics lens. With his book Theory of Economic Development (1911, 1934), he unveiled his concept of the entrepreneur against the backdrop of economic development, defending that development is a dynamic process that involves the disturbing of the economic status quo, hence attributing to the entrepreneur the responsibility for disturbing that equilibrium. Actually, Cosgel (1996) advances three categories of explanations for this disappearance of the entrepreneur from economic theory: a first one related to the modern theory of the firm, a second one related to the increasing emphasis on equilibrium and a last one related to (mathematical) method of economics itself.

For Schumpeter, the economic system was regarded as a closed circular flow, being in a state of equilibrium through a continuous reiteration of the flows between buyers and sellers. However, this did not mean that changes could not occur, but rather that all actors involved should adapt to the new situation as soon as the changes were detected. He rather defended the so-called called “creative destruction” of stationary equilibrium. In other words, development was viewed as the disturbance of the circular flow and it was attributed to the entrepreneur, who played a fundamental role as innovator (Hébert and Link 2006), by introducing innovations in the form of new products, markets or methods of production.

Entrepreneurship, under Schumpeter, is thus the expression of the human impulse to be creative (Khalil 2007) and the role of the entrepreneur in the growth economy is argued to be direct and unambiguous. Schumpeter’s basic realization was that economic growth resulted not from capital accumulation, but from innovations and “new combinations” (Landström 2005). Precisely, Schumpeter has declared that “the carrying out of new combinations we call ‘enterprise’; the individual whose function is to carry them out, we call ‘entrepreneurs’” (1934).

In summary, Schumpeter argued that entrepreneurial rewards (or profits, according to Knight (1921)) flow from the temporary monopoly rents that arise when the entrepreneur successfully carries out those “new combinations” of ideas and resources. Innovating, improving existing goods and services, creating or expanding markets, and improving production processes and organizational structures were some of the functions that Schumpeter attributed to the entrepreneur (Montanye 2006). Moreover, the Schumpeterian entrepreneur, by being responsible for the disturbance of the equilibrium, was seen as the source of crises, by pushing the economy away from the equilibrium through the introduction of his innovations. However, Schumpeter’s ideas about the role of the entrepreneur changed considerable over time and this enthusiastic view of the entrepreneur corresponded mainly to his most youth phase. Later, in a more mature phase, Schumpeter became much more reserved on his writings about entrepreneurship, predicting a decline in the economic importance of the entrepreneur (see, for instance, Santerelli and Pesciarelli 1990, Ebner 2006).

### b. Frank Knight and the Uncertainty Concept

After Schumpeter, Frank Knight (1921) prompted one of the pioneer economic approaches of entrepreneurship in the 20th century, with his thesis Risk, Uncertainty and Profit. Knight, strongly inspired by Cantillon (Hébert and Link 2006), stressed the distinction between risk and uncertainty: risk exists when outcomes are uncertain but can be predicted with some probability, being insurable; uncertainty arises when the probability of outcomes cannot be calculated; and true uncertainty occurs when the future is not only unknown, but also unknowable with unclassifiable instances and a non-existent distribution of outcomes. Knightian uncertainty bedevilled many economists in their analyses of entrepreneurship (Schultz 1980) by suggesting that entrepreneurship is mainly characterized by action under true uncertainty. Additionally, Knight argued that it was such uncertainty that gives rise to the “pure profit”, which in turn is the entrepreneurship’s life blood (Montanye 2006).

Cantillon had already argued that the origin of entrepreneurship lies in the lack of perfect foresight, as individuals cannot know the future and/or its impact on economic life. Knight extended Cantillon’s ideas and devoted his attention to the function of entrepreneurs in a dynamic market economy, where the uncertainty about the success of one’s enterprise is a central feature in the decision to switch between being an employee and entering self-employment and thus becoming an entrepreneur (Parker, 1996). Entrepreneurs were hence held responsible for economic progress, through for instance improvements in technology and business organization, but becoming an entrepreneur was known to involve risk and uncertainty.

The Knightian entrepreneur assumes the uninsurable business hazard (van Praag 1999). This was clearly opposite to the Schumpeterian entrepreneur, who was never the risk bearer (Schumpeter 1934). For Schumpeter, risk-taking is no case an element of the entrepreneurial function, and even though entrepreneurs may risk their reputation, the direct responsibility of failure never falls on them (Kanbur 1980). In few words, while the Schumpeterian entrepreneur was the dynamic innovator, the Knightian entrepreneur was the residual uncertainty-bearer (Martin 1979).

### c. Israel Kirzner and the Austrian School

Since von Mises (1949) and Menger (1950), and later extensions by Kirzner (1979, 1997), modern Austrian explanations have been sharply differentiated from the neoclassical approach. Von Misses’ views on entrepreneurship were clearly preceded by Knight’s influential insights, being centred on the role of uncertainty. Von Mises argued that the entrepreneur’s “success or failure depends on the correctness of his anticipation of uncertain events. If he fails in his understanding of things to come, he is doomed. The only source from which an entrepreneur’s profits stem is his ability to anticipate better than other people the future demand of consumers” (1949).

Later, Kirzner (1973, 1997) introduced the key concepts of “spontaneous learning”, “alertness” and “entrepreneurial discovery”. According to the Austrian approach, imperfect information involves an element which cannot be fitted at all into neoclassical models, that of "sheer" (i.e., unknown) ignorance (Kirzner 1997). Entrepreneurial discovery thus plays a role, as it is seen as gradually pushing back the boundaries of sheer ignorance, by increasing mutual awareness among market participants and thus, in turn, driving prices, output and input quantities and qualities toward the values consistent with equilibrium (which corresponds to the complete absence of sheer ignorance). In other words, and contrasting the Schumpeterian view, the dynamic competitive process of entrepreneurial discovery (which is the driving element of the Austrian approach on entrepreneurship) is seen as tending systematically toward, rather than away from, the path to equilibrium.

Kirzner’s view of entrepreneurship is based on what he called “spontaneous learning”, by comparing the entrepreneur to Robinson Crusoe (Kirzner 1979; Cosgel 1996). In particular, as Crusoe gradually becomes aware of his entrepreneurial vision, he learns, that, the state of mind that enables spontaneous learning to occur is “alertness”. It is alertness that allows entrepreneurs to identify profitable exchange (or in other words, arbitrage) opportunities, validating the importance of the entrepreneur’s “information-transforming” function already defended by Hayek (1948).

Hence, for Kirzner, the market process is said to be driven by entrepreneurs “alertness” to unnoticed, unexploited gains from exchange. Alertness thus refers to an attitude of receptiveness or preparedness to recognize existing, overlooked opportunities and, consequently, the attainment of market equilibrium requires entrepreneurial action (Casson 2005; Endres and Woods 2006). In summary, for the Austrian School, in opposition to the German Tradition of Schumpeter, only in disequilibrium are there opportunities for entrepreneurial profit. Austrians, and Kirzner in particular, rediscovered the entrepreneur as the equilibrating force in the economic system. His role is created by the state of disequilibrium in the economy and his activities ensure a tendency towards equilibrium (Kirzner 1971: 1999-2000; Hébert and Link 1989; Khalil, 2007).

### d. William Baumol and the role of incentives

In a now classic paper lamenting the elusiveness of the entrepreneur in formal economic analysis, Baumol (1968) was convinced that economic “theory...fails to provide a rigorous analysis of the behaviour of the entrepreneur”. In this article, he stated that in “neoclassical models” the “theoretical firm is entrepreneur less”. The entrepreneur had “virtually disappeared” from mainstream economics, as his presence was inconsistent with the conditions satisfied in the equilibrium state (Baumol 1993). This was a little like a performance of Hamlet with the Danish prince missing (Baumol 1968).

Baumol’s position was motivated by the neoclassical conception of the entrepreneur as a functionary and as another factor of production separate from the standard triumvirate: land, labour and capital. The traditional production function describes an engineering relationship between inputs and outputs rather than a behavioural phenomenon. Entrepreneurship, like other inputs, is a deployable scarce resource (Endres and Woods 2006). This has led to the never escaping Baumol’s (1968) original observation that neoclassical entrepreneurs are “automaton maximizers” and automaton maximizers they have remained.

Baumol’s work on entrepreneurship pays homage to the insights of Schumpeter, namely on his ideas about the entrepreneur as an innovator and as the potential source of equilibrium destruction. Throughout his career, Baumol has urged the profession to pay attention to the instrumental role of entrepreneurship in economic renewal and growth (Elliasson and Henrekson 2004). In this respect, he argued that entrepreneurship can be found in many societies throughout history, but while it is productive in some, it is unproductive and even destructive in others. In other words, entrepreneurial activities may have negative consequences in terms of decreased social income and welfare, particularly when the entrepreneur earns money at the expense of other citizens in society. Baumol’s (1990; 1993) basic thesis says that the supply of entrepreneurs in a society is constant, but that the societal value of their self-interest varies according to the rewards available.

This has led Baumol to defend new ideas on the need for the right incentives to promote entrepreneurship. Defending that growth cannot be explained by the simple accumulation of various factors of production per se, Baumol argued that human creativity and productive entrepreneurship are needed to combine the inputs in profitable ways. As a result, an institutional environment that encourages productive entrepreneurship and human experimentation becomes the ultimate determinant of economic growth. Accordingly, in order to encourage creative entrepreneurship, it is necessary to create conditions that allow the entrepreneurial pursuit of self-interest to accord with social wealth creation.

Baumol has been working for years to create more space for entrepreneurship and innovation in economic theory. His most recent work has been focusing on the incentives under which judgmental decision-making takes place, with special reference to the issue of how far “rent-seeking” dominates entrepreneurial motivation under perverse incentive systems (Casson 2005). Baumol’s more recent efforts have also been related to the development of a micro-theory of the entrepreneur, highlighting the distinction between innovative and replicative entrepreneurs, as well as the importance of entrepreneurship to economic growth and development (Baumol 2010). Currently, his work on entrepreneurship is recognized as being highly influential, having documented the central role of the entrepreneur in long-term economic development and welfare through his human creativity. His decades of work have thus highlighted that a significant body of economic theory had been failing to deal with what is likely to be the most important factor for growth and renewal – individuals pursuing entrepreneurial opportunities (Elliasson and Henrekson 2004).

In 2003, Baumol was rewarded with the Global Award for Entrepreneurship Research (Eliasson and Henrekson 2004) for his persistent effort to give the entrepreneur a key role in mainstream economic theory and for his studies on the importance of institutions and incentives for the allocation of entrepreneurship.

### (RE) DISCOVERING THE INVISIBLE MAN IN THE SEVERAL FIELDS OF ECONOMIC THEORY

2.5***. Labor Economics***

After Knight, Schumpeter, Kirzner and Baumol, among many other economists, economic theory started to pay an increasing attention to the entrepreneur, before treated as an invisible man in the economy, particularly in the firm. It was mainly from the late 1970s onwards that economics literature rediscovered the entrepreneur and started to include him formally in economic models, mainly through models of occupational choice between entrepreneurship and paid employment (Parker 2009: 31). By that time, and from the entrepreneur perspective, entrepreneurship was considered an activity where individuals work for themselves and trade off risk and returns, rather than opting for safe returns in a different occupation – typically, paid employment.

It was surely Frank Knight who motivated economists’ attention to the problem of the entrepreneur: to be or not to be entrepreneur, attending that every entrepreneurial decision entails risk and that individuals must respond to the risk-adjusted relative earnings opportunities associated with employment and self-employment (e.g., Evans 1949). First economic models trying to formalize the entrepreneurship phenomenon focused the attention on the individual, the potential entrepreneur deciding between remaining employed (and leaving unemployment) and becoming self-employed. Economic theory, particularly that closer to labor economics, started to develop occupational choice models of entrepreneurship in which agents were first treated as homogeneous, to then extend the approach in order to account for individuals’ heterogeneity in terms of, for instance, entrepreneurial ability or risk attitudes. The idea of occupational choice had, however, some roots in Roy’s (1951) work, which already postulated a model of sectorial choice according to which people predict the earnings on two sectors and choose the one that provides a higher utility.

This branch of economic theory took as starting point the Knightian premise that individuals do not have to be entrepreneurs. Instead, they can choose between entrepreneurship and some outside option (usually assumed to be paid employment), following a utility maximization framework (Parker 2005; 2009: 36). Some classic occupational choice models form the foundations of entrepreneurship as an occupational choice problem in economic theory, particularly in labor economics: Lucas (1978), Kihlstrom and Laffont (1979) and Holmes and Schmitz (1990).

Lucas’s (1978) seminal paper motivated subsequent models in occupational choice on the basis of a continuous distribution of entrepreneurial talent among the workforce. He defended that individuals differ in terms of their innate entrepreneurial ability, so skills are the source of individuals’ heterogeneity in the model. Agents choose the occupation that gives them the higher expected utility, such that the less talented individuals (those who share common skills) remain as employees, while the most able (positioned above a certain ability threshold level) become entrepreneurs. The “marginal entrepreneur” thus has an ability that makes him just indifferent between entrepreneurship and paid employment.

Kihlstrom and Laffont (1979), based on Knightian insights, modelled entrepreneurial choice as a trade-off between risk and returns. Individuals are heterogeneous in terms of risk aversion and must face a trade-off between higher returns with greater levels of risk, and safer but lower earnings. The model predicts that more risk-averse individuals become employees while more risk-tolerant agents opt by entrepreneurship.

Holmes and Schmitz’s (1990) model, in turn, assumes that the economy is in a permanent state of disequilibrium and that individuals are continually exposed to new opportunities, which are spawned by exogenous technological progress. Individuals’ heterogeneity appears in terms of ability, which affects the probability of survival of new ventures. The Holmes-Schmitz model assessed the circumstances under which an entrepreneur should continue operating a venture or transfer it to a possibly less able entrepreneur in order to release time and resources to explore new opportunities. The least able individuals are found to only manage existing firms, while the most able ones specialize in setting up new businesses. Those with intermediate ability optimally either manage the business they have started or replace them by higher quality businesses purchased from the able entrepreneurs. In summary, Holmes and Schmitz (1990) were very influential, not only by incorporating and extending the key ideas of Schumpeter and Kirzner about opportunity recognition, but also by prompting the basis for the understanding of more complex behaviour of the entrepreneur, namely the reasons behind being “portfolio” entrepreneurs or “serial” entrepreneurs.

Subsequent economic models started to formalize not only the (heterogeneous) individuals’ decision between entrepreneurship and another option (commonly, paid employment), but also the determinants behind such decision. The role of credit rationing and financial constraints was one of the first real forces that economists tried to introduce on the theoretical models dealing with the decision of becoming entrepreneur (see, for instance, Stiglitz and Weiss (1981), de Meza and Webb (1987) and Evans and Jovanovich (1989).

All these models were crucial to prompt the interest of economic theory on the entrepreneur, after several highly respected mainstream economists – from Schumpeter in the early 20th century to Baumol and Lucas more recently – had rediscovered the entrepreneur and attributed to this figure several crucial roles. This first focus on entrepreneurial decisions of the individuals, thus fitting a labor economics approach, was crucial to the (re)discovery process of the “lost Heffalump” by economic theory. By the same time, other fields of economics were starting to pay an increasing attention to the entrepreneur figure and to his importance to explain particular economic phenomena.

***2.6. Microeconomics and Industrial Organization***

Besides the attention particularly devoted to the entrepreneur, namely within labor economics, micro economists and industrial organization (IO) specialists also started to be concerned with the entrepreneur’s firm itself, namely its success, survival and growth. More than looking at the entrepreneurs as those who leave employment (or unemployment) to create their own employment and exploit a (potentially profitable) business opportunity, economic literature also started to see the entrepreneur as the small firm’s owner, the responsible for establishing new firms and the job creator.

Lucas’s (1978) seminal paper had already prompted some signs of concern with the firm entry phenomenon associated with the entrepreneur, by showing that individuals with a specific entrepreneurial talent become entrepreneurs and found firms that employ the others, and that the most able entrepreneurs end up running the largest firms. Thus, from a theoretical point of view, Lucas (1978) put forward the first theory of the size distribution of firms on the relative endowment of entrepreneurial talents (Santarelli and Vivarelli 2007). Economists from IO different areas thus started to develop increasing efforts to include the entrepreneur in their analysis.

From the early 1980s onwards, owing to the seminal work of Jovanovic (1982) on the post-entry evolution of new-born firms, economics literature started to redirect the attention from the entrepreneur to the entrepreneur’s firm. Actually, one of the more fundamental changes that have taken place in this process through which the entrepreneur (re)entered into economic theory was the decline of the research interest in the entrepreneur as an individual in favour of an increasing focus on contextual aspects and on the process associated to the entrepreneurial actions (Landström 2005). Gartner (1988) confirmed this “shift”, claiming that “Who is the entrepreneur?” was the wrong question; rather, he argued that more relevant questions were “How are new organizations created?”, thus strongly contributing to the shift in economic thought from the personal characteristics and intentions of entrepreneurs themselves to a stronger focus on their actions and outcomes, mainly at the firm and industry-levels.

Jovanovic’s (1982) model is surely the most influential study concerning the growth and survival of firms, linking innovation, entry, exit and the evolution of the industry. His model became indispensable to understand the industry effects of entrepreneurial learning about (initially unknown) entrepreneurial abilities. In essence, Jovanovic assumes that firms, or more explicitly entrepreneurs, have incomplete information at start-up and they learn more about their efficiency as they operate in an industry. Able entrepreneurs’ firms grow and survive, while the less able (or unlucky) decline and fail, exiting the market. In result, firms differ in size not because of any fixed capital accumulation per se, but due to some learning that they are more efficient than others. Also, Jovanovic’s key premise that newer and smaller firms will have higher and more variable growth rates, and also higher exit rates than older and larger firms, have opened the doors to the entrepreneur and entrepreneurship phenomenon within Industries/Organizations.

Jointly with the advances of Jovanovic (1982), the economic context of the 1970s has motivated the discussion around small firms and entrepreneurship, as the dynamics of the (new) firms (involving birth, growth and/or exit) and their impacts in the industry (for instance, regarding employment creation) were a major concern for Industries/Organization economists. “Twin oil” crises also played a role (Landström 2005), during which many large companies were hit by severe economic difficulties, with the unemployment becoming a major problem in many western societies. Large firms were increasingly seen as inflexible and slow to adjust to new market conditions.

It was also under that context that David Birch presented his seminal work “The Job Generation Process” (1979), showing which type of firms played the key role on job creation. He found that the majority of new jobs were created by firms – often independent and young firms – with 20 or less employees, so it was not the large firms which created the new jobs, but the small and young firms in the economy (Parker 2009). Birch’s report, published within the framework of the MIT Program Neighbourhood and Regional Change, was only sold in twelve copies, but its influence was enormous, both on policy makers and the research community, especially in Industry/Organization.

Even being a source of large controversy and criticism, it provided the intellectual foundation for researchers throughout the world to incorporate smaller firms into their analyses of industrial evolution and economic development. Margaret Thatcher in the UK and Ronald Reagan in the US also contributed to this change in the economic thought, by changing their political ideology and pursuing policies strongly in favour of promoting small business and entrepreneurship (Landström 2005). Entrepreneurs, as small business owners, besides innovators and arbitrageurs, started then to be understood as potential job creators.

Such scenario shifted the focus from large companies to smaller firms, which in some cases started to outperform their larger counterparts in innovation and job creation (Aces 1992). New areas of interest emerged during this stage, as the relationship between entrepreneurship, innovation, industrial dynamics and job creation started to dominate the public debate. Simultaneously, theoretical and applied literature started trying to understand the transition of the entrepreneur from a simple self-employed status to a job creator status (e.g., van Praag and Cramer 2001). The increasing access to firm-level data contributed to the development of Empirical Industrial Organization (Einav and Levin 2010), where entrepreneurship started occupying a greater room over the most recent decades.

From the second half of the 1980s onwards, researchers within the field of Industrial Organization, namely from empirical IO, started to pay attention to a wider set of phenomena associated to entrepreneurship (Landström 2005). David Storey’s book” Understanding the Small Business Sector”, published in 1994, became one of the most highly cited works by economists’ in their entrepreneurship research. Policy oriented work on small business and entrepreneurship (e.g., Storey and Tether 1998; van Stel et al. 2007; Audretsch et al. 2007) or the relationship between “small firms and innovation” (e.g., Aces and Audretsch 1988, 1990) were two of the most common lines of entrepreneurship research within empirical IO over the most recent decades.

### 2.7. Macroeconomics: Economic Growth and Development

Since Schumpeter (1911), the entrepreneur emerged as the key figure being considered the personalcausal of economic development (Hébert and Link 1989; Santarelli and Pesciarelli 1990). The way through which entrepreneurs could promote growth and development seemed to be evident on the academic debates. From the different roles of the entrepreneur distinguished by the several “Heffalump hunters” (Hébert and Link 1989), two main roles had been highlighted as the key ones to link entrepreneurship to economic growth and development – the entrepreneur as the innovator (identified as the Schumpeterian entrepreneur) and the entrepreneur as the creator of new firms and new jobs (a role mainly identified by IO economists). Actually, by founding and operating a new business firm, even if there is nothing innovative in these acts, the entrepreneur was expected to create value and new jobs, which in turn might impact positively on the overall economy. Similarly, by innovating and transforming inventions and ideas into economically viable entities, entrepreneurs were also expected to improve economic development and promote growth (e.g., Wennekers and Thurik 1999).

However, despite this widespread belief that entrepreneurship was a key factor in economic growth and development, a conviction that remained alive during almost the whole 20th century, few attempts were made to incorporate entrepreneurship in formal growth and development models, at least until the early 1990s (Schmitz 1989;Wennekers and Thurik 1999). Until then, perfect competition assumptions from traditional theoretical neoclassical models and models of general equilibrium, which did not take into account the dynamics of the Schumpeterian innovator entrepreneur, still obstructed the formal inclusion of the entrepreneur.

**2.8Endegenous growth theory** has created new possibilities for fitting entrepreneurship or the assumed entrepreneurs’ innovative behavior into growth models. Endogenous growth models (e.g., Roomer 1986, 1990; Lucas 1988) started highlighting the role of knowledge and innovation for the growth of nations. New knowledge was argued to lead to innovations and it could be capitalized by being transformed into new products, processes and organizations. Besides assuming knowledge externalities, these models started to propose increasing returns to scale. However, these two processes appeared as a black box in the mainstream growth theory, which did not go very far toward illuminating the process by which knowledge externalities produce growth, or by which increasing returns can be manifested in the production process.

Knowledge spill overs were however recognized to not occur automatically, but rather to require some channel(s) through which they could work. Some mechanism was necessary to serve as a conduit for the spill over and commercialization of knowledge. The recognition of entrepreneurship’s role in the market process filled this gap (Holcombe 1998). Subsequent theoretical models started introducing entrepreneurship and/or entrepreneurs’ innovative activities in the endogenous growth models, by identifying entrepreneurship as the missing link in the previous models, being responsible for the conversion of knowledge into economically relevant knowledge (ACS Et Al. 2004, 2009). Schmitz (1989) and Aghion and Howitt (1992) provided key advances by that time. While the former developed a model in which endogenous entrepreneurial activity was found to be a key determinant of economic growth, the later showed that industrial innovations conducted by entrepreneurs, which improve the quality of products, were the key channel to induce progress and growth in the economy.

Incorporating entrepreneurship into the framework of economic growth added to the growth theory mainly by showing the nature of increasing returns to scale, knowledge externalities and the role of human capital. Knowledge externalities occur when the entrepreneurial insights of some produce entrepreneurial opportunities for others, while increasing returns occur because the more entrepreneurial activity an economy exhibits, the more new entrepreneurial opportunities it creates ( Holcombe 1998). Moreover, the new focus on entrepreneurship pushed growth theory forward, towards the institutional setting within which growth occurs, and away from neoclassical theories that focused on production process’ inputs.

Entrepreneurship is already considered one of the key growth components in “new growth theory”,(Audretsch et al. 2006; Henrekson 2005). More recent concerns of economic growth theory have been related to the quality of the entrepreneurship. Recent models have been suggesting the need to encourage high ability entrepreneurs, as reduced quality of entrepreneurs is argued to retard growth (Jiang et al. 2010; Jaimovich 2010). These new results stress the need to provide the right incentives to the most able entrepreneurs, in order to promote productive and growth-enhancing entrepreneurship, and avoid unproductive or even destructive entrepreneurial activities, in line with Baumol (1990).

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## 2.9 THE ECONOMICS OF ENTREPRENEURSHIP

Despite research about entrepreneurship and small business had been limited through economics lenses during large decades, the late 1970s and early 1980s witnessed the publication of a number of pioneering scientific studies, mainly in the area of what can be termed “small business economics” or “economics of entrepreneurship”, which had a very strong influence on the subsequent development of entrepreneurship as an academic research field (Landström 2005: 61). “Small is beautiful” became the catchphrase in an increasingly wider number of publications, debates and policy concerns.

This section aims at providing a brief quantitative overview of the evolution of entrepreneurship research in Economics literature over the last decades. The analysis is based on ISI Web of Science database and intends to show how entrepreneurship research has been evolving, towards the Economics of Entrepreneurship or Small. Despite the debate has emerged in the 18th century with Richard Cantillon, entrepreneurship remains the phenomenon which is most emphasized yet least understood by economists (Kanbur 1980; Montanye 2006). Though some of the most important economists as Cantillon, Mill, Say, and Marshall, had tried to give some life to the entrepreneur within economic theory, by the end of 19th century, the entrepreneur had virtually disappeared from the economic thought, requiring a rebirth after that (Blaug 1998). In fact, many microeconomic theory and industrial organization texts always omitted mention of entrepreneurship altogether because neoclassical economics posits no need for it (Baumol 1993).

However, from the early 20th century onwards, economics felt the need for including the entrepreneur into the analysis of several economic problems. Several roles started to be attributed to the entrepreneur and he was understood to be responsible for important phenomena, as labour market and industry dynamics, innovation, economic development or economic growth. It was the man behind the firm, who remained invisible to the economists’ eyes for long time, endowed with creative talent (Lucas 1978), learning capacity and alertness (Kirzner 1979, 1997) to the profitable opportunities in the market - though facing high risk and uncertainty (Knight 1921) – who prompted the dynamics and the progress in the economy (Schumpeter 1911, 1934).

The recognition of these roles of the entrepreneur led to the rebirth of this figure within Economics by the beginning of the 20th century. An increasing anxiety to understand the importance of the entrepreneur for several economic problems was noticeable in several Economics fields. Some of the first attempts to infuse some life to the entrepreneur were concerned with the identification of the reasons behind the decision to engage into entrepreneurship. Economic theory, particularly the fields closer to Labour Economics, started to develop the first occupational choice models applied to the entrepreneur, trying to explain his decision between remaining (UN) employed and becoming self-employed.

By the same time, the entrepreneur started to receive other new labels from the economics literature, becoming increasingly viewed as the creator of new jobs, new andpromising firms. This contributed to redirect the emphasis towards the entrepreneurial firm rather than the entrepreneur alone. Within IO, and moreover among empirical IO researchers, the impacts of entrepreneurship at the firm and industry-level gained a growing interest and an increasing attention by policymakers.

Regarding economic growth and development theory, it was only by the late 1980s and early 1990s that entrepreneurship has formally found its place in economic models. Endogenous growth theory has created new possibilities for fitting entrepreneurship or the expected entrepreneurs’ innovative behavior in growth models. Despite the long time required to achieve its deserved room, entrepreneurship has recently gained an increasing importance as one of the key explanatory factors of economic growth and development, working as the channel trough which knowledge spillovers and increasing returns to scale work in endogenous growth theory.

Over more recent years, owing to this evolution of economic though about the entrepreneur and his roles, we can discern the development of entrepreneurship and small business research within existing disciplines toward the establishment of a distinct domain of research, which is becoming known as Economics of Entrepreneurship or Small Business Economics. Even though the field is still young and of an eclectic nature, much has been achieved, and we know a great deal more about, for example, the characteristics of the entrepreneur, the entrepreneurial process, the context of entrepreneurship, and the role of small businesses in the economy, than we did a couple of decades ago. However, Economics of Entrepreneurship is an emerging and growing academic interest, so we could expect great developments of the topic, both theoretical and empirical, in the near future.( Asian Society Of Business and Commerce),vol.1,No.11;July 2012.

## Personality Traits theory

Coon (2004) defines personality traits as “stable qualities that a person shows in most situations”. To the trait theorists there are enduring inborn qualities or potentials of the individual that naturally make him an entrepreneur. The obvious or logical question on your mind may be “What are the exact traits/inborn qualities?” The answer is not a straight forward one since we cannot point at particular traits. However, this model gives some insight into these traits or inborn qualities by identifying the characteristics associated with the entrepreneur. The characteristics give us a clue or an understanding of these traits or inborn potentials. In fact, explaining personality traits means making inference from behavior. Some of the characteristics or behaviors associated with entrepreneurs are that they tend to be more opportunity driven (they nose around), demonstrate high level of creativity and innovation, and show high level of management skills and business know-how. They have also been found to be optimistic, (they see the cup as half full than as half empty), emotionally resilient and have mental energy, they are hard workers, show intense commitment and perseverance, thrive on competitive desire to excel and win, tend to be dissatisfied with the status quo and desire improvement, entrepreneurs are also transformational in nature, who are lifelong learners and use failure as a tool and springboard. They also believe that they can personally make a difference, are individuals of integrity and above all visionary. The trait model is still not supported by research evidence. The only way to explain or claim that it exists is to look through the lenses of one’s characteristics/behaviours and conclude that one has the inborn quality to become an entrepreneur. 3.1.1Locus of Control Locus of control is an important aspect of personality. The concept was first introduced by Julian Rotter in the 1950s. Rotter (1966) refers to Locus of Control as an individual’s perception about the underlying main causes of events in his/her life. In other words, a locus of control orientation is a belief about whether the outcomes of our actions are contingent on what we do (internal control orientation) or on events outside our personal control (external control orientation). In this context the entrepreneur’s success comes from his/her own abilities and also support from outside. The former is referred to as internal locus of control and the latter is referred to as external locus of control. While individuals with an internal locus of control believe that they are able to control life events, individuals with an external locus of control believe that life's events are the result of external factors, such as chance, luck or fate. Empirical findings that internal locus of control is an entrepreneurial characteristic have been reported in the literature (Cromie, 2000, Ho and Koh, 1992; Koh, 1996; Robinson et al., 1991). In a student sample, internal locus of control was found to be positively associated with the desire to become an entrepreneur (Bonnett & Furnham, 1991). Rauch and Frese (2000) also found that business owners have a slightly higher internal locus of control than other populations. Other studies have found a high degree of innovativeness, competitive aggressiveness, and autonomy reports (Putsch et al., 1999).The same is reported of protestant work ethic beliefs (Bonnet and Furnham, 1991), as well as risk taking (Begley & Boyd, 1987).

## Need for Achievement theory;

While the trait model focuses on enduring inborn qualities and locus of control on the individual's perceptions about the rewards and punishments in his or her life, (Pervin, 1980,), need for achievement theory by McClelland (1961) explained that human beings have a need to succeed, accomplish, excel or achieve. Entrepreneurs are driven by this need to achieve and excel. While there is no research evidence to support personality traits, there is evidence for the relationship between achievement motivation and entrepreneurship (Johnson, 1990). Achievement motivation may be the only convincing person logical factor related to new venture creation (Shaver & Scott, 1991). Risk taking and innovativeness, need for achievement, and tolerance for ambiguity had positive and significant influence on entrepreneurial inclination Mohar, Singh and Kishore (2007). However, locus of control (LOC) had negative influence on entrepreneurial inclination. The construct locus of control was also found to be highly correlated with variables such as risk taking, need for achievement, and tolerance for ambiguity. The recent finding on risk taking strengthens earlier empirical studies which indicate that aversion to risk declines as wealth rises, that is, one’s net assets and value of future income (Szpiro, 1986). In complementing Szpiro’s observation, Eisenhauer (1995) suggests that success in entrepreneurship, by increasing wealth, can reduce the entrepreneur’s degree of risk aversion, and encourage more venturing. In his view, entrepreneurship may therefore be a self-perpetuating process. Further evidence suggests that some entrepreneurs exhibit mildly risk-loving behaviour (Brockhaus, 1980).These individuals prefer risks and challenges of venturing to the security of stable income.

## Economic Theory

* Entrepreneurship and economic growth take place when the economic conditions are favourable.
* Economic incentives are the main motivators for entrepreneurial activities
* Economic incentives include taxation policy, industrial policy, sources of finance and raw material, infrastructure availability, investment and marketing opportunities, access to information about market conditions, technology.

Unit 3

# ENTREPRENEURSHIP AND SOCIETY

# This chapter looks at the relationship of society and entrepreneurship. The impact that is directly or indirectly experienced by individuals goes beyond money.

**OBJECTIVES:**

As you study and work through this unit, you are expected to:

* Explain different ideologies that support entrepreneurship in society
* Apply the ideologies
* Discuss the importance of these ideologies.

## Introduction

This chapter takes the discussion of entrepreneurship beyond the individual level and into the environment or society in which entrepreneurship takes place. We will therefore examine the effect that this environment and the individual have on each other. There is no question that the reality that entrepreneurs will be seeking to enhance will include more than just themselves. The impact of entrepreneurship will be directly or indirectly experienced by other individuals and institutions that constitute this reality. The inverse is also true. The entrepreneur will be affected by the various individuals and institutions that are within the same context.

We will devote this chapter to considering the place of society in the experience of entrepreneurship. Society can be understood as *the setting, space or environment in which various forms of interaction and situations involving individuals, groups of individuals and institutions arise*.

Society does therefore provide a context within which entrepreneurship may occur. We will see in this chapter that, beyond the individual’s psychology, society (with its associated elements) not only helps us interpret the world but that it can also ‘colour’ what we see.

## Theories of entrepreneurship

Theory of entrepreneurship helps us to comprehend phenomena better. Understanding theory one can apply the same in practice more effectively. Various theories of entrepreneurship have been propounded by thinkers. They can be classified in three categories:

1. Sociological.
2. Economic.
3. Cultural.

## Sociological theories of entrepreneurship

1. **Max Weber’s theory:**Salient features of his theory are:
   1. Spirit of Capitalism is highlighted.
   2. Adventurous spirit facilitate taking risk.
   3. Protestant ethic embodying rebellion is conducive.
   4. Inducement of profit is the criterion.
2. **E.E. Hagen’s theory**
   * Reveals general model of the social- interrelationship among physical environment, social structure, personality and culture.
   * Thinks economic theories are inadequate.
   * Political & social change– catalyst for entrepreneurs.
   * Rejects follower’s syndrome imitating western technology. Technology is an integral part of socio- cultural complex.
   * Historic shift as a factor initiates change.

## Economic theories of entrepreneurship

1. **Schumpeter’s theory of innovation:**Development implies carrying one of new combinations of entrepreneurship. ‘Entrepreneur’ is an innovator– who carry new combination of:
   1. New goods/ services.
   2. New method of production.
   3. New market.
   4. New source of supply of raw materials.
   5. New organization.
2. **Harvard Business School** considers entrepreneurship as the outcome of the combination of internal and external forces.
   1. **Internal forces**– Individual’s  traits and qualities viz:
      1. Intelligence.
      2. Skill.
      3. Knowledge.
      4. Intuition.
      5. Exposure & experience.
   2. **External forces**– Surrounding’s conditions  viz:
      1. Economic.
      2. Political.
      3. Social & cultural.
      4. *Legal frame-work:* Stable Govt. External security, law & order and legal process are the influencing factors.

## Cultural theories of entrepreneurship

1. **Hoselitzs theory:**He explains that the supply of Entrepreneurship is governed by cultural factors & culturally minority groups are the spark – plugs of entrepreneurial economic development.
   1. **Marginal men-** Reservoir of entrepreneurial development. Ambiguous positions from a cultural or social statement make them creative.
   2. **Emphasis on skills-** Who possess extra-ordinary skills. Function of managerial additional personal traits & leadership skills. Additional personal traits. Exportation of profit ability to lend.
   3. **Contribution of social classes-**Socio-economic economic background of specific classes make them entrepreneurs. Family patterns in France, Protestants in UK/USA & Parsees in India.
2. **Peter F Drucker on entrepreneurship:**“An entrepreneur is one who always searches for change, rapidness to it and exploits it as an opportunity.” He emphasizes on:
   1. Innovation.
   2. *Resource*: A thing is regarded as resource when its economic value is recognized. Example- Fixed salary can also be an opportunity. Thus instalment purchase was introduced.
3. **ECO  model**
   1. Entrepreneurship.
   2. Creativity.
   3. Organization.

Our consideration of entrepreneurship within the context of society will incorporate 3 subject perspectives: 1) Psychology, which will only be to a very limited extent because this is well-covered in the previous chapter; 2) sociology, which will form the main thrust of this chapter; and 3) social psychology, which ensure that we are able to demonstrate the interplay between sociology and psychology in the context of developing country entrepreneurship.

Psychology was defined in the previous chapter as the study of mental functions and behaviour.

Sociology, on the other hand, is the study of human social interaction, which may involve individuals, groups or entire societies. Social Interaction is however generally understood to involve encounters between an individual and a particular group, through which the preferences of the individual are influenced (Scheinkman, 2006). What is term “social behaviour” is therefore individual behaviour that is influenced by such particular groups.

As a discipline, sociology assists us to enquire into how society is organized and to better understand the various social institutions that emerge and the culture that supports them.

Social psychology is a discipline that employs scientific methods to study the impact of situational variables (or social phenomena) on behaviour. It is important to our discussion because entrepreneurial experiences are informed by and also give rise to discrete situations whose impact on individuals needs to be considered.

## Fundamentals of Sociology

Sociologists are mainly interested in how people relate to one another and influence each other’s behaviour. They tend to focus on the group rather than the individual.

The thinking behind sociology (also referred to as the science of society) has its roots in ancient philosophy, but was helped to emerge as a separate discipline through the work of Frenchman and positivist philosopher Auguste Comte (1798 – 1857) and Karl Marx (1818 – 1883), a German national best known for his revolutionary socialist views. They sought to explain and influence changes in livelihoods caused by the French Revolution, secularisation, democratisation, industrialization and other economic and political changes of the time.

The fact that economic changes had important bearing on the emergence of sociology is important to keep in mind as we proceed towards linking it to entrepreneurship. Observable phenomena of the time included large scale production, increased search for paid work, rural-urban migration, rapid growth of cities, etc., most of which led to the advent of different ways in which society impacted on people (in terms of form and scale), such as the increased threats and actual experience of high unemployment, housing shortage, crime, pollution, and various forms of cultural shocks.

Max Web (1864 – 1920) a German national was another important early thinker in sociology who had significant interest in groups, and in understanding their patterns and reasons for particular behaviour. His view was that sociology needed to go beyond considering what could be observed, and capture feelings and thoughts through an interpretive empathetic understanding of the meanings others attached to their actions. The German term “Verstehen” (literally meaning “understand”), was associated with this approach.

Weber hence described sociology as *“. . . a science which attempts the interpretive understanding of social action in order thereby to arrive at a causal explanation of its course and effects.”* (Weber & Secher, 1962). He had also considered *social stratification*, and identified social status as one component that defined and economically determined relationship to the market (owner, renter, employee etc.)

Elizabeth Chell (1985, 1999), a social psychologist, has examined numerous psychological trait-based approaches and concluded that, whilst psychological aspects such as ‘entrepreneurial intention’ and the ‘ability to recognise opportunities’ are strongly linked to entrepreneurial behaviour, the context in which the entrepreneur operates is also very important.

## Theoretical perspectives in sociology

Three broad sociological perspectives can be identified:

1. The functionalist perspective
2. The conflict perspective
3. The interactionist perspective

Let’s briefly consider each perspective, keeping in mind that what each really presents is merely a different focus on social life.

### Functionalist Perspective

From this perspective society is viewed as a set of interrelated parts that work together to produce stable social systems that are held together through consensus (i.e most people agreeing on what is best and so working together on this basis).

Various social elements can therefore be identified within these social systems and within these efforts to attain and/or preserve what is perceived as best for society. The elements are identified based on their effect, whether positive (functional) or negative (dysfunctional) on the system. Such effect can be manifest (i.e., intended, openly stated, recognised consequences) or latent (unintended, hidden, unrecognised consequences).

### Conflict Perspective

This perspective focuses on those forces in society which promote *competition* and *change* and how power and other social dynamics (e.g gender, race, wealth, and other social positioning) are at work in these processes.

Competition is seen to emerge primarily as a result of scarce resources and, within the context of the various social dynamics, this may lead to social conflict. This conflict, in turn, leads to social change. Conflict theorists will therefore see social change as an integral feature of society.

### Interactionist Perspective

As the reference suggests, this view focuses on how individuals interact in society, how they respond to one another and the meanings that they attach to their actions and those of the others.

Symbols are seen to play an important role in social interaction. These symbols include words, gestures, physical objects, events, etc. However, members of society have to agree on the meanings to be attached to these symbols if they are to facilitate interaction. This process of *symbolic interactionism* is central to the perspective.

## Levels of Sociological Analysis

Based on the work of Liebow (1967) and Anderson (1997) we are able to identify two worlds for the purpose of sociological analysis.

The first world provides a close-range (micro-level) view of human social behaviour. It allows for understanding of how individuals relate on a person-to-person level, how they view themselves and how they balance their values and aspirations with their expectations. This represents *microsociology*.

The second world involves large-scale (macro-level) view of structures (organisations, groups and other resources), including patterns associated with recurrent activities. Examples at this level include hierarchy, prejudice and discrimination, stereotypes concerning behaviour, etc. Entire political and economic systems are captured in this world which represents *macrosociology*.

The two worlds are obviously related and so each needs to be considered in the light of the other. An individual’s relationship with another (micro-level) will be best understood in the context of the overall social environment (macro-level). This recognition is important as we come to consider the sociology of entrepreneurship.

It is within this discussion of interconnectedness between micro and macrosociology that attention has been given to competitive and profit-oriented institutions that are seen to dominate society. An important view advanced is that poverty is profitable for those at the top of the economic hierarchy – the fact that some people live in poverty enables others to live in luxury. A reference point within this view is that the economy is constructed in such a way that there are numerous dead-end jobs i.e. those with no vertical mobility or prestige. From a sociological perspective, occupants of these dead-end jobs may be described as follows:

* Lacking the education for a better job;
* Lacking role models who have achieved success;
* Lacking contacts in the business or employment world;
* With family background where a parent held a similar job, had similar limitations with similar consequences.

The above perspective has an important bearing on how wealthier parts of either local or global society respond to developmental efforts. Will all the rich genuinely support poverty reduction if any of them believed that poverty for some enables them to be rich?

## UNDERSTANDING SOCIETY

### What is Society?

Serge (1978) defines society as *a social structure made up of individuals, statuses, roles, groups, organisations and social relationships*.

### Social Structure

Social structure can be understood as the *stable or enduringpatterned behaviour, including the arrangement of social positions, among members of a group or culture*. The patterns of behaviour and arrangement are both emergent from and determinants of the actions of the constituent individuals.

Social structure can be examined at macro, meso (i.e. intermediate) and micro levels. Macro level structures will include social classes, social institutions and other large group segmentations. The meso level will capture stratifications such as social networks whilst micro level will consider resultant behaviour of actors based on existing social norms. These levels are not separate, but closely connected and influencing each other.

Sewell (1992) postulates that social structures have a dual character involving: 1) *schemas,* which are virtual but fundamental tools of thought, informal and not always conscious, including metaphors and assumptions that are presupposed within particular society; and 2) *resources*, which are actual formal components such as people, information, time, finance, etc.

The above understanding of society and social structure will be particularly important for us as we later look at entrepreneurship and society.

Below is a brief discussion of each of the identified elements of society (excluding the individual who we are constantly coming back to at various points in this book):

1. **Social Status**

In the context of sociology, status refers to the ascribed or achieved niche or position held in society.

1. **Social Roles**

Individuals identified with a particular status will be expected to behave in a certain way and these individuals will, in turn, expect others to behave in a particular way towards them. Roles therefore emerge and become established, constituting the expected behaviours by and towards those in various social positions.

Roles are not always very clear and not always and easily accepted by all social actors.

1. **Groups**

Groups are two or more individuals that regularly interact on the basis of common identity and shared expectations of each other’s behaviour.

Giddings (1906) coined the concept of “*consciousness of kind*” in trying to capture the social phenomenon whereby individuals tend to associate (or form groups) with others that are perceived as having similarities to themselves (i.e those perceived as being of their kind).

The nature of interaction is what distinguishes a social group from a *social category*, which could share similar characteristics but not interact regularly and with greater depth as a group would. A *social aggregate* is a collection of individuals in a common location but who do not interact and do not possess similar characteristics.

Whilst loyalty is likely to be built within a social group (e.g church congregation members, entrepreneurs with common ethnicity, etc), antagonism may arise between members of different groups (e.g soccer fans or political supporters belonging to different camps, differences in ethnicity, etc).

Groups can be divided into primary and secondary, with the former representing smaller clusters with closer interaction and the latter capturing larger and loose groups.

1. **Social Institutions**

A social institution is a complex integrated set of social positions, roles, norms and values organized around the preservation of a basic social processes such as producing life-sustaining resources, reproducing individuals, and in sustaining viable societal structures within a given environment (Turner, 1997).

These are, by definition, the more enduring features of social life and will include modes of discourse (e.g. in determining kinship, transmitting knowledge between generations, etc.), and be evident in the political (i.e. in providing for the legitimate use of power), economic (in regulating the distribution of goods and services) and legal realms (ensuring adherence to agreed norms).

Examples of basic social institutions include family, government, economy, education and religion. (Giddens, 1984; Sociology Guide, 2011).

Clearly, the individual and existing social practices form the key components of social institutions (Harre, 1979).

Institutions will typically be different in nature from organisations. Whilst organisations will have a clearly defined legal form and parameters, institutions are identified by people and practices, and so will have social parameters. Further organisations are not necessarily identified by enduring practice, but by the way collective practice seeks to achieve set goals.

It must be understood that reference to “enduring” does not necessarily imply “static”. Indeed, change is constantly taking place in many institutions, and so what is likely to be enduring is the nature and purpose of the institution.

### Other Relevant Terms and Concepts in Sociology

1. **Social System**

Talcott Parsons (1951) in his major theoretical work, “The Social System”, defines a social system as consisting of two or more individual actors interacting in a situation that has at least a physical or environmental aspect, and who are motivated towards optimization of their gratification, and are doing so in a context of a system of culturally structured and shared symbols.

The major units of a social system are said to be collectivises (i.e. the collective whole as opposed to individuals) and roles. What connects these units are values and norms.

Whilst there may be some variations on what are defined as social systems, the key features would still include a common focus or orientations and a shared mode of communication among a majority of actors. This understanding does not necessarily preclude the possibility of conflict within a social system!

1. **Culture**

Culture has been described as ‘a whole way of life’, ‘a signifying system’ through which a social order is communicated, reproduced, experienced and explored (Raymond Williams (1983).

It includes sets of *learned* traditions, rules, symbols that shape and are enacted as feelings, thoughts, and behaviors of groups of people. Culture will distinguish one society from another because of the distinctiveness of these elements. Language is one important symbol that emerges from a culture and provides an important distinguishing social element. Culture will also heavily influence values and norms (discussed below).

1. **Social Values**

These refer to views that a social group shares about matters such as what is good, bad, desirable, and/or undesirable. Social values could be looked at as broad principles that a particular society believes are important guides to social interaction. They may be influenced by religion, politics or the economic circumstances, and will often cut across different situations and, by their nature, will not be prescriptive.

Social values have a power effect on entrepreneurship and development as a whole. Collier and Batty (1990), for instance, argue that social (including cultural and religious) beliefs and attitudes can sometimes attach little importance to monetary gain, restrict economic and social mobility, or assign very low status to entrepreneurs. This is an aspect that will be revisited in our consideration of entrepreneurship in a developing country (social) context.

1. **Norms**

These represent particular beliefs about acceptable behaviour in particular circumstances and in a particular social group. They are more specific (compared to values) and establish expectations that shape social interaction. They can vary with, for instance age and social status.

## SOCIALISATION

This is an important area of discussion because the entire book is premised on the view that when dealing with developing country contexts, there are specific sociological factors that need to be understood if entrepreneurship is to be successfully developed. Socialisation is an important process that is both driven by and also a result of these sociological factors.

Socialisation is predominantly an unconscious and often slow process through which individuals learn the values, beliefs, attitudes, rules and regulations of a society in which they are found. It involves the internalisation of the existing culture.

This process will include developing knowledge of what is and why (cognitive and evaluative) and identification with (including emotional attachment to) a particular cultural group (affective). It assists in equipping individuals to appropriately function within society.

Socialisation may be categorised as primary (e.g family level) or secondary (in a group that is part of a larger social context). Different forms of socialisation may be perceived as positive or negative depending on the experiences encountered by those being socialised. Ordinarily, an individual will have little control of the form of socialisation experiences over the first 10 to 20 years of their life because this is a period when they would typically be in a family and would occupy a social position that limit their options. However, with time, most people will learn how to influence their socialisation as they pick up life skills.

### Agents of Socialisation

Socialisation takes place through various “agents” that include the family, education institutions, peers, media and “significant others”.

Functionalists place significant emphasis on families as primary locus of procreation and socialization of children, as well as the primary source of emotional support for even adults. Our view of the world and of what could be achieved, including ambition, is often significantly influenced by interaction at family level (including interaction between families).

Education institutions traditionally focus on teaching specific knowledge and skills that have a profound effect on a child’s self-image, beliefs and values. But as the concept of “life-long learning” takes root, the impact (whether positive and/or negative) of these institutions on society as a whole continue to grow stronger.

The functionalist perspective clearly brings out the positive effect of education institutions in terms of equipping individuals to function in society, but conflict theorists highlight the undesirable effect of potentially locking the lower strata of society into roles that serve those higher up (e.g. preparing them to be employees who, in turn, also look down at those that cannot get employment due to little or no education!). In fact, education systems in Africa (that came with missionaries and colonizers) have been especially criticized on this social stratification effect.

It therefore becomes important to carefully consider what prospects exist for transformation of developing country education institutions so they can be perceived to be advancing sociological processes that support entrepreneurship development (which includes having increasing numbers of individuals setting up and running their own ventures).

Peer groups also function as agents of socialization by contributing to our sense of belonging and our feelings of self-worth. With time, these close social networks tend to take on an economic dimension and can prove vital to entrepreneurship in developing country contexts which often have few formal entrepreneurship support systems.

In the modern day, mass media, in their various technological forms, have become very important socialization agents for children and adults alike. Beyond informing, educating and entertaining, they introduce us to different people, viewpoints and even lifestyles that can eventually become our own. Advancement in information and communication technology (ICT) now allows for online interaction on social media and groups (Facebook, yahoo groups, etc.) from just about any place on the earth that has cellular telephone coverage.

Another agent of socialisation is referred to as “significant other” (Mead, 1934). This is any person who has great importance to an individual's life or well-being and who has a strong influence on an individual's self- concept. These are persons whose care, affection, and approval are especially desired and who are therefore important to the development of the self. They are likely to be found in the immediate and extended family and other primarily levels of socialization, but could be at the secondary level and include teachers, church leaders and others with whom we may have ongoing interaction.

### Re-socialization

This is a social identity transformation process that is often two-fold: 1) learning how to function in new and different social roles, and 2) unlearning some aspects of the old roles.

It may involve engaging at the levels of norms, values, beliefs, and practices. Re -socialisation may be voluntary, such as when one desires to fit within a new status (profession or corporate position) or it may be involuntary, such as when a person is confined to a prison or a mental health facility. The process may sometimes involve going back to previous social roles (because it has been found that these are better, or when one returns to a particular society)

This book takes the view that socialisation is, in various ways, an important and yet little appreciated concept in human transformational development. Adopting new social roles is, in many instances, key to sustainable development. For instance, we now hear of calls to consider our environment as we pursue profits. Also, various challenges in maintaining social order have caused many to call for a return to certain old social practices.

Within the context of developing countries, deliberate thought and strategies towards socialisation can assist in removing sociological barriers to development. There are, for instance, many developing countries that have switched towards capitalistic system of economic management (from socialistic or other systems). Whilst governments may have made great strides in creating suitable investment climates and business environments, one might still ask: what sociological mechanisms have been put in place to aid related social transformation amongst local citizens?

Without looking into this aspect, only a few local and probably more foreign nationals (who are already socialised to this environment) are likely to benefit. Indeed, this seems to be the case in a number of developing countries where the gene coefficient (measure of the gap between rich and poor) remains high, with resultant instances of social unrest (e.g the 2008 xenophobic violence in South Africa). The reverse is also possible – a more affluent society may despise poor immigrants, as may be the case for the EU which has a wealthier north-west receiving an influx of migrants from the south and east.

### Socialisation and Human Development

Human development may be said to involve the physical, psychological and social changes that take place across the life span of an individual.

With regard to social changes, social psychologists tell us that socialization continues all across the life span, as long as people continue to learn from social experiences. This provides opportunity to continue tapping into human potential and fostering creative and pro-social behaviour, ultimately benefiting societies and fostering overall development.

**The Social Self**

The concept of the social self is embedded in social psychology and refers to an individual’s identity within a particular social context. This is based on the self-concept (what we “know” about ourselves). This knowledge of ourselves is often based on what we learn from watching our own actions (Bem, 1972) which may be evaluated through comparison with others (Fastinger, 1954).

Trafimow et al. (1997) found that our understanding of self is influenced by sociological factors such as social symbol. In this particular study, it was found that the language (a social symbol) used to describe self-affected the results (see adjacent textbox).

Our understanding of social self feeds into our self-esteem (i.e. what we feel about ourselves – an aspect of affect) which in turn affects our social interaction. Individuals with high self-esteem are likely to be more self-confident, more driven, are more likely to challenge the status quo when they are dissatisfied, and are less likely to be overly worried about failure, humiliation and rejection. Based on forgone discussion, it can be seen that this has a clear bearing on entrepreneurship.

An individual will also use their self-concept to deal with self-presentation (impression management), which can sometimes lead to egocentric bias (thinking we are more visible to society than we really are!). Whichever the case, individuals will ordinarily be conscious of their behaviour in public, and will constantly consider what others may think of it. Feedback often plays a part in our subsequent behaviour.

### Rational choice theory (RCT) or Theory of Reasoned Action (TRA)

This theory advances an explanation of all social behaviour (whether conforming or deviant) in terms of the self-interest of individuals and how this, in view of their preferences, informs their choices. It views social interaction as being similar to economic exchange where all parties try to maximize their advantage or gain, and to minimize their disadvantage or loss.

RCT's basic premises are that: 1) human beings base their behavior on rational calculations; 2) they act with rationality when making choices; 3) their choices are aimed at [optimization](http://t.ms00.net/s/c?u.nema.28.r8hq.23bue) of their pleasure or profit.

This sociological concept has applications in economics and marketing, amongst other fields. RCT, however, cannot explain the existence of certain social phenomenon such as altruism, reciprocity, and trust (which are especially evident in many traditional underdeveloped settings), and why individuals voluntarily join associations and groups where collective and not individual benefits are pursued. (businessdictionary.com, 2012)

Language & The Social Self

*A group of Chinese and English speaking individuals were asked to describe self.*

*Half were given the test in English and the other in Chinese.*

*The English half brought out personal traits whist the Chinese component brought out group affiliation*

*Each language response carried with it the culture that the language symbolised (i.e. Individualism vs. collectivism).*

(Trafimow et al., 1997)

## Collective behaviour

Collective behaviour is a term that can be used to refer to spontaneous social processes and events involving several individuals and which do not conform to existing social structure, while yet not being necessarily deviant. In these instances, individuals will be operating in a situation where the norms of behaviour may be unclear from the onset, and may only gradually emerge as people go along.

Examples of such situations may include people responding to an emergency rescue situation, an unplanned student riot or celebrations by soccer fans. It could also be gradual, such as the increase in urban street vendors, an increase in community members avoiding a particular store due to a rumour, or the number of individuals adopting a particular manner of speaking. The distinguishing mark in each of these instances is that the process and outcome would have been uncoordinated.

It is a concept that was highlighted in the work of Park and Burgess (1924) and Blumer (1951), but was later criticized for not being as definitive. It has nonetheless been useful in capturing types of behaviour that may not emerge from conventional social groups.

The focus of research into collective behaviour is on trying to understanding the social structure and behavioural pattern of collections of individual that, due to certain preconditions, tend to function in a particular manner.

The concept has gained even greater traction in these times when ICT has not only increased humanity’s connectedness (those increasing the possibilities for and nature of collective behaviour), but also made it easier to study the behaviour at both individual and collective levels. We are now much better able to examine the aggregate effects of individual decisions and behaviour, and to also examine the influence of the collective on the individual cognition.

Two prominent theories used to explain collective behaviour are 1) contagion theory by Le Bon (1896) that states that the hypnotic power of the crowd encourages one to give up their individuality, and 2) emergent norm theory by Turner and Killian) which argues that individuals in a crowd retain different attitudes, behaviours and motivations.

Through whichever theory (or the combination thereof) knowledge gained from understanding collective behaviour may assist us answer age-old questions such as the following:

* How is social order possible? How fragile is the social order and what happens when it breaks down?
* How rational is modern man in an industrial urban setting?
* How do societies change? Does history follow a pre-determined path? Are individuals simply pawns of some more profound historical necessity or do persons make their own history?
* Why are social reform efforts frequently unsuccessful or limited in their impact or duration?

Notable examples of collective action may be the “Arab Spring” uprising in a number of Arab countries starting with Tunisia in December 2010

**Social Movements**

Many social movements evolve from collective behaviour and transform into long-term group efforts to promote or prevent specific social change. They may operate as loose alliances but can also be (or at least seek to be) well-organised, and will typically have clear internal power structures.

Some of the well-known social movements have had strong political objectives and, in many developing countries, where linked to political liberation struggle. They continue to be a popular means of expressing dissent and also ensuring that society does not lose its moral conscience.

Various theories underpin our understanding of the development of social movements. We will not go into any of them, because our interest in briefly discussing social movements is based on the fact that they can play an important role in the emergence or otherwise of a conducive environment for entrepreneurship development. A number of western social movements operate in developing countries and have mandates that seek to promote equity in a number of spheres. There are indications that the effects of strategies of some of these movements may be counter-developmental. For instance, championing certain rights of the rural poor, without equally articulating their responsibilities (and so inadvertently creating a “victim culture” amongst them) could negatively affect entrepreneurship development.

**Collectivism**

As a sociological construct, collectivism refers to a social outlook that emphasises collective identity and interdependence of human beings. Self is defined in terms of the group, with the demands and interests of the group taking precedence over individual needs and desires. In such a scenario, social behaviour is therefore more likely to be driven by social norms, duties, and obligations as established in the group.

Collectivism may be divided into two types: 1) horizontal, and 2) vertical collectivism. Horizontal collectivism emphasises collective decision-making, with group members being seen as equals. Cooperatives are an example of such type of collectivism, representing decentralised structures. Vertical collectivism exhibits a hierarchical structure of decision-making. This is typical of most African traditional social settings.

Once one appreciates these two distinct types of collectivism, it may become clearer why cooperatives have struggled in many Africa countries. They represent one type of collectivism that is being introduced to an environment operating with another type! If horizontal collectivism is felt to be ideal, then there is the inevitable need for re-socialisation.

## SOCIOLOGY AND ENTREPRENEURSHIP

It can be seen from the earlier discussion that sociology is a form of consciousness that assists us in examining and understanding processes, patterns and practices in society, and in developing our own perspective. This way, we can then identify opportunities and constraints and develop a perception on how we can pursue aspirations and what could, in the process, be feasible.

This consciousness enables us to become active participants in terms of responding to society and also actually shaping it. We are therefore able to move beyond merely accepting the status quo by developing a critical tendency towards our environment.

Entrepreneurship reflects complex interactions between the individual and situations which involve other individuals, groups and entire social institutions. In this sense, entrepreneurship has a significant social dimension to it. The manner in which entrepreneurship occurs will therefore be influenced by the existing social context. The inverse is also true – that the social context will be influenced by entrepreneurship. It is this dynamic two-way relationship between sociology and entrepreneurship that will be explored in this section.

***Why is the manifestation of entrepreneurship different between countries?***

It is well-documented that the form, nature and levels of entrepreneurship activity will differ across countries and even across regions within countries (Van Stel 2005). What still needs to be better understood are the specific factors that inform such variations.

We have in the previous chapters demonstrated how entrepreneurship has evolved, including the fact that its early recognition has been linked to particular geographical and scientific disciplines (i.e. emerging from Europe and the USA, and from an Economics perspective).

We have also shown that part of the failure to develop a clear theoretical framework (as has happened in other disciplines) is linked to what appears to have been attempts to define global entrepreneurship from a developed country and economics perspective. This approach is well-reflected in the Global Entrepreneurship Monitor (GEM), which is one of the most significant efforts to understand and track entrepreneurship across countries.

The explicit intention of GEM, from creation in 1997, was to explore the link between entrepreneurship and economic development (Carree and Thurik, 2003). The focus was (at least initially) on the more developed world. One should then naturally realise that many of the (especially developing country) non-economic issues discussed in this book would, from the onset (from the very conceptualisation stage) have therefore been largely left out of the research process.

It is therefore little wonder that, whilst seemingly singing the praise of GEM after 10 years of existence, Acs et al (2009) still makes the following admission

*“However, we have much to learn about why entrepreneurship rates differ not only among countries with different development stages but also among regions in a single country, and why not all entrepreneurial efforts have the same impact on economic development.”*

While GEM has assisted in the development of a consistent and country-comparable mechanism for entrepreneurship, it still does not go far in identifying and capturing the key determinants or drivers of entrepreneurship in the different contexts that it studies. In fact, its main measure, the Total early-stage Entrepreneurial Activity (TEA), does not necessarily provide an indication of higher or lower levels of entrepreneurship in any context. Acs et al (2009) go on to recognize that there are other non-economic contextual factors (demographic, culture, individual aspirations,) that need to be taken account of.

In-depth consideration, by mainstream entrepreneurship researchers, of non-economic factors related to entrepreneurship is still relatively new, largely sparse and still heavily influenced by the economics perspective (Blanch flower 2000; Wennekers 2006; Freytag and Thurik, 2010).

Why is it important to consider these non-economic factors even in instances when our interest is in economic development?

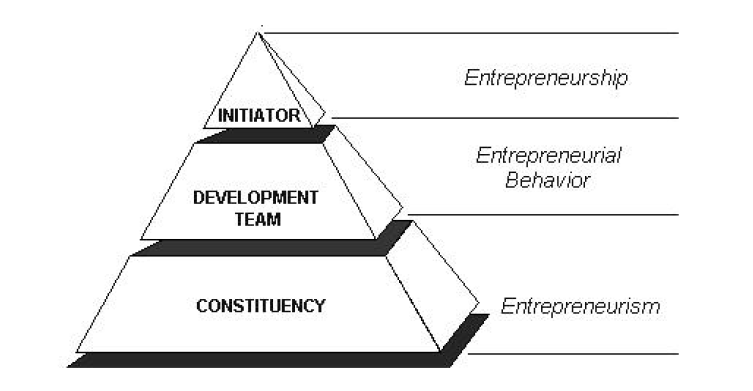
Van Gelderen and Masurel (2012) demonstrate that variations in levels of entrepreneurship between countries (even if there are subject to similar economic conditions) are attributable to non-economic factors. Put differently, the field of economics is not able to explain why two countries faced with similar economic conditions will have different levels of entrepreneurship. This is because the explanations have been found to lie outside the economic realm and have to do with local institutions and cultures, and how these interact (Stenholm, et al, 2012).

By focusing on the sociological dimension of entrepreneurship, this chapter is seeking to deepen understanding of important non-economic factors influencing (and being influenced by) entrepreneurship. The chapter therefore continues to build on the primary thesis of this book – that context matters in entrepreneurship development.

**Emergence of the Sociology of entrepreneurship**

Various sociologists and other social scientists have considered different aspects in their field that relate to entrepreneurship. Greenfield &Stricken (1981) are amongst the earliest to consider population characteristics and their impact on entrepreneurship. Aldrich (1990 & 1999) and Aldrich & Wiedenmayer (1993) built on this by looking at population ecology and how this helps provide information on the environmental context within which entrepreneurs operate. Reynolds (1992) also examined population and organizational ecology and how this could serve as productive paradigm in which to develop research on the societal context of entrepreneurship.

Educationist Marilyn L. Kourilsky (1995) provided a remarkable topology of how education can trigger a process with the individual entrepreneur that eventually affects the firm and the entire community



*Fig1: The Entrepreneurship Implementation and Support Pyramid, from Kourilsky (1995)*

The pyramid helps depict the context-based symbiotic relationship between the entrepreneur, the firm and its environment, as also described by Julien (1998).

One of the earliest comprehensive research works on entrepreneurship by a sociologist appears to be by Patricia H Thornton in 1999. A publication entitled “The Sociology of Entrepreneurship” (1999) sought to develop a sociological perspective to entrepreneurship as a whole, and was a response to the then growing focus on the psychology of entrepreneurship. The purpose was to move this focus beyond the supply side and individual traits of entrepreneurship, and consider the demand side that captures the (sociological) context in which entrepreneurship occurs.

The research focused on the influence of firms and markets as social institutions, and helped provide a research continuum from the individual entrepreneurs to the firm that they founded, and on to the markets in which these firms operated. Whilst this was an important step forward, one can still note that the choice of social institutions selected (i.e. firms and markets) was still heavily influenced by the economics perspective on entrepreneurship.

Also, an important attempt by Thornton (ibid) that does not appear to have readily been picked up by other researchers relates to the need to identify explanatory sociological factors that are universal across different contexts (including time) and which factors are context (and time) specific.

Amongst the most recent studies on particular contextual aspects of entrepreneurship include Fortunato & McLaughlin (2012) who consider the amount, purposes and nature of interaction as possible explanations of community-level variation in entrepreneurship. They utilizedifferent theories about social interaction to understand: (1) how large, diverse networks may impact information exchange and skills development for entrepreneurship; and (2) how network ties and associated content in the form of a common community purpose can also structure behavior around entrepreneurship. Key theories include Granovetter’s (1973) theory of weak ties, Burt’s (1995) theory of structural holes, and Wilkinson’s (1991) interactional field theory.

### Culture and Entrepreneurship

Thurik and Dejardin in their contribution to the work by van Gelderen and Masurel (Eds, 2012) focus on culture as a subset of broader contexture factors affecting entrepreneurship. To assist them consider the relationship between entrepreneurship and culture, they adopt a strict economic-oriented definition of an entrepreneur – an owner/manager of either an unincorporated or an incorporated business. They then take culture to be represented by values, beliefs and behaviour. Hence, in view of the work by Mueller and Thomas (2000), Thurik & Dejardin (2012) assert that differences in culture between different countries (or societies) can be detected in the differences in values, beliefs and also observable behaviour, such as that resulting in the choice of self-employment.

Whilst several other researchers had earlier considered the relationship between entrepreneurship and culture (e.g. including, in the more recent past: Stephan and Uhlaner 2010; Autio et al, 2010), the particular importance of the work by Thurik & Dejardin (2012) is probably with the fact that they present four schools of thought relating to culture, that they see as helping explain its relationship with entrepreneurship, and therefore accounting for the effect of culture in the variations of entrepreneurship in different contexts. These schools of thought are briefly discussed below:

1. ***The aggregate psychological (or cultural) traits perspective***

Cultural traits represent a nation’s “mental programs” that are developed in socialization processes such as in the family, in schools and organizations (Hofstede 2001). Within such an environment, and based on the work by Davidsson (1995), It is only logical that if there are more people with entrepreneurial values and beliefs in a country, there should then be an ever increasing number of people displaying entrepreneurial behaviours. The effect of social influence will clearly be greater. Empirical research by Noorderhaven, et al (2004) on risk avoidance and entrepreneurship is used to demonstrate this perspective.

1. ***Post-materialism and entrepreneurship***

The post-materialism perspective recognises changes in (mainly western) society that relates to a move beyond a materialistic social orientation to one that places greater value on non-materialistic life goals.

Whilst this phenomenon may be post-materialistic for the developed world, many traditional cultures (e.g in Africa) are actually still at pre-materialistic stage.

The view is that any society that is at this stage is likely to be less entrepreneurial. This view appears strengthened by the typically narrow definition of entrepreneurship (i.e as being largely economic). Whilst materialism will be a major motivator of entrepreneurship, it is important to recognise that there are other altruistic motivators, as observed through the growth of social entrepreneurship.

Thurik & Dejardin (2012) cite the interplay between the concept of socialisation and scarcity to explain why the modern generation of young people in the developed world ascribe less value to non-material goals. It doesn’t however explain the behaviour of pre-materialistic societies that may be found in developing countries.

1. ***The social legitimation or moral approval***

Based on the work of Etzioni (1987), this view states that greater rates of entrepreneurship will be found in societies where the entrepreneur has a higher social status, receives attention within the educational system, and is backed by a favourable national policy framework.

This, together with the cultural traits perspective, is probably the more closely applicable to a developing country context. They essentially approach a connected phenomenon from two ends. In the case of this perspective the influence is from society (outside-in) as opposed to being from individuals to society (inside-out), as is the case with the cultural traits perspective.

Researcher like Freytag and Thurik (2010), and Henrekson and Sanandaji (2010) have written on this aspect in the recent past.

1. ***The dissatisfaction perspective***

This presents a comparatively different perspective that argues that differences in values and beliefs between particular individuals on one hand and society in general on the other hand could drive the individuals towards entrepreneurial behaviour such as self-employment. These values and beliefs (the subject of the differences) could be around entrepreneurship itself (e.g. innovation, achievement, etc.), or could be around other social aspects such as corruption or discrimination of one form or another.

You may have noticed that this perspective provides the very opposite prediction to that of the cultural traits and the moral approval perspectives.

The perspective is more likely to be evident in environments that offer entrepreneurial options that could be taken up by the “dissatisfied” individuals. Thus, it may be more pronounced in emerging and developed countries.

## The Family and Entrepreneurship

**Collectivism, Individualism and Entrepreneurship**

The more traditional entrepreneurship view has been that entrepreneurship, by its nature, tends to be individualistic (Brockhaus 1982; Gunther et al, 1992; Littunen, 2000). Subsequent studies have tended to disagree with this seemingly narrow view (Nguyen et al, 2010, Finkelstein, 2011; Houston et al, 2012). *Liñán* et al (2013) assert that the relationship between economic development, culture and entrepreneurship is a complex one. They attempt to upack this by demonstrating that the effect of particular cultural values on entrepreneurship and on economic development will differ depending on where a country is in terms of actual level of development. They argue that in low-income countries collectivism (or embeddedness) could favour entrepreneurial activity, whereas in higher-income countries individualism (or autonomy) can stimulate entrepreneurial activity.

Put differently, resource constraints and other challenges faced by low income countries may call for drawing on collective strength in order to obtain entrepreneurial traction. Beyond a certain level of development, and with more abundant resources and opportunities, greater individual autonomy may be more appropriate so as not to restrain the more far-reaching entrepreneurial aspirations that may held by some individuals.

This is however not to suggest that entrepreneurial societies should operate at two extremes (collectivism for low income and autonomy for high income). Indeed, it is not likely that any of these can exist exclusively and in their pure form. The point being made is that, because of reasons stated above, stronger elements of the collectivist form of entrepreneurship have been associated with the developing country context (or a low-income part or a phase in time in a country), while the individualistic form with a developed country context (or a high income region or stage of the same country).

Appropriate forms of collective entrepreneurship (see discussion above on horizontal and vertical forms of collectivism) may also be useful in providing incubation and in stirring up subsequent individual entrepreneurship.

From a development management perspective, it therefore becomes important to understand the place for collective forms of entrepreneurship (such as cooperatives) and individually owned MSMEs so that these are prioritised appropriately in order to achieve desired developmental results.

**Social Entrepreneurship**

Social entrepreneurship is the field in which entrepreneurs focus their energies on creating social value, often with little or no intention to gain personal profit. This form of entrepreneurship plays an important role in addressing critical social problems and thereby improving the well-being of society ([Zahra et al., 2008](http://dx.doi.org/10.1002/sej.43)).

This is a field of study that has helped demonstrate that entrepreneurship is more that starting and successfully running an economic enterprise, but that it includes identifying and exploiting opportunities that enhance reality, whatever form this reality might take.

As you would imagine, the field is at an even earlier stage of development than the entire area of entrepreneurship. Empirical studies are therefore much fewer. What is more prevalent are ever-growing numbers of success stories of individuals and even entire organisations that have committed themselves to solving complex social problems. It is these that are mostly being used to legitimize the field of social entrepreneurship.

Samer Abu-Saifan, 2012 suggests the following definition of a social entrepreneur:

*The social entrepreneur is a mission-driven individual who uses a set of entrepreneurial behaviours to deliver a social value to the less privileged, all through an entrepreneurially oriented entity that is financially independent, self-sufficient, or sustainable.*

This definition combines factors that present similarities and differences between social entrepreneurs and economic entrepreneurs. Whilst social entrepreneurs will also act entrepreneurially, their drive will be to deliver social value to the underserved. Also, while they too will utilize organizational vehicles that are entrepreneurial in orientation, these organizations will often be a blend of social activities with those that are of a profit-making nature. The profit-making activities will ensure that social value can be delivered sustainably and without undue reliance on hand-outs (Bacq et al., 2011).

Just like there isn’t complete agreement on who an entrepreneur is, there are also debates about who qualifies to be a social entrepreneur. Should the definition include notable individuals such as America’s Bill Gates and Africa’s Mo Ibrahim, and organizations such as Ashoka and One World Health?

The Skoll Centre for Social Entrepreneurship argue that the definition of social entrepreneurship should not extend to philanthropists, activists, companies with foundations, or organizations that are simply socially responsible, as important as these might be to society. It is this aspect of blending social and profit activities that seems to provide the vital distinctiveness of social entrepreneurship.

A social entrepreneur “combines the passion of a social mission with an image of business-like discipline, innovation, and determination commonly associated with, for instance, the high-tech pioneers of Silicon Valley” (Dees, 1998).

### Entrepreneurship and the Political Economy

The CEFE method is based on a perception that the process of enterprise development is composed of five mutually interdependent factors that are continuously influencing the expansion or contraction of businesses. The first two factors are the entrepreneur's motivation and competencies; while the next three, consist of the macro economic framework, the prevalent culture, the micro-climate or the immediate circumstances make up the enabling or disabling environment. These factors are brought together in the shaping of a business activity or situation that reconciles the entrepreneurs’ internal strengths and weaknesses with the existing external environment. Any or all five of these factors can, at any time, be linked in "causal chains" of differing sequences or combinations setting in motion the activities that make a business grow, stagnate or decline. For example, an opportunity may arise and be recognised as one, because of a combination of a person's motivation, competence and an imperfection in the micro-climate. Or an enterprising culture can motivate a person to acquire the competence needed to start a business.

There is no single linear relationship between these factors and their sequencing and combination can be random, the strength of their influences can vary in individuals and in societies. Each factor is in a constant state of flux: cultures are dynamic; economies grow, stagnate and decline, only to grow again; in the micro climate, markets may come and go, competition will sometimes be weak or strong and resources will vary in their availability; motivation is constantly being shaped by activity and feedback; and competencies are learned and lost. But it is this process of change that creates opportunities and scope for entrepreneurs to start and grow businesses. (Kolshorn, 1999).

### Sociological Entrepreneurship Theory;

The sociological theory is the third of the major entrepreneurship theories. Sociological enterprise focuses on the social context .In other words, in the sociological theories the level of analysis is traditionally the society (Landström, 1998). Reynolds (1991) has identified four social contexts that relates to entrepreneurial opportunity. The first one is social networks. Here, the focus is on building social relationships and bonds that promote trust and not opportunism. In other words, the entrepreneur should not take undue advantage of people to be successful; rather success comes as a result of keeping faith with the people. The second he called the life course stage context which involves analyzing the life situations and characteristic of individuals who have decided to become entrepreneurs. The experiences of people could influence their thought and action so they want to do something meaningful with their lives. The third context is ethnic identification. One’s sociological background is one of the decisive “push” factors to become an entrepreneur. For example, the social background of a person determines how far he/she can go. Marginalized groups may violate all obstacles and strive for success, spurred on by their disadvantaged background to make life better. The fourth social context is called population ecology. The idea is that environmental factors play an important role in the survival of businesses. The political system, government legislation, customers, employees and competition are some of the environmental factors that may have an impact on survival of new venture or the success of the entrepreneur.

•Entrepreneurship is likely to get a boost in a particular social culture

•Society’s values, religious beliefs, customs, taboos influence the behaviour of individuals in a society

•The entrepreneur is a role performer according to the role expectations by the society

### Anthropological Entrepreneurship Theory;

The fourth major theory is referred to as the anthropological theory. Anthropology is the study of the origin, development, customs, and beliefs of a community. In other words, the culture of the people in the community .The anthropological theory says that for someone to successful initiate a venture the social and cultural contexts should be examined or considered. Here emphasis is on the cultural entrepreneurship model. The model says that new venture is created by the influence of one’s culture. Cultural practices lead to entrepreneurial attitudes such as innovation that also lead to venture creation behaviour. Individual ethnicity affects attitude and behaviour (Baskerville, 2003) and culture reflects particular ethnic, social, economic, ecological, and political complexities in individuals (Mitchell et al., 2002). Thus, cultural environments can produce attitude differences (Baskerville, 2003) as well as entrepreneurial behaviour differences (North, 1990; Shane 1994). 6. Opportunity–Based Entrepreneurship Theory;

### The opportunity-based theory

Is anchored by names such as Peter Drucker and Howard Stevenson. An opportunity-based approach provides a wide-ranging conceptual framework for entrepreneurship research (Fiet, 2002; Shane, 2000). Entrepreneurs do not cause change (as claimed by the Schumpeterian or Austrian school) but exploit the opportunities that change (in technology, consumer preferences etc.) creates (Drucker, 1985). He further says, “This defines entrepreneur and entrepreneurship, the entrepreneur always searches for change, responds to it, and exploits it as an opportunity”. What is apparent in Drucker’s opportunity construct is that entrepreneurs have an eye more for possibilities created by change than the problems. Stevenson (1990) extends Drucker’s opportunity-based construct to include resourcefulness. This is based on research to determine the differences between entrepreneurial management and administrative Management. He concludes that the hub of entrepreneurial management is the “pursuit of opportunity without regard to resources currently controlled” (European Journal of Business and Management, vol.3, No.6, 2011.).

### Resource- Based Entrepreneurship Theories;

The Resource-based theory of entrepreneurship argues that access to resources by founders is an important predictor of opportunity based entrepreneurship and new venture growth (Alvarez & Busenitz, 2001).This theory stresses the importance of financial, social and human resources (Aldrich, 1999). Thus, access to resources enhances the individual’s ability to detect and act upon discovered opportunities (Davidson & Honing, 2003). Financial, social and human capital represents three classes of theories under the resource – based entrepreneurship theories. Financial Capital/Liquidity Theory;

Empirical research has showed that the founding of new firms is more common when people have access to financial capital (Blanch flower et al, 2001, Evans & Jovanovic, 1989, and Holtz-Eakin et al, 1994). By implication this theory suggests that people with financial capital are more able to acquire resources to effectively exploit entrepreneurial opportunities, and set up a firm to do so (Clausen, 2006). However , other studies contest this theory as it is demonstrated that most founders start new ventures without much capital, and that financial capital is not significantly related to the probability of being nascent entrepreneurs (Aldrich,1999, Kim, Aldrich & Keister, 2003, Hurst & Lusardi, 2004, Davidson & Honing, 2003).This apparent confusion is due to the fact that the line of research connected to the theory of liquidity constraints generally aims to resolve whether a founder’s access to capital is determined by the amount of capital employed to start a new venture Clausen (2006). In his view, this does not necessarily rule out the possibility of starting a firm without much capital. Therefore, founders access to capital is an important predictor of new venture growth but not necessarily important for the founding of a new venture (Hurst & Lusardi, 2004) This theory argues that entrepreneurs have individual-specific resources that facilitate the recognition of new opportunities and the assembling of new resources for the emerging firm (Alvarez & Busenitz, 2001). Research shows that some persons are more able to recognize and exploit opportunities than others because they have better access to information and knowledge (Aldrich, 1999, Anderson & Miller, 2003, Shane 2000, 2003, Shane & Venkataraman, 2000).

### Social Capital or Social Network Theory

Entrepreneurs are embedded in a larger social network structure that constitutes a significant proportion of their opportunity structure (Clausen, 2006). Shane and Eckhardt (2003) says “an individual may have the ability to recognize that a given entrepreneurial opportunity exist, but might lack the social connections to transform the opportunity into a business start-up. It is thought that access to a larger social network might help overcome this problem”. In a similar vein, Reynolds (1991) mentioned social network in his four stages in the sociological theory. The literature on this theory shows that stronger social ties to resource providers facilitate the acquisition of resources and enhance the probability of opportunity exploitation (Aldrich & Zimmers, 1986).Other researchers have suggested that it is important for nascent founders to have access to entrepreneurs in their social network, as the competence these people have represents a kind of cultural capital that nascent ventures can draw upon in order to detect opportunities (Aldrich & Cliff, 2003., Gartner et al, 2004., Kim, Aldrich & Keister, 2003).

### Human Capital Entrepreneurship Theory;

Underlying the human capital entrepreneurship theory are two factors, education and experience (Becker, 1975). The knowledge gained from education and experience represents a resource that is heterogeneously distributed across individuals and in effect central to understanding differences in opportunity identification and exploitation (Anderson & Miller, 2003, Chandler & Hanks, 1998, Gartner et al, 2005, Shane &Venkataraman, 2000). Empirical studies show that human capital factors are positively related to becoming a nascent entrepreneur(Kim, Aldrich & Keister, 2003,Davidson & Honing,2003, Korunka et al, 2003), increase opportunity recognition and even entrepreneurial success (Anderson & Miller, 2003,Davidson & Honing,2003).

### Theories of entrepreneurship andentrepreneurial motivation

Economic, sociological and psychologicalEntrepreneurship Innovation theory. Theory of Achievement Motivation

Motivation theory by McClelland (Acquired Needs theory). The Kakinada ExperimentMotivating factors for entrepreneur- Internal and external

### Entrepreneurship Innovation theory

•Theory by Joseph Schumpeter who believes that entrepreneur helps the process of development in an economy

•He says that an entrepreneur is the one who is innovative, creative and has a foresight

•According to him, innovation occurs when the entrepreneur

–Introduces a new product–Introduces a new production method–Opens up a new market–Finds out a new source of raw material supply–Introduces new organization in any industry.

## Theories of Entrepreneurship

There is a myriad of opinions among economists and social scientists about the character and role of entrepreneurs in economic and social development of a country. Much of the confusion arises due to a variety of definitions at different stages of development. However, attention has been made by Mark Casson to put the whole approach into two categories, namely 'Functional Approach' and 'Indicative Approach'.While the functional approach specifies some functions of entrepreneurs, the indicative approach provide some description of an entrepreneur by which we can identify him. Once identification problem is solved, we are confronted with the problem of short supply of such entrepreneurs, particularly in a developing country. However, there is no unanimous prescription as to how the supply of entrepreneurs can be increased in a country.

Basically there are two schools of thought - 'Psychologists' and 'Sociologists' - on promoting entrepreneurship in a country.

According to Peter Kilby, entrepreneurial supply are, "the theories of constructed from either psychological or sociological elements. These theories try to identify social and psychological factors governing the appearance of the entrepreneurs and further, the role of social groups and social mechanism by which individuals are recruited into business operations. However, the theoreticians are not unanimous about the role and functions of entrepreneurs. While some have defined entrepreneurs as 'the co-ordinator and risk bearer', others have defined him as technical 'innovator' and 'adopter'. Even the motives behind entrepreneurship are different. While economists have thought the 'profit' as the primary motive, the psychologists thought that 'achievement motivation' is the supreme in the mind of entrepreneurs. Therefore there is no single method to identify the roles function and characteristics of entrepreneurs. It is, therefore, necessary to examine some of the leading theories on entrepreneurship to find entrepreneurs and factors out the major determining the competent entrepreneurs in a society.

### Richard Cantillon traits.

Supply of Richard Cantillon, anIrishman living in France, who wrote in the early 18th century, was probably the first to discuss the entrepreneur. Cantillon divided the inhabitants of a country, except for princes and landlords, into two classes:

(1) Entrepreneurs, including farmers and merchants, and

(2)Hired people. He distinguishes between the owner and the entrepreneur, although the two categories are not clearly spelled out. In Cantillon's framework, entrepreneurs buy services at certain prices for selling his products at uncertain prices thus bearing a great risk when the demand for the product is depressed.

### J.B. Say

The function of entrepreneurs has broadly been described at the first time by Jean Baptiste Say2 who maintained that the entrepreneurs bring together the factors of production and bear the risk. The success of entrepreneurs depend on their judgment of future demand, estimation of appropriate timings and input, judgment and calculation of probable production costs and selling prices, and supervision and administration. Since the combination of these is not common, the quantity of entrepreneurs is limited, especially in industry.

### C. Leon Walras

The Entrepreneur as Coordinator of Production successful Leon Walras, 3 whose theory of general equilibrium in the last part of the nineteenth century has yet to be surpassed, argued that the entrepreneurs are the fourth factor of production who hires others - land, labour and capital. Entrepreneur, in his scheme, is a profit maximizer and his endeavour is to move production to equilibrium. The entrepreneur would expand output when selling price is more than the production cost, i.e. the price paid to the owner of the productive services. Output is contracted when selling price falls short of the price of the productive services. Leon Walras, thus, made the entrepreneurs a central figure of production.

### Frank Knight

The Entrepreneur \_as Decision Maker under Conditions of Risk. According to Frank Knight, the entrepreneur is the recipient of 'pure profit' which is a residual left over after payment of all categories of contractual costs. In Knight's model, the primary function of entrepreneur is to bear non-insurable risk and uncertainties for which he receives the reward (profit). There are two types of risk: insurable and non-insurable. The former can be insured while the latter is not. Insurable risk can be calculated statistically and precautionary measures can be taken, while non-insurable risk cannot be calculated and therefore no precautionary measures can be taken. Entrepreneur in such an uncertain situation has to play the role of a special functionary and the success or failure depends on the foresight and judgment of the entrepreneur.

In the state where all men have perfect knowledge of the future, there are no entrepreneurs, but only labourers performing the purely routine functions of reacting in mechanical fashion to date concerning the future. However, in a world of uncertainty, the entrepreneur, a new economic functionary endowed with knowledge, judgment, foresight, confidence in his own judgment, and capacity for ruling others, is required. As the person responsible for decisions in instances where there is unmeasurable uncertainty the entrepreneur can make profits, since the lack of perfect foreknowledge prevents adjustment of supply by competitors to equilibrium.

* The perfect a no-profit Knight's entrepreneur bears the risk, a function which Schumpeter explicitly indicates belongs to the capitalist. The ultimate decision making and control in the firm lie with the risk bearer and not with the hired manager, even though he may be the managing director or chairman of the board of directors. Generally, it is not possible for a person to exercise only the function of entrepreneurship in the firm. The nearest case to this would be a man who borrowed all the resources for operating a firm (i.e., took the risk) and then hired a manager to was given a completely free hand.
* In Knight's view, it is fruitless to try to separate profit from interest, since the entrepreneur, almost of necessity, owns property. Profit is a residual share of income which falls to the person in responsible control of business, who generally also receives property income.

In contrast to Schumpeter's thesis, Knight's explanation has the advantage of making profit a return to the function of entrepreneurship. However, there is no reason why the reward to the entrepreneur needs to be in the form of profits in all institutional settings. Most economists would contend that the control of the giant corporation in the United States today is generally not in the hands of the stockholders but of management, which in many cases is self-perpetuating. Where this is true, Knight's contention that the persons who exercise the function of control in the firm also bear risk can be questioned.

### Adam Smith

The Merging of the Entrepreneurial and Capitalist Functions Adam Smith, writing in 1776 at the time of the putting out system and before the advent of the factory system, does not distinguish between entrepreneurs and capitalists, referring to "three different orders of people: ... those who live by rent, ... those who live by wages, and those who live by profits" (i.e., employers, who receive profits from capital stock). Accordingly, he attributes the net income of a proprietor to returns for labour and capital (including a premium for risk), and does not allow any returns for direction and organization. Although Smith had no clear conception of the entrepreneurial function, he placed much stress on the importance of the business class. He believed that each individual would unwittingly add to wealth and welfare by furthering his own selfish ends.

In part, perhaps because of the authority of Smith, the classical economists of the early nineteenth century merged the entrepreneurial and capitalist functions, and failed to develop a theory on the differentiation between interests and profits. The classical school did not have an adequate concept of the entrepreneur: first, because of the inadequacy of the English language; second, they lacked an adequate theory of distribution which included the entrepreneur sincethey had no theory of general equilibrium, unlike the French economists such as Richard Cantillon and Francis Quesnay; third, their belief that economic relationships are determined by natural law may have precluded an emphasis upon a conscious agent such as the entrepreneur, at the centre of economic process.

### Joseph Schumpeter

The Entrepreneur as Innovator. The most celebrated theory on entrepreneurship was propounded by the Harvard University Professor Joseph Schumpeter, who brought the conceptual change in the definition and function of entrepreneurs. The Schumpeterian theory of entrepreneurship is an integral part of his theory of development. Development in his sense implies carrying out of new combinations. This concept of new combinations covers the following five cases:

The introduction of a new good - that is one with which consumers are not yet familiar - or of a new quality of good.

The introduction of a new method of production, that is one not yet tested by experience in the branch of manufacture concerned, which need by no means be founded upon a discovery scientifically new, and can also exist in a new way of handling a commodity commercially.

The opening of a new market, i.e. a market into which the particular branch of manufacture of the country in question has not previously entered, whether or not this market has existed before.

The conquest of a new source of supply of raw materials or half-manufactured goods, again irrespective of whether this source already exists or whether it has first to be created.

The carrying out of the new organisation of any Industry like the creation of a monopoly (for example, through fructification) breaking up of a monopoly position or the carrying out of these new combinations, Schumpeter calls 'enterprise', the individuals who carry them out he calls 'entrepreneurs'. Usually the entrepreneur would finance his innovative activity by bank credit. The entrepreneurial activity represents a disequilibrium situation, a dynamic phenomenon and a break from the routine or 'circular flow' or 'tendency towards equilibrium'. An entrepreneur in short engages himself in unaccustomed activity. "While he swims with the stream in the circular flow which is familiar to him, he swims against the stream if he wishes to change its channel. What was formerly a help becomes a hindrance. What was a familiar datum becomes an unknown. Where the boundaries of routine stop, many people highly can go no further and the rest can only do so in a variable manner". This is the very rea5on why • carrying out of new combinations is a special 'object of a special kind of function'. Process and Schumpeter characterises his position in respect of entrepreneurship by three corresponding pairs of opposites, first, by the opposition of two real processes: the circular flow or the tendency towards equilibrium on the one hand, a change in channels of economic routine or a spontaneous .Change in the economic data arising from within the system on the other. Secondly, by the opposition of two theoretical apparatuses; statistic and dynamics. Thirdly by the opposition of two types of conduct, which following reality, we can picture as two types of individuals, mere managers and entrepreneurs.

Next Schumpeter takes up the question of characteristic motives of the entrepreneurial conduct. Although he tries to indicate the 'psychology of entrepreneur', he believes that "none of the results t0 which our analysis is intended to lead stands or falls with 'psychology of the entrepreneur' or could be vitiated by any errors in it".

Schumpeter refers to "dream and the will to found a private kingdom", will to conquer, and finally "the joy of creating, of getting things done or simply of exercising ones energy and ingenuity" as the motives that inspire the innovative entrepreneur to undertake the innovation.

Schumpeter's theory, nevertheless, suffers from many inbuilt shortcomings. E.W. Nafziger11 has pointed out that Schumpeter's theory is purported to have validity only in capitalist economies prior to the rise of giant corporations. This theory has only limited applicability in less developed country. Further, this theory cannot be tested empirically because the persons performing Schumpeter entrepreneurial functions cannot be identified as also not entrepreneurs. Clearly stated about the supply Peter Kilby says that the great bulk of Schumpeter's analysis is concerned not with supply of entrepreneurship but with the reactions of the economic system. However, in spite of shortcomings, it should be admitted that Schumpeter has put the entrepreneur theory on sound footing by making the entrepreneur a key functionary of economic development.

### Peter Kilby

An Economist's Model of Entrepreneurship · According to Kilby, the researcher faces the problem of identification familiar, for instance, in supply demand analysis. When a change in entrepreneurial performance is observed, how can it be ascertained whether this has happened because of a shift in the supply of entrepreneurial effort or because of an improvement in the economic environment.

We can find a number of instances where these two sets of factors on the supply and demand side get mixed up and raise the problem of identification. Kilby provides an illustration from the Colombian experience. In addition to the competing entrepreneurial supply explanations of Hagen and Kasdan, it is possible that changes in the external environment were the key factor in explaining the flowering of Antiquarian entrepreneurial activity Using output as a proxy for entrepreneurship and rate of return on investment as surrogate for entrepreneur's 'wage'{residual profit per standard unit of entrepreneurial service), Kilby shows the various possible shifts in the supply demand functions pertaining to entrepreneurship.

The supply schedule is a function of socio - psychological variables and to some extent, the past amount of entrepreneurial "training". The derived demand for entrepreneurial services at any point in time is a function of the price of all cooperating factors of production, the stock' of known or transferable technology, the level of managerial organisation and consumer income. The possibilities are that the increase in entrepreneurial activity may be primarily due to shift in supply; may be essentially a result of shift in demand; following Hirschman an outside disturbance may shift the demand function which induces an increase in output which in turn generates new investment opportunities through backward and forward linkages and creates expansion inducing external economies for existing producers. The psychological drive for pecuniary gain (desire to maximise profits) is an exogenous factor taken to be given which is supposed to be operative in all societies. This profit motive combined with "a particular definition of entrepreneurial role provides the highly elastic supply of entrepreneurial services. All the remaining factors on the demand side constitute economic environment. This environment consisted of demand for industrial products, level of company taxation, case of importing essential inputs, regulatory environment, political stability and security of property". Given a favourable economic setting, the main function of an entrepreneur is to make decisions under uncertainty. This model eschews the supply side of entrepreneurship and focusses on the demand side. This model explains the lack of vigorous entrepreneurship in terms of various product and factor market imperfections and inappropriate government policies, abrupt political changes etc. Thus diagnosis of poor entrepreneurial performance makes economists suggest remedies like appropriate monetary, fiscal and trade policies, removal of market imperfections, provision of inputs and technical assistance to industry. Kilby points out that the above model defines entrepreneurial function in a narrow way. The model is based on an unrealistic assumption that an underdeveloped economy is a well-functioning one characterised by the following traits.

Factors of production possess a relatively high degree of mobility; that inputs and output are homogeneous; that producers, consumers and resource owners have knowledge of all the possibilities open to them; and that there are not significant indivisibilities.

But, when these conditions do not obtain, then the entrepreneurial function is much more complex and entrepreneurial role becomes much more significant. It is also essential to recognise the socio-political setting which can further or hinder entrepreneurial activity. Although not a fully worked out theory, Kilby's model highlights the environmental economic variables present on the demand side of the market for entrepreneurship. But the important drawback of Kilby's formulation is that it virtually assumes away the supply side which in our opinion requires a more detailed treatment as the problem of entrepreneurship in developing economies like India is one of supply of entrepreneurship rather than demand for it. For this economists have to draw from socio-psychological theories.

### Liebenstein: 'Input-Completing' and 'Gap-Filling' Function

Harvey Liebenstein (1968) departs from the neoclassical theorists and maintained that the entrepreneurs have only a trivial role to play in an economic model which assumed complete certainty. Liebenstein entrepreneurial distinguishes two broad that types of activity. First, "routine" entrepreneurship is associated with the managerial function of the business. Second, the "bew type" entrepreneurship which is basically of Schumpeterian type. He identified "gap-filling" as an important characteristic attributable to entrepreneurship. In economic theory, the production function is considered to be well defined and completely known. But the theory is silent about the keeper of the knowledge of production function.

Where and to whom in the firm this knowledge is supposed to be available is never stated. In reality, there exists larger gaps of knowledge about the production function.

There are many deficiencies so far as the production function is concerned. It is the entrepreneurial function to make up the deficiencies or to fill the gaps. These gaps arise because all the inputs in the production function cannot be marketed because some inputs like motivation, leadership, are vague in their nature and whose output is undermined. This "gap-filling" activity gives rise to a most important entrepreneurial function, namely "in put completing". He has to marshal all the inputs to realise final products.

Liebenstein defines entrepreneur as an individual or a group of individuals having four major characteristics: connection of different markets, capability of making up of market deficiencies (gap-filling), "input-completing" and creation and expansion of time-binding input transforming entities (i.e. firms). On the supply side of entrepreneurship, Liebenstein states that supply of entrepreneurship is governed by input completing capacity and inadequate motivational state.

Secondly, investment criterion also affects the supply of entrepreneurship and suggests that a lower profit investment that releases entrepreneurial energies and capacities may be more fruitful in the long run than a higher profit investment, lastly, though not all the characteristics are trainable, training can do something to increase the supply of entrepreneurship.

### Maurice Dobb

The Entrepreneur as Innovator, Risk-Taker and Monopolist Maurice Dobb22 acknowledges that any society with modern machine techniques and extensive division of labour requires some coordinating, controlling, or integrating force, which is, he indicates, the entrepreneurial function. The principal elements of this function, a synthesis of the concepts of Schumpeter and Knight, are the capacity for adjustment and innovation, which includes, most importantly, the ability to make correct judgments about the future. The capitalist undertaker, who usually also plays the role of the capitalist, generally obtains profits as a result of some monopoly advantage. This fact does not mean that he inhibits economic progress, nor that the situation is necessarily morally undesirable. The monopoly or advantage that the undertaker exploits, except that which results from inherent ability, is the result of the possession of greater opportunities such as (1) greater information; (2) superior access to training and education;

(3) A lower discount of future earnings; (4) greater firm size; and (5) agreements to restrict entry or output. All five are facilitated by the possession of wealth or position.

### For Dobb

capitalist undertaking in conditions of some monopoly privilege is par excellence a progressive force, as indicated by the economic growth of the hundred years prior to 1926 (when he was writing). Few persons are willing to face the burden of uncertainty in an environment where they have little control. The head of a large capitalist corporation or a communist planning board is more likely to commit large resources to expanding output than is a small enterprise in a freely competitive economy. Despite the success of capitalism in the past century,

Dobb questions whether it can, in the future, with the rise of trusts and imperialism, satisfy the demands of economic adjustment and income distribution more effectively than communism. Economic theory cannot help us very much with this problem, he continues, without new approaches, since the theory of capitalist undertaking is, as of 1926, primarily based on the assumption of a society of classless individualism. Despite the analysis of imperfect competition by Joan Robinson and Edward Chamberlain in the following decade, much of Dobb's criticism of economic theory is still valid.

### McClelland

Entrepreneurship: A Function of High Achievement David McClelland's is a psychological theory of entrepreneurial supply centering on the concept of achievement in his book "The Achieving Society". McClelland believes that the need for achievement is largely for economic development. A society with a generally high level of n-achievement will produce more energetic entrepreneurs, who in turn produce more rapid economic growth. McClelland used the term entrepreneur not in the sense of capitalist which connotes ownership. Entrepreneur is simply someone who exercises control over production that is not just for personal consumption. The entrepreneurs are different individuals with high n-achievement.

McClelland has noted three major ingredients of the behaviour of an entrepreneur. They are:

1. Desire to take personal responsibility for decision.

2. Preference for decision involving a moderate degree or risk.

3. Interest in concrete knowledge of the results of decision.

McClelland believes that a society with high level of -achievement will produce more entrepreneurs who in turn would assist more rapid economic development. The promotion of an achievement oriented. He prescribed ideology in a country, by inculcating the achievement motivation in child rearing system. There has been conceptual differences among theoreticians about the basic thesis of McClelland. S.P. Schatz26 has maintained that the data selected by McClelland to test the theory does not support his hypothesis. Some authors have questioned about the forces to increase the frequency of n-achievement of the society. However, in spite of the doubt about the data and reservation about McClelland's process of economic development, the theory of -achievement has further developed the psychological base of entrepreneurial theory and given a new direction to the entrepreneurship development, particularly in developing economies.

**Everett Hagen**

Entrepreneurship: A Function of ‘status Withdrawal' Everett Hagen (1962) in his theory of social change Characterised an entrepreneur as a creative personality with high need for achievement, order and autonomy and appears as a problem solver in the process of social transition. Hagen, while describing the process of change in any society as the transition to economic growth searched for the causesof the transition. He states that the transition to economic growth has been very gradual and typically occupies a period of several generations. He suggests that growth has been led not by individuals randomly distributed throughout a society but disproportionately by individuals from some distinctive group. He identifies 'creative innovation' or 'change' as the fundamental characteristic of economic growth.

Hagen, after analysing the traditional societies, maintains that the positions of authority are granted in such societies not on the basis of individual 'ability' but on the basis of his 'status'. This structure ischaracterised by typical 'authoritarian' personality. In contrast, Hagen, visualises an 'innovational' personality.

Hagen's concept of innovation involves both arriving at a new mental concept and transmitting that concept into material form. Again, innovation requires creativity and such creative individuals cause economic growth.

Hagen has postulated a sequence of the formation of creative and authoritarian personalities. He identified child-rearing practices as the main element in giving a particular shape to all the personalities. Since the traditional society has great stability, the forces required to disrupt it must be equally powerful. Hagen argues that such disruption is necessary to have creative personalities from the traditional societies. Of course, such change may not occur in the same generation but it is more likely to be an inter-generation change. Hagen's principal theme is that such creative personalities or groups emerge when the members of some social group experience, what he calls, "the withdrawal of status respect". Hagen does not mean "high" status, but merely that it is deemed appropriate by the person occupying it and is respected by others. The withdrawal of status respect' may occur when a traditionally alike group is displaced by force from its previous status by another traditional group, or when any superior group changes its attitude toward a subordinate group or on migration to a new society, whenever there is any withdrawal of status respect it would give rise to four different responses and create four different personality types:

(a) R**etreatist**: He who continues to work in the society but remains indifferent to his work and position.

(b**) Ritualist:** He who adopts a kind He who adopts a kind of defensive behaviour and acts in the ways accepted and approved in his society but with no hopes of improving his position.

(c) **Reformist:** Is a person who foments a rebellion and attempts to establish a new society.

(**d) Innovator: ·** He is a creative individual and is likely to be entrepreneur. Schumpeter and Hagen have much in· common so far as analysing the growth process is concerned and Hagen's '"Creative personality'" is also characterised by McClelland's high need for achievement. Hagen's work has an important merit in that unlike McClelland and other entrepreneurial theorists, his work is based on the experience of backward areas of Asia and Latin America. His description of childrearing in backward areas like Burma would serve equally well for the advanced countries. Hagen's analysis fails to give policy measures for backward countries which are striving for economic development as he is identifying •status withdrawal' as the causal factor in emergence of creative personality and status withdrawal by force cannot be contemplated in a democratic set up.

### John Kunkel

Entrepreneurship: A Function of Social, Political and Economic Structure Kunkel's (1970) is a behavioural model which starts with the premise that ''man's internal state is beyond the scope of presently available means of measurement and objective analysis, and knowledge of it is largely unnecessary for the explanation and prediction of behaviour.

The **model** is concerned, instead with the overtly expressed activities of individuals and their relations to the previously and presently surrounding social structures and physical conditions". John Kunkel states that the industrial entrepreneurship depends upon four structures which are found within a society or community:

**(a)Limitation Structure**: The entrepreneur is viewed as the most important "deviant" individual in economic development and the major determinant which causes such a deviance is a social structure which restricts the behavioural pattern of a population segment. The society limits specific activities to members of particular subcultures. This limitation structure affects all the members of a society.

**(b)Demand Structure**: The limitation structure is basically social and cultural but the demand structure is mainly economic. The demand structure is not static and changes with economic progress and government policies. Demand structure can be improved by providing material rewards. Such rewards are necessary to lay the foundation for future social gains. In short, by manipulating certain selected components of the demand structure, behaviour of people can be shaped in an entrepreneurial way.

**(c)Opportunity Structure:** This structure is necessary to increase the probability of entrepreneurial activity. The opportunity structure constitutes: the availability of capital, management and technological skills, information concerning production methods, labour and markets, opportunity to learn directly or through limitation, and all the activities associated with the effective planning and successful operation of industrial enterprises.

**(d) Labour Structure**: Kunkel separates supply of competent and willing labour from the opportunity structure. He argues that the labour supply cannot be viewed on par with the supply of other material conditions like capital. He states that labour means "men" and is a function of several variables. The supply of factory labour is governed by available alternative means of livelihood, traditionalism and expectations of life.

According to Kunkel, the supply of entrepreneurs depend on the existence and extent to which these four factors are found in a society and proposes the hypothesis that "the incidence of entrepreneurship depends on both the objective and perceived configuration and the actual incidence of entrepreneurs will be due to inadequate or incorrect perceptions of the various structures... It is evident, however, that entrepreneurship depends on rather specific combinations of circumstances which are difficult to create and easy to destroy". Kunkel goes on to refer to the ambiguity and inadequacy of concepts like values, attitudes, personality and points out that "any sociological analysis will be inadequate as long as poorly defined concepts are given great weight as integral parts of casual chains when, in fact, these concepts refer to the 'end products' of such chains". He illustrates the above point by referring to the various country case studies. For instance, he considers the question: are Hindu values detrimental or conducive to India's economic development? According to some writers, the spiritualism, philosophy of renunciation and asceticism present almost insurmountable obstacles to economic development. But Kunkel approvingly quotes from Singer, Srinivas and Lambart who attributed India's under development to existing social and political institutions rather than to the values and religious attitudes.

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### Boselitz – Knt -Entrepreneurship:

A Function of Managerial Skills and Leadership

In the context of reviewing the theories and suggestive hypotheses pertaining to supply of entrepreneurship, it is relevant to refer to the observations of Hoselitz. He emphasizes the role of culturally marginal groups like Jews and Greeks in medieval Europe, the Lebanese in West Africa, the Chinese in South Asia,and the Indians in East Africa in promoting economic development. Making use of the work of Stone Quist and Park, Hoselitz formulated the hypothesis that "marginal men, because of their ambiguous position from a cultural or social stand point, are peculiarly suited to make creative adjustments in situations of change and in the course of this adjustment process to develop innovations in social behaviour. Genuine Hoselitz states that "a person who is to become an industrial entrepreneur must have additional personality traits to those resulting from a drive to amass wealth. In addition to being motivated by the expectations of profit, he must also have some managerial abilities and more important he must have ability to lead". Hoselitz maintains that financial skills have only a secondary consideration in entrepreneurship. According to him, managerial skills and leadership are the important facets of entrepreneurship. To strengthen his argument, he quotes the history of French and German industrial establishments of the early 19th century where the former were men with mechanical skills rather than financial skills. He identifies three types of business leaderships in the analysis of economic development of underdeveloped countries. The **merchant moneylender** type, the **managerial**type and the e**ntrepreneur** type. The merchant moneylenders' function is predominantly market oriented. The managerial function has authoritarian orientation and the function of entrepreneurs, along with the above two orientations, calls for individuals with predominant production orientation. Hoselitz's analysis of entrepreneurship naturally suggests a method for the development of entrepreneurship which depends upon allowing the maturation and development of personalities whose predominant orientation is in the direction of productivity, working and creation and creative integration along with the establishment of social institutions which create a favourable environment for the establishment enterprise and existence of independent individual.

Hoselitz, in his book also maintained the same argument suggesting that only a strong desire to make profit is not enough to succeed in becoming an industrial entrepreneur. But in this book, he added one more characteristic to entrepreneurship which is absent in moneylending type, namely liquidity of wealth. The commodity with which a money-lender deals is acceptable to everyonebut an industrial entrepreneur creates his own commodity and its acceptability is unknown. Therefore, the entrepreneur assumes more risk than those in trading and the lending professions.

Here, Hoselitz also further suggests that entrepreneurship can develop in a society when its culture permits a variety of choices and where social processes are not rigid and in a situation which encourages the development of personalities interested in enterprises.

### Harbison - Entrepreneurship

An Organisation Building Function

Frederick Harbison has made very interesting observations regarding entrepreneurship as a factor in economic development. According to him, entrepreneurship means the skill to build an organisation. He found identification of entrepreneur with an individual person in the context of modern industry as unreasonable. For there may be number of individuals who perform different entrepreneurial functions. "In most enterprises, a hierarchy of individuals is required to perform them. Thus, the entrepreneur is in essence an organisation which comprises all of the people required to perform entrepreneurial functions". He suggests that entrepreneurship should be treated as a resource which has both qualitative attributes and quantitative dimensions and hence it will be possible to make empirical studies of such resources as it is related to other factors of production. He categorises the functions of modern entrepreneurial organisation in the following way: (**1)"**the undertaking or managing of risk and the handling of economic uncertainty; (**2**) Planning and innovation; **(3)** Coordination administration and control; **and (4)** routine supervision".

Of course, in a small enterprise, these different functions will be performed by the same individual. Harbison characterises all the persons who perform entrepreneurial functions in a large organisation as 'managerial resources'. The effectiveness of business organisations require dynamic and innovative entrepreneurs. "A dynamic organisation needs its idea –mean, its creative thinkers, its people who can plan and initiate changes. It may be reiterated here that Harbison's definition of entrepreneurship lays more stress on the managerial skills and creativity so far as organisation is concerned. His definition is not far from Schumpeter's concept of innovation. It also allows creation of new organisation as innovation and Harbison also emphasises the organisations' building ability.

### Frank W Young

Entrepreneurship: A Function of Group Level Pattern

Before elaborating a macro sociological interpretation of entrepreneurship, Young39 deals with the deficiencies of psychogenic mediation model. Stating that there is general agreement in regard to the point that development is an organisational phenomenon, he points to the inability of the psychogenic interpretations to explain the appearance of new kind of organisation. "Without exception, they are mute on the question of how individual tendencies, special abilities, unusual motivation, or perception of particular opportunities are transformed into the emergent property that is social organisation". Of entrepreneurs in particular activities during certain periods, the time actually taken by the development process in some instances are some of the other shortcomings of psychogenic interpretation of entrepreneurship. He reinterprets the individual level entrepreneurial characteristics as the "underside" of a group level pattern.

"Instead of looking at individuals, one must find clusters; ethnic communities, occupational groups, or politically oriented factions". Of these groups, those which show a certain reactiveness or solidarity, defined on the degree to which members create, maintain, and project a coherent definition of their situation", that "seize upon the rhetoric of religion or politics as a vehicle for expressing their deviant view of the world". The chief aspect of this group definition of entrepreneurship is that the entrepreneur typically does not work single-handed. ''He is simply the most visible member from an economic point of view of what is typically a cluster of families whose activity is mutually reinforcing and coordinated by a coherent outlook on the world".

Young claims that many entrepreneurial functions are implied in his concept of solidarity. "Given a group bent on finding a suitable reformulation of its outlook on the world, it is likely that recombination of economic factors, higher standards of labour, the search for new resources, technology, markets and a more disciplined management of money and time will emerge as part of this effort". This solidarity of entrepreneurial group also avoids many economic problems that crop up in the case of an individual entrepreneur.

Then Young discusses the similarities and differences between his 'sociogenic’ explanation of solidarity structures and some other explanations of entrepreneurial supply. He claims that the approach to measurement and analysis that comes out of the macro sociological perspective will in the long run be its most attractive feature".Young's theory is a theory of change based on society's incorporation of reactive sub-groups. A group will become reactive, as per Young's theory, when the three conditions coincide. The conditions are firstly, when a group experiences low status recognition, secondly, when the denial of access to important social networks and thirdly, when the group has better institutional resources than other groups in the society at the same level.

### Thomas Cochran

Cochran has propounded a sociological theory of entrepreneurship. Starting with the premise that fundamental problems of economic development are none·) Nomic, emphasises cultural values, role expectations, and social sanctions as the key elements that determines the supply of entrepreneur5·. According to him, an entrepreneur is neither a super-normal individual nor a deviant person but represents a society's model personality. The executive, therefore, plays a social role partly shaped by the model type of personality that comes from the social conditioning of his generation. While the unusual characters will always depart from the norms, in general, invention and innovation will tend to be along lines congenial to the type of conditioning. In a well-established corporation, senior officers or the board have well-formed expectations. These constitute the defining groups and the entrepreneurial role is 'closely defined' by them. "It is obvious that the primarily cultural factors operating on the personality of the executive and the defining of his role by those involved must accommodate to some degree to the necessities of the operations to be carried out’ . There is no guarantee accommodation always takes place there.

The executive's inner character is largely conditioned by the type of child-rearing and schooling common to the culture. "This relatively simple framework of an entrepreneurial role defined by the personality of the actor, the expectations of groups with power to sanction deviations from expected behaviour, and the operational needs of the function to be performed, subsumes all the social or cultural factors".

He tried to demonstrate the dynamics of his entrepreneurial model by selecting instances from American economic history. He points to important changes that have taken place in the last 150 years in the U.S. economy.

First, the rapid adoption of industrial machinery in first half of the 19th century; second the rise of professional management in the large corporation, starting in the second half of the century; and the third, the spread of mass production techniques in the 19th century. In each of these major changes the social factors in American culture operating through the entrepreneur appear to be well marked.

The analysis may also be used to answer questions to why corresponding changes did not occur in other cultures.

Thus the individual's performance as entrepreneur will be influenced by his own attitude toward his occupation the role expectations held by sanctioning groups and the operational requirements of the job. The former two elements are determined largely by the society's values, while the last element will be influenced by changes over time in such exogenous variables as population, technology, consumer demand or merely "cumulative institutional drift".

### Max Weber

Entrepreneurship: Function of Religious Beliefs

Weber, 49 a great German sociologist, in his treatise

'The Protestant Ethic and the Spirit of Capitalism ‘,formulated a theory of social change. After presenting a picture of traditional economic life, very much comparable to the circular flow of Schumpeter, Weber introduces the new business-man into the picture of tranquil routine;

"Now at some time leisureliness was suddenly destroyed, and often entirely without any essential change in the form of organisation, such as the transition to a unified factory, to mechanical weaving etc. What happened was, on the contrary, often no more than this:

Some young man from one of the putting-out families went out into the country, carefully chose weavers for his employ, greatly increased the rigour of his supervision of their work and thus turned them from peasants into labourers. On the other hand, he would begin to change his marketing methods at the same time, he began to introduce the principle of low prices and large turnover. There was repeated what everywhere and always is the result of such a process of rationalisation: those who would· not follow suit had to go out of business. The idyllic state collapsed under the pressure of a bitter competitive struggle, respectable fortunes were made, and not lent out at interest, but always reinvested in the business. And what is most important in this connection, it was not generally in such cases a stream of money invested in the industry which brought about this revolution in several cases known to me the whole revolutionary process was set in motion with a few in such cases a stream of money invested in the industry which brought about this revolution - in several cases known to me the whole revolutionary process was set in motion with a few thousands of capital borrowed from relations, but the new spirit, the spirit of modern capitalism, had set to work. Its entry on the scene was not generally peaceful. A flood of mistrust, sometimes of hatred, above all of moral indignation, regularly opposed itself to the first innovator. As a result of this, the business to make profits even if there takes place fall in prices as a result of increase in output. The inducement of profit results in greater number of business enterprises and a complete reorganisation of the industry occurs.

In the Weberian system, the entrepreneurial energies are generated by following exogenously supplied religious belief i.e., Protestant ethic. For people who believe in this ethic, hard work in their walks of life is not only to enable them to have their worldly desires met but also to have their spiritual needs satisfied. Thus in the Weberian system, the motivating force for entrepreneurial activity is provided by Calvinist ethic irrespective of the cultural background, personality type of the individual and the social environment to which he lives.

A.N. Pandey challenges the Weberian proposition and maintains that Indian religions and traditions cannot restrain the economic pursuits as they provide for identity conceptions or set of identity symbols. Tripathi doubts the assumptions of Weber in identifying a single Hindu value system. On the contrary, Hinduism is a collective name for so many beliefs. The overstress on "spiritualism" and "other wordiness" to signify the cruse of Hinduism do injustice to Hinduism by ignoring the material contact. Max Weber, at the same time, in interpreting the spirit of enterprise amongst Jains, locates approximated "Protestant ethics" among Jains. In Indian situation, Weber's analysis for the presence of spirit of capitalism in Jain community fails completely. One thing is certain Jainism with its stress on aparigraha (non-attachment), ahimsa (non-violence), aasatya (non-stealing) and brahmacharya (desirelessness) is neither less ascetic nor less otherworldly than Hinduism. The Weberian model is inadequate to explain the entrepreneurship in Indian situation.

Conclusion

Different theories above involve varied approaches economic to grapple change, the outlined with the problem change agent and of social and nature of its motivation. While some theories represent essentially mental constructs not very much based or influenced by circumstances surrounding the theorists (Schumpeterian and Weberian theories belong to this category), others are 'empirical' in the sense that they are inspired by social and economic reality as perceived by the theorists. Further, the theories by and large do not focus on merely the narrow aspect of entrepreneurial supply as such but on broad social and economic changes and factors, individuals and groups which trigger them off in a society. The theories also represent bold attempts at bringing together into a theoretical mould the whole gamut of psychological, and economic factors and socio-cultural, the mutual interaction.

**Theory of extraordinary.**

Schumpeter's view is an integral part of his economic development. The focus is an individual's (entrepreneurial function according to him is the privilege of a type who are less numerous than all those who have the objective possibility of doing it') energized by an urge to achieve 'success'. No doubt such individuals might have played an important part in the capitalist development of different countries of the West and may be doing so in the present day developing economies. But the policy importance of such a view in present day develop1ng economies is very little except when government could identify individuals to provide special assistance. But, according to Schumpeter, such individuals do not need special assistance any way as they could rely on normal banking channels to meet their credit needs and on their ingenuity to cross other hurdles. The theory does not yield any directly testable hypothesis. Cut to its essentials, Weber's theory draws our attention to the religious precepts that induce or inhibit entrepreneurial activity. Some historical evidence has been adduced by critics to support Weber's theories not only in the case of countries in Western Europe and North America but also in the case of some developing countries. For example, Jains (followers of Jainism) in India have found religious approval and encouragement for their business activities, as development proceeds socio-cultural factors which reflect religious beliefs would become lesser and lesser influential of human behaviour relative to economic forces. However from Weber's theory emerges one major (ortestable hypothesis namely while some religiousdenominations in the case of each religion) are helpful in developing entrepreneurial qualities, others are not among them. McClelland's theoretical formulations discourage and their empirical applications give an apparent impression: of empirical testability of the underlying propositions. But the empirical counterparts of concepts used by McClelland are found to be highly suspect and one wonders how many of the individuals who are judged (by McClelland's methods) to have high n-achievement could succeed in utilizing it in practice in the present day developing countries unless strengthened by other reinforcing circumstances. However, the achievement of McClelland's elaborate theoretical and empirical investigations lies in its ability to draw the policy maker's attention to the following two important points:

**1.** It is necessary to create a climate (especially in educational institutions at various levels) to enable the children to grow to become individuals with high achievement.

**2.** It is possible to improve the performance of existing entrepreneurs through imparting proper training and education. Hagen's theory is the most involved and grandly designed model of social change which did prove to be valid in some instances (country case studies) as Hagen himself showed that entrepreneurial supply can be expected from groups which experienced 'status withdrawal' is an interesting hypothesis which emerges from the theory.

Indian case offers many instances where the social groups experienced status withdrawal (due to zamindari abolition, land reforms in general, increased mobility in the caste and decline in the importance of some traditional occupations) and one can test the hypothesis with reference to these groups.

Hoselitz's thesis about minority (Marginal) groups also is amenable to empirical testing. In India, the ethnic minority communities have been found to have displayed considerable entrepreneurial drive.

The theories of Cochran, Young and Kunkel, while providing good insight into the social processes, do not yield hypotheses amenable for testing with particular reference to entrepreneurship. Kilby's model highlights the environmental economic variables present on the demand side of market for entrepreneurship.

To conclude, it can be observed that the concept of entrepreneur and entrepreneurship have intermingled. The concept of entrepreneur and his function has been seen by different that arise below: authors from different angles. The major in the light of above theories can be points listed;

**1**. Entrepreneur is a co-ordinator of factors of production and he manages production and sales.

**2.** Entrepreneur is a co-ordinator of factors of production land-labour and capital. He is a profit maximizer and endeavour to reach to equilibrium.

**3**. Entrepreneur is an innovator, who innovates new production method, market, source of raw materials, etc. The entrepreneur is motivated by monetary gain i.e. profit.

**4.** Entrepreneur is a risk bearer who works under uncertain situation and he received reward in terms of pure profit.

**5.** Entrepreneur is a gap filler and input completer.

6. Entrepreneur exercises controls over production which is not just for personal consumption.

7. The entrepreneur is a creative personality who appears as a problem solver in the process of social transformation.

8. Entrepreneurs are 'Solidarity Group' combining resources and exceling.

Unit 4

# THE PSYCHOLOGY OF ENTREPRENEURSHIP

**OBJECTIVES:**

**At the end of this unit, students should be able to:**

* Differentiate the effect of psychology on entrepreneurship
* Explain how the analysis of psychological theories is done
* Discuss the fundamentals that are relevant to entrepreneurship

## Psychological Entrepreneurship Theories.

•Entrepreneurship gets a boost when society has sufficient supply of individuals with necessary psychological characteristics.

* The psychological characteristics include need for high achievement, a vision or foresight, ability to face opposition
* These characteristics are formed during the individual’s up bringing which stress on standards of excellence, self- reliance and low -father dominance.

The level of analysis in psychological theories is the individual (Landström, 1998). These theories emphasize personal characteristics that define entrepreneurship. Personality traits need for achievement and locus of control are reviewed and empirical evidence presented for three other new characteristics that have been found to be associated with entrepreneurial inclination. These are risk taking, innovativeness, and tolerance for ambiguity.

## FUNDAMENTALS OF PSYCHOLOGY IN THE CONTEXT OF ENTREPRENEURSHIP

It is important for us to start with a consideration of certain fundamentals of psychology that will be relevant to entrepreneurship in a developing country context.

### What is Psychology?

Psychology is discipline that focuses on the study of the mind and behaviour, and on how this is influenced by the external environment.

Psychology is based on a large body of research on social and behavioural sciences that has further expanded into the natural sciences. Key issues considered in psychology will include how people develop mentally, how they perceive, learn and think; what kind of personalities exist and how people interact. These issues have been studied since ancient times under philosophy, but is only from the 19th Century and through the work of individuals such as Wilhelm Wundt (18xx to 19xx) that psychology became defined as a separate discipline.

There are now many branches of psychology, with some more commonly known ones being clinical psychology, industrial and organisational psychology, developmental psychology, personality psychology, social psychology, education or school psychology, cognitive psychology and neuropsychology.

The main goal of psychology can be broken down into the following components:

1. To describe behaviour,
2. To explain what processes are driving such behaviour,
3. To understand why these processes occur,
4. To be able to predict future events
5. To be able to influence behaviour and mental processes

### Schools of Thought in Psychology

The development of psychology as a separate discipline was closely followed by the emergence of different schools of thought that are largely linked to different philosophical perspectives. Below is a brief description of eight of the main schools that are relevant to our study of entrepreneurship:

1. ***Structuralism*** is said to be the earliest school of thought in psychology. It drew from natural sciences to try and understand behaviour. The approach involved describing the mind in terms of the most basic elements of mental experience. These experiences include (1) sensations (elements of perception), (2) images (elements of ideas) and (3) affections (elements of emotions). Structuralism is associated with Wundt and others like Edward B Tichener (1867 - 1927).

Amongst the criticisms of structuralism was its emphasis on *introspection*, which is an activity undertaken by the enquirer on themselves. Critics felt that this could not produce objective results.

1. ***Functionalism*** emerged as a reaction to structuralism and was heavily influenced by the work of an American cast that included William James, John Dewey and Harvey Carr. They argued for the need to focus on the purpose or *function* of consciousness and behaviour.

The perspective therefore considers mental life and behaviour in terms of its active adaptation to the person’s environment. This helped in the development of various psychological theories and also helped in the emergence of applied psychology. Functionalism theories have however been criticized for possessing very limited predictive abilities.

1. ***Behaviourism***, sometimes referred to as the learning perspective, became the dominant school of thought around the 1950s due to the work of individuals like John B Watson( ), Ivan Pavlov ( ) and B F Skinner ( ). Their view was that all psychological processes could be explained by observable behaviour which, in turn, could be explain explained by environmental causes (not by internal forces as advanced by structuralists).

From this perspective, it was held that psychological conditions could therefore be altered by altering behavioural patterns and/or modifying the environment. Their rejection of the existence of internal mental processes become and remains the main point of criticism.

1. ***Psychoanalysis***and its development can be attributed to Sigmund Feud (18xx to 19xx), Carl Jung (same) and Erik Erikson (same) who emphasised the powerful effect of the unconscious mind on behaviour and cognition.

They presented the human mind as consisting of 3 elements: (1) the Id - present at birth as the repository of basic instincts; (2) the Ego - operating on the 'reality principle’ and concerned with mediating between the urgings of the id and the realities of the external world; and (3) the Super Ego - part of the ego in which self-observation, self-criticism and other reflective and judgemental faculties develop. The Ego and Super Ego are both partly conscious and partly unconscious.

Its main criticism has been from the view that psychoanalytic theories constitute pseudo-science!

1. ***Humanistic Psychology*** was popularized by individuals such as Carl Rogers and Abraham Maslow. It developed as a response to psychoanalysis and behaviourism (thus sometimes referred to as “the third force”) and focused on individual free will, personal growth and self-actualisation. They asserted that human behaviour exhibited “actualizing tendency”, described as the urge to expand, extend, develop and mature.

**Humanistic** psychologists do not generally believe traditional research methods understand are suitable for understanding human consciousness and behaviour (especially because they are often drawn from the physical sciences). As a result, many have argued that humanistic psychology is not so much a *discipline* within psychology as a *perspective* on the human condition that informs psychological research and practice

1. ***Gestalt psychology*** (with Gestalt being German for “essence” or “shape of an entity’s complex form) was another reaction to structuralism, championed by Christian von Ehrenfels, that argued for the need to look at the whole experience before observing the parts. This view holds that perception is the product of complex interactions amongst various stimuli.

A lot of developments regarding Gestalt psychology has related to visual perceptions, though some psychologists like Max Wertheimer have applied the view to problem-solving processes (productive and reproductive thinking).

1. **The *Cognitive Revolution*** in psychology can be traced to the work of George A Miller and Ulric Neisser. It was born out of the study of mental processes, including how people think, perceive, remember and learn. Cognitive science thereafter became established by drawing on psychology, anthropology and linguistics, and has since been used in artificial intelligence, computer science and neuroscience.

The field was a departure from behaviourism, advancing 5 key ideas (Pinker, 2002):

1. The mental world can be grounded into the physical by concepts of information, computation and feedback;
2. The mind cannot be a blank slate because blank slates don’t do anything;
3. An infinite range of behaviour can be generated by infinite combinational programmes in the mind;
4. Universal mental mechanisms can underlie superficial variations across cultures; and
5. The mind is a complex system composed of many interacting parts

Proponents of the cognitive revolution hold to the view that psychology studies behaviour in order to infer unobservable explanatory constructs, such as "memory," "attention," and "meaning" (Baars, 1986). Advances in artificial intelligence and computer science have made it possible to make testable inferences about invisible human mental processes.

By observing the behaviour of a device with artificial intelligence when stimulated in various ways, it may be possible to use these results to understand what happens in a human mind when he/she exhibits similar behaviour. This approach is used in a process called reverse engineering.

Using this approach, it becomes possible to undertake empirically valid or objective research on constructs that may have hitherto been too subjective.

*“Entrepreneurship is the ultimate exercise in developing the attributes that we know from positive psychology to be essential to having a good life: self-competence, optimism, engagement, and resilience.”*Pamela B Rutledge, 2009

1. ***Positive Psychology***

This is one of the more recent branches of psychology which is really intended to complement other traditional schools and not so much vie for prominence.

It has been described as a psychology of positive human functioning which achieves “a scientific understanding and effective interventions to build thriving individuals, families, and communities." (Seligman & Csikszent mihalyi, 2000).

Positive psychologists are concerned with four topics: (1) positive experiences, (2) enduring psychological traits, (3) positive relationships and (4) positive institutions. (Peterson, 2009).

Whilst some have criticized it as being “shallow”, it does have clear relevance to our thinking about entrepreneurship because it raises critical questions concerning reality and how this can be enhanced, and touches on issues of *self-efficacy* (a belief in one’s own competence – discussed in more detail later) which is seen to be key in decisions to venture out and attempt the seemingly impossible. It also considers the form and nature of internal and external stimulation that promotes positive human functioning.

### The Trait Theory of Psychology

This theory involves the study of human personality*Traits or dispositions* that often result into habitual patterns of behaviour, thought, and emotion (Saul Kassin, 2003).

Traits are believed to be relatively stable over time and to also differ across individuals. There are numerous traits that can be identified, with even more numerous permutations and combination of traits that inform personality. But the statistical technique of factor analysis has demonstrated that particular clusters of traits reliably correlate together.

Initial work on traits pioneered by Gordon All-port (1897 –1967) showed that personality traits could be reduced to 3 categories (from Kandra Cherry, ND):

1. *Cardinal Traits:* these dominate an individual’s personality to the extent that the person would become particularly known for them. References such as narcissism, Don Juan, or Christ-like would become synonymous to a person’s name. All-port suggested that cardinal traits are rare and tend to develop later in life.
2. *Central Traits:* These are the general characteristics that form the basic foundations of personality, and which, though not as pronounced as cardinal traits, would ordinarily be used to describe a person. Terms such as *intelligent*, *honest*, *shy* and *anxious* are considered central traits.
3. *Secondary Traits***:** These are the traits that are sometimes related to attitudes or preferences and often appear only in certain situations or under specific circumstances. Some examples would be getting anxious when speaking to a group or impatient while waiting in line.

*Common traits* are sometimes also mentioned. These are traits that are recognized within a culture and may vary from one culture to another.

Various other researchers have attempted to identify and categories traits, and a new trait theory based on the *five-factor model of personality* (often referred to as the "*Big Five" theory, pioneered by* Costa & McCrae, 1992) eventually emerged. This represents a framework of five core traits that are believed to interact to form human personality and inform resultant behaviour.While researchers often disagree about the exact labels for each dimension, the following are most commonly used:

1. Extraversion (*outgoing/energetic* vs. *solitary/reserved*)
2. Agreeableness (*friendly/compassionate* vs. *cold/unkind*)
3. Conscientiousness (*efficient/organized* vs. *easy-going/careless*)
4. Neuroticism (*sensitive/nervous* vs. *secure/confident*)
5. Openness (*inventive/curious* vs. *consistent/cautious*)

Some of the most common criticisms of trait theory centre on the fact that traits are often poor predictors of behaviour. While an individual may score high on assessments of a specific trait, he or she may not always behave that way in every situation. Another problem is that trait theories do not address how or why individual differences in personality develop or emerge (from Kandra Cherry, ND).

Social psychologists like Elizabeth Chell (1985, 1999) have studied numerous psychological trait-based theories and approaches and concluded that, whilst these may have strong links to entrepreneurial behaviour, the entrepreneur’s context is also very important. Indeed, entrepreneurship, as a phenomenon, is ultimately a reflection of complex interactions between the individual and their situation (which is invariably dynamic).

So, whilst we focus on some particularly key theories below, we need to keep in mind that the context in which they need to be understood and utilised is often very dynamic. Real life solutions often lie in a combination of interventions that may very well be drawn from even what appear to be opposing theories!

**Psychological Orientations**

Krauss et. al (2005) argue that while traits are dispositional and stable over time and situations (McCrae et. al, 2000), orientations are culturally-conditioned and influenced by the environment, and are therefore a better predictor of eventual behaviour (Thomas & Mueller, 2000). Orientations include components of *affect, cognition* and *behaviour*, but have a particular bias towards behaviour (Eagly & Chaiken, 1993). They can be contrasted with *attitudes* which are *alterable evaluative preferences* that are based on affective and cognitive beliefs (Ajzen, 2001, Petty et al., 1997). An orientation’s main distinction from attitudes is therefore its strong emphasis on behaviour and that an evaluative preference is not necessarily required.

**Can a Person’s Psychological Characteristics be influenced?**

We should probably first raise the important question: is human psychology “pre-programmed” or does it develop from the time one comes into existence? The debate around this question has been around for many centuries and is linked to the philosophical debate often referred to as “nature vs. nurture”

The discussion can be approached from two extreme viewpoints:

1. You may have come across an important epistemological theory called “tabula rasa” which literary means “erased slate” though it is more popularly known as the “blank slate” theory. The thinking behind it goes back to the times of ancient philosophers, but has for the more recent times been attributed to 17th Century philosopher John Locke.

In its simplest form, the theory presents the view that a human mind is like a blank slate at birth and that it develops through experiential learning from its environment. The original literal interpretation adds further dimension of the human mind being “erasable”, and completely re-programmable.

1. The opposite extreme view could be that individual character is inherent within the biological make-up of the person. This view, which has been closely associated with Eugenics, represents a perspective that suggests that all is genetically set and nothing can be done to significantly influence personality or character.

The above are being considered as extreme views because the current substantiated knowledge (episteme) as we have it, tells us that the truth lies somewhere in between. Modern genetic science does tell us that aspects of the human character is inherited. Further, we also do know from developmental psychology that whether inherited or acquired, character can be influenced.

So, to answer the question paused in the heading to this section, we can certainly say the following:

1. The psychological profile of a person can certainly be influenced.
2. Whilst there are elements of a person’s psychology that are genetically inherited, others are acquired.
3. It is possible to influence what psychological characteristics a person acquires by, for instance, influencing the experiential learning processes they are exposed to.
4. Further, it is possible to influence a person’s already existing psychological characteristics, whether these are acquired or genetic.

This conclusion will prove to be very important to our discussion of entrepreneurship education.

PSYCHOLOGY AND ENTREPRENEURSHIP

The study of entrepreneurship from a psychological perspective gained prominence from the 1990’s onwards because as small enterprises began to move into the developmental limelight, the entrepreneur was found to sit at the boundary line of individual work psychology (they are an important employee of a small business.), organizational psychology (as founders/workers they have an enormous influence on the firm), and market psychology (small firms have effect on economic activities in the market).

“*To understand the entrepreneur, you first have to understand the psychology of the juvenile delinquent*.”Alexander Zelaznick, Professor emeritus of psychology at Harvard Business School

Other areas such as industrial psychology can also be studied in entrepreneurs. In fact, Rauch & Frese (2000) assert that all aspects of psychology are implicated when studying entrepreneurs.

Much of the research on the psychology of entrepreneurship has focused on *entrepreneurial success*, which (unfortunately) has largely been around business success, and not adequately examined other spheres of entrepreneurial success (e.g social, political, etc).

Nonetheless, by examining entrepreneurial success even from the business perspective, we still have the opportunity to use the outcomes of such entrepreneurial endeavours as a starting point to asking questions that may help us understand what psychological aspects assist entrepreneurs to be successful (or even to be unsuccessful!).

# Lateral thinking

[Idea generation](http://t.ms00.net/s/c?u.ncg4.11.kap0.23bue) and [problem solving](http://t.ms00.net/s/c?u.ncg4.12.kap1.23bue)[technique](http://t.ms00.net/s/c?u.ncg4.13.gcag.23bue) in which new [concepts](http://t.ms00.net/s/c?u.ncg4.14.gu35.23bue) are created by looking at things in [novel](http://t.ms00.net/s/c?u.ncg4.15.jk6d.23bue) ways.

Whereas the logical ('vertical') thinking carries a chosen [idea](http://t.ms00.net/s/c?u.ncg4.16.g0on.23bue) forward, the sideways ('lateral') thinking provokes fresh [ideas](http://t.ms00.net/s/c?u.ncg4.17.g0on.23bue) or [changes](http://t.ms00.net/s/c?u.ncg4.18.fsmz.23bue) the [frame of reference](http://t.ms00.net/s/c?u.ncg4.19.kap2.23bue).

And, while vertical thinking tries to overcome [problems](http://t.ms00.net/s/c?u.ncg4.20.fwgt.23bue) by [meeting](http://t.ms00.net/s/c?u.ncg4.21.66v1.23bue) them head-on, lateral thinking tries to [bypass](http://t.ms00.net/s/c?u.ncg4.22.kap3.23bue) them through a radically different approach.

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Put differently, if we can identify successful entrepreneurs, then we can study them from a psychological perspective and try to understand what it is about them that has enabled them to succeed. This understanding can then be used to try and predict entrepreneurial success. It therefore becomes possible to identify individuals that have the potential to be successful in their entrepreneurial activities, even before they become successful. It also becomes possible to identify what measures need to be put in place to improve the likelihood of entrepreneurial success. Potential future success can then be better actualised through interventions such as better access to finance and various other facilities and technologies, market linkage and relevant trainings.

On the other hand, by identifying psychological factors that contribute to failure of entrepreneurial endeavours it becomes possible to introduce interventions that could mitigate or completely eliminate the possibility of such failure.

It is easy for us to think that only researchers, governments and development organisations need to develop this kind of understanding. Indeed they do, by virtue of the role they play in facilitating entrepreneurship development. But it is actually critical that everyone appreciates key issues pertaining to the psychology of entrepreneurship.

An individual who sees themselves as being entrepreneurial would need to understand what aspects of their psychology may need to be enhanced and what environment they may need to get exposed to. Individuals and institutions that make up society need to think about how they can identify and support entrepreneurs because of the clearly important role that we know entrepreneurship plays.

At the very least, an entrepreneur will need encouragement in a form and manner most appropriate for them. But they often need more than this. They may need a “soft loan”, or extra minds, hands and legs from family members and friend to help them launch out or move forward. As we will discuss later, it is actually quite easy to misunderstand an entrepreneur and, even with good intentions, provide inappropriate forms of assistance that may not ultimately help them at all!

From the above, we can see that psychological factors do not operate on their own whether it is in the case of entrepreneurial success or failure. They work with other factors outside the individual – factors in the environment. These external factors will be discussed further in most of the later chapters.

For now, let’s consider some key concepts within the psychology of entrepreneurship.

### The Traits Theory of Entrepreneurship

We will start with looking at the traits, and within these, two relevant theories may be identified: (1) the traits theory and (2) the psychodynamic theory. Because the psychodynamic theory has not gained much traction over time, we will opt to restrict ourselves to the traits theory.

The two basic assumptions underpinning the traits theory, as applied to entrepreneurship, are that:

1. The person who *decides* to create a new enterprise (hence the entrepreneur) has a different psychological profile from persons that do not make this decision.
2. The person who is more successful in entrepreneurial endeavours has a different psychological profile from those that are less successful. (Veciana, 2007)

Based on the above assumptions, it then becomes important to identify what attributes aid the entrepreneurial decision process and the extent of entrepreneurial success.

You may have noticed that these two assumptions directly relate to entrepreneurship as defined by Bygrave (1994) when he refers to (1) *opportunity identification* and (2) *opportunity exploitation*. What we are therefore now really seeking to understand (through the use of the traits theory of psychology) is what personal attributes assist in identifying good entrepreneurial opportunities and also assist in successfully exploiting these opportunities.

Theoretically, this should then assist in distinguishing entrepreneurs from those that are not, and, even further, also help in identifying different levels of entrepreneurship amongst those that are. This has value to individuals, entire communities, countries and even the world at large. If entrepreneurship is indeed good for individuals and society, then those that may not be as entrepreneurial should be assisted to see where they are so they could seek to develop themselves. Part of doing this may be to identify and learn from entrepreneurs.

Society as a whole should ideally be interested in identifying and supporting those that are found to be entrepreneurial. Most cultures in developing countries are closely knit and so could be fertile ground for the spread of entrepreneurship. But this can only happen if such societies understand entrepreneurship, appreciate its value to them, and therefore support it.

**What Traits are Associated with Entrepreneurs?**

A significant amount of empirical investigations has shown that the main psychological traits and inner motivations of the entrepreneur include the following (Veciana, 1989):

* Need of independence
* Need for achievement
* Internal locus of control
* Risk-taking propensity
* Unsatisfied or “marginated” person
* Intuition
* Tolerance of ambiguity

It is important to mention that the above list is not intended to highlight what are felt to be the “good attributes” of an entrepreneur. It is merely seeking to show particular attributes that have been associated with entrepreneurship. It is therefore possible that some, most or even all of these attributes may have a “dark side” to them. For instance, we are not in any way suggesting that the higher the need for independence, the better an entrepreneur one will be. It is possible that too high a need for independence could result into undesirable effects on the entrepreneur and even the environment.

Whilst each of these attributes may be desirable for entrepreneurship, various combinations of different levels of each of them may therefore be appropriate for different entrepreneurial scenarios. As such, the better the match between this combinations of personal attributes to the entrepreneurial scenario the better the entrepreneurial results. It is clear then that individual entrepreneurship needs to be explained from the interface of particular personal characteristics and particular situations.

It is therefore possible that any shifts in a person’s traits and/or any change in the situation could very well lead to change in the form and nature of entrepreneurship being exhibited. Put differently, an entrepreneur is not necessarily an “all-rounder” who exhibits consistent levels of entrepreneurship over time and in different situations. Entrepreneurs are likely to respond differently to different situational cues of opportunity (Mwikisa, 2011).

### The Concept of Entrepreneurial Orientation (EO)

This concept is based on the theory of psychological orientation as discussed earlier. Though originally developed in this psychological context, Entrepreneurial Orientation (EO), had for a period of time been more associated with organisations and not so much individuals (see Covin & Slevin, 1991). It was used to depict entrepreneurial characteristics of a firm in its early years and was found to be important for *firm emergence* and *firm success*.

But, as we have noted above, an individual entrepreneur will have a significant role and influence on the start-up and eventual success of especially a small firm. The fact that the psychology of the founder is often evident at these circumstances implies that the concept of EO as seen at firm level can actually be associated with the firm owner.

In this context, EO can be viewed as the *psychological orientations* of the owner that *relate to their daily tasks and fit with the environmental requirements* (Krauss et. Al, 2005). This definition of EO focuses on person variables that are more closely associated with entrepreneurial tasks and behaviour (Kanfer, 1992) rather than traits.

Various researchers (Begley & Boyd, 1987; Utsch et. al, 1999; Stewart & Roth, 2001)) showed that some components of EO (autonomy, innovativeness, competitive aggressiveness, achievement orientation, and risk-taking) are higher in samples of business founders (supposedly entrepreneurs) than in samples of managers. The research therefore showed that EO plays a role in firm emergence.

Krauss et. al (2005 ) decided to look into the role of EO in firm success in an important study of the general relationship between individual EO and performance of Southern African small business owners. They stressed the importance of the owner of a firm because of his/her role in determining a firm’s strategies, culture (Schein, 1983), vision, and goals. In this regard and to a large extent, the owner “pre-sets” the firm in a direction that would determine whether or not it will eventually become successful, even though their influence will reduce as the firm grows (Frese et. al, 2000).

Krauss et. al (2005) further argue that EO has better predictive value as it considers factors closest (proximal) to behaviour, unlike other approaches (such as trait) which they feel have a more remote (distal) link to what the entrepreneur eventually does (tasks). They make use of Lumpkin's and Dess' (1996) concept of EO which consists of *autonomy orientation, competitive aggressiveness, innovative orientation, risk-taking orientation, and Proactiveness*and also add *learning orientation and achievement orientation*.

1. ***Autonomy Orientation***

Autonomy, in the context of entrepreneurship development may be described as *"the ability and will to be self-directed in the pursuit of opportunities"* Lumpkin and Dess (1996; p.140).

This psychological orientation is likely to make one less likely to settle in employment or to want to ‘hide’ under someone else’s leadership for the sake of obtaining the security that this may be perceived to provide. Entrepreneurs place a premium on their ability to make decisions and take actions that go towards enhancing their reality. And success becomes eventually evident as this reality unfolds with time and deliberate actions.

Utsch et al. (1999) found higher autonomy orientation in business owners than in managers, showing that this was a psychological orientation exhibited typical of entrepreneurs.

1. ***Competitive Aggressiveness***

For them to achieve their goals in a world that may not be going in what they feel is the right direction (at least with regard to their goal), entrepreneurs will need to assert themselves in the market place and are likely to enjoy the enhancing effect that this may produce.

Competition is therefore an inevitable process for the entrepreneur to obtain resources and other forms of support needed to achieve their goal. Off course, this competitive aggressiveness can be either or both “outdoing the competitors” or “undoing the competitors”! (Covin & Covin, 1990, p.36). There may be various ethical issues to be considered in either case, but all would nonetheless be done to enhance attainment of set goals – which is the ultimate measure of success. It is generally agreed that competitive aggressive orientation is one of the basic characteristics of successful entrepreneurship (Covin & Slevin, 1991).

1. ***Innovative Orientation***

Put simply, innovation has to do with putting new ideas into good use. Entrepreneurs tend to have a knack for breaking out of the status quo by working with new ways of doing things and producing results.

This psychological orientation is exhibited by a positive mind-set toward new ideas with regard to *what* can be done and *how*. The emphasis in innovation is not so much invention (identifying new things) but selecting the best idea for a particular scenario and working with it to achieve desired ends. So old ideas may, for example, be applied to new situations or to old situations they have not been considered for. The result-enhancing effect that this produces becomes a positive indicator of success.

Innovation orientation may probably be one of those dispositions not exhibited enough in the developing world. Many commentators have attributed this to the impact of colonization, and to the social systems (including the forms of education) that came with this. Without getting bogged down in the possible debate that could ensue, what may be more relevant is to advance a possible roadmap that takes account of what we think could be the underlying cause of the problem. Indeed, a failure to do this would in itself be reflective of a low innovation orientation!

1. ***Risk-Taking Orientation***

Venturing into new fields if fraught with risk associated with limited existing knowledge.

Chell et al. (1991) refer to entrepreneurial risk-taking as *"pursuing a business idea when the probability of succeeding is low"* (p.42). It is important to state that the mere pursuit of risky endeavours does not create an entrepreneur. Risk is not sought after for its own sake. In fact, the focus is on the potential results, whilst being conscious of the associated risk. A decision to engage in a risky undertaking would therefore need to be based on some determination of the potential benefits versus the likelihood of success and possible dangers along the way. This generally positive stance towards risk-taking is the kind of psychological orientation envisaged here.

It is otherwise actually possible that a negative correlation can exist between risk-taking and firm success as was found byRauch and Frese (2000). The question in this case may arise as to whether or not this form of risk-taking is entrepreneurial! Evidence suggests that successful entrepreneurs take calculated risks (Begley & Boyd, 1987; Timmons, Smollen, & Dingee, 1985).

The decision to go against “the grain” of the existing order of things is probably the first step into a risky direction. Various other steps follow from this, with each step possessing different levels of risk associated with the fact that the terrain may be largely unknown.

1. ***Personal Initiative***

This psychological orientation seeks to capture individual tendency towards being proactive, self-starting, and persistent (Frese, et.al, 1996).

This orientation describes individuals that have a mental disposition towards looking ahead identifying issues that need action, being willing to take necessary steps, and being willing to persist for as long as reasons to do so remain. Practical examples could include acting on anticipated problems (e.g shortage of fuel in the coming weeks) by making larger than normal fuel stock orders, or remaining in a particular business location in view of anticipated future benefits from a new roads project. Both instances may require taking action independently from competitors and seeking to influence the market.

Studies from different parts of the world, including the US (Crant, 1995), Austria (Korunka et al., 2003) and Uganda (Koop et al., 2000) have shown that personal initiative of the person in charge is related to entrepreneurial success.

1. ***Learning Orientation***

Learning orientation is concerned with *an individual’s stance toward learning from experience* (Krauss et al, 2005).

Learning from positive as well as negative experiences is essential for successful entrepreneurial behaviour (Minniti & Bygrave, 2001) because it serves to overcome (or mitigate) the effects of venturing into an unexplored field, especially when opportunities for formal training are limited (as is often the case in the developing world). Learning then becomes the process of developing more adequate mental models that support successful decisions-making.

It is probably well-known that an individual mind-set that is oriented towards learning has significant positive influence on the individual and their environment, particularly in terms of enhanced performance. Indeed, once this translates into an organisational culture the benefits are clearly visible at the firm level (Argyris, 1992). Research has actually shown, for instance, that firms that foster a culture of learning from mistakes perform better than those that do not (Van Dyck et al, 2003).

1. ***Achievement Orientation***

Based on the work of McClelland (1961) which has been cited earlier, we know that achievement motivation is an important aspect in the psychology of the entrepreneur. It is therefore possible to examine the orientation that this aspect produces in the individual.

As they engage in the process of “creative destruction” as described by Schumpeter, entrepreneurs will exhibit high levels of performance in non-routine tasks and take responsibility for the outcomes (high locus of control). Because their desire is for success, these individuals will actively seek out opportunities for feedback and will compare themselves against others. This will provide a basis for continuous improvement as they reach out towards set goals (these are goals that may actually be constantly shifted upwards because they enjoy the challenge that this may continue to present!).

Some typical tasks of achievement oriented individuals may include acquiring a new customer, whilst a continuously challenging goal might be to beat the previous weekly, monthly or annual sales record. Save for the negative effects of other exceptional variables, this orientation will undoubtedly lead to improved individual and firm performance in the particular task and goal areas. Such reality-enhancing performance is also likely to attract attention from customers and investors, and so result in accelerated firm growth.

From the above in-depth consideration of the 7 aspects of EO as proposed by Krauss et al (2005), one may ask the question: is it expected that an outstanding entrepreneur will exhibit high levels of psychological orientation in each of the aspects?

Well, certainly not.

In fact, it is not so much how high any one particular orientation is that indicates a high level of EO. Firstly, particular orientations need to be exhibited in relation to external environmental conditions. We would therefore not expect a good entrepreneur to display high levels of competitive aggressiveness in an environment where this is not warranted! Secondly, just like in the case of traits, it is important to look at all the 7 aspects together (the pattern or profile) and this, as mentioned, in the light of the environmental circumstances.

### The Concept of Opportunity Recognition

Researchers like Vyakarnam (2003) have argued that the concept of EO fails to recognise the aspect of opportunity which, based on our earlier discussion, is clearly considered to be a key factor in successful entrepreneurship.

Kirzner (1973) is amongst the first to identify the central importance of the discovery of opportunities to entrepreneurship: “Entrepreneurs find and exploit opportunities by taking advantage of economic disequilibria by knowing or recognising things that others do not”. De Koning and Brown (200 point to Vesper (1980) and Cooper (1981) as pioneer researchers in the specific study of Opportunity Recognition (OR). Though even this concept (just like EO) has been largely utilized in the consideration of firm-level entrepreneurship, it is rooted in the psychology of the individual entrepreneur whose personality will, as we have stated earlier, inevitably dominates the emergent firm behaviour.

OR is seen as an event dependent on an antecedent (psychological) state of *opportunity alertness*, which Kirzner (1979) defines as the ‘ability to notice, without search, opportunities that have hitherto been overlooked’.

Different researchers have sought to identify and classify OR processes that take place in an individual or firm. Long and McMullan (1984) developed a four-stage model of OR that includes pre-vision, point of vision, opportunity elaboration and decision to proceed. Lumpkin, Hills and Schrader (2001) uses this model to develop an approach that ‘suggests that OR is inherently a creative process and link this to creativity models found in psychology literature. They in turn developed a five components model that includes preparation, incubation, insight, evaluation and elaboration. They saw these as being ‘necessary and sufficient to explain multiple diverse methods of OR.’ Yet others have included systematic search, effectuation, and cognition as part of OR processes, or even sought to classify different forms of OR as being either “idea-first” or “business-first”.

Notwithstanding the form and nature of the OR process, various other research (e.g Cohen and Levinthal, 1990; Shepherd and DeTienne, 2001; and Bishop, 2010) have emphasised the important of prior knowledge, skills and abilities (KSA) in the manner in which OR operates. It is felt that a broad range of KAS makes an individual more creative, thereby enhancing OR. This is based on the view that individuals will often associate past experiences with their present and possible future encounters, and so are able to use these past experiences to enhance the way they respond to what they are facing or anticipate. This thinking has been used to explain the increasing levels of success exhibited by many repeat or serial entrepreneurs (i.e. entrepreneurs that have prior experience in starting and developing enterprises).

*‘The most promising efforts to increase entrepreneurship in the inner city focus specifically on changing the mind-sets of disadvantaged individuals (Todd, 1995) and by providing needed skills and the belief in those skills (Hood and Young, 1993b).’* Krueger as quoted by Vyakarnam

Researchers, policy makers and developmental practitioners have sought to use different models for OR processes to try and understand, predict and influence entrepreneurial behaviour.

### The Concept of Entrepreneurial Self-efficacy (ESE)

This is a concept from social learning theory that is employed in arguing that opportunities are psychologically constructed and not just stumbled upon. Self-efficacy stems from the work of Bandura (1997) and refers to a mental disposition (or attitude) of viewing situations as controllable and positive. Put differently, it refers to an individual’s belief in their personal capability to accomplish a job or a specific set of task. Krueger (2000) advanced the view that the perception of opportunities depends on an individual’s self-efficacy

This view is drawn from social psychology where Kim & Hunter (1993) show the following relationship between attitudes, intentions and behaviour

**Behaviour**

**Attitudes**

**Intentions**

*Since ESE is a cognitive construct, it can be learned. Mind-sets, however, as Krueger (1997) points out, are less tractable, ‘particularly in communities where learned helplessness is rampant.’*Vyakarnam (2003)

Krueger (1999) had pulled this relationship into entrepreneurship and asserted that entrepreneurial behaviour is informed by entrepreneurial intent which, in turn, is backed by entrepreneurial self-efficacy (ESE) as the underlying attitude.

Lindsay et.al (2010) therefore define ESE as *the belief in one’s ability to successfully engage in entrepreneurial behaviour.* This belief is rational and linked to experience and not merely perceived self-confidence (Taylor 1991). Based on past relevant successes (or even failures!), the entrepreneur will be in a better position to predict outcome of personal effort.

Based on the above, it can therefore be said that if one sees themselves as capable and competent, they are more likely to see a course of action as feasible, and hence more likely to see an opportunity.

Proponents of this view criticise theories that focus on static personality traits or predispositions of individuals, arguing that these have been found to be ineffective at predicting entrepreneurial activity (e.g. Sandberg and Hofer, 1987).

ESE being a cognitive construct that links more closely to behaviour, has instead been felt by some (e.g Bandura, 1995) as being more reliable. In fact Chen et al (1998) pioneered research work that seemed to confirm this view.

It is further believed that individuals can develop self-efficacy through prior cognitive, social and physical experiences (Bandura 1986, Gist, 1987). From this view, formal education therefore becomes one means through which ESE can be developed (Izquierdo & Buelens, 2008).

High levels of self-efficacy have an important role in helping individuals sustain effort until goals are reached.

For the entrepreneur such an attitude can facilitate transition from the nascent stage and through the start-up phase when ambiguities pertaining to the venture are often high (De Noble et al, 1999). This role extends to entrepreneurial performance during the phases when the venture is more established (innovativeness and risk-taking remain key to continued (Stajkovic and Luthans 1998; Randhawa 2004).

Chen et. al (1998) go on to identify five factors that they believe constitute ESE: marketing, innovation, management, risk-taking, and financial control.

Using these factors, they were able to provide research evidence that ESE is one of the strongest distinguisher of entrepreneurs from managers. It is clear from their work that ESE is one concept in the psychology of entrepreneurship that has probably not been utilised enough, especially in a developing country context and particularly in entrepreneurial assessment, education, counselling, and community intervention.

### The Psychology of Entrepreneurship at Different Stages of Enterprise Development

Much discussion on entrepreneurship has focused on venture formation. Quite understandably, this is probably a stage where entrepreneurship is most likely to be visibly pronounced. Many enterprises will experience some form of growth or transformation at some point or other. Others may focus on sustaining existing operations. One would think that some amount of entrepreneurship would be necessary in either case, as much as it may not be equally evident.

*Zhao et al (2009) studied the relationship between personality and* outcomes associated with two different stages of the entrepreneurial process: entrepreneurial intentions (associated with start-up) and entrepreneurial performance (linked to growth and sustenance).

They found that four of the Big Five personality dimensions were associated with both these dependent variables, with agreeableness failing to be associated with either. Risk propensity, included as a separate dimension of personality, was positively associated with entrepreneurial intentions but was not related to entrepreneurial performance. This is actually one of those studies that provides strong backing for the view that personality plays a role in both venture start-up and subsequent performance.

Over time, research conducted on entrepreneurial intention has resulted in the development of various theories and models, including

1. The theory of planned behavior which advances the view that entrepreneurial intent is based on three elements: the person’s attitude towards the behavior; subjective norms; and the perceived behavioral control (Ajzen, 1991);
2. Krueger’s model of Entrepreneurial intent (Krueger, Reilly & Carsrud, 2000);
3. The entrepreneurial event model: This asserts that the entrepreneurial intent is dependent on three factors: perceived desirability; perceived feasibility; and propensity to act (Shapero, 1982; Shapero and Sokol, 1982); and
4. Davidsson’s psychological-economic model (Davidsson, 1995).

Some of these are discussed in this chapter and elsewhere in the book.

***Corporate Entrepreneurship***

As an institution grows, the identity and direct influence of the founder may begin to be diluted by the presence of other key individuals. The need to constantly innovate often remains critical to many businesses (Dess et al, 2003). Such innovation may take different forms and affect the enterprise and its environment differently. A different form of entrepreneurship – *Corporate Entrepreneurship (CE)* - is therefore required at this stage.

Researchers such as Wiklund & Shepherd (2005) have studied how corporate entrepreneurial orientation (EO) contributes to financial performance and adds to strategic value. Leading thinkers like Kuratko et al (2005) have emphasised the importance of identifying and documenting specific types of entrepreneurial activities in established corporations in order to highlight their meaningful contribution to organisational success.

The whole subject on CE is dealt with in another chapter, but has been mentioned here purely because individuals remain at the heart of the process. That is why Stopford & Baden-Fuller (1994) argued that attributes of *individual behaviour* is what ultimately “infects” the firm as a whole. More recent research (Phan et al, 2009) actually points to the need to segment *individuals* at different levels in the institution because of their different role and effect on CE. Belausova & Gailly (2009) specifically studied activities and behaviours of employees that developed entrepreneurial initiatives within established organisations, and how this works through the institution to culminate into a formal CE strategy.

**Do we have to make a choice of which psychological theories and concepts to work with in understanding entrepreneurship in a developing country context?**

It is probably common for academic and philosophical arguments to want to side with a single perspective and to try and shoot down everything else. Well, this book is about real life scenarios that often require different perspectives for them to be well-understood.

As stated earlier, the book has adopted a *perspectivist* approach towards the process of better understanding entrepreneurship in a developing country context. The view being espoused is that entrepreneurship is best understood by identifying a context and then isolating and examining key perspectives within that context. The “truth” is believed to lie somewhere within this combination of perspectives.

In this regard, the book does not seek to advance one theory ahead of the others. It seeks to identify different aspects of psychological theories that are relevant to entrepreneurship in a developing country context. The objective is to assist the reader to use these aspects in a *sense making* process (see Weick 1995) that should assist in building a more appropriate understanding of entrepreneurship in a developing country context.

### Other Recent Research Advances in the Psychology of Entrepreneurship

1. *Measuring Entrepreneurial Passion (EP)*

Cardon and a team of researchers (2012) have attempted to develop a conceptual framework that would enable entrepreneurial passion (EP) and its inherent dimensions (intense positive feelings toward inventing, founding ventures and developing them) to be captured and measured.

EP which sits within the affective realm of psychology is clearly an important entrepreneurial attribute. Empirical studies of EP have hitherto been hindered by the absence of a credible measurement instrument.

The results of the study could have significant implications to our knowledge and how we work with affective dimensions of entrepreneurship.

1. *The potential cost and benefits of being affectively “up”*

Baron et al (2011) worked with the concept of Dispositional positive affect (DPA) and tried to identify its implications on entrepreneurship.

DPA is a stable psychological tendency to experience positive moods and emotions. It is known to have positive effects on a person (e.g career success, social relationships, personal health, etc), though high levels of DPA have been found to produce negative outcomes (e.g lower task performance, selective recollection, impulsivity, etc).

The study results demonstrate a curvilinear relationship between an entrepreneur's level of DPA and their entrepreneurial performance. This is, performance will increase with rising DPA, but beyond a certain point, processes that interfere with specific aspects of cognition, perception, motivation, and self-regulation kick in.

1. *A study on Opportunistic Overconfidence (OO) in entrepreneurs*

Optimistic overconfidence (OO) refers to being certain of success even when actual outcomes eventually prove otherwise. We know that entrepreneurs will generally exhibit high levels of confidence. But OO is a psychological state that can be potentially catastrophic for an entrepreneur! How then can we distinguish healthy optimism from that which blinds the entrepreneur from realities?

A study by Simon and Shrader (2011) used the new product launch processes of enterprises to try and identify what entrepreneurial actions could be associated with OO.

It was found that OO was more evident when introducing products that involved more resources and were more pioneering, and also when product market conditions were highly competitive and threatened the firm. Another interesting finding was that OO was actually negatively associated with constantly changing (dynamic) market scenarios.

1. *Examining the role of prior experience and coping strategies on an entrepreneur’s Psychological Well-Being (PWB).*

A study by Uy et al (2012) sought to understand the effect of coping strategies (active and avoidance) affects the PWB of an entrepreneur, and how prior start-up experience moderates this effect.

A key finding was that avoidance coping has a clear positive relationship to PWB of an entrepreneur where there is prior experience but negatively related for those with less prior experience.

Unit 5

# Cultural theories of entrepreneurship

# Objectives:

# As you study and work through this unit, you are expected to:

# Explain the three main theories that focus on the cultural aspect of entrepreneurship

# Discuss the utilization of theories

# Identify and associate the theories with relevance of entrepreneurship

## CULTURAL THEORIES

Entrepreneurship is the product of culture. Entrepreneurial talents come from cultural values and cultural system embedded into the cultural environment.

Entrepreneurs are considered to be the seeds of the development of industries. Entrepreneurs play a pivotal role in the process of the promotion and execution of the business. In other words, entrepreneurs are the persons who are responsible for the organizing and managing the business by the judicious utilization of the theories of entrepreneurship. The different theories of entrepreneurship are relevant for the development of the business which helps the beneficiaries to perform better. The objective of these theories is not only to enhance the skills and knowledge of the entrepreneurs but also to help them apply them in the practical world (Chakraborty et al., 2014). The entrepreneurial theories can be divided into sociological, economic and cultural aspects.

There does not exist one universal theory that can be utilized and applied by the entrepreneurs. Every individual is responsible for making cultural choices. Entrepreneurs are one of the important product of culture. It is important for the entrepreneurs to apply their cultural values within the cultural environment. Cultural theory of entrepreneurship helps to influence the stakeholders of their enterprise by instilling in their minds the importance of culture with respect to the business (Chatterji et al., 2013). The cultural theories of entrepreneurship provides a massive knowledge on some traditional and effective theories on entrepreneurship.

The three main theories that focus on the cultural aspects of the entrepreneurship are discussed below.

## Hoselitz’s theory

**Hoselitz’s Theory**

The supply of entrepreneurship is governed by cultural factors, and culturally minority groups are the spark-plugs of entrepreneurial and economic development. In many countries, entrepreneurs have emerged from a particular socio-economic class.

Hoselitz socio-cultural theory is based on the assumption that every individual is endowed with social and cultural power. According to him entrepreneurs can be developed where the society is well developed. Most of the entrepreneurs hail from a certain socio-economic class. Hoselitz centres on the concept that the culturally marginal people in the society who are considered as culturally developed and belong to a well-developed society are considered eligible for being entrepreneurs. These sections of the society stimulate the entrepreneurial and economic development (Hofstede, 1993). In this regard, the marginally cultural groups of the society include Jews in medieval Europe, Chinese in South Africa, Indians residing in East Africa etc. (Lounsbury & Glynn, 2001). The basis of Hoselitz is derived from the following viewpoint:

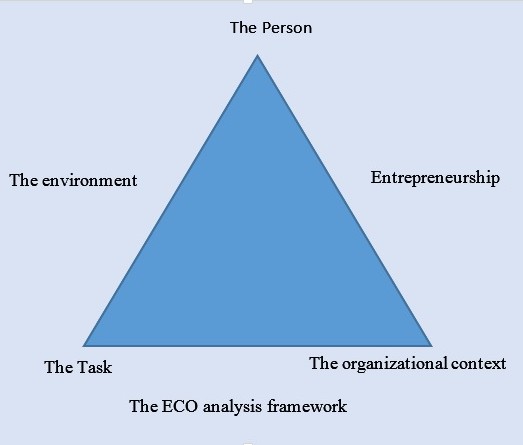
1. **Marginal men hypothesis-** Hoselitz explained that the marginal men are the pools of the development of entrepreneurs. These marginal men have the potentiality to adjust in variable situations in spite of their ambiguous social and cultural position. In the process of adjustment, they innovate their social behaviour.
2. **The importance of the managerial and leadership skills-** Entrepreneurs must possess extraordinary leadership and managerial skills which would drive them to yield profits. Hoselitz emphasizes on the fact that the managerial and the leadership skills are both necessary for the company as it would not only help to manage the company well but would also motivate the entrepreneurs to lead (Lounsbury & Glynn, 2001).
3. **Involvement of specific social classes-** The entrepreneurial talents are prevalent in every country but the persons having socio-economic backgrounds are the ones that shine in the entrepreneurial skill. One example can be drawn from India where the Marwaris and the Parsis are the leading social class in the arena of entrepreneurs (Hofstede, 1993).

## Peter F. Drucker’s entrepreneurship theory

Peter F. Drucker explained that the entrepreneurs are one that are constantly looking for new avenues to change and utilize this change as an opportunity. Drucker’s theory is based on two important factors which are innovation and resources; innovation depends on resources and resources gain importance only when perceived to possess economic value. Innovating new ideas as well as new products or any elements related to his business help him to increase his productivity. Similarly, resources like capital is important to incorporate new innovations. (Simpeh, 2011). The theory explains that there is a complex relationship between the innovation, resources and the behaviour of the entrepreneurs. Peter F. Drucker had derived three main points which help to explain the role of the entrepreneurs:

1. Entrepreneurs increase the value and satisfaction of the customer through the efficient utilization of the resources.
2. Entrepreneurs are responsible for the creation of new values.
3. Entrepreneurs must combine the existing materials and the resources (Scholte et al., 2015).

## ECO Model

[](https://www.projectguru.in/publications/wp-content/uploads/2016/06/1.jpg)

ECO analysis framework

J.J. Kao’s conceptual model forms the basis of the ECO Model. The ECO analysis is derived from three key points which are **Entrepreneurship**, **Creativity** and **Organization**. Kao had stated that entrepreneurship and creativity are derived from the interrelationship between three components which are the person, the task and the organizational context (Dacin et al. 2010).

1. The person is regarded as the most important element of this model where new ideas are implemented by the efficient persons. The entrepreneurial talents of a person include skills, motivation, experience and psychological factors (Alvarez & Busenitz, 2007).
2. The task emphasizes on acquiring opportunities, management of resources and implementing leadership qualities which are necessary for the entrepreneurial growth.
3. The organizational context is the concatenation of the creative and entrepreneurial work. For example, the organizational structure affects the entrepreneurial environment.

There is no single entrepreneurial theory that would be enough for any entrepreneur to operate in the competitive environment yet most of the theorist fail to explain different aspects of the entrepreneurship. The cultural theories are one such example where the cultural aspects are considered to motivate the entrepreneurs.

Unit 6

# Image result for www.projectguru.in - meta-analytical dimensionsImage result for www.projectguru.in - meta-analytical dimensionsMETA- ANALYTICAL DIMENSIONS

Objectives:

As you study and work through this unit, you are expected to:

* Define the exploitation and identification process of business opportunities.
* Discuss entrepreneurial alertness
* Justify entrepreneurial alertness process.

**Development**

We first present meta-analytic findings showing that personality dimensions, such as (general) self-efficacy and need for achievement, and entrepreneurial orientationarehighlyassociatedwithentrepreneurship(businesscreation and business success). We then discuss constructs that were developed within entrepreneurship research, such as entrepreneurial alertness, business planning,financialcapitalas resources, and entrepreneurial orientation, and howtheycanbebetterunderstoodbytaking a psychological perspective. Next, we elaborate how traditional psychological constructs have been utilized in entrepreneurship and howthismayenhanceour knowledge inindustrialandorganizational psychology (with respect to, for example, knowledge, practical intelligence, cognitive biases, goals and visions, personal initiative, passion, and positive and negative affect). Finally, we provide an overall framework useful for the psychology of entrepreneurship, and implications for future research.

## INTRODUCTION.

Entrepreneurship is definedastheidentificationandexploitation of businessopportunitieswithin theindividual–opportunitynexus(Shane&Venkataraman2000).Entrepreneurshipisimportant for The creationofjobs,theeconomicandsocietaladvancement ofnations,andinnovations(VanPraag&Versloot,2007).Moreover, large firmsareattemptingtobecomemoreentrepreneurialin their approaches (corporate entrepreneurship). Because of this importance, entrepreneurship has becomeadynamicanddifferentiatedresearch field(withareassuchasfamilybusiness,small business, social entrepreneurship, international/regional entrepreneurship, developmental entrepreneurship, and entrepreneurshipeducation)withits own universitydepartments ,conferences ( the Babson conference series), journals (most important, the Journal of Business Venturing andEntrepreneurship:

TheoryandPractice, and professional divisions (withintheAcademy of Management). The most important drivers of entrepreneurship research came from economics, psychology, and sociology. The scholars credited to be the fathers of the field of entrepreneurship research, Schumpeter (1934) and later McClelland (1967), took a psychological perspective, with individuals being the major objects of entrepreneurship research. This changed in mainstream entrepreneurshipresearcharoundthe year’s .1980–2005.Theapproachduringthisperiodwasto explain entrepreneurship by using economic and strategy theories (Kirchhoff 1991). More recently, scholars have once again acknowledged the importance of a psychological perspective because “entrepreneurship is fundamentally personal” (Baum et al. 2007). Entrepreneurship is considered to be a process with (at least) three phases: **(a**) the prelaunch or opportunity identification phase in which the entrepreneur identifies viable and feasible business opportunities, **(b**) the launch or development and execution phase in which the entrepreneur assembles thenecessaryresourcesforstartinga venture, and (c) thepostlaunchphaseinwhichthe entrepreneur manages the new venture in such a way that it grows and survives (Baron 2007). Psychologicalconceptsplayaroleineachofthese phases, although the individual entrepreneurship, probablymostimportantinthefirst phases, and hisorherinfluenceprobablybecomes weakerasthe enterprisegrows (althoughanorganization’sleaderneverbecomes unimportant), (Hambrick2007).Weconcentrateonapsychologicalapproachtoentrepreneurshipinthis article. We proceed as follows: **First,** we present established (meta-analytic) knowledgeon theimpact of psychologicalorquasi-psychological constructs on entrepreneurship. **Second**, we present constructs that are based in entrepreneurship research to discuss how a psychological perspective improves these constructs (an inside-out view). **Third**, we alsotaketheoppositeperspectiveanduseconstructstraditionallyusedinpsychologytodiscusshow industrial and organizational (I/O) psychology is improved when it enters the field of entrepreneurship (an outside-in view). And finally, a general model of the psychology of entrepreneurship and its implications for research is described.

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## META-ANALYTIC KNOWLEDGE ON PSYCHOLOGICAL OR QUASI-PSYCHOLOGICAL CONSTRUCTS RELATED TO ENTREPRENEURSHIP.

It may be useful to begin with a brief overview of meta-analytic findings of psychological and quasi-psychological constructs in entrepreneurship. Correlations (all effect sizes weretransformedintocorrelations) of themostrelevantconstructswithtwodependentvariables: startingabusinessandsuccessinthe business. There havebeenanumberofmeta-analyticstudies on personality and entrepreneurship (Brandstatter 2011). Although entrepreneurship research initially falsely assumed that personality research did not offer it anything useful (Aldrich 1999,Gartner 1989) argued that this changed with the advent of meta-analytic studies in entrepreneurship. The mostimportantproblemofnarrativereviewsat thetimewastheydidnotpayenough attentionto matching the relevant personality variables to the task characteristics of entrepreneurs. Once personality constructs were separated into high and low matches, the results became quite clear: The task-matched personality characteristics correlated RC ¼ with business success, and the non-matched factors correlated near zero, with RC ¼. (Rauch & Frese 2007). The same reasoning also applies to the Big Five personality dimensions. Entrepreneurship research should not rely on Big Five constructs alone. For example, the subdimensions of conscientiousness should show quite different correlations with entrepreneurship. Dutifulness should be negatively correlated and achievement striving should be positively correlated with entrepreneurship. Therefore, we suggest looking at more specific personality dimensions. For example, self -efficacy, proactive personality, and achievement motivation correlate more highly with business creation and success than do all other factors, including the Big Five or human and social capital. Onlyentrepreneurialorientation—aconceptderivedfromSchumpeter’s work—showsacorrelation ashighasthat ofpersonality.Thefactthatall thecorrelations(exceptone). It is not surprising given the multidimensional nature of entrepreneurship. It is important to note that nearly all correlations are heterogeneous, suggesting it would be useful and necessary for future research to search for moderators of these relationships.

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## ENTREPRENEURSHIP CONCEPTS CAN BE IMPROVED USING A PSYCHOLOGICAL PERSPECTIVE.

Specifically, here we discuss how entrepreneurial alertness (Kirzner 1979), business planning (Boyd 1991, Castro Giovanni 1996), financial capital (Ho & Wong 2007), and entrepreneurial orientation (Lumpkin & Dess 1996) can be improved through the use of a psychological perspective.

**Entrepreneurial Alertness;**

Entrepreneurial alertness has been defined by Kirzner (1979) as the ability to notice business opportunities without searching for them. According to Kirzner, markets are in a constant disequilibrium with local discrepancies in prices. These discrepancies are business opportunities forrealizing entrepreneurial profits. Entrepreneurs are the people in the economy who are alert to these discrepancies; they buy products when prices are low and sell them when prices are high. Through the entrepreneurial discovery of business opportunities, entrepreneurs become equilibratingforcesinan economy. Although entrepreneurialalertnessisappealingforexplainingbusiness opportunity identification, scholars have recently criticized the “fuzziness” of entrepreneurial alertness(Tang. etal.2012).InKirzner’s(1979) conceptualization,entrepreneurialalertnesshasno apriormeaningbecauseitcanserveonlyasapost hoc explanation (McMullen&Shepherd, 2006)

: People who identified a business opportunity must have shown entrepreneurial alertness. Apsychologicalapproachfocusingmoreon behavioural andcognitiveaspectshelpstoshednew light on entrepreneurial alertness. With regard to behavioral aspects, Kaish & Gilad (1991) conceptualized entrepreneurial alertness as searching for information related to business opportunities, and they found significant differences between entrepreneurs and managers with respect to entrepreneurial alertness. Although their study has been criticized for its purely behavioralapproachandthelimitedgeneralizability ofitsfindings(Busenitz 1996), it hasprovided anewperspectiveonentrepreneurialalertness,specifyingtheactionsperformedbyentrepreneurs to be more entrepreneurially alert. With regard to cognitive aspects, Gaglio & Katz (2001) conceptualizedentrepreneurialalertnessascognitiveschemata thatpromptpeopletothinkinnew and unusual ways. Thinking in new and unusual ways should help people to identify innovative business opportunities. Other scholars have proposed putting a stronger focus on basic cognitive capacities, such as general mental ability and creativity, as the foundations of entrepreneurial alertness (Baron& Ensley 2006, Shane & Venkataraman 2000). General mental ability and creativity are cognitive capacities that influence how people process information, that is, how people comprehend and make associations between information. Comprehending information and making new associations between information are central processes underlying business opportunity identification (Mitchell et al. 2007, Shane 2000). Empirical research provides support for the hypothesis that creativity (and to a lesser extent also general mental ability) also contributes to opportunity identification (Baron & Tang 2011; DeTienne & Chandler 2004; Gielnik et al. 2012). More recently, entrepreneurship researchers have suggested that neither behavioral nor cognitive aspects alone are sufficient to understand the concept of entrepreneurial alertness, thus necessitating a more integrated approach (Gielnik et al. 2012b, Tang et al. 2012). Tang et al. (2012) found that search behavior for information and the cognitive aspects of making associationsandevaluatingideaswerepositivelyrelatedtoentrepreneurs’innovativenesswithrespectto new products or services. Gielnik et al. (2012b) developed a theoretical model proposing that ajointexaminationoffactorsrelatedtoinformationprocessing(suchasgeneralmentalabilityand creativity) and information acquisition is needed to explain opportunity identification. Indeed, they found that active information search moderated the positive effect of creativity on business opportunityidentificationandproduct/service innovations. Creativity hadastrongeffectincases of high active information search but no effect in cases of low active information search (Gielnik et al. 2012). This research helps to elucidate the construct of entrepreneurial alertness by illustrating how a psychological perspective examining the joint effects of cognitive (information processing) and behavioral (information acquisition) aspects results in theoretical models with better predictive validity. Business Planning Business plans are written documents that describe the current state and presupposed future of a business (Honig 2004). They usually cover various areas, such as products/services, customers, competitors, industry, business strategy, operations, and financial projects, and include forecasts and models of future scenarios, evaluation of risks, and calculations of financial developments (Boyd1991, Castro giovanni1996). Business plans are central to entrepreneurship, as they provide legitimacy and are commonly used by venture capitalists to make funding decisions (Delmar & Shane 2004). Courses focused ondeveloping business plans are therefore often thought tobe the mostimportantpartofbusinessschoolcurriculums(Honig2004).However, there isalsoadebate ontheusefulnessofwritingabusinessplan(cf.Brinckmannetal.2010, Gruber2007).One group of scholarsevenstatedthatthereisa“dichotomouswarbetweentheneedto‘developafull-blown business and marketing plan’ and the need to ‘just get started’” (Chandler et al. 2011, p. 376). Advocates of business plans have argued that business plans have three positive functions: symbolism, learning, and efficiency (Castro Giovanni 1996). Business plans have a symbolic (or legitimating) function, as they demonstrate that entrepreneurs are committed to their business ideas because they have invested effort into specifying those ideas. The details of a plan also help to legitimate the new business because they should provide evidence that the concept is feasible and viable. Writing plansalsohelpsentrepreneurstolearn;preparingbusinessplansforcesentrepreneurs to gather information about their industries and stakeholders that contributes to both greater knowledge and better understanding of the business environment. Finally, business plans increase theefficiencyofthestart-up process. They structuretheprocess(throughgoals andplans), and they provideaframeworkthatallowsquickdecisionmakingandmoreefficientmanagementofresources (Delmar & Shane 2003). There is empirical evidence supporting the beneficial effects of business planningonpersistenceintheentrepreneurialprocess(Delmar&Shane2003,Liao&Gartner2006, Shane&Delmar2004);thereisalsometa-analyticevidenceofhigherentrepreneurialperformance with business planning, although the effect size is not very large (Brinckmann et al. 2010). Opponents of business plans have argued that business planning is detrimental because it is time consuming, hinders flexibility, and is based on insufficient knowledge about future events. According to this camp, instead of planning, entrepreneurs should instead spend their time on organizing activities, such as acquiring capital or equipment (Carter et al. 1996). Plans are often interpreted as fixed and rigid structures and thus reduce adaptability and flexibility even when environmentalchangescallforchangesinthebusinessconcept(Gruber2007,Honig2004).With regardtoinsufficientknowledgeaboutthefuture,scholarshavenotedthatbusinessplansattempt to make predictions about a future that is unknown and uncertain (Sarasvathy 2001). Given the potential negative effects of business planning, scholars have suggested alternative strategies, such as effectuation (Sarasvathy 2001), bricolage (Baker & Nelson 2005), and improvisation(Bakeretal.2003).Incontrasttoplanning(orcausationin Sarasvathy terminology), thestartingpointineffectuationisnotthegoaltobeachievedbut themeans.Therearethreebasic categoriesofmeansavailabletopeople

: The person(whoareyou), knowledge (whatdoyouknow), and other people (whom do you know) (Sarasvathy 2001). Entrepreneurs then select those effects that can be realized with the means available. Efforts to predict an uncertain future will likely fail, according to effectuation theory. Entrepreneurs should instead control the future by being opportunistic (implementing what is possible and reinforced by the environment; Sarasvathy 2001). Similartoeffectuation,bricolagemeansmakingdobyrecombiningavailableresourcesfornew purposes(Baker&Nelson2005,Bakeretal.2003).Severalstudieshaveprovided evidenceforthe usefulness of bricolage in resource-constrained and adverse business environments for making progressinthenew-venturecreationprocess(Baker&Nelson2005,Baker.etal.2003,Desa2012, Edelman & Yli-Renko 2010). Anotherstrategyis improvisation. With improvisation,designandexecutionofactions happen atthesamepoint orveryclosetoeachother (Bakeretal.2003).People donotplantheiractivities beforehand but generate ideas about what to do and how to do things on the spot. According to Baker et al. (2003), improvising entrepreneurs usually start with a rough idea, and the final businessconceptdevelopsandunfoldsovertimeinongoinginteractionswith customers, suppliers, or other stakeholders. Instead of planning, improvising entrepreneurs start by taking action and design their actions along the process of creating the new venture (Baker et al. 2003). Apsychologicalperspectiveon planning, effectuation,andbricolage/improvisationmaymake it possible to discuss these three concepts within a common framework and to develop a new approach that takes into account the advantages and disadvantages of planning. Much of the critique ofbusinessplanning focuses onthestrategic function ofplanning. Thestrategic function implies a written and formal business plan often accompanied by specific calculations, for example, break-even points. These strategic plans often rely on unclear data, thereby producing pseudo-exact calculations that turn out to be wrong given future uncertainties. By contrast, the action-regulating function ofbusinessplansislesscriticized.Action plansare mentalsimulations of actions that are not necessarily written down and that have some degree of flexibility (Frese 2009, Frese & Zapf 1994). From a psychological perspective, the action-regulating function of business plans helps initiate and maintain action (Frese & Zapf 1994, Gollwitzer, 1999). Action plans specify the when, where, and how of action and the sequence of operational steps leadingtogoal achievement. They helptoadjusttheactionstothe situation. Once anif–then action planis formed, the situationalparameterstriggertheexecutionoftheplannedaction (Gollwitzer& Sheeran2006).Furthermore, by specifyingthe sub steps, action plans structure the process and direct efforts to key activities important for goal achievement. This helps a person to return to an action pathafteradistraction.Thus,actionplansincreasepersistentgoalpursuit.Finally,actionplanswith specific sub step sallowpeopletogetfeedbackaboutwheretheystandandtomonitortheir progress and make necessary corrections. In summary, action plans help people to initiate, maintain, and evaluate the actions necessary for goal accomplishment (Frese 2009). Research has provided evidence for the beneficial effect of action planning in the entrepreneurialprocess.For example, action planningispositivelyrelatedtobusiness performance (Frese et al. 2007). Furthermore, action planning enhances the positive effects of goal intentions in the new-venture creation process (Gielnik & Frese 2013). In two separate samples, Gielnik et al. (2013) showed positiveeffectsofentrepreneurialgoalintentions on entrepreneurialactionsand new-venture creation in cases of high action planning but not in cases of low action planning. Thepsychologicaldiscussionofbusinessplanningallowsafine-grainedanalysisofthefunctions ofplansinentrepreneurship. Both advocates and opponents agree that business planshave a legitimatingfunction(Honig&Karlsson2004).Thereis disagreement, however, about whetherbusiness planseitherhelptoinitiateactionandinducepersistenceinthenew-venturecreationprocessorare awasteoftime,constrainingentrepreneurs’ flexibility.Apsychologicalperspectivehelps toresolve this issue. If business plans are formulated and developed in a way that facilitates and regulates action, they shouldpromotesuccessintheentrepreneurial process (Delmar&Shane2003, Liao& Gartner 2006, and Shane& Delmar 2004). If business plans lack these aspects, their function may be limited to only legitimating the new venture (Honig & Samuelsson 2012). Thus, it is important to consider theaction-regulating or action-facilitating function of businessplanstobetterunderstand theirroleintheentrepreneurial process. For example,therearedetailedtemplatesforbusinessplan development, and sometimespartsoreventhefullbusinessplanmaybedoneby outside consultants. Inthese cases, the regulatoryfunctionofthebusinessplanisnegligent (verylittle learning; very little impact on helping to initiate, direct, and keep on track in one’s actions), and the primary function is giving potential investors or banks a sleek business plan (legitimating function). In addition, a psychological approach allows discussing the inherent relationships between planning andthestrategiesof effectuating, bricolage, and improvising. Obviouslytherearedifferent formsofplanning.Freseet al.(2000)differentiated “complete planning, ”critical pointplanning,” “opportunistic strategy,” and “reactive approach”: Complete planning implies a comprehensive mentalrepresentationoftasks,alongtime frame, alargeinventory of signalsandknowledgeofthe taskenvironment,anticipationoferrorsituations,andaproactiveapproach.Critical pointplanning isorientedtowardthemostimportant point (localizedplan).Itincludes aniterativeplanningprocess that leaves things unplanned until action is needed. Much of what is discussed under bricolage and effectuationisinrealitycriticalpointplanningandopportunisticstrategy.Thereisapartialoverlap betweenopportunisticstrategyandbotheffectuationandbricolage.Anopportunisticstrategystarts withsomeformofrudimentaryplanningforpotentialopportunities,anditisproactive.Thismeans that entrepreneurs experiment with and develop opportunities whenever it seems to be possible. It would be useful to differentiate between effectuation as critical point planning and as opportunistic strategy.Incontrasttothethreeforms ofplanningjustdiscussed,areactiveapproachisnotproactive. Itisdrivenbyimmediatedemandsandemulation.A reactive approachcomes close toaSkinnerian shapingprocessinwhichtheenvironmentshapesthe behaviorwithoutactive input (Skinner1953). Empirical studies show consistently that the reactive approach is highly negatively related to success, whereas complete planning and critical point planning are positively related to success (Frese 2000, Frese et al. 2007, Hiemstra et al. 2006, and Van Gelderen et al. 2000). There is less empiricalworkonopportunistic planning, but unpublisheddatasuggestthatitscorrelationwith success depends upon environmental conditions. At first glance, some of Sarasvathy (2001) theoretical writing implies that by effectuation, she means the reactive approach. But this is not reallytruewhenonelooksattheempiricalstudiesmoreclosely.Forexample, expert entrepreneurs using an effectuation approach nevertheless plan how to sell their products to various segments (Dew et al. 2009). Similarly, Sarasvathy (2003) gives the example of Gillette when describing effectuation, stating that the founder “had to develop a cheap, effective removable-blade razor, generateanadequateinitial market alwaysmodifyinghisplansashegainednewknowledge.” Theseexamplesillustratethatwithinthestrategicapproachofeffectuation, entrepreneurs develop and flexibly modify action plans to implement their ideas. An action-regulating approach toward planning does not view action plans as rigid instruments but rather sees them as dependent on changes in the business environment; people should stick to their goals and flexibly change their plans to achieve their goals (Frese 2009). Thus, planning is not necessarily antithetical to effectuation; action planning and effectuation can jointly lead to goal accomplishment (V. Cha, A.Y. Ruan & M. Frese, and unpublished manuscript). Similarly, in bricolage and improvisation, entrepreneurs improvise or make do with existing resources. This means that they may lack long-term, strategic orientations, but they initiate and maintain actions to pursue opportunities and solve problems (Baker & Nelson 2005). Initiating and maintaining actions are facilitated by developing action plans (Frese 2009). Also, forming plans when using the strategic approaches of bricolage or improvisation should contribute to success in the entrepreneurial process. And differentiating between critical point planning and opportunistic approaches mayhelptopredict whether there are direct positive relationships with success (critical point planning) and whether situations moderate the fruitfulness of an opportunistic strategy. Themorecentralissueisprobablywhetherornottherecanbeano-planningapproachthatis proactive. We assume this is not so, and psychological research seems to support our conclusion (Gielnik et al. 2013c). Any effectuation needs to have some small plan of action to actually push people into action; improvisation impliesthatplanningandactingare overlapping, but againthere needs to be some kind of plan, as acknowledged by Baker et al. (2003). There can be little effectuation, bricolage, or improvisation without some degree of action planning, because without any goal and at least minimal planning, there would be no action. Financial Capital A central concept to explain success in entrepreneurship from an economic perspective is the availabilityoffinancialcapitaltostartanew business. Financialcapitalisimportantforacquiring the necessary assets in terms of equipment and raw materials, avoiding liquidity problems, and thus ensuring ongoing operations. Several studies have argued that financial constraints are amajorfactorlimitingentrepreneurship(Ho & Wong 2007) and that access to capital promotes entrepreneurship(DeMeletal.2008).However,lackoffinancialcapitalissometimesusedasan excusetoblameinstitutionsorotherexternal causesfor one’sownfailures(Naudeetal.2008).The medianstartingcapitalprovidedbyfoundersintheUnitedStateswas$22,700(1987datain1996 dollars) (Hurst & Lusardi 2004), and most entrepreneurs start their businesses with even less capital (Winborg &Landström 2001). Furthermore, research based on a nationwide representative panel study in the United States showed that neither the objective existence nor the perceptionofresourcesaffectedentrepreneurs’entrepreneurial efforts (Edelman&Yli-Renko2010). Thesefindingssuggestthatapurelyeconomicperspectivefocusingonfinancialresourcesdoesnot fully explain entrepreneurship. We argue that a psychological perspective with a particular focus on entrepreneurs’ actions complements theeconomicperspectivewithitsfocusonthenecessityof financialcapital.Research has shownthat entrepreneurscantakeactionstoovercome financial constraints by using financial bootstrapping (Grichnik et al. 2013, Winborg &Landström 2001). Financial bootstrapping involves actions to acquire resources without relying on formal debt from banks or equity financing from investors. It isusedby80–95%ofentrepreneurstofinancetheiroperations(Ebben&Johnson 2006).Financialbootstrappingcantakedifferent forms, such asowner financing(,withholding own salary, employing relatives), minimization of accounts receivable (e.g., speeding up invoicing, charging interest on overdue payment), joint utilization (e.g., owners share and borrow resources from each other), delayed payments (e.g., delaying payments to suppliers and leasing equipment), minimization of capital invested in stock (e.g., optimizing stock, minimizing inventory), and obtainingsubsidies (fromgovernmentorpublicorganizations)(Winborg&Landstrom2001). Empirically, using financialbootstrappingisaneffectivewaytoover -comecapitalconstraintsandto achievehigherventure growth (Pateletal.2011).Focusingonmentalmodels,Bischoffetal. (2013) examined how differences in nascent entrepreneurs’ mental models moderated the effect of capital constraintsonnew-venture creation. They foundthatcapitalconstraintsdidnotaffectnew-venture creation when nascent entrepreneurs had mental models similar to those of experienced entrepreneurs; there was a negative effect of capital constraints on new-venture creation only when nascententrepreneurs’mentalmodelscorrespondedtothoseofnoviceentrepreneurs.Bischoffetal. (2013) also showed how these expert mental models could be taught. These findings suggest that entrepreneurs can take actions and develop mental models to overcome financial constraints.

**Entrepreneurial Orientation**

Entrepreneurial orientation is characterized by autonomy, innovativeness, risk taking, competitive aggressiveness, and proactivity (Lumpkin & Dess 1996). The strategy literature construes entrepreneurial orientationatthefirmlevel:Atopmanager,most commonlytheCEOorgeneral director, describes the strategic stance of the firm. Firms with high entrepreneurial orientation outperform other firms because autonomy, innovativeness, risk taking, Proactiveness, and competitive aggressiveness help firms to seek and exploit new opportunities for growth (Lumpkin & Dess 1996). Indeed, research has provided meta-analytic evidence that entrepreneurial orientation and its subcomponents are highly correlated with firm performance (Rauch et al. 2009, Rosenbusch et al. 2013). Entrepreneurial orientation is a curious concept: In essence, the concept is derived from Schumpeter’s individualistic model of entrepreneurship. Moreover, the measurement is based on managers’ perceptions of their firms’ strategic stances. It assumes first that these perceptions are veridical to some extent, second that these managerial perceptions matter for the firm, and third that theyare notjust after-the-factattributions toexplainsuccessorthelackofit.Thus, itmakes sensetoexaminethisconceptwithinapsychologicalapproach(Robinsonetal.1991).Kraussetal. (2005) developed a theoretical model of entrepreneurial orientation on the level of the entrepreneur showing that entrepreneurs’ individual characteristics—in particular, autonomy orientation, innovativeness,risktaking, proactivepersonality, andcompetitiveaggressiveness—formed an individual-level factor of entrepreneurial orientation. This factor was indeed related to firm performance (Kraussetal.2005). Webelievethatthereareanumberofimportantpsychological issues related to the concept of orientation itself (is it an attitude, an action characteristic, or a personality factor?), to the question of which intervening variables play a role (moderators, mediators?) in starting a firm and making it successful, and to the causal question (does orientation lead to success, or does it follow from success?).

## PSYCHOLOGICAL CONSTRUCTS AND RESEARCH IN THE FIELD OF ENTREPRENEURSHIP

Studying entrepreneurship helps I/O psychology. First, entrepreneurship research provides new and important (and often highly objective) dependent variables, such as first sales, starting an organization,andorganizationalsuccess.Second,thesituationofentrepreneursisoftenuniquein its unpredictability, complexity, and changing demands in the course of the entrepreneurial process.Thisshows,forexample,inthecaseofoptimism.Ononehand,optimismisrequiredfor entrepreneurstobelieveinthefeasibilityandsuccessofanidea.Ontheotherhand,optimismmay havenegativeconsequencesbecauseitcanleadtooverextensionandflawedforecasts,particularly inanunpredictableandhighlycomplexsituation.Third,animportantfunctionoforganizationsis to set standards for how employees behave (there is an inherent tendency toward alignment, uniformity, andfit).Thisisnotthecase,however,intheverybeginningofanorganization—in its foundingmonthsandyears.Intheseearlystages,therearefewprescriptionsforhowthingsshould be done, and this is therefore an interesting situation for I/O psychology with many new opportunities (and often this is, of course, a source of innovation). Finally, I/O psychology researchers’ needtobeinterestedinhowtheveryorganizationstheystudycomeintoexistence—inabroadsense, any genesis of an organization comes about through entrepreneurial acts. Inthefollowingsections, we donotcoverallimportantconstructsthathavebeenstudied; rather, wefocusonthosetraditionalpsychologicalconstructsthatcanbestudiedeasilywithinthedomainof entrepreneurship because they are related to the tasks of entrepreneurs. Entrepreneurship, particularly in its beginning phases, is characterized by enormous uncertainty and a high degree of complexityin task demands(Markman2007,McMullen&Shepherd2006).Entrepreneursneedto act as inventors, investors, accountants, facilitators, organizational change specialists, leaders, technologists,marketingspecialists,andtopsalespeople.Therefore,themoreknowledgeandskills theentrepreneurisabletobringtothetable,thebetter.Moreover,therearemanyareasthatrequire action on the basis of insufficient knowledge. Additionally, the chances of success are often overestimated, because otherwise the daunting lack of knowledge and skills would stop entrepreneurs from pursuing the start-up of firms. Therefore, we focus on knowledge, practical intelligence, and biasesandheuristics(overconfidence/over optimism).Theseareallcognitivefactors.Wealsodiscuss motivational/emotional approaches that help entrepreneurs deal with their unique task situation. Specifically, we discuss goals and visions, personal initiative, passion, and affect. Cognitive Factors Knowledge. Knowledgeprovidesthecognitiveandmentalstructuresthatdeterminehowpeople perceive and integrate new information (Fiske & Taylor 1984). Mental structures provide a framework to interpret and comprehend (give meaning to) new information. In entrepreneurship, several scholarshavearguedthatinterpretationandcomprehensionofnewinformation are central to discovering new business opportunities (Mitchell et al. 2007). Shane (2000) has provided evidence that people’s prior knowledge creates mental corridors that influence the way new information is interpreted. Entrepreneurs interpreted the same information (i.e., a new technological invention) in different ways based on their prior knowledge; the different interpretationsthenledtothediscoveryofdifferenttypesofbusinessopportunities(Shane2000).This would not be surprising were it not for the fact that economics (with its assumption of equilibriums) assumes that knowledge differentials are not so important for pursuing opportunities. Entrepreneurship has been a good area in which to study the effects of knowledge and experience, aswellasofexpertise, onopportunityidentification andonsuccess. Byand large, general education is important in developing countries because there is wide variance in the schooling entrepreneurs have received, ranging from no/little schooling to college education; findings also suggest that it is less important in developed countries (Unger et al. 2011). Furthermore, specific knowledge of areas related to entrepreneurial tasks (industry and managerial experience) is more important for entrepreneurial success than general knowledge is (Unger et al. 2011). Of particularimportanceisexpertise, inthesensethatEricsson& Lehmann (1996) described it, as it leads to superior performance in entrepreneurship (Baron& Ensley 2006, Unger et al. 2009). However, in line with other research on knowledge and experience, there may also be disadvantages of experience. For example, Ucbasaran et al. (2009) have argued that being experiencedmayleadto liabilities, such asrelyingtoomuchonheuristicsanddecision-makingshortcuts thathaveworkedinthepast.Beinghighlyexperienced mayleadtoinferring toomuchfromlittle information,andatendencytobecomeconstrainedbythefamiliarsuchthatpeoplearelessableto think beyond what is known (West head et al. 2009). Similarly, Gielnik et al. (2012b) argue that experiencemayleadtoacognitivefixednessimpedingtheintegrationofnewinformationandthus hindering business opportunity identification. Knowledge provides mental models to interpret information (Fiske&Taylor1984),whichalsomeansthatexperiencedentrepreneurscanfallinto “mental ruts” (Shepherd & DeTienne 2005) with negative consequences, such as cognitive entrenchment, stereotyped thinking, and discounting of new information. Experienced entrepreneursdiscountnewinformationthatisnotconsistentwiththeir preconceptions,andtheyrelyon their past experiences even when circumstances are changing (Parker 2006). As a result, experienced entrepreneurs may refrain from using and combining new information, with detrimental effects on business opportunity identification. Ucbasaran et al. (2009) provide evidence for an inflectionpointafterwhichtheeffectofexperienceonbusinessopportunityidentificationbecomes negative. Similarly, Gielnik et al. (2012b) showed that experienced entrepreneurs benefited less from active information search than did their less experienced counterparts, supporting the argument that seasoned entrepreneurs use new information to identify business opportunities to a lesser extent than do inexperienced ones.

**Practicalintelligence**.

Theconstructofpracticalintelligencehasrecentlygained attention (Baum& Bird 2010, Baum et al. 2011). Practical intelligence encompasses knowing and doing; it reflects entrepreneurs’ experience-basedskillsandtacit knowledge easel astheirabilities toapplythese skills and knowledge to accomplish entrepreneurial tasks. This construct can be thought of as “streetsmarts” (Baum&Bird2010).Baumandcolleagues(Baum&Bird2010, Baumetal.2011) havearguedthatpracticalintelligencehaspositiveeffects on venturegrowththroughentrepreneurial actions. Practical intelligence helps entrepreneurs to make fast and accurate decisions because it encompassesknowledgeabout ideas, processes, and operationalpaths that have beenprovedtobe successful.Furthermore,practicalintelligenceprovidestheskillsandknowledgetotakeswiftactions ahead of rivals to exploit unexpected opportunities or to adopt new technologies. It also helps entrepreneurs to constantly perform actions to improve business in terms of process and product/ serviceinnovations.Practicalintelligencepromotesrepeatedexperimenting, testing,and revising of the business concept to continuously improve it (Baum & Bird 2010, Baum et al. 2011). Practical intelligenceis thus animportantpredictoroftaking fast and flexibleactionstorespondtochangesin themarketandtoachievehigherventuregrowthrates.Supportingthesearguments, research shows that practical intelligence both has direct effects on new-venture growth and predicts multiple improvement activities and their swift performance (Baum & Bird 2010, Baum et al. 2011).

**Cognitivebiasofoverconfidence/over optimism**.

Severalscholarshavearguedthatcognitivebiases are a factor that distinguishes between entrepreneurs and nonentrepreneurs or managers (Baron 2004,Busenitz&Barney1997).Cognitivebiasesarecognitivemechanismsthatassistpeopleinfast decision making (Busenitz & Barney 1997). Cognitive biases have a positive function, as they help entrepreneurstomakedecisionswithoutputtingtoomuchstrainontheirtimeandcognitiveresources andthustostayactionableinspiteofhighcognitivedemandsonnewlearningandcomplexsituations. However, cognitive biases may also lead to errors because people make less rational decisions and discount available information (Simon & Houghton 2002). In entrepreneurship, the cognitive bias of overconfidence/overoptimism has received wide attention. Overconfidence refers to entrepreneurs’ overestimation of their abilities, in particular with regard to making accurate forecasts, having higher abilities relative to others, and becoming successful (Koellinger et al. 2007). Overoptimism (or optimistic bias) is a similar construct referring to entrepreneurs’ tendency to expect positiveoutcomesortoperceiveheightenedchancesof success (Baronetal.2012, Cooperetal.1988). The interesting aspect of overconfidence/overoptimism is its controversial role in the entrepreneurial process. On one hand, scholars have noted that overconfidence/overoptimism is necessary to initiate entrepreneurial action given the uncertainty entrepreneurs are facing (Cassar 2010, Simon & Shrader 2012). On the other hand, scholars have argued that overconfidence/ overoptimismhasdetrimentaleffectsbecauseentrepreneursmakestrategicmistakesortakeontoo many tasks, resulting in overextension (Hmieleski & Baron 2009). Both perspectives have theoreticalfoundations.Motivationaltheories assertthathigheroutcomeandabilityexpectationsare positively related to performance (Van Eerde & Thierry 1996). Accordingly, it is possible that overconfidence/overoptimismincreasesentrepreneurs’ motivationto initiate action andtopersist eveninthepresenceofhighfailureratesandlowexpected returns (Cassar2010,Simon&Shrader 2012). Furthermore, entrepreneurs face many setbacks and obstacles in the entrepreneurial process, and overconfidence/overoptimism mayincreasetheiremotionalandcognitiveresilience, helping them to deal with the challenges (Hayward et al. 2010, Hmieleski & Baron 2009). By contrast, prospect theory (Kahneman&Tversky1979) suggeststhatcognitivebiasesmayleadto flawed decisions and suboptimal performance. In the entrepreneurship domain, scholars have argued that the cognitive bias of overconfidence/overoptimism may lower entrepreneurs’ perceptionsoftheriskassociatedwithastrategy,suchthattheysetunrealisticgoals,makenonoptimal decisions, or interpret ambiguous information as promising opportunities (Hmieleski & Baron 2008,Simon&Houghton2002).Thismayresultinoverentryintonewmarkets,overinvestment in and escalation of commitment to new projects (throwing good money after bad), or failure to preserve resources (cf. Hayward et al. 2010). Moreover, overconfidence/overoptimism may bias entrepreneurs in their forecasts such that they underestimate the competitive response or overestimate the demand for their products and services (Simon & Houghton 2002). The empirical evidence reflects the theoretical controversy on overconfidence/overoptimism. Several studies show that entrepreneurs have high levels of overconfidence/overoptimism in that they overestimate the probability of succeeding in an operating venture (Cassar 2010, Koellinger et al. 2007). For example, Cooper et al. (1988) examined 2,994 entrepreneurs and showed that a third of the entrepreneurs believed that their odds of success were 100%. This overconfidence/overoptimism is related to actually initiating the necessary activities to launch aventure (Koellingeretal.2007) and tothesuccessfulintroductionofmorepioneeringorradically innovative products and services (Simon & Houghton 2003, Simon & Shrader 2012). Thus, researchsuggeststhatunrealisticexpectationsintheformofoverconfidence/overoptimismmaybe an important prerequisite to entering the entrepreneurial process, particularly when the new product or service is pioneering or radically new. However, there is also empirical evidence suggesting that overconfidence/overoptimism has negative effects. Koellinger et al.’s (2007) study suggests that entrepreneurs who are highly confident have a lower likelihood of survival. Hmieleski & Baron (2009) showed that entrepreneurs’ optimism had a negative effect on their venture growth over a period of two years. Similarly, Simon & Shrader’s (2012) study revealed that overconfidence had a curvilinear relationship with subjective firm performance, suggesting that overconfidence has a negative effect onperformance after aninflection point.Finally, Lowe&Ziedonis (2006) provideevidence that overoptimistic entrepreneursaremorelikelytocontinueunsuccessfulventuresforlongerperiods of time, thus wasting valuable resources. In conclusion, theories and research suggest that overconfidence/overoptimism may have positive and negative effects on entrepreneurship. Particularly at the beginning of the entrepreneurial process, a certain extent of overconfidence/overoptimism may be necessary to make the decision to pursue a business opportunity (e.g., Cassar 2010). However, in later phases, overconfidence/overoptimism may be detrimental to performance, reducing the likelihood of survival and venture growth and leading to unjustified commitments to unsuccessful ventures (Hmieleski & Baron 2009, Koellinger et al. 2007). Thus, across different phases of the entrepreneurial process, overconfidence/overoptimism may have different effects.

Motivational/Affective Factors Motivational/affective factors have recently attracted a lot of research in the entrepreneurship literature (cf. Cardon et al. 2012). Several theoretical frameworks in this area suggest that motivational/affective factors are important antecedents of entrepreneurial action (Baron 2008, Frese2009).Inthisreview, weputaparticularfocusongrowthgoals/visions,personalinitiative, entrepreneurial passion, and positive and negative affect.

Growth goals/visions. Although goals and visions are conceptually different, we jointly discuss growth goals and growth visions because both refer to a future state (a desired end) that people seek to achieve (Kirkpatrick & Locke 1996). Goals are the objects or aims of an action, that is, intentions to achieve a certain standard within a specified time frame (Locke & Latham 2002). Goal-setting theory proved (Locke & Latham 2002) that goals have important action-regulating functions. Setting specific and challenging goals leads to greater effort and persistence and ultimately to higher performance than setting nonechallenging or unspecific goals does. Indeed, entrepreneurswhosespecificandchallenginggrowthgoalsfortheir ventures (e.g., regarding sales andemploymentforthenexttwoyears) achieved highergrowthratesoverperiodsoftandsix years.

Thesefindingssuggestthatentrepreneurs’visionsexertapositiveeffectonventuregrowththrough the employees.

Personal initiative.

Personal initiative plays a role in all phases of the entrepreneurial process. It relates to active performance characterized by self-starting, proactive, and persistent behavior (Frese et al. 1996). Self-starting means that the impetus for action comes from the entrepreneur him- or herself; the entrepreneur’s actions are less driven by other people or immediate external demands.Self-startingisthedriverofinitiatingchangesinthestatusquoordoingsomethingnew. Thus, self-starting leads to creating something new and is therefore an essential mechanism in effective entrepreneurship (Frese 2009). Ineffective business is often characterized by simply copying existing products or services without any innovative changes to these ideas. Self-starting entrepreneurs are better able to differentiate their businesses from other businesses and to create competitive advantages that should result in higher performance (Rosenbusch et al. 2011). Beingproactiveimplieshavingalong-termorientation, whichhelpsentrepreneurstoanticipate andprepareforpotentialopportunitiesandthreats.Ifsuchopportunitiesorthreatsactuallyoccur, proactiveentrepreneursarebetterpreparedandlesslikelytomisspromisingopportunities.Being proactive is key for entrepreneurship because entrepreneurs have to identify and exploit new businessopportunities(Shane &Venkataraman 2000). Furthermore, anticipating and preparing forpotentialthreatsin the processofdeveloping, launchingandmanaginganewventure allowan entrepreneur to form contingency plans with positive effects for performance (Boyd 1991). Finally,beingpersistentmeansbeingresilientandovercomingbarriersthatoccuringoalpursuit. Persistent entrepreneurs do not give up in the face of difficulties but rather solve their problems or findalternativeroutestoaccomplishtheirgoals.Because entrepreneurshiptakesplaceinadifficult and unpredictable environment, persistence is needed to overcome setbacks and to correct one’s mistakes in the development of a product, service, or organization (Markman et al. 2005). There is empirical evidence that personal initiative has positive effects on entrepreneurship, supporting the claim that active actions (showing a higher degree of active performance) are acentraldeterminantofsuccessfulentrepreneurship.Koop et al. (2000) and Krauss et al. (2005) showed that small business owners’ personal initiative was positively related to business performance. Focusing on personal initiative in the context of social networking, X.Y. Zhao et al. (2010) provided evidence that being proactive and persistent in developing social networks was associated with higher business success. One group also developed a training intervention to promote entrepreneurs’ personal initiative (M. Glaub, M. Frese, S. Fischer & M. Hoppe, unpublishedmanuscript).Theirrandomizedcontrolledexperimentshowedthatchangesinpersonal initiative led to higher business success over a period of one year.

Entrepreneurial passion.

Entrepreneurial passion is defined as an intense positive feeling toward entrepreneurial tasks and activities that are relevant to the entrepreneur’s self-identity (Cardon et al. 2009). Other scholars have conceptualized entrepreneurial passion as love of the entrepreneurialwork(Baum&Locke2004).Passionimpliesstrongfeelingsandhighmotivation.Most entrepreneurs attribute their persistence, particularly in the beginning phase of starting a firm, to entrepreneurs attribute their persistence, particularly in the beginning phase of starting a firm, to theirgreatpassion.Thus,entrepreneurialpassionshouldbeadriverandsourceofenergytowork hard, long hours with high levels of effort and persistence (Baum & Locke 2004, Cardon et al. 2009). According to Cardon et al.’s (2009) theory, entrepreneurial passion should have a motivatingfunctioninalphasesoftheentrepreneurialprocessfortworeasons: withinRussell&Carroll’s (1999) two-dimensional semantic structureofaffect, passionispleasant andactivating. Pleasant and activating feelings are a source of motivation and, thus, have an effect on people’s efforts (Seo et al. 2004). Experiencing pleasant, activating feelings creates action tendencies to move toward an object (in contrast to avoiding an object), and pleasant, activating feelings are linkedtoaphysiologicalresponsethat providestheenergeticbasisformakingactive efforts (Elliot 2006). Second, entrepreneurial passion positively affects entrepreneurial effort through goal setting (Baum & Locke 2004, Cardon et al. 2009). High levels of entrepreneurial passion should leadtosettingmorechallenginggoalsbecausethepositivefeelingassociatedwithentrepreneurial passionshouldincreaseentrepreneurs’expectationsandneedsforbeingsuccessfulintheactivities relatedtothatpositive feeling (Cardonetal.2009, Seoetal.2004).Asaconsequence, passionate entrepreneurs should set high goals because they would not be satisfied with achieving only low or medium goals (Locke & Latham 2002). Additionally, entrepreneurial passion should lead to higher levels of goal commitment. There is empirical evidence for a positive effect of passion in the postlaunch phase of the entrepreneurial process as well (Baum & Locke 2004, Murnieks et al. 2012). However, it is also important to note that entrepreneurial passion may be an outcome of entrepreneurs’ actions. Some scholarshavearguedthatentrepreneurs’effortsmayincreaseentrepreneurialpassion(M.M.Gielnik, A.Schmitt,M.Spitzmüller,D.K.Klemann&M.Frese,unpublishedmanuscript).Basedongoalsetting theory (Locke & Latham 2002) and self-perception theory (Bem 1972), they have hypothesizedthathigheffortleadstogoalachievementandhighself-perceivedeffort,whicharetwo mediating mechanisms in relationshipbetweenentrepreneurial effortandpassion.Thegroup found support for their hypothesized effectofeffortonentrepreneurialpassion(M.M.Gielnik, A. Schmitt, M. Spitzmüller, D.K. Klemann & M. Frese, unpublished manuscript). Hence, future research should examine the potential virtuous cycle of entrepreneurial passion and effort.

Positive and negative affect. Affect (including feelings, moods, and emotions) is a hot topic in entrepreneurship (Cardon et al. 2012). Baron et al. (2012) focused on positive affect and argued that positive affect has positive effects on cognitive performance, accuracy of perception, task motivation (see also the section on entrepreneurial passion above), and self-regulation. They further argued that this relationship, however, is curvilinear such that positive affect has positive effects up to an inflection point beyond which the effects become negative. Beyond the inflection point, positive affect is associated with costs, such as increased susceptibility to cognitive errors, inappropriate long-term goals, or increased impulsivity. Research findings support the hypothesizedpositiveeffectsofpositive affectt inentrepreneurship: For example,positiveaffectinfluences the introduction of product/service innovations through creativity (Baron & Tang 2011). Moreover, positive affect positively influences effort on entrepreneurial tasks beyond what is immediately required for the start-up (Foo et al. 2009). Likepositiveaffect, negative affectmayhaveapositivefunctioninentrepreneurship.Basedon control theory (Carver & Scheier 1990), Foo et al. (2009) argued that negative affect serves as information that progress toward the goal is inadequate and slower than expected. This should promptentrepreneurstoinvestmoreeffortintotasksthatareimmediatelyrequired.Theauthors’ diary study provided support for this positive effect of negative affect (Foo et al. 2009). Furthermore, Foo (2011) also showed that negative affect in the form of anger may have positive effects for opportunity evaluation. Anger is associated with appraisal tendencies of high confidence and control, thus leading to lower risk perceptions and more positive opportunity evaluations (Foo2011).Itwouldbeinterestingtoexaminewhetherpositiveaffectandnegativeaffect interact as described by the affective shift model advanced recently in the areas of creativity (Bledow et al. 2013, George & Zhou 2002) and engagement (Bledow et al. 2011). These studies suggestthat thecombinationofnegativeandpositiveaffectisimportant.First, negative affecthas to be present, and second, it needs to be reduced; the result is then a much higher degree of creativity and engagement than that produced by positive (or negative) affect alone.

Conclusion We have selected psychological constructs and shown how they can help both to broaden our understanding of the entrepreneurship process and to develop a fuller picture of I/O psychology. That understanding should include how organizations come into existence, how individuals and small teams of entrepreneurs affect the economic conditions of societies, and how actions in the specific situation of entrepreneurship are developed. The fascinating part of entrepreneurship is notjustthatitisahighlycomplex job, but thatthejobchanges its taskstructureindifferentphases of the entrepreneurship process. The first phases present a different task structure than the postlaunch phase; therefore, there are a number of interesting relationships, both between the individual and the task structure and between individuals within start-up teams, which have not beenstudiedmuch.Also,thestrongactionorientationofentrepreneurshipmayallowresearchers to examine a number of hypotheses that cannot be studied in established organizations, such as the relationship between strong individuals and how some individuals may dominate groups of entrepreneurs, how organizational cultures come to be developed in firms, what changes happen duringthesevariousphases,orhowindividual andorganizationalcharacteristicsinteractwiththe environment to produce positive and negative effects for entrepreneurs and their firms.

## A FRAMEWORK FOR THE PSYCHOLOGY OF ENTREPRENEURSHIP

Instead of a lengthy summary of the research presented above, we present a model that is largely basedonearlierworkofourgroup—theso-calledGiessen-Amsterdammodelor, as wenowcallit more descriptively, the action-characteristics model of entrepreneurship. It is aworkingmodel, because wethinkthatresearcherscanadjustittotheirspecificareasofinquiry; further, it is a loose model in the sense that additional constructs can easily be added or deleted depending upon our current state of knowledge. For the sake of completeness, we have included variables in this model that we did not discuss above; a major reason for leaving them out of the above discussion isthatitisorganizedalongtheissueofhowentrepreneurshipcanlearnfromI/O psychologyandviceversaandtheknowledgedevelopedviameta-analyses.Therefore, we omitted a number of constructs that have already been studied in the psychology of entrepreneurship. Obviously, the model is more of a framework than a real theoretical model. However, it offers several hypotheses to inform the area of the psychology of entrepreneurship. First, the model puts action characteristics at center stage. There are no direct paths hypothesizedtoentrepreneurialsuccessexceptfromactionandactioncharacteristics.Itmaybesurprising tomanypeoplethatwedonotexpect apart fromtheenvironmenttoentrepreneurialsuccess, but this reflects the idea that action is of basic importance. If the environment is not affecting action characteristicsorifitisnotmoderatingtheeffectsofactioncharacteristics, thenwehypothesizeno effect. Similarly, personality, motivation, education, and cognitive factors do not affect success directly but only indirectly through the entrepreneurs’ actions.

PERSONALITY MOTIVATIONAL/AFFECTIVE ANTECEDENTS

Passion

Positive/negative affect

Entrepreneurial orientation

Need for achievement

Loss of control

Autonomy

Generalized Self-efficacy

Innovativeness

Stress tolerance

Risk taking

The action-characteristics model of entrepreneurship (Frese 2009).

Second, actioncharacteristicsareatcenterstageinallphasesofentrepreneurship, whichleads totheideathatdifferentactioncharacteristicsareimportantindifferentphases.Inthefirstphase, taking action is important for identifying and developing a business opportunity (Dimov 2007). Entrepreneurs who come up with a business idea have to gather feedback and seek additional informationtomodify, shape, andrefinetheideasuchthatitbecomesaviableandfeasiblebusiness concept (Dimov 2007). In this phase, the product or the service has to be actively built. In the secondphase, entrepreneurshavetoperformseveralstart-upactivitiestoestablishviablebusiness structuresandoperational procedures (Gartner1985).Thesestart-upactivitiesincludeacquiring the necessary resources and equipment, fulfilling legal requirements, and developing marketing and sales strategies; furthermore, an entrepreneur has to test whether the product/service can attract buyers (Reynolds 2007). Entrepreneurs who are more active in this phase, that is, who perform more start-up activities and who spread those activities over time, are more likely to successfully start a new venture (Carter et al. 1996, Lichtenstein et al. 2007). In the third phase, entrepreneurs have to take the necessary action to manage survival and growth of the new company. Important actions are, for example, handling conflicts, negotiating contracts, forming alliances, developing new business strategies, and so forth (Baron 2007). The construct summarized under action characteristics is not action sparse, but rather ways of performing an action. It may help to provide an example here: Any action is accompanied or followed by feedback. However, there are large differences in how feedback is processed and developed.Someentrepreneursdevelopanumberoffeedbacksystems,inwhichtheygetfeedback frompotential customers, they askmore questions, and theyattempttousewhateverunobtrusive feedback exists. Some entrepreneurs also actively encourage critiques and negative feedback in order to learn to improve their products/services. All of this determines how effective feedback is.

## Entrepreneurship and Regional Economic Growth; Towards

A General Theory of Start-Ups Thomas Gries1 and Wim Naudé2 August 2008.

Start-ups of new firms are important for economic growth. However, start-up rates differ significantly between countries and within regions of the same country. A large empirical literature studies the reasons for this and attempts to identify the regional determinants of start-ups. In contrast, there is a much smaller theoretical literature that attempts the formal modelling of the start-up process within a region. In this paper, we attempt to contribute to this small literature by introducing a general theoretical model of the entrepreneurial startup process. The model links start-ups to economic growth and can be applied to understand growth in a regional context. We derive five propositions that fit the stylized facts from the empirical literature: (i) growth in the regional economy is driven by an expansion in the number of start-up firms that supply intermediate goods and services; (ii) improvements in human capital will enhance the rate of start-ups; (iii) improvements in the relative rates of return to entrepreneurs and business conditions will raise start-up rates; (iv) an increase in regional financial concentration will reduce the start-up rate in a region and; (v) increased agglomeration/urbanization in a region has an a priori ambiguous effect on start-up rates.

Entrepreneurship, the ‘process of starting and continuing to expand new businesses’ (Hart 2003: 5) is important for economic growth and development (Naudé 2008; Baumol et al. 2007; Schramm 2004).2 Substantial resources are devoted in developed as well as developing countries on raising the rate of entrepreneurship (Blanchflower and Oswald 1998: 27). The rate of entrepreneurship can be measured statically as the self-employment rate or dynamically as the start-up rate of business firms (Wennekers et al. 2002: 29). The start-up rate is increasingly seen as important, if not more so, as the growth of existing firms. They are more likely to grow (Lingelbach et al. 2005; Johnson et al. 2000), to create new jobs (Audretsch et al. 2006: 25; McMillan and Woodruff 2002: 166), and to promote new and flexible organizational forms (Kim et al. 2006: 20). In many transition countries, where there were no significant private sectors to start out with, new firms often strengthened reforms by improving economic conditions (McMillan and Woodruff 2002: 153). It is therefore understandable that many countries and regions devote increasing resources towards raising the rate of start-ups. It is however the case—and here the empirical evidence is fairly robust—that start-up rates of new firms differ significantly between countries and even between different regions of a country (Reynolds et al. 1994; Tödtling and Wanzenböck 2003; Stam 2006; Naudé et al. 2008). Given the relationship between entrepreneurship and employment creation (Fonseca et al. 2001) this difference in regional start-up rates can be an important reason for regional disparities (Naudé et al. 2008). A large empirical literature attempts to identify the determinants of start-ups, most of this focusing on the regional context. In contrast, there is a much smaller theoretical literature which attempts the formal modelling of the start-up process. Existing models aim to explain various aspects or obstacles of start-ups such as start-up costs (Fonseca et al. 2001), firm growth and size dynamics (e.g., Lucas 1978; Jovanovic 1982), credit constraints (e.g., Banerjee and Newman 1993; Evans and Jovanovic 1989), and exit decisions (e.g., Bosma et al. 2005). A general theory of entrepreneurial start-ups, and the effect that these might have on regional economic growth, is however still lacking. In this paper, we attempt to fill this gap, by formulating a theoretical model of the entrepreneurial start-up process. The model is a dynamic, non-linear model in contrast to many studies which have used linear models to empirically predict new firm births or introduce borrowing constraints in a homogeneous linear form (Reynolds 1993: 19; Mesnard and Ravallion 2005: 3). A further novel aspect is that we link start-ups to regional output growth in our model—an aspect that is paid scant attention in the theoretical literature. We derive a number of propositions and testable hypotheses from our model.

There are many different views on the nature of entrepreneurship. Wennekers and Thurik (1999: 30) identifyThere are many different views on the nature of entrepreneurship. Wennekers and Thurik (1999: 30) identify thirteen distinct roles of an entrepreneur. More commonly, however, and for purposes of this paper, entrepreneurship is seen as involving either/or risk-taking, innovation, arbitrage and coordination of production factors in the start-up of a business. (Fogel et al. 2006: 542). 2 According to Iyigun and Rodrik (2004: 1-2) ‘a key obstacle to growth in low-income environments is an inadequate level of entrepreneurship in non-traditional activities’.

The determinants of start-ups

In this section we provide a brief review over the literature on the regional determinants of entrepreneurial start-ups. The purpose is to identify the main determinants of startups. In the next section we build on this literature by formalizing start-ups in a general endogenous growth model. At the outset it should be noted that most empirical studies on the determinants of startup rates make use of regional data within a particular country, because comparisons between countries are often difficult due to non-comparable data and definitions (Reynolds 1993). One can distinguish between studies that attempt to identify macro level constraints or determinants, those focusing on industry level and firm level, and those that attempt to test the predictions from theoretical models on the relationship between wealth, inequality, credit market constraints, and entrepreneurship. On a macro level, evidence tends to suggest that macroeconomic conditions such as the state of employment, GDP and inflation, and interest rates matter. Highfield and Smiley (1987) empirically analysed the determinants of start-ups in the USA over the period 1948 to 1984, using rates of incorporation as an indicator of start-ups. They found that on a macroeconomic level, five factors were significant in affecting start-up rates: real GNP growth, expenditure on equipment (investment), the unemployment rate, real interest rates and inflation. Wang (2006) finds that in Taiwan production costs, capital costs, and unemployment are significant determinants of start-up rates. Bosma et al. (2005) using data for the Netherlands over 1960 to 1999 find that unemployment is statistically significantly associated with higher start-up rates. Macro level conditions will apply to all regions in a country, but will have different spatial implications to the extent that economic activity agglomerates, and to the extent that industry level composition and dynamics will differ across regions. Reynolds (1992) found that industry level characteristics such as industry profits and entry barriers affect start-ups rates. Reynolds (1993) and Reynolds and Storey (1993) identified six broad determinants of entrepreneurial start-ups in a region, namely demand (measured by the size of the population and size of the economy), urbanization (agglomeration), unemployment, personal household wealth, specialization (industry level differentiation), and government spending on infrastructure, education, and health.

The model Most of the studies into start-ups as surveyed in the previous section have focused on particular determinants or obstacles to start-ups. They have also, despite the fact that most empirical studies of determinants have made use of regional data, not explicitly considered the regional (spatial) dimensions of the decision to start up a firm. In the model that we set out in this section, we attempt to address these shortcomings by constructing a general model that explains the most salient determinants of start-ups, and by incorporating a regional (spatial) dimension. The latter is based on the notion that when different regions (space) of a country are introduced into a model, it allows for space to permit regional monopolies of products and services to come into existence, wherein entrepreneurs can fulfil the functions of creating (innovating) new goods and services and imitating goods and services from other regions (arbitrage/disequilibrium). Thus our entrepreneur acts according to both the Schumpeterian and Kirznerian notions of entrepreneurship.

Aggregate production process in the region. In this model entrepreneurs start up small firms which we assume supply intermediate goods to a final goods sector. Intermediate goods include activities such as services, maintenance work, craft and trade, transport and logistics, commerce activities, and engineering. These small firm activities are local, and offered to the local producer of the final product. In treating start-ups as providers of intermediate goods, our model is related to that of Ciccone and Matsuyama (1996) who show that if a particular (regional) economy produces a limited range of intermediate goods, the final (consumer) goods sector will be characterized as ‘primitive’ in production methods and will have little demand for sophisticated, new inputs. This will lead to lower incentives for potential entrepreneurs to start-up new firms. The economy can get stuck in such an underdevelopment trap with primitive production in its (small) modern sector. They also point out that there might, in such an ‘underdevelopment trap’ be a case for assistance to new start-ups since these can provide both pecuniary and technological externalities if they start producing new intermediate goods—which will induce final good producers to demand more of these (which will improve the incentives for other entrepreneurs to start up firms due to greater demand and the example provided in the application of new technology). In their model, as in ours, start-ups face positive start-up costs which include the costs of developing a product variation and all other cost of bringing a new good to the market.

Unit 7

# IMPORTANCE OF SYSTEMS THINKING IN ORGANISATIONS TODAY

# As you study and work through this unit, you are expected to:

# Define systems thinking

# Identify different models that describe systems thinking

# State the difference between internal and external environmental factors in a system.

# Discuss the interdependence of different systems in an organization

In contemporary dynamic business scenario, the inter-dependence of organisations and influence of external & internal environmental factors on trade and organisational practices has intensified manifolds. The resulting complex trade and financial practices and enhancing intersection between various global economies warrants more complex organisational structures.

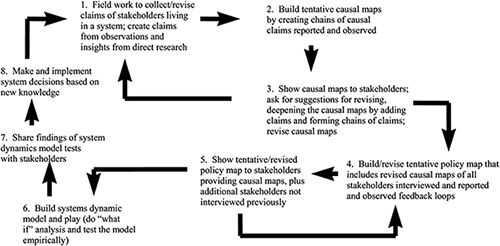
**Need for systems thinking as a model**

The demand for newer structures require systematic skills that are competent enough to provide suitable advises of organisational management. It is high time that organisations go beyond the linear perspective of models and algorithms for business operations. Managers need to develop the art of proactive thinking which will enable them to intuit about circumstances and make rational plan of actions rather than classifying the events as per pre-determined linear patterns of thinking. In other words, managers need to widen their horizon and plan what is possible in future and how emerging phenomenons can be tackled to leverage benefits. The top management of the companies need to adopt a preemptive approach towards planning of organizational activities in purview of business environment. This is possible only through continuous and righteous deciphering of continuous change and making swift moves to be able to cash on the opportunities. Thus arising and also combating threats, if any (Dominici, 2012). This strategic thinking process from a holistic perspective and seeking lessons from mistakes of the past is known as “systems thinking”. Apart from business complexities, the ever-changing consumer behavior theories like hedonistic consumption, consumer culture, consumer identity project etc. also build pressure for “out-of-box” thinking and management techniques. Also, to be better equipped for alarmed emergencies and ensure long-term sustainable competitive advantage. There is an ardent need for thnking beyond linear business decision making models and adopting systems thinking (Dominici and Levanti, 2011).

## Applying systems thinking model

Systems thinking can be understood as the capacity of viewing things holistically encompassing all types of different inter-relationships between the existing elements in a complex system. Senge (2010) defined it as, “Systems thinking is a sensibility – for the subtle inter-connectivity that gives living systems their unique character”. Systems thinking perceives the world as systemic with emergence and inter-connectivity being the founding rocks. Systems thinking is instrumental in developing a simplified thought process which is a prerequisite for effectual accomplishments in the prevalent complex world. However, systems thinking is more layered than the mere usage of “casual loop diagrams”. In fact, it instigates a model conceptualization. Managers can utilize systems thinking to be able to view a clearer, better “larger picture” without segregating the phenomenon based on functional orientation  (Flood, 2010).

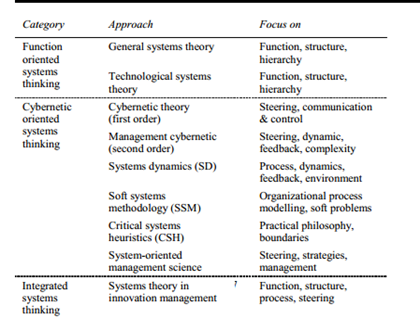
The vital tool for systems thinking is computer software programs which enable integration of learning pertaining complex team interactions and business interactions. Following is the diagrammatic representation of adoption of systems thinking in research prior to decision making.

[](https://www.projectguru.in/publications/wp-content/uploads/2014/04/xc.png)

Adoption of systems thinking. Source: Woodside,(2006)

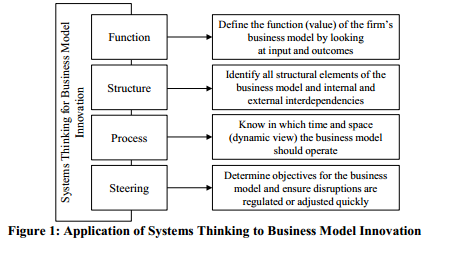
## Approach to systems thinking in entrepreneurship

There are many approaches for systems thinking which help managers to take better researched and structured management decisions. Following is the tabular presentation of the various approaches.

[](https://www.projectguru.in/publications/wp-content/uploads/2014/04/sy.png)

Adapted from: Halecker and Hartmann (2013)

In the present competitive business landscape, innovation is the key to sustainability. Halecker and Hartmann (2013) advocate systems thinking for business model innovation. Following diagrams clearly explains the impact of systems thinking:

[](https://www.projectguru.in/publications/wp-content/uploads/2014/04/sas.png)

Impact of systems thinking. Source: Halecker and Hartmann (2013)

Thus, it can be concluded that systems thinking is a formidable means of rational thinking which can be invigorated in multiple economic endeavors to device newer ways of confronting challenges and strengthens the business understanding of the managers. This is possible through radical re-engineering initiatives and positive support of the top level management.

Concentration of market power in financial markets.

Concluding remarks.

Start-up rates differ significantly between countries and within regions of the same country. A large empirical literature studies the reasons for this and attempts to identify the regional determinants of start-ups, and the obstacles or impediments to start-ups across different regions. However, the theoretical literature which attempts the formal modelling of the start-up process within a region and its impact on regional growth is much smaller. In this paper, we try to contribute to this small literature by introducing a general endogenous growth model of the entrepreneurial start-up process. The model links start-up frictions to economic growth and can be applied to understand growth in a regional context. Our model has two crucial ‘foundational’ assumptions. We assume that when spatial considerations come into play, alert entrepreneurs can identify region specific opportunities and by utilizing these become local monopolists. In doing this they can imitate technological innovations from other regions, or innovate. We also assume that these entrepreneurs are especially active in supplying intermediate goods and services to final good producers. This distinction has been shown in the literature to be important to link entrepreneurs with qualitative and structural economic change in a region. It allows us to relate increases in the number of start-ups (which correspond to greater diversity in intermediate goods) to increases in economic growth. As in basic models of entrepreneurial occupational choice, access to finance plays an important role in our model. We generalize our model to include other constraints by linking these to the availability of finance. Thus for instance our model is able to show, as in Fonseca et al. (2007), that higher start-up costs reduce start-up rates through a capital market effect. As the start-up costs need to be financed, the access to external finance becomes important. Even if the financial intermediation is called sometimes ‘bank’ in this model, it is easy to think of other lenders (even the Mafia) to the start-up entrepreneur. The important issue addressed is that there is market concentration and hence inefficiency in the financial sector. Further, we derived propositions that education, the relative opportunity costs of being an entrepreneur, and the business environment are positively related to start-ups. We also show that agglomeration (urbanization) is ambiguously related to start-ups, and that regional financial concentration will have an adverse impact on start-ups. In this latter regard, we are one of a few models concerned about the impact of financial sector concentration on regional economic development. We set out to provide a basic general theoretical model that could account for the startup process in a manner that allows for regional distinctions. Further extensions could include linking it to the structural economic transformation experienced by economies as they develop (so that start-ups not only influence the economic growth rate, but also the structural composition and rate of urbanization in the economy), by allowing for growth in firm sizes, and to model the process of firm exit.

“What separated the modern schools of economic theory from one another was largely nothing more than a matter of language and style.” L.V. Mises(2001), INTRODUCTION For any economic theory, it is important to focus on what questions the theory is designed to answer and what tools are being used to answer them. When the concept of entrepreneurship is used in economics, the purpose of analysis is mainly to explain (i) how the market system works and (ii) the various kinds of income -especially profit- and their relation with entrepreneurship. Entrepreneurship is always linked with profit, and the main emphasis of this paper will be on the part played by the entrepreneur in economic process.

Even though there are several approaches to entrepreneurship, to profit and to functions that the entrepreneurs provide in the market process, this paper will focus on the ideas of the Neoclassical Theory (in general, the ideas of Marshall), the Schumpeterian approach, and mainly the Neo-Austrian theories of entrepreneurship (Kirzner). In analysing entrepreneurship, Marshall mainly tries to explain how markets reach to equilibrium under the assumption of perfect competition and does not give each individual manufacturer a specific role in terms of innovation or change. Many small size firms compete, and, in equilibrium, there is no excess profit is earned by each firm. The model fails to explain profit and how changes and innovations occur in a capitalist economy and ignores the role of creative entrepreneurs’ effects on economic development. Schumpeter rejects the equilibrium analysis and he believes that human economic development is the history of continuous creative destructions by entrepreneurs. The entrepreneur is an innovator, not an imitator in the production and, as an innovator, naturally he is monopolist. Since economic progress comes from innovations, innovator monopolist should be protected and entrepreneurship should be encouraged. Kirzner's entrepreneur is an alert arbitrager and competition between alert entrepreneurs helps the market clearing process. Economic agents have different information and knowledge and this difference creates opportunities for entrepreneurs to exploit them and cause market to go equilibrium. He believes that in the markets the tendency towards a single price is continually interrupted- but continually resumed. In this paper, each of the above indicated approach to entrepreneurship will be critically analysed and at the end some implications-regarding regulations- will be discussed.

## MARHALLIAN APPROACH TO ENTREPRENEURSHIP

The Neo-classical theory and thereby the Marshallian analysis tries to explain equilibrium conditions in the markets under the assumptions of perfect knowledge and information, perfect competition (existence of many firms), existence of homogenous goods, and free entry and exit. Marshall's main concerns and at the same time goal is to show that markets clear under the perfect competition assumptions and there are no excess profit opportunities and hence there is no exploitation of labor in production process since everyone earns his marginal contribution to production and national income. However, while he analyses zero profit equilibrium conditions, at the same time he has to explain without profit incentives how change and progress occurs and what leads producers to innovate or develop new production methods and techniques. To answer this question, Marshall uses small changes (innovations) in the market process by many small competitors and confusingly indicates that large scale production is essential for economic progress and economic innovation. Marshall1 stresses the cooperative relationship between capital and labor based on the principle of partnership. The producer obtains his dominant position in the production process due to his superior managerial abilities. Hence this superior ability is the reason that producers get more of the income: their contribution to national income is greater than the labor. According to Loasby (1982), Marshall analyzes the normal running business as entrepreneurship, but he recognizes that some businessmen are much more enterprising than others. He does not make this distinction because he does not want to further analyse the difference between a stationary state and the evolving economy and "...he regards the formal analysis of a stationary state as a potentially misleading guide to the study of economic progress." (p.235) Thus, in the Marshallian analysis, the firms have to organize their production and marketing functions in an evolving economy which is an environment of uncertainty and change. Producers face the uncertainties in various ways: • Estimating the pattern of consumer preferences and technologies available to meet them; • Anticipating the actions of rivals; • Developing techniques to respond to changes in consumer preferences, to the emergence of new technologies or to new entrant firms. Marshall attempts to deal with all of these issues. In Marshall's analysis (1947, p.297), the successful entrepreneur who produces for the market, as a merchant and as an organizer of the production has true knowledge of the things in his own trade. He has the ability (i) of forecasting the movements (changes) of production and consumer preferences, (ii) of seeing new opportunities for supplying new goods or services that either will meet the demand or improve the plan of producing an old commodity and most importantly being able to take risk. Loasby (1982) calls the Marshallian competition as a "Hayekian discovery process" Loasby states that, according to Marshall, the advantage of having many firms in an industry was not that they should facilitate perfect competition, but they should be different so that they would discover different things. Thus, the formal assumptions of perfect competition (firms are similar and many, they produce homogenous goods and are price takers) destroy Marshall's analysis. In summary, Marshall tries to explain economic progress- like Austrian economists (Kirzner) try to explain today, in terms of the numberless small improvements in productivity and in the range of quality of products available. In Kirzner's analysis of entrepreneurship, the disequilibrium is corrected by alert entrepreneurs who produce and exchange, but the emphasis is on the exchange opportunities and progress comes mainly from this part. Unlike Schumpeterian analysis, in Marshallian theory the progress does not depend on "great man" but it does depend on many men. There are important problems in Marshall's analysis that create controversy in his own model: • The manufacturer producing for the general market who is supposed to be represented by the perfectly competitive firm of the standard theory and in this, there is no introduction of neither new products or new methods, Marshall states that "...a characteristic task of modern manufacturer is that of creating new wants by showing people something which they have never thought of having before; but which they want to have as soon as the notion is suggested to them." (p.280) In this statement, Marshall is contradicting with his competitive market theory by indicating that creating new products and technologies the entrepreneur will have monopoly power and earn monopoly rents in that market unless everybody in the market have same technology and will produce same good as efficiently at the same time and start to sell at the same time. • Marshall gives role to his entrepreneur to anticipate the actions of his rivals. If the market is perfectly competitive and for each firms the market price is given, then there is no need for each firm to anticipate the actions of the other firms since their production decisions does not affect the market price. • In Marshall's treatment of economies of scale, the economies themselves are related to knowledge and change: the law of increasing returns implies that an increase in inputs (L, K) improves the organization of the production, which increases the efficiency of these inputs. Thus the advantage of large scale is that it leads to innovation, not only in technology but also in products. If this is true, then the accumulation of capital leads concentration in the market and this leads existence of imperfect market competition that we in reality have. • In Marshallian analysis, manufacturers produce for the market getting zero profits but it is not clear what stimulates these people to be producers instead of -say- labour. Thus there is no explanation for profit Entrepreneurship and profit disappear from theory which formally excludes exchanges." (Loasby, 1982) As a result, we see that Marshallian analysis has its own controversies to explain equilibrium conditions and is not able to explain the market process that gives accurate explanations about the role of entrepreneur and how profit is explained.

## SCHUMPETER: CREATIVE DESTRUCTION

Schumpeter (1991) defines entrepreneur as someone who establishes a new business to produce a new product or to make an old product in a new way. In his work, the entrepreneur takes the center stage of socioeconomic development. He takes the role of socioeconomic leader since he has the ability to decide, to direct, to push matters through. The Schumpeterian entrepreneur differs from imitators in applying new methods of production on the market, in opening up new markets. This creative ability differences gives entrepreneur a chance of accumulation of a surplus but this eroded as imitators appear in the market using same methods. Thus, the temporary monopoly profits made by the entrepreneur shows the dynamic of the capitalist system and also show that each cycle of innovations by entrepreneurs is the main cause of business cycles. He sharply differentiates himself from Marshallian-Neoclassical theories of economic development and growth. While, in the Marshallian analysis, small contributions from a very large number of modest entrepreneurs lead economic progress, Schumpeter's entrepreneur plays the role of a revolutionary in creation of new production functions and methods. Thus, entrepreneurs create disequilibrium and this creative destruction is possible only under capitalistic system. He states that "Capitalism...is by nature a form or method of economic change and ...never could be stationary." (1942, p.82) As a result, unlike Marshall and Kirzner, he believes that due to capitalist system's dynamic nature the neoclassical general equilibrium model could never apply to capitalism. Schumpeter does not define those who are imitators or those who simply recognize and respond to the new situations as entrepreneurs unless their responses consist of forming new firms to create new innovations. In this sense, his definition of entrepreneurship and explanation of economic progress in a capitalistic system differ from the Kirzner's explanation as we will see below. Schumpeter would not see Kirzner's alert arbitrager as an entrepreneur. In contrast to Marshall, Schumpeter's analysis progress does depend on the "great man" and as an innovator, economic and social leader the entrepreneur by definition is a monopolist. Since the entrepreneur is the engine of the economic progress in the capitalist system, monopolies should be encouraged to lead to new innovations. The entrepreneurship ability is scarce and the business of entrepreneurs is too risky. Since they undertake the economic activities that lie outside of the routine tasks and they do these under the social and economic resistant environments their activities should be encouraged, some protection should be provided and to reduce the risk they take. Entrepreneurial risk and uncertainty are reduced by large scale enterprise and restrictive practices such as patents. Thus the reward of innovations and taking entrepreneurial risky activities is profit. The profit for Schumpeter is the result of innovation and also the inducement to innovation and only the capitalist system allows the successful entrepreneur to take profit. With his analysis unlike Marshall, Schumpeter is able to explain how the system works and where the profits come from. There is some criticism against Schumpeter's creative destruction theory: • Schumpeter puts all the responsibility of innovations on the shoulders of 'great man'. However, if innovations and the act of pushing them through commercially are carried out not by individuals, but by a generation, then the contrast between the leader and imitators irrelevant. • What about those who have tried but have not succeeded? Recently, in the U.S. and in Europe, some economists and legal authorities discuss whether Microsoft has broken anti-trust laws and try to answer whether it should be regulated. Economists mostly cite Schumpeter's idea about innovation and argue that Bill Gates is a Schumpeterian innovator and for destructive creation sense the Microsoft should not be tried. Marz, known for his research about Schumpeter, indicates that Schumpeter's innovator as an economic and social leader does not care much about economic profits and only joy he gets from being an innovator and being a server to his society. Marz (1991), states that "Schumpeter ...hardly denied that the process of accumulation is the ladder to social power and social prestige; but he thought the very mainspring of the exercise of the entrepreneurial function is the powerful will to assert economic leadership. The joy of carrying through innovations is the primary motive, the acquisition of social power a subsidiary to it." (p.24-25). To decide whether Bill Gates, in Schumpeterian sense, is an innovator, we have known his motivations. Even though as an individual who seeks his own interest before anybody else, Bill Gates as an innovator and monopolist should be protected and encouraged in Schumpeterian sense.

## KIRZNER'S "ALERT" ENTREPRENEUR

While in Neoclassical analysis (Marshall) the main focus is the conditions necessary to sustain an equilibrium, and Schumpeter's focus was to explain the progress in capitalistic system by using innovator entrepreneur's destructive creation, Kirzner- representing the Neo-Austrian approach to entrepreneurship- focused on answering the question of whether a market economy works and, if it does so, what the process that leads the economy towards an equilibrium is. Kirzner claims that initially the economy is in disequilibrium and the competition among 'alert' entrepreneurs leads to equilibrium. Unlike Neo-classical economists, Kirzner realizes that markets are not always clear, there is no perfectly informed representative agent and for change the entrepreneurs need incentives and this incentives comes from the difference among agents in terms of information and knowledge. In order to explain his model, Kirzner benefits from Mises' “profit seeking and speculating entrepreneur” and Hayek' "mutual learning" ideas. For Mises (1949), the driving force of the market process and cause of market equilibration is the profit seeking and speculating entrepreneurs. Since each agent has different knowledge and information set in a real economy, every actor (agent) is an entrepreneur and speculator. Hayek (1948) does not directly emphasize the role of entrepreneur in the market process but he states that the market process gives information about everyone's plans to every other person. He believes that there is tendency towards equilibrium, but this does not mean markets always reach to equilibrium. He has doubt whether the assumption of a perfect market where every event becomes known instantaneously to every member exists. According to Kirzner (1997), The Neoclassical theory examines marketsabstracting from institutional detail- by focusing only on supply, demand and price and he goes on stating that "it explains in great detail the relationships that would prevail in markets that already do work; it is silent on the nature of the process that might generate those relationships." For Kirzner (1997): "The entrepreneur who 'sees' (discovers) a profit opportunity, is discovering the existence of a gain which had...not been seen by himself or by anybody else." To Kirzner, profit opportunities stimulate entrepreneurship. Different from Schumpeter, the profit arises from arbitrage not from innovation. "The pure entrepreneurial function consists in buying cheap and selling dear- that is, in the discovery that the market has undervalued something so that its true market value has up to now not been generally realized. This permits the pure entrepreneur to buy something for less than he will be able to sell it for. His act of entrepreneurship consists in realizing the existence of market value that hashitherto been overlooked." Kirzner's entrepreneur does not cause destructive creation and his activities do not cause change. The alert entrepreneur realizes that a change has occurred and sees profit opportunities. An improvement in technique of production or a shift in preferences leads to change (disequilibrium) in a market that initially was in equilibrium. ".... Entrepreneurial discovery which enables decentralized decision-makers to recognize when present decisions can be improved upon and to anticipate future changes in the decisions being made by others. Movements in prices, production methods, choices of outputs, and resource owner incomes generated by entrepreneurial discovery tend to reveal where current allocation patterns are faulty, and stimulate changes in the corrective direction." However, in his analysis there is no explanation of why a change has occurred and who or what forces caused that change. There is no representative agent in his theory and agents are not homogenous in terms of ability, alertness and ability to reach information. In his analysis there are mainly two types of agents in the economy. Entrepreneurs, who are seeking to exploit opportunities, take the decisions and the bulk of the population do not take decisions. Entrepreneurs differ from the second group since they are alert and they have the ability to see that a change has occurred and there are exchange opportunities to exploit. As long as agents have different level information and level of knowledge, the limitations of non-entrepreneurs' knowledge provide an incentive and a profit opportunity for entrepreneurs. The difference in knowledge and information lead to differences in the valuation of a particular good. According to Kirzner, an improvement in the technique of production or a shift in preferences leads to change (disequilibrium) in market initially there was equilibrium. If there is equilibrium in the market there is nothing for the entrepreneur to do and no exchange and profit opportunities for them since everybody will be able to carry out his initially determined exchange plans. But whenever the change has occurred, some planned activities will not be realized. In this point, the importance of the entrepreneur is understood, since they realize that the market is not in equilibrium due to either excess demand or excess supply and competition among entrepreneurs leads to equilibrium again. Kirzner (1997) states that in an equilibrium world-the only world the neoclassical model deals with because of perfect knowledge-there is no room "...for entrepreneurial discovery and creativity: the course of market events is foreordained by the data of market situation." and for the system to create profit opportunities for entrepreneur there is need for an exogenous shock to system. In Kirzner's model, unlike the Neo-classical theory, complete and perfect information is not assumed. If there is no market clearing price, those who pay a higher price are unaware of the lower price that is available and thus the divergence between the two prices constitutes a pure profit opportunity for alert entrepreneurs. Entrepreneurial discovery, by seizing profit, is a powerful force pushing the two prices towards each other and eliminating the opportunity it initially offered. After explaining the entrepreneurial discovery process, he states that "the tendency towards a single price is continually interrupted-but continually resumed." The Kirzner's ideas about entrepreneurship can be summarized as: • At any given moment economic agents are likely making errors as they try to estimate true present and future plans of other market participants. • Such errors or miscalculations happen due to over optimism or over pessimism • Entrepreneurial discovery process leads towards a single market price

## DISCUSSION ABOUT KIRZNER'S MARKET PROCESS MODEL

The main concern is regarding this explanation of market process is that since the focus is on exchange not in production then the following questions have to be answered: • If producers are passive agents and they do not have the ability to cause change who or what factors cause improvements in the technique of production? • Since the bulk of the population do not take decisions and they simply behave in a programmed way what is the cause of shift in preferences? • Since in Stigler's theory of investment in information consumers' investment in information leads market clearing prices and market equilibrium, why do not rational agents behave same way and allow entrepreneurs to exploit the opportunities? It seems that consumers and producers behave as if they are programmed robots and they do not respond to incentives. Thus, the lack of respond to incentives gives opportunities to entrepreneurs to exploit them. If Hayek's learning process works properly, after one incidence when market price is made single, the non- entrepreneurs should learn the game and respond to incentives as if there are rational behaviour and rational expectations. According to Loasby (1982), the main limitation of the model is that "Kirzner argues that new opportunities are continually being created by changes in the underlying data, but his model provides no incentives to produce such changes....’’. IMPLICATIONS REGARDING REGULATION OF MONOPOLIES Kirzner's and, thereby, the Neo-Austrian theory's definition of competition clearly differ from the traditional approach. For Kirzner, the definition of competition requires only the condition of 'freedom of entry' into market. "A single producer not protected against entry of potential competitors does not constitute a monopoly in the relevant sense." Thus, the existence of freedom of entry not only forces the monopolist to increase efficiency in production by decreasing production costs, but also reduces the product prices. He indicates that "Competitive entry and the threat of competitive entry bring about the lowering of the product prices towards their lowest possible costs of production..." (p.48) Having many firms in the market for Kirzner is not the requirement to call that market as competitive. In the absence of entry barrier, entrance of only one or two new firms can make it the market competitive. Entrance of -say- only one firm indicates that either others could not see the profit opportunities in the market that this firm saw or the others correctly understand that no such profit opportunity exists. As a result, the approach indicates that if there is no barrier to entry, the threat of new entries from potential entrants will force the monopolist to behave as if the market is competitive, there will be no excess profit and the threat will force the monopolist to reduce production costs. Since the outcome is close to the perfect competition outcome, and the dead weight loss is zero or close to zero, then there no room for government regulation. Kirzner indicates that this new approach to regulation differ the NeoAustrian theory from Neo-classical approach. However, Baumol' (1982), 'contestable markets' model indicates same results regarding monopoly regulations. Kirzner does not cite this model and keeps criticizing the neoclassical theory. Another problem in this approach is that it implies if there is no regulation, in the long run, there will be many competitors in the market to bring profits to zero by exploiting given opportunities. If this were true, we would have seen non-regulated markets to be competitive in terms of number of producers and also marginal cost equal to prices. In reality, we see mostly oligopolies and certainly prices are higher than marginal cost in these markets.

4. CONCLUSION

Theories of entrepreneurship are mainly designed to answer the questions: (i) how market system works and, (ii) what the relationship between entrepreneurship and profit is. Marshallian theory which indicates the existence of perfect information and perfect competition assumptions fails to answer both questions accurately. The model indicates the non-existence of excess profits and does not distinguishes entrepreneurship from routine production process. The Schumpeterian analysis is the closest to the reality regarding the work of market system and creation of profit. However, he gives to much importance to individual innovations and ignores the effects of generations and previous failures to discover those innovations. He sees all innovations exogenous in this sense not endogenous to the system. Kirzner's alert entrepreneur is an arbitrager and sees profit opportunities and exploits them. His model sees all non- entrepreneurs as programmed robots who do not respond to incentives and do not learn from past experiences. His model also fails to explain the above mentioned questions accurately. However, the model sees the mistakes of Marshallian analysis and tries to correct them. Even though Kirzner sees his model's indication about competition and regulation, the model indicates same kind of policy implications for regulation of monopolies. Also, both Austrian and Neo-classical theories at the end reach market equilibrium. It would be appropriate to quote Mises' understanding for similarities of these two approaches: “What separated the modern schools of economic theory from one another was largely nothing more than a matter of language and style.”

## ENTREPRENEURSHIP: THEORY AND PRACTICE.

Module Overview The module covers: the new business lifecycle (selecting and testing a moneymaking idea, preparing a business plan, raising finance, the Exit), aspects of new business operation (registering a company, setting up your office, understanding financial statements), and exploiting new eCommerce tools and techniques (doing business electronically, company web sites, online business software and services). Invention and innovation – finding and qualifying new opportunities. Business Model Generation.

• Confirming customer needs & testing market demand. Customer development. • Lean Start-ups: what is your minimum viable product? The value of prototyping. • Delivery channels and customer relationships. Business Plan & Preparing a Pitch. • Financial Forecasting, Costing and Pricing. Management accounts. Cash-flow and Profit & loss. • Developing sustainable competitive advantage. Intellectual Property Rights. • Corporate form & structure. Founder dilemmas - team, equity, remuneration etc. Developing your brand. • Defining and testing critical business model uncertainties. Measuring progress - common start-up metrics. • Sources of Funding. Presenting to VCs. • Class presentations. Conclusions and next-steps.

Module Aims

This module is designed for students who wish to develop the skills and techniques to develop and test a new business idea. It covers methods for analysing, specifying, designing and launching new ventures along with strategies for the assessment of business opportunities and techniques for effective business planning to secure the necessary resources (including finance). The module introduces frameworks to assess and to mitigate key risks to new ventures including those relating to personnel, markets and technologies. The module will draw on case studies that illustrate the challenges of creating high potential enterprises but will also explicitly focus on the testing and validation of new venture concepts generated by participants.

## Theory of High Achievement/Theory of Achievement Motivation

McClelland identified 2 characteristics of entrepreneurship–Doing things in a new and better way–Decision making under uncertaintyHe stressed that people with high achievement orientation (needto succeed) were more likely to become entrepreneurs Such people are not influenced by money or external incentives•They consider profit to be a measure of success andcompetency

### The Kakinada Experiment

•Conducted by McClelland in America, Mexico and Mumbai •Under this experiment, young adults were selected and putthrough a three month training programme•The training aimed at inducing the achievement motivation. The course contents were–Trainees were asked to control their thinking and talk to themselves, positively–They imagined themselves in need of challenges and success for which they had to set planned and achievable goals–They strived to get concrete and frequent feedback–They tried to imitate their role models/those who performed well the experiment:–Traditional beliefs do not inhibit an entrepreneur–Suitable training can provide necessary motivation to an entrepreneur–The achievement motivation had a positive impact on the performance of the participants. It was the Kakinada experiment that made people realizethe importance of EDP (Entrepreneurial Development Programme) to induce motivation and competence in young, prospective entrepreneurs.

## THEORIES AND MODELS OF ENTREPRENEURSHIP

Entrepreneurship is an evolved thing. With the advancement of science and technology it has undergone metamorphosis change andemerged as a critical input for socio-economic development. Variouswriters have developed various theories on entrepreneurship andpopularized the concept among the common people.

Sociological theories

Economic theories

Cultural theories

Entrepreneurship Innovation theory

Psychological theories

Theory of Achievement Motivation

Motivation theory by McClelland (Acquired Needs theory)

## SOCIOLOGICAL THEORIES

Entrepreneurship is likely to get a boost in a particular social culture Society’s values, religious beliefs, customs, taboos influence the behavior of individuals in a society. The following theories explain how sociological factors accelerate the growth of entrepreneurs:

### Theory of religious beliefs

Max Weber has propounded the theory of religious belief.

Entrepreneurism is a function of religious beliefs and impact of religion shapes the entrepreneurial culture.

Entrepreneurial energies are exogenous supplied by means of religious beliefs.

### ELEMENTS OF WERBER’S THEORY

Spirit of Capitalism-In the Weberian theory, spirit of capitalism is highlighted. We all know that capitalism is an economic system in which economic freedom and private enterprise are glorified, so also the entrepreneurial culture.

### Adventurous spirit -

Weber also made a distinction between spirit of capitalism and adventurous spirit. According to him, the former is influenced by the strict discipline whereas the latter is affected by free force of impulse. Entrepreneurship culture is influenced by both these factors.

•

### Protestant ethic-

**T**he spirit of capitalism can be grown only when the mental attitude in the society is favorable to capitalism.

### Inducement of profit -

 The spirit of capitalism intertwined with the motive of profit resulted in creation of greater number of business enterprises. In fact, this theory suited the British rulers, who desired to encourage European entrepreneurship in India. This theory was vehemently criticized by many researchers because of the unrealistic assumptions.

### Theory of social change

Everett E. Hagen, in his theory of social change propounded how a traditional society becomes one in which continuing technical progress takes place.

### Presentation of general model of the society-

 The theory reveals a general model of the society which considers interrelationship among physical environment, social structure, personality and culture.

**Rejection of followers’ syndrome -**

Hagen rejected the idea that the solution to economic development lies in imitating western technology. So the follower’s syndrome on the part of the entrepreneur is discouraged.

**Historic shift as a factor of initiating change-**

Hagen in his book, How Economic Growth Begins, depicts historic shift as the crucial force which has brought about social change technological progress thereby leading to the emergence of entrepreneurial class from different castes and communities.

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**Withdrawal of status respects as the mechanism for rigorous entrepreneurial activity-**

Closely consistent with the historic shift it is the social group that plunges into rigorous entrepreneurism which experiences the status withdrawal or withdrawal of status respects.

## ECONOMIC THEORY

•Entrepreneurship and economic development are interdependent. Economic development takes place when a country' real rational income increases overall period of time wherein the role of entrepreneurs is an integral part.

•Entrepreneurship and economic growth take place when the economic conditions are favorable.

•Economic incentives are the main motivators for entrepreneurial activities.

•Economic incentives include taxation policy, industrial policy, sources of finance and raw material, infrastructure availability, investment and marketing opportunities, access to information about market conditions, technology etc.

## PSYCHOLOGICAL THEORY

•Entrepreneurship gets a boost when society has sufficient supply of individuals with necessary psychological characteristics.

• The psychological characteristics include need for high achievement, a vision or foresight, ability to face opposition.

## THEORY OF HIGH ACHIEVEMENT/ACHIEVEMENTMOTIVATION

•McClelland identified 2 characteristics of entrepreneurship

 –

Doing things in a new and better way

 –

Decision making under uncertainty

•He stressed that people with high achievement orientation (need to succeed) were more likely to become entrepreneurs.

•Such people are not influenced by money or external incentives.

•They consider profit to be a measure of success and competency.

## MOTIVATION THEORY (ACQUIREDNEEDS THEORY)

•According to McClelland, a person has three types of needs at any given time, which are:

 –

Need for achievement (get success with one ‘sown efforts).

 –

Need for power (to dominate, influence others)

 –

Need for affiliation (maintain friendly relations with others).

• The need for achievement is the highest for entrepreneurs.

## ENTREPRENEURSHIP INNOVATION THEORY.

Theory by Joseph Schumpeter believes that entrepreneur helps the process of development in an economy.

•He says that an entrepreneur is the one who is innovative, creative and has a foresight.

•According to him, innovation occurs when the entrepreneur-

* + - * + Introduces a new product.
        + Introduces a new production method.
        + Opens up a new market.
        + Finds out a new source of raw material supply.
        + Introduces new organization in any industry

•The theory emphasizes on innovation, ignoring the risk-taking and organizing abilities of an entrepreneur.

Unit 8

# MODELS OF ENTREPRENEURSHIP

# Objectives

# As you study and work through this unit, you are expected to:

* Differentiate models in entrepreneurship
* Discuss biological theory
* Justify theories of gender implications.

Introduction

## CONSULTANT MODEL

This model is common among academicians and those with who gained expertise in the industry.Many corporate executives, after retiring from their regular jobs also take the consulting route, either directly or by taking on director roles at different companies. Many IT professionals, especially those with niche skills and/or certifications also tend to move on to consulting roles.

## MOONLIGHTING MODEL

This model is common among those want to experience entrepreneurship “part-time” without taking the risks associated with full-time entrepreneurial activities.This model is not really new.Opportunities with industries that use their expertise to implement the research ideas fine-tuned in academia.Some professionals take the public speaking or column writing route where they try to publish their ideas outside the confines of their organizations.

## BRILLIANT IDEA MODEL

Model applied to professionals and others working in the corporate world or for regular employers.

 They realize that they have a “million dollar idea “that they can capitalize on.

Employees take their new/innovative idea to the employer with a suggestion to implement it on the job. When the ideas are not taken up by the management, they contemplate the entrepreneurial route if they feel strongly about it.

## BUSINESS/FRANCHISEMODEL

Individuals who do not want to continue in the corporate world decide to start their own venture. Entrepreneur approaches a corporation.

Takes on the responsibility of running his business using the brand and marketing support from the enterprise.

**Different Approaches of Entrepreneurship**

Neoclassical Constraints;

An economy cannot be static and therefore the state of static equilibrium is unrealistic. Large profits in the entrepreneurial situation are also not easy to come by. The wholesome application of the neoclassical theories is also unrealistic.

Biological Theory of Entrepreneurship;

According to Eagly (1995) several of the academic theories of gender differences offer explanations based on deeply seated cultural or even biological differences between men and women. The practitioner literatures are also particularly likely to emphasize gender differences, construing them as core aspects of what it means to be a man or a woman in the entrepreneurial process. However, other especially rolebased theories emphasize that gender differences in behavior should be expected to change along with other social changes. Moreover, even theories of more stable gender differences generally also admit the co-existence of more malleable gender differences (Udry, 2001). Risk has long been a central concept in the entrepreneurship literature suggested by Adam Smith and J.S. Mill (Schumpeter, 1999) Entrepreneurial activities are frequently assumed to involve risk-taking, especially relative to managerial activities within established corporations. However, research has failed to consistently find risk-taking propensity to be a trait distinguishing entrepreneurs from others (Brockhaus, 1980; Aldrich and Wiedenmeyer, 1993; Gartner, 1989). A more promising recent line of research has suggested that entrepreneurs differ in cognitive style from others and that they may be more likely to make particular cognitive errors (Baron, 1998; Kahneman and Lovallo, 1994; Palich and Bagby, 1995), especially errors of overconfidence (Busenitz and Barney, 1997, Cooper, Dunkelberg & Woo, 1988; Manimala, 1992). Psychologists have documented moderate and consistent levels of differences between men and women in risk-taking behaviors. An analysis of 150 studies examining such differences found some evidence of a temporal trend toward smaller differences, but still found that men were significantly more likely than women to engage in 14 of 16 types of risky activities. Their results showed that “males took more risks even when it was clear that it was a bad idea to take a risk,” and that females “seemed to be disinclined to take risks even in fairly risky situations or when it was a good idea,” leading to the speculation that “men and boys would tend to encounter failure or other negative consequences more often than women and girls” and that “women and girls would tend to experience success less often than they should”.

Unit 9

# FIRM AND BUSINESS

In this unit, we discuss firms and business.

As you study and work through this unit, you eill be expected to:

* Carryout a scope for synthesis in the theory of the firm
* Discuss the comprehensive theory
* Explain firm behavior

INTRODUCTION

## Entrepreneurship and the theory of the firm

Entrepreneurship is a missing component of several leading theories of the firm. Entrepreneurship is key to the growth and survival of firms in a volatile environment, because entrepreneurial judgement is necessary to success in making complex decisions under uncertainty. The addition of entrepreneurship is not a minor refinement of the theory of the firm, but represents a radical change. The paper summarises the principle changes. It suggests that the introduction of entrepreneurship can facilitate the development of an integrated synthetic theory of the firm.

## Scope for synthesis in the theory of the firm

In the 1970s the theory of the firm was relatively straightforward. It was based on a critique of neoclassical theory. The objective was to ‘open up’ the black box of the neoclassical production function in order to explain technological change and the scope of the firm [Coase (1937); Loasby, (1976)]. The firm was regarded as a planning mechanism which superseded prices within its boundaries.

Today the theory of the firm has become a multi-disciplinary subject [Foss (1997)]. It seeks to explain many different aspects of firm behaviour. There is more emphasis on analysing the success and failure of individual firms. The widespread use of strategic management terminology reflects the increasing use of the theory of the firm in management education and consultancy.

One reason for this change is the growing demand for a comprehensive theory of the firm. Academic researchers - especially PhD candidates - need a framework within which to assimilate and structure an increasingly vast literature, whilst students - especially MBA students – prefer a single received theory – or dogma – to a confusing array of alternatives which are endlessly debated. Management consultants require an intellectual product that can be standardised and explained in simple terms to clients, while business advisers supporting SMEs need a ‘grounded’ theory of the firm which leads to practical advice.

There are many partial theories of the firm, explaining different aspects of firm behaviour, but these partial theories have proved difficult to synthesise into a comprehensive theory. One reason for this difficulty may be that until recently little attempt was made to integrate entrepreneurship into the theory of the firm. This neglect may be due to the fact that much of the traditional literature on entrepreneurship [e.g. Cantillon (1755); Knight (1921)] is economic, and has little to say about the management of firms. Another factor is that some of the economic literature on entrepreneurship is characterised by distinctive psychological assumptions which, although very insightful, do not fit well with mainstream theory. Schumpeter (1934, 1939), for example, adopts a social and cultural approach to entrepreneurial motivation, highlighting the ‘will’ to succeed, the urge to prove oneself superior to others, and the desire to establish a dynasty. More recently, Kirzner (1973, 1997) has claimed that a special psychology of alertness to opportunity is a feature of the successful entrepreneur.

The primary objective of this paper is to argue that managerial perspectives on the firm can be usefully combined with economic insights into entrepreneurship to move closer towards the goal of a synthetic theory of the firm. A number of important contributions of this type have recently appeared – notably Foss and Klein (2002), Sautet (2000) and Witt (1998a,b). While these writers draw heavily on Austrian and evolutionary theory, however, the present paper approaches the issue from a more institutional approach to entrepreneurship, based on information costs.

## Defining the entrepreneur: judgement and the subjective perception of risk

The theoretical literature on entrepreneurship had grown dramatically over the last ten years, and there is too much to survey adequately in this paper; see Shane (2000), Westhead and Wright (2000) and ACS and Audretsch (2003) for recent summaries. This paper therefore focuses on a single theoretical tradition, rooted in the classic economic writings on the subject noted above; for a review of this tradition, see the introduction to Casson (1990).

A critical review of these writings points to judgemental decision-making as a common feature of their accounts of the entrepreneur. Judgemental decision-making involves an element of improvisation, rather than exclusive reliance on routines. It makes use not only of publicly available information but also private information available only to a few. The exercise of judgment involves a synthesis of all this information, for it is rarely the case that a single item of information is sufficient for taking an important business decision. Although everyone makes judgemental decisions from time to time, only the entrepreneur specialises in this activity (Casson, 1982). For the purposes of this paper, therefore, specialisation in judgemental decision-making is taken as the defining characteristic of the entrepreneur. All the other characteristics imputed to the entrepreneur are deduced from this by introducing specific assumptions about the environment in which the entrepreneur operates.

The decisions to which judgment is applied concern investments in projects of various kinds. Cantillon (1755) emphasises investment in hiring labour and materials to produce consumer goods in anticipation of future sales. Knight (1921) is more concerned with the large-scale fixed investments characteristic of early 20th century big business. Schumpeter's conception of investment is even more heroic than Knight’s, involving the creation of new industries, sometimes triggering the next ‘long wave’ of capitalist economic development. Austrian writers, by contrast, emphasise the kind of speculation and arbitrage which is characteristic of SMEs in the wholesale trades. Harper (1996) has argued that the judgements made by entrepreneurs resemble the judgements made by scientists in deciding which experiments to carry out: the entrepreneur’s ‘business model’ corresponds to the hypothesis, whilst the profitability of the project corresponds to the result of the experiment. The more recent work of Baumol (2002) focuses on the incentives under which judgemental decision-making takes place, with special reference to the issue of how far ‘rent-seeking’ dominates entrepreneurial motivation under perverse incentive systems.

Judgemental decision making is closely allied to risk and uncertainty. When an entrepreneur takes a decision based on information that is not available to other people, the other people may perceive the decision to be a risky one. The entrepreneur perceives the risk as much lower, however, because of the information in his possession.

While the entrepreneur may feel confident about the accuracy of his information, he cannot in fact be certain that it is correct. No item of information comes accompanied by a cast-iron endorsement of its truth: observations on primary sources of information are subject to error, and second-hand accounts are liable to distortion or misrepresentation. An entrepreneur who perceives a lower level of risk than other people may well be right: if so, his investment is likely to be profitable because other people's perceptions will discourage them from competing against him. But if his perception is wrong then his investment will prove unprofitable: the successful decisions will be those made by potential competitors who decided to stay out of the activity. The theory of entrepreneurship therefore highlights the subjectivity of risk perceptions [Shackle (1979)].

Standard neoclassical economic models imply that risk is allocated on a simple insurance principle: overall risk is reduced by pooling, and the remaining (‘systematic’) risks are then allocated to the least risk-averse individuals. In effect, the least risk-averse insure the most risk-averse. From this perspective, entrepreneurs are simply people with low risk aversion [Milgrom and Roberts (1992)]. The theory of entrepreneurship attempts to extend this view by allowing for individuals to differ, not only in risk-aversion, but also in their access to information, and hence in the subjective probabilities that enter into their assessments of risk.

When people differ in their degree of optimism, as reflected in subjective probabilities, but have similar degrees of risk aversion, the optimistic will invest and the pessimistic will not. Entrepreneurs who invest in projects will thus tend to be more optimistic than people who do not invest. Potential investors in a project may be ranked according to the subjective probability that they associate with a ‘good’ rather than a ‘bad’ outcome to a project. The higher the probability that a person associates with a good outcome, the more optimistic they are said to be. This optimism reflects the entrepreneurs’ interpretation of the privileged information at their disposal (for a formal model constructed on these lines see Casson (1995)).

If these optimistic entrepreneurs are aware that other people are more pessimistic than themselves then they will naturally ask why this is so. Their answer must be that they are confident that the additional information which they are using is correct. An individual is said to be self-confident when, although they are aware that other people’s subjective probabilities are different to their own, they remain convinced that their own subjective probability assessment is correct. By contrast, a person lacking in self-confidence will adjust their own subjective probabilities to align them with the subjective probabilities expressed by other people whom they respect. Thus a person lacking self-confidence would go ahead with a project on the basis of an optimistic evaluation only if they were unaware of other people’s views. A combination of optimism and self-confidence is therefore characteristic of the entrepreneur who proceeds with a project which he knows that others consider to be excessively risky.

It could be objected that this emphasis on optimism and self-confidence in the theory of entrepreneurship is of no significance because it does not imply any difference in behaviour compared to the risk aversion view. This is incorrect, however. Optimism and self-confidence reflect different aspects of personality to risk aversion. More importantly, optimism and self-confidence can be influenced in a way which risk aversion cannot. It is argued below that successful entrepreneurs can influence their customers, employees, suppliers, and financial backers to be more optimistic, and hence more entrepreneurial themselves. By influencing their environment in this way they can improve the performance of their enterprise and, under certain conditions, the performance of the economy too. Such influence would be impossible if an autonomous level of risk aversion was characteristic of every individual, as assumed in neoclassical theory.

To summarise:

1. Specialisation in judgemental decision-making is the defining characteristic of the entrepreneur, for the purposes of this analysis.
2. Superior judgment stems from privileged information (which is substantially correct).
3. Perceptions of risk are subjective. A confident entrepreneur may perceive no risk where others perceive considerable risk. An entrepreneur invests when others do not when he is both optimistic and confident in his own judgement, relative to others.
4. The entrepreneur’s perception may be right or wrong. If his optimism is warranted, his investment will be profitable, while if it is not, he will make a loss. In the long run an entrepreneur with good judgement will, on average, be successful while an entrepreneur with bad judgement is likely to be unsuccessful. Successful entrepreneurship is sustainable because it generates profits that can be used to finance subsequent investments, and build up reputation, whereas unsuccessful entrepreneurship is not sustainable because it eventually destroys reputation and uses up all available funds.

## Developing a theory of entrepreneurship: volatility and information cost

Focusing on judgment indicates the fundamental reason why the theory of entrepreneurship has diverged from neoclassical orthodoxy. It is not primarily a question of psychologism, but rather a recognition of the crucial importance of volatility in the environment. Allied to this is a recognition of the costliness of maintaining up-to-date information about the environment [Richardson (1960)].

Volatility reflects the fact that the economic environment is continually subjected to shocks. Shocks are extremely varied: they include disruptions to raw-material supply caused by accidents, fads and fashions in consumer tastes, labour absenteeism, and technological progress generated by scientific experiment. Wars and natural disasters are extreme shocks: they are not ad hoc disruptions to an equilibrium state, as economic orthodoxy tends to suggests, but simply limiting cases of the kind of volatility that affects the economy all the time.

Volatility and information cost are, to some extent, two sides of the same coin. Volatility means that information about the state of the environment is constantly obsolescing, so that a continuous flow of new information is needed to keep the picture of the environment up-to-date. But collecting information is costly - in particular it is very time-consuming [Lippman and McCall (1979)]. To maintain upto-date information at minimum cost it is appropriate to specialise the collection and processing of information. Specialisation can be based on? The separation of routine decisions from improvised decisions?The allocation of different routine decisions to different organisations (or to different people within an organisation), and? The allocation of different improvised decisions to different entrepreneurs.

To understand in detail the link between the entrepreneur and his firm it is important to appreciate the different types of shock to which the entrepreneur must respond. Four main dimensions of volatility may be distinguished for this purpose.

Shocks may be either general or specific: general shocks affect an entire sector or even the macro-economy, whilst specific shocks affect a particular individual, firm or market. Information relating to general shocks is often supplied through independent intermediaries, such as the media. Information about specific shocks normally has to be gathered at first hand by people specialising in a particular field of activity. The privileged information exploited by an entrepreneur is normally of the specific variety. It is the ability to deal with shocks of a specific nature which is the hallmark of the successful entrepreneur.

Some shocks are short-term, such as those due to accident or illness, whereas others are long-term, such as those caused by technological progress or demographic change. Short-term shocks are typically of a limited range of types: they occur frequently, their individual impacts tend to be small, and their effects are transitory, and easily reversed. By contrast, long-term shocks are very diverse; any given type of shock occurs only occasionally, its impact tends to be large and its effects are persistent and even irreversible.

For decisions dealing with short-term volatility, which need to be taken on a regular basis, it is usually economic for the entrepreneur to devise routine procedures for collecting information, as well as algorithms for calculating the best decision on the basis of this information. Different individuals may specialise in different stages of the information processing, so that the routines are implemented by an organisation comprising a team of individuals. Although the organisation is routine in its operation, the design and establishment of the organisation, and its procedures, involves judgemental decisions at the outset by the entrepreneur.

Most key investment decisions are a response to long term volatility. Investment decisions are not sufficiently alike, and do not recur sufficiently often, to warrant the development of routine procedures. These decisions therefore need to be improvised. Since their information requirements are difficult to anticipate in advance, the appropriate strategy is to concentrate responsibility for the decision on a suitable individual, who has an unusually wide range of experience, and a network of personal contacts appropriate for bringing to bear all the information necessary to take the decision. This individual is a classic entrepreneur. He synthesises information from diverse sources in order to take an important and risky decision. He is responding to long-term volatility of a specific nature - volatility which corresponds to the bottom right-hand cell in Table 1. His investment, once established, will, however, be subject to short-term volatility, and so he will establish an organisation to monitor and adapt to this volatility. This organisation is the firm – it is the legal framework through which the entrepreneur controls his organisation (the classic work on the design of efficient o

ganizations is Marschak and Radner (1972); a recent influential paper is Bolton and Dewatripont (1994)).

It is important not to exaggerate the opposition between the improvisation of the entrepreneur and the routine decision-making of the ordinary members of the organisation that he controls. Managerial and clerical employees who notice anomalies, such as deviations from trends, or variability outside of normal bounds, may report these anomalies to the entrepreneur. By focusing the entrepreneur’s attention on the explanation of such anomalies, new investment opportunities may be identified. Even where small businesses are concerned, the entrepreneurs who found them may have developed their initial ideas from noticing anomalies of this type whilst employed by a larger firm. Thus routine and improvisation are not perfect substitutes - there are significant elements of complementarity too. The innovative entrepreneur and the routine-driven manager perform complementary roles within a typical firm.

Finally, some shocks are tangible - relating to physical stocks and flows of materials - whereas others are intangible - relating to beliefs and values, including technological beliefs and legal and institutional arrangements. Much economic analysis of entrepreneurship implicitly assumes that entrepreneurs monitor mainly tangible shocks, such as the effects of income, prices of inputs and competing products, and so on. Historical accounts of entrepreneurship, however, tend to emphasise the importance of monitoring intangible factors such as changing social attitudes. Changes in intangible factors often lead changes in tangible factors; for example, changes in beliefs about the role of women in society influence the supply of labour to various occupations, and also affect patterns of consumer demand.

Combining all these four dimensions together provides a reasonably comprehensive basis for analysing how different patterns of volatility lead to different manifestations of entrepreneurship, which lead in turn to firms of different sizes and structures. The implications of any given type of volatility can be inferred from its classification. For example, disruptions to raw-material supplies exemplify short-term tangible shocks which are supply-related and sector specific. Volatility of this type strengthens the need for specialised procurement managers in the firm. Conversely fads and fashions in consumer tastes exemplify intangible shocks which, though also short-term and specific, are intangible and demand-related. Volatility of this type requires the entrepreneur to invest in marketing, and to socialise with trend-setters, in order to anticipate the direction in which demand will change.

Competition is also a source of volatility. Rival firms do not always compete with constant intensity, but may initiate periodic drives to enter markets or increase their existing market shares. Entrepreneurs need to monitor the launch of their rivals’ initiatives, so that they can neutralise their impacts quickly. Competition in the product market arising from the market-making initiatives of rival firms generates a succession of short-term, tangible, specific, demand-related shocks.

This view of the business system is radically different from the one that appears in most economics textbooks. The focus is no longer on flows of material products between production plants, and the balancing flow of money payments; instead, it focuses on the flow of information [Boisot (1995)]. At any given time the system as a whole, and the individual firm in particular, is subjected simultaneously to shocks of many different types. Entrepreneurs establish organisations which identify and then monitor key sources of volatility. They maintain social networks which channel selected information to key decision makers in these organisations. Entrepreneurial organisations are located at nodes on social information networks. Information from diverse sources converges on these nodes, and it is there, in the headquarters of entrepreneurial firms, that the information is synthesised prior to investment decisions being made. From this perspective, the ‘economic problem’ is one of devising an appropriate division of labour in the processing of information, and in investing in an infrastructure that will support it. This infrastructure includes both tangible elements such as lines of transport and communication, and intangible elements, such political structures and social networks [Eliasson, Folster, Lindberg, Pousette and Taymas (1990)].

. The entrepreneur as market-maker: implications for the theory of the firm

An important difference between the theory of entrepreneurship and the neoclassical theory of the firm concerns the nature of the investments made by entrepreneurs. In neoclassical theory investment is typically associated with fixed investment, which is combined with labour in a manufacturing process which generates material output. One of the main outcomes of the entrepreneurial synthesis of information, however, is not the identification of a superior form of fixed capital, but rather the identification of a market-making opportunity - that is, an opportunity to bring together suppliers of inputs and consumers of outputs through the establishment of a new market [Casson, (1997)]. In some cases - such as product innovation - the market may not have existed before. In other cases, such as the development of new wholesale and retail outlets, an existing market is extended to new locations, so that new groups of customers can be served. Evidence from business histories suggests that one of the most important forms of entrepreneurial activity is to identify changes in patterns of demand and to create new markets to meet these demands. This is not the only form of entrepreneurial activity, by any means, but it is an important, and often neglected one.

Major market-making investments typically involve the design of a new product or the refinement of an existing product. The product may be promoted by a brand using an image built up through advertising. This is part of the influencing activity of the entrepreneur described in more detail below. To solicit orders and collect payment, retail outlets will be required, and these outlets will, in turn need to be served by wholesale facilities. Training schemes for staff may need to be provided too. All this activity will certainly require fixed investments, but they are more likely to be in the form of offices, shops and warehouses than factories.

The activities of the market-making entrepreneur may be regarded as a specific manifestation of the ‘market process’ as described by Austrian economists [Kirzner (1979)]. But the market-making entrepreneur is in some respects more subversive of neoclassical theory than the Austrian approach. The Austrian market process is usually construed, in neoclassical terms, as asserting that markets are always out of equilibrium, and that entrepreneurial interventions tend to move markets towards equilibrium, without them ever reaching that state. This interpretation presumes, however, that the markets already exist: this is reflected in the reference to entrepreneurial activity as speculation or arbitrage – both of these are activities which the entrepreneur as market-maker: implications for the theory of the firm.

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Focusing on the entrepreneur as a market-maker points to some other dramatic differences between the theory of entrepreneurship and the neoclassical approach. Neoclassical theory is strongly influenced by the concept of the Walrasian auctioneer who maintains an equilibrium in competitive markets. Even though the Walrasian model has been refined by theories of monopolistic competition and oligopoly, the basic idea that the market is somehow already there, and the entrepreneur is merely a producer who supplies it, continues to influence the neoclassical literature on industrial organisation. However, the presence of the Walrasian auctioneer, or a preexisting market, is incompatible with the analytical thrust of the theory of the entrepreneur. In the absence of the entrepreneur there would be no markets at all.

From the entrepreneurial perspective it is very obvious why the Walrasian auctioneer is a pure fiction. The Walrasian auctioneer can be considered as an unusual kind of market-making entrepreneur. He is unusual in three senses. First, he incurs no costs, because the information he requires is available free. Thus Walrasian theory implicitly sets information cost to zero so far as market-making is concerned.

Secondly, the Walrasian auctioneer is an absolute monopolist. Unlike ordinary entrepreneurs, he faces no competition from rivals. One reason why rivals do not enter is that the auctioneer is completely altruistic. Despite his unprecedented monopoly power, he extracts no profit, because he sets no margin between buying price and selling price. There are therefore no profits for which others can compete.

His altruism is the third unusual characteristic of the auctioneer. The model of the auctioneer would provide a sound basis for analysing markets only if, among a population of potential entrepreneurs, there was a single God-like figure, who was all powerful and totally altruistic. The only way to model markets rigorously is to consider fully all the implications of abandoning this Utopian view, and that is, in effect, what the modern theory of entrepreneurship has done.

The fact that market-making is such an important activity also sheds light on the debate in the theory of the firm over vertical integration. Most analysis of vertical integration has focused on the coordination of adjacent facilities within a multi-stage production process [Williamson (1985)]. In practice, one of the most important vertical integration issues concerns integration between market-making and production. This involves the issue of whether an entrepreneur who has identified a market-making opportunity will also invest in production facilities to generate his own supplies of the product that he sells. The ‘hold up’ approach to vertical integration predicts that integration will occur only when there is ‘lock in’ between the contracting parties [Klein, Crawford and Alchian (1978)]. This suggests that market-makers will integrate backwards when production requires irreversible investments. Bilateral monopoly models of vertical integration suggest that vertical integration will occur when there is only one independent firm to which production could be subcontracted, irrespective of whether that firm would have to make substantial irreversible commitments or not. Theories of intellectual property rights suggest that vertical integration will occur where the design of the product is difficult to patent, but contains novel features which could be copied by a dishonest producer and used to produce a rival good. Theories of asymmetric information suggest that quality control may be an important issue. The producer, as the ‘agent’ of the marketmaker, may put too little effort into production when poor quality workmanship is difficult to observe. To provide appropriate incentives, the producer may have be made responsible for all warranty work, all replacement, and be made liable to pay compensation for any reduction in the value of the brand, which means, in effect, that producer and market-maker have to be one and the same firm.

In the context of quality control, the optimism of the entrepreneur becomes an important consideration. If the market-maker is significantly more optimistic about the product than anyone else then, in particular, he is going to be more optimistic than any producer to whom he subcontracts production. If the producer expects the product to fail, then he will be less concerned about the consequences of producing faulty output, as the items may never be used by customers. Other production decisions may be affected too; thus if the producer expects the production run to be short then he will covertly economise on set up costs. This issue is examined in further detail below.

It is evident, therefore, that the ownership and control of fixed capital is not as critical to the market-making entrepreneur as neoclassical theory suggests. Although marketmaking requires offices, shops and warehouses, all these forms of fixed capital can be easily rented or leased; they are not, therefore, specific irreversible investments. Few entrepreneurs will invest in owning buildings at an early stages of a firm's growth, when financial resources are limited. Only when a firm is mature, and cash-flow is strong, will the typical entrepreneur consider property investments of this kind.

There is, however, one form of investment which is almost mandatory for a marketmaking entrepreneur at the start-up phase. This is investment in working capital, such as finished stocks and work in progress. The explanation lies in expectations. The expectations of the entrepreneur diverge from those of other people regarding the prospective demand for the product – in particular, the price that the product will command. From the standpoint of more pessimistic people, the entrepreneur’s stocks of work of progress and finished product, accumulated in advance of sale, carry considerable risk. Independent financial backers, such as banks, will therefore expect the entrepreneur to bear some (indeed most) of this risk himself. The relative risk of inventory is augmented by the fact that individual consumer products are often much less versatile than the physical capital assets employed in their production and distribution: offices, shops, factories and warehouses can be redeployed to alternative uses fairly easily, but unsold stock of an unwanted consumer product must normally be heavily discounted or even disposed of as waste. Thus while neoclassical theory tends to emphasise the riskiness of fixed investment, the theory of entrepreneurship emphasises the riskiness of investment in inventory instead.

Ownership of inventory has important implications for liquidity. Many small firms fail through bankruptcy. Their cash flow is inadequate to support the inventory investment they require. The firm also requires an inventory of cash to buffer volatility in payments and receipts (which may vary independently as lines of credit expand or contract). Due to unforeseen circumstances, demand may contract at the same time that production expands, or customers pay more slowly, or suppliers reduce their credit terms, and so a liquidity crisis may ensue. Efficient inventory control, and cash flow management, supported by the appropriate statistical and accounting techniques, are therefore vital to the financial stability of the firm. The importance of such controls is confirmed by the emphasis placed on such controls by venture capitalists, and other financial backers, and by the prominent role they occupy in the business studies courses taken by many budding entrepreneurs.

## Refining the theory: the contractual position of the entrepreneur

The market-making entrepreneur also provides a vital theoretical link between the world of information flow, which generates ideas for entrepreneurial activity, and the world of material flow, in which entrepreneurs implement their ideas by taking decisions on what and where to produce. This link has so far been portrayed as a fixed link, in which an entrepreneur who has developed a market-making project must take responsibility for implementing it himself. It could be argued, however, that entrepreneurs who are good at generating ideas for projects are not necessarily good at implementing them, and vice versa. This suggests that there should be a market in ideas, with some entrepreneurs specialising in producing and licensing ideas to others, who specialise in running market-making organisations which implement them. In practice, markets of this kind do not exist to any significant extent. There are two main reasons for this. The first is that property rights do not normally apply to ideas, unless they are associated with patented technologies or copyrighted materials – and even then, the enforcement of the property rights may prove costly. Secondly, even if property rights were efficient, there would still be a problem of divergent expectations. The entrepreneur who had the idea would tend to be more optimistic about its value than the entrepreneur who was best fitted to implement it. The organiser-entrepreneur would therefore be unable to offer sufficient compensation to the ideas-based entrepreneur to persuade the latter to license his idea.

It would, in principle, be possible to devise a contract in which the supplier of the idea was rewarded according to the value imputed to it from the results of the implementation. Difficulties would arise, however, not only in monitoring compliance with the contract, but also in devising terms which would align the expectations of the organiser with those of the originator. Any contract of this kind would almost certainly have to make the originator the bearer of most of the risk. This would be tantamount to the originator taking control of the implementation, so the contract would simply reproduce the ‘ownership’ solution. The fact that the entrepreneur must normally take responsibility for implementation of his ideas implies that he usually requires both financial resources and organisational skills in order to start up. Financial resources are required to fund inventory, as described above, whilst organisational skills are required to set up the routine procedures required for market-making - the soliciting and despatch of orders, together with payment collection and credit control. This demonstrates that entry into entrepreneurship is not free: financial endowments and organisational skills are both significant barriers to entry. The problem of financial resources may be overcome in various ways - for example, by mortgaging a house to obtain a business loan, or marrying a wealthy heiress, but all such strategies still require the entrepreneur to possess certain resources from the outset - for example, a house in which he holds positive equity, or social connections and good looks. Similarly, organisational skills must normally be acquired through experience, which means having worked for a large professionally-run firm. This in turn requires the entrepreneur to have gained a job with such a firm, and perhaps to have gained a professional qualification first in order to obtain the job. Although there some individual exceptions to these rules, around which influential myths have developed, the biographical evidence on successful entrepreneurs indicates that the theory is substantially correct - the most successful entrepreneurs are not from the humble beginnings which the popular stereotype suggests. The theory of entrepreneurship not only provides a basis for a critique of neoclassical theory, but also provides a standpoint from which to expose popular misconceptions of the entrepreneur, some of which have already been noted above. One prevalent misconception is that entrepreneurship is about self employment. Many statistical studies of the choice between employment and self-employment identify a selfemployed person as an ‘entrepreneur’. This is misleading, because there are certain trades and professions in which self-employment is the natural contractual form for work – for example, plumbers, window cleaners, and other workers in construction and property maintenance. To describe plumbing, for example, as a highly entrepreneurial activity, simply because it has high levels of self-employment, would erroneously suggest that it was characterised by high levels of product innovation and technological progress, which is clearly not the case.

Another variant of this fallacy is evident in the literature on SMEs. The highly empirical nature of much of this literature means that little attention has been given to the conceptual and definitional issues surrounding the entrepreneur. An entrepreneur is often defined simply as the founder or owner-manager of an SME. The theory of entrepreneurship, however, does not require people to found new firms in order to become entrepreneurs – anyone who specialises in taking judgemental decisions is qualified for the role. In some cases it may be more effective for an entrepreneur to take over an existing firm, or simply to succeed to the chief-executive position through internal promotion. Many SMEs remain small because of the limited vision of the founder, which restricts the firm’s capacity to grow. In such cases takeover or succession may inject entrepreneurial ideas and thereby stimulate the growth of a previously dormant firm. Contemporary focus on SMEs represents an understandable reaction to the failings of many large firms in the 1970s and 1980s, [see Burton (1999)] but arguably the case for SMEs is better founded when it is based on the limitations of large firms than when it is based on exaggerated claims for the personal qualities of founder-entrepreneurs [Ogbor (2000)].

In practice many of the most highly entrepreneurial individuals are the CEOs of large firms. The fact that these people draw salaries does not remove their incentive to perform. For many CEOs, enhancing their personal reputation is an important motivator. In addition they may benefit financially from stock options and performance-related pay. It normally takes a very long time to grow a small firm into a very large one - sometimes several generations. A talented and impatient entrepreneur may therefore find it advantageous to acquire control of an established large firm rather than to found and grow his own. There is a popular view that the politics of internal promotion in large firms do not result in the selection of highly entrepreneurial CEOs. This may well be the case. There is, however, a market for entrepreneurial talent that is mediated by head-hunters and merchant bankers. Using this market, it is possible for entrepreneurial people to be brought into ailing large companies in order to turn them around. Theory therefore suggests that entrepreneurship is just as likely to be found in large firms as in SMEs. Some business researchers claim that the theory of entrepreneurship does not apply to large firms because large firms are governed by routines. Others claim that large firms are controlled by groups of entrepreneurs, rather than by a single entrepreneur. These propositions are only half-truths, however. It has already been shown that short-term volatility will be handled by means of routines. Furthermore, as Schumpeter emphasised, judgemental decisions are so infrequent that not even a specialist will take them on a continuous basis. Hence even entrepreneurs carry out routine activities as part of their normal job.

Furthermore, there is nothing in the theory of entrepreneurship which limits a firm to having a single entrepreneur. Indeed, a successful entrepreneur is likely to grow his firm by developing entrepreneurial qualities amongst his employees. Decentralisation to product divisions or national subsidiaries can empower the employees of a large firm to act in an entrepreneurial way. Nevertheless, the CEO will ultimately take responsibility for coordinating the decisions of these other entrepreneurs.

7. Extending the theory: the entrepreneur as information manager

It has been repeatedly emphasised that one of the major characteristics of an entrepreneur is that he is more optimistic than other people. In particular, he believes that the chances of success of a new market-making investment are higher than other people think. This creates both problems and opportunities. The way the entrepreneur responds to these problems and opportunities has a significant influence on a firm’s behaviour. (Some of the issues raised in this section have recently been addressed by Witt (1998), but using an evolutionary approach rather than an information cost approach.)

Optimism creates an opportunity because the pessimism of other people creates a psychological barrier to entry. If the entrepreneur’s judgment is correct then, the greater this psychological barrier, the more profit is likely to made. For if other people share his optimistic estimates then they will compete for the same resources, driving up their buying price, and also compete for the same customers, driving down the selling price, and thereby eliminating the margin from which the entrepreneur derives his profit [Hayek (1937)]. If, on the other hand, other people are very pessimistic, then there will be no competition, and so the entrepreneur will be able to exploit his market power to the full.

From the entrepreneur’s point of view, the problems are just as significant as the opportunities, however. To implement his plan, the entrepreneur requires the cooperation of other people. He requires hard work from the employees who carry out the routine activities in his organisation - processing orders, collecting payments, and so on. If his investment is large, he may require independent financial backers to underwrite his judgment by incurring risks of their own. If he has developed a new product and sub-contracted its production, he will require the producer to commit himself to high quality and prompt delivery (as explained above).

One way that the entrepreneur can address these problems is by influencing the opinions of other people. He attempts to align their judgments with his own. If he can persuade his financial backers to share his optimism then he can reduce the risk they perceive, and thereby cut his cost of capital by reducing the risk premium that he must pay.

Similar considerations apply to the entrepreneur’s suppliers. A subcontractor who receives a bonus for meeting quality standards is more likely to invest in the necessary mechanisms for quality control if he anticipates that the volume of orders will grow, for if orders were to die away instead then he would be unlikely to recover the fixed cost of his investment.

The degree of optimism may also influence employees’ behaviour if they believe that the impact of their effort on measurable outcomes varies according to the state of the environment. Thus if an employee’s pay or bonus is based on some observed outcome of their work, rather than unobserved effort, and the correlation between this observed outcome and their unobserved effort is stronger when the environment provided by the entrepreneur is good, then the effectiveness of performance-related pay will be improved by good conditions. The entrepreneur will be able to reduce the level of bonus, with only a modest increase in basic salary, because the employee perceives only a modest income-related risk.

Management literature [e.g. Schein (1985)] suggests that people can obtain emotional as well as material rewards from observed success. These emotional rewards are based on the feeling of ‘making a difference’ as a result of their efforts. Similar reasoning applied to emotional rewards suggests that people who are optimistic about the situation in which they work are more likely to suppose that they can ‘make a difference’ by working hard. Conversely, if they are pessimistic then they may feel that failure is inevitable whether they work hard or not.

The natural way for the entrepreneur to promote optimism is for him to share the information on which his judgment is based. If other people are naive then they will accept his information at face value, but otherwise they may question his interpretation of the information. The entrepreneur therefore requires a reputation for honesty, and such a reputation can be costly and time-consuming to acquire. To build a reputation, the entrepreneur needs to present the evidence on which his claim is based, just as a defendant would do in a court of law. The difficulty with this is twofold. Firstly, there may be a problem with the evidence itself. No evidence may be available, because the judgement is based simply on the ‘hunch’ of the entrepreneur, or there may be so much evidence that its detail and complexity makes it impossible to explain, and so it is not worth other people's time to check it out.

By providing detailed evidence to back up his optimistic claims, the entrepreneur may undermine his bargaining power. Financial backers presented with detailed evidence may acquire sufficient information to undertake a market-making project for themselves, and thereby ‘cut out’ the entrepreneur. Employees and subcontractors may put up their prices because they believe that the value of their services is higher than they originally thought. Optimism may also encourage rivals to compete with the entrepreneur: a successful entrepreneur will wish to keep his profitability secret to avoid encouraging entry; promoting a climate of optimism is counter-productive in this respect.

The entrepreneur must therefore refine the message that he communicates to other people. He may claim that his market-making is profitable only because of unique skills that he possesses - for example, making the market requires a special type of organisation which only he knows how to design and control. This deters potential rivals from thinking that they can achieve similar results for themselves. Thus the optimism generated is not a general optimism that the conditions for everyone are good, but a specific optimism that conditions are good only because of the personal involvement of the entrepreneur.

The strategic advantage of relating optimism to the exceptional personal qualities of the entrepreneur may explain the considerable effort which entrepreneurs devote to enhancing their personal image. The heroic vision of the entrepreneur promoted through the corporate public relations departments of the firms they control is useful both for discouraging competitors, and at the same time bolstering the confidence of employees and suppliers. It is unfortunate that claims for entrepreneurial ability are often taken at face value by writers of management case-studies and business histories. By failing to recognise the strategic value of self-promotion, they inadvertently pander to the narcissism of successful entrepreneurs.

Another strategic ploy is to direct different messages to different groups of people. Shareholders, employees, suppliers and competitors may all be regarded as different ‘constituencies’ requiring reassurance on different points. While some messages, such as those extolling the personal qualities of the entrepreneur, are suitable for all constituencies, other messages are only suitable for a single constituency. For example, employers and suppliers need to be told that general trading conditions are good in order to motivate their efforts, whilst rival entrepreneurs need to be told that they are bad in order to discourage entry. If different constituencies derive their information from different sources - such as different publications - then different messages can be planted at each source to achieve the desired effect. Despite the obvious dangers of causing confusion when audiences overlap, this strategy seems to be widely used in practice.

This role of the entrepreneur as information manager explains a great deal about the personality of the successful entrepreneur. Optimism, self confidence, effective social networking and low aversion to risk have already been noted as entrepreneurial characteristics. To these can now be added the plausibility of the entrepreneur in disseminating information. Face-to-face interviews with successful entrepreneurs frequently reveal their plausibility in constructing impressive myths about themselves and their businesses. Entrepreneurs often enjoy a reputation for motivating staff by encouraging ‘positive thinking’ and setting high targets. Plausible entrepreneurs can also build consensus among different groups of shareholders by creating unanimity of perceptions. This perception involves shared optimism about the firm's prospects which is underpinned by admiration for the exceptional qualities of the entrepreneur. The theory developed in this paper therefore explains very simply why entrepreneurs devote so much time to spreading optimism among their collaborators through social networking and corporate publicity.

## Applications to other issues in the theory of the firm

It is clearly impossible within the scope of a single paper to explain in detail how the theory of entrepreneurship can be applied to all the fields of study encompassed by an integrated theory of the firm It is, however, quite straightforward to indicate in general terms the strategy that must be followed if the programme of synthesis described in section 2 is to be carried out. This section considers some outstanding issues in the theory of the firm, and shows how they can be further illuminated using the entrepreneurial perspective set out above.

The systematic promotion of optimism explains many of the human resource management practices characteristic of entrepreneurial firms. It also explains why firms find it difficult to operate in a steady state; they either grow in an atmosphere of optimism, or decline sharply in an atmosphere of pessimism. A switch to pessimism is precipitated when the entrepreneur loses credibility as a consequence of an adverse change in conditions, which he cannot explain. Once employees become pessimistic, their incentive to work diminishes, because their perceived ability to ‘make a difference’ to outcomes declines. Whilst revenues fall due to depressed demand, costs prove difficult to cut because productivity also declines, and so financial crisis ensues. Optimism may eventually be restored if the firm is taken over, though not until painful process of rationalisation has been endured.

The theory of entrepreneurship can also explain the precise form of the administrative procedures used within a firm. The theory of information cost is well adapted to explaining the derivation of optimal decision rules. In setting up the organisation, the entrepreneur identifies the main sources of volatility, estimates the cost of monitoring them, and the profit impact of responding to them. Rules are then formulated which relate decisions to inputs of information from the sources concerned. These rules are then delegated to managers for implementation. It is therefore quite unnecessary to depart from the paradigm of rationality in order to explain the administrative procedures adopted by entrepreneurs.

One reason why behaviourism has been so popular in the study of organisations is the evident difficulty that many firms have encountered in changing their rules [Nelson and winter (1982)]. This is because a change of rules is extremely costly. In practical terms it involves substantial retraining of staff and the installation of new IT systems. It can also disrupt morale by undermining traditional lines of authority within the organisation. Indeed, it could be argued that the rules selected by an entrepreneur as a basis for his organisation are the nearest thing to a fixed factor within the theory of the firm. This is because they are the single thing that is most costly to change.

The difficulty of changing the rules in large organisations will also reflect the influence of ageing on the entrepreneur. The founder of a firm is likely to be fairly old by the time his organisation has reached maturity, and the incentive for him to oversee a radical reorganisation, which may alienate some of his most loyal employees, is usually small. Accelerated succession may be one solution, provided the entrepreneur is willing to relinquish power .

The difficulty of changing the rules within large firms provided a rationale for the break-up of some large firms in the 1980s and 1990s, although other factors were important too. This involved divestments and management buy-outs in private firms, as well as the privatisation of nationalised firms. In effect, rigidities in the internal capital markets of large firms were resolved by recourse to the external market. The theory of entrepreneurship explains the timing of these changes in terms of an increase in volatility in the business environment in the late 1970s, driven mainly by the process of globalisation. The appearance of new sources of international competition fundamentally changed the patterns of volatility faced by many large firms, which had become used to a ‘quiet life’ as ‘national champions’. The increased volatility required greater flexibility, based on new forms of organisation. Where the cost of adapting procedures was too great, the large firm was often replaced by a group of small ones through divestment. The more entrepreneurial firms survived by implementing internal changes – such as ‘downsizing’, ‘delayering’ and ‘empowerment’. A significant aspect of empowerment was the promotion of ‘intrapreneurship’, i.e. a more entrepreneurial attitude by individual staff. Of course, other factors were prominent too [Bhide (1990)]: as external capital markets became more sophisticated, with a wider range of risk management tools, there were efficiency gains to be achieved by making greater use of them to allocate resources between different business areas.

The increasing focus on intrapreneurship within corporate strategy may also be explained by the growing importance of maintaining intellectual property rights in innovative industries. The legal costs of enforcing property rights are often high, and considerable expertise is required in hiring suitable counsel. The large innovative multi-product firm has an advantage over the small single-product firm in defending property rights. Hence there are significant advantages for an innovative entrepreneur in becoming an intrapreneur, provided that the internal capital market through which they receive their funds is reasonably efficient [Myers and Majluf (1984); Stein (1997)]. In other cases, they may form a joint venture or strategic alliance with a larger firm simply because of that firm’s superior ability to enforce intellectual property rights.

The most significant area in which the theory of entrepreneurship contributes to the theory of the firm is the one in which existing theories are weakest: namely the longterm survival and growth of the firm. By carefully defining the role of the entrepreneur in terms of judgemental decision-making, the theory makes it possible to discuss the market for this resource. There is a demand for entrepreneurs driven by the volatility of the environment, which creates a stream of investment opportunities which need to be decided upon under uncertain conditions. The supply of entrepreneurs is represented by people who, for one reason or another, prefer to control resources rather than to be controlled themselves. These optimistic, selfconfident and opinionated people not only look for new opportunities to found a firm; they also look for opportunities to take over resources from ageing or failing entrepreneurs less able than themselves.

## 9. Relations to other theories

Technological innovation is closely allied to entrepreneurship, as the Schumpeterian paradigm makes clear. It is a mistake, however, to identify entrepreneurship exclusively with innovation, and innovation with technology. Few entrepreneurs ever undertake radical innovations of a pure Schumpeterian type – it is well known that most innovations are of an incremental nature [Loasby (1991)]. Where a technology is expensive or unreliable, the entrepreneurial decision may be not to innovate, but to wait until the technology has been refined instead. Furthermore, not all innovations are technological: Schumpeter identified five types of innovation, and no more than two of them are technological. In this respect, the theory of entrepreneurship is more ‘true to Schumpeter’ than the modern technologically-oriented Schumpeterian paradigm, which focuses narrowly on innovations of a particular type.

The theory of entrepreneurship is generally consistent with transaction cost economics, since it is based on very similar assumptions. Both theories agree upon the importance of ‘market imperfections’ and ‘asymmetric information’. However, while transaction cost theory emphasises that people with privileged information may profit by cheating others, the theory of entrepreneurship suggests that they will profit by speculating against them as well, by investing in projects that they would not wish to invest in themselves. The theory of the market-making firm, set out above, illustrates how the two strands of theory can be combined. The theory of entrepreneurship therefore provides a richer sets of insights than conventional transaction costs theory, because it takes a broader view of information asymmetry.

It has been said that the resource-based theory of the firm is incompatible with transaction cost theory, but the theory of entrepreneurship makes it clear that this is incorrect (a similar point is made by Langlois and Robertson (1995)0. Both theories are compatible with the theory of entrepreneurship, and can therefore be synthesised within this framework [Foss (1997)].

Resource-based theory highlights the importance of human resources, as reflected in competencies and capabilities, to the performance of the firm [Teece and Pisano (1994)]. The theory of entrepreneurship simply asserts that the abilities of the entrepreneur are the principal human resource possessed by the firm. Other resources, such as the capabilities of scientists and managers, derive from those of the entrepreneur, since it is the entrepreneur who has selected the people with these capabilities to work for the firm.

The theory of entrepreneurship, however, has the advantage of a much longer intellectual tradition than resource-based theory, which is usually traced back only as far as Penrose (1959). It provides greater breadth and depth, and is therefore better qualified to afford a synthesis of the kind discussed in this paper. The greater breadth arises from the fact that it explicitly relates the capabilities of the entrepreneur to the nature of the business environment – in particular, to volatility and information cost. Its depth arises from the fact that it generalises the established rational action model of decision-making to multi-stage decision making, thereby providing specific predictions about the strategies used by entrepreneurs, and about the procedures that their organisations will employ. By generalising rational action, rather than adopting an overtly heterodox stance, the theory of entrepreneurship makes itself peculiarly well-adapted to form the basis for a synthetic view of the firm.

The key to understanding the entrepreneur is, in turn, to understand the environment in which he operates. This environment is volatile. Changes are endemic. What is more, many changes are unpredictable. Information is scarce and localised. Different people face different degrees of scarcity, and are located at varying distances from key sources of information.

Furthermore, some people have a reputation for knowing more than others because of their superior access to information. These people can influence the expectations of others. They can use their influence to align people's expectations, and thereby facilitate co-operative activity. Alternatively, they can use their influence to make other people’s expectations diverge, creating opportunities for speculation and arbitrage. Those who really do know more than others will, on average, succeed, but those who think that they know more than others when they do not will eventually fail.

Many of the key strategic issues in the theory of the firm are clarified when viewed from the standpoint of the entrepreneur. Seemingly unconnected phenomena, addressed by different partial theories of the firm, can be seen as different manifestations of the same phenomenon – namely the subjectivity of perceptions, and the relative optimism of the entrepreneur.

Although it is radical in many of its implications, the modern theory of entrepreneurship is quite conservative in terms of the analytical methods it employs. Specific areas of firm behaviour are analysed in detail using a multi-stage decision model in which decision-makers search across a range of information sources, as well as across the usual set of alternative courses of action. The implications for research are therefore quite straightforward. The implementation of the research agenda in the theory of firm requires more detailed modelling of decision problems in established areas of business strategy. It does not require more ‘brainstorming’ in search of an entirely new theory. There is a progressive research agenda which is quite straightforward to carry out.

Finding the best fit between mission, opportunities and firm capabilities is frequently a major challenge for small business owner-managers (Bryan, 1998). External consultants such as accountants or business advisors can assist effective business planning within small firms, but it is the owner-manager who must take ultimate responsibility for the plan and its implementation (Bracker and Pearson, 1985). Small business owner-managers have been found to have a less sophisticated approach to formal business planning than their counterparts in larger firms. This is generally related to a lower level of systematic data gathering or statistical analysis. However, owner-managers are strategically aware and realise the consequences of their decision (Rice, 1983). The lack of formal business planning has been attributed to the high failure rate among small firms, particularly among start-ups (Castrogiovanni, 1996). This study examined the strategic thought and planning orientation of small business owner-managers engaged in growing firms. The principal research questions that this study sought to address were:

1. What are the key managerial factors associated with growth oriented small firms?

2. Is there a difference between the managerial behaviour of small business owners who adopt formal business planning and those who do not?

3. What factors are associated with small firms that grow faster than others?

The Growth of Small Firms Research into the growth of small firms has indicated a series of stage-models in which the business moves through a number of defined stages as it grows (Churchill and Lewis: 1983). While various models identify different numbers of stages, these models generally suggest that the business is initially conceived in the mind or minds of its founders (pre start-up), is then established (start-up) and passes through several additional stages as it grows into a mature large firm. These additional stages might encompass a period of survival while the firm struggles to achieve sustainable profitability, growth (sometimes divided into early and late stages) in which the firm takes on employees, wins new markets and introduces new products. Once it starts to grow it will either plateau off or enter a further stage of expansion in which transitions from a small to a medium or even large firm before reaching maturity (Scott and Bruce, 1987). While the actual growth of individual small firms may not be as linear as such theoretical models suggest, they provide a useful framework against which to analyse the experiences of particular firms. At each stage of the process the small firm can grow, plateau or even die. In the initial stages of formation and survival the owner-manager is largely focused on keeping the business alive and must find new customers and maintain sufficient cash flows to pay running costs. The owner-manager is likely to be the most important asset the little firm has, providing all its managerial skill, direction and financial capital. It is common for many small firms to plateau and remain quite small with limited resources and local horizons. This capped-growth is usually the result of a conscious decision by the owner-manager to restrict the firm’s expansion out of a desire to avoid risk, uncertainty and 35th Entrepreneurship, Innovation and Small Business (EISB) Conference, Barcelona, Spain. 12-14 September 2005. The general problems associated with hiring more employees, winning new markets, developing new products or securing new capital investment (McMahon, 1998). There may also be a lifestyle decision involved in which the owner-manager chooses not to grow the firm due to satisfaction with a small-scale operation that delivers low stress and an easier life. Such abandonment of the desire to grow by the owner-manager may take place in the relatively early stages of development where the firm has fewer than 10 employees and sales revenues of less than US $0.5 million (usually associated with the lifestyle decision), or it may take place later when the firm has grown to around 25 employees and a sales turn over of about US $2 million (a capped-growth decision) (Hanks, Watson, Jansen and Chandler, 1993). Should the firm move successfully into a growth or expansion phase the owner-manager will be required to increase the scale and scope of its operations. Part of this expansion will involve hiring additional employees, and increasing the overall complexity of the firm’s activities. It is likely that the need for greater levels of professional management will be required to operate the firm, along with the need for enhanced planning and the introduction of systems to support the new levels of complexity. The transition from a small, owner-managed firm to a large systems-managed business will require the development of a team-based management approach with greater specialisation within the management team. Corporate governance is also likely to change as the growth cycle takes place. As it grows, the business will become more formalized in its accounting, management and other systems. The need for greater quantities of capital is likely to lead the business towards equity finance. As new equity partners are taken into the company the original owner-managers may find their level of control diminished. The larger the firm becomes the more likely its management structure will become decentralised with greater separation between the owner and the firm in terms of operational and financial matters.

The Owner-Manager’s Influence on Growth.

Although successful growth within the small business sector is contingent upon many factors, the most important is arguably the attitude of the owner-manager. The decision to grow is a risky one that many entrepreneurs choose not to make. For example, a survey of 1,996 Small and Medium Enterprises undertaken by the Japan Small Business Research Institute in 1994 found 64 per cent of respondents did not wish to grow into large corporations (Kazumi, 1995). Similar findings were produced by the Yellow Pages Small Business Index (1995) survey of Australian small businesses that found less than 10 per cent of respondents were growth oriented. The reasons why so many small business owner-managers should not desire growth are numerous. Concern over having to go into debt is a deterrent to many, particularly women (Taylor, 1986). Growth can also represent a loss of personal control by the owner-manager who may dislike the idea of passing the responsibility of running the business over to professional managers. It is important to realise that the problems associated with growth in the small business are just as difficult as those confronting much larger firms are. Effective growth strategies require careful planning and most small business lack the resources needed to undertake this (Shuman and Seeger, 1986). Efmd 35th Entrepreneurship, Innovation and Small Business (EISB) Conference, Barcelona, Spain. 12-14 September 2005.

For many small business owner-managers the decision to grow is fraught with problems (Bosworth and Jacobs, 1989). Inadequate management skills, particularly in strategic planning, can serve as a deterrent (Scase and Goffee, 1980). Access to finance has also been identified as a major impediment to small business growth in firms requiring it for R&D (Jones, 1992). The inability of the small business to seek out sources of information and technology needed for growth has also been found to act as a potential barrier (Rothwell and Beesley, 1989). According to Jones (1992) the majority of barriers to small business growth are found inside the business. These include a lack of technical and managerial skill, inadequate organisational adaptability and ability to acquire or use technology. Alpander, Carter and Forsgren (1990) in a study of 526 small early stage firms found similar results with the majority of problems being solved by logical decision making and management skills .

Research into the reasons why owner-managers from small firms might make a conscious decision to grow their business has focused in part on their psychological or personality characteristics (Moran, 1998). Some evidence exists to support a link between growth focus and the strategic orientation and entrepreneurial character of the owner-manager (Kotey and Meredith, 1997). For example, a link appears to exist between the owner-manager’s need for achievement (nAch) and their growth orientation (Perry, Meredith, and Cunnington, 1988). The importance of managerial competence as a key factor in the capacity of small firms to grow has also been highlighted in the literature (Watson, 1995). Also important is the firm’s ability to adapt and change as threats and opportunities emerge. A particular strength of small firms is their ability to flexibly adapt, with their organisational culture being adaptable due to their small size and openness. Firms with too much rigidity and formalisation or those with no structure or rules are less likely to succeed than those that can strike an effective balance (Stoica and Schindehutte, 1999).

The Benefits of Planning The benefit of formal planning to small business performance has been debated within the academic literature throughout the past twenty years. Some authors have argued that formal strategic planning is more appropriate within larger firms and of limited benefit to the financial performance of small business (Robinson and Pearce, 1984). Despite such views the empirical evidence to support the case for formal planning having a benefit to small firms has been both inconsistent and contradictory (Pearce, Freeman and Robinson, 1987). Schwenk and Schrader's (1993) examination of 14 research studies relating to formal strategic planning and performance in small business was unable to offer conclusive support to the benefits of such planning to small firms. However it did reject the notion that it was appropriate only to large firms (Schwenk and Schrader, 1993). Empirical studies of small firm performance and the relationship with formal planning suggest that such plans do make a difference although the precise nature of the link between the two is poorly defined. A study of 51 small firms by Robinson, Pearce, Vozikis and Mescon (1984) found formal planning to be beneficial to business performance regardless of the growth stage in which the business found itself. Start-up firms tended to be more profitable if the owners engaged in formal planning. Firms engaged in growth stages were likely to benefit from higher sales growth if they conducted formal planning. Efmd 35th Entrepreneurship, Innovation and Small Business (EISB) Conference, Barcelona, Spain. 12-14 September 2005.

A further study by Olson and Bokor (1995) of 442 small start-up firms supported the case for formal planning enhancing business performance although this was found to be context dependent. Characteristics of the entrepreneurs – prior management experience or previous work history – were found to be significant. Sexton and Van Auken (1985) undertook a longitudinal study of 357 small firms in Texas over a four-year period. They found formal planning was conducted by only a relatively small number of firms and concluded that adoption of systematic planning might not take place unless a strategic-planning orientation was adopted. Failure rates among firms with high-levels of formalized planning were significantly lower than among firms that had little or no formal planning. The relationship between financial performance and planning within the small firm has also not been strongly supported by previous research, although there appears to be some relationship between planning and growth (Robinson and Pearce, 1983). This lack of strong evidence between formal planning and performance raises the question as to whether it is the plan or the process of planning is most important in determining the performance of small firms (Bracker and Pearson, 1986).

Does Business Planning Really Matter?

The evidence that possession of a formal written business plan makes it more likely a business will succeed is inconclusive. Most small firms do not possess written business plans (Unni, 1984) and many entrepreneurs lack business planning skills (Posner, 1985). A review of past research studies undertaken into the benefits of strategic business planning within small firms found a positive relationship between formal strategic planning and performance. Small firms can benefit from strategic planning particularly if it involves long-range thinking and systematic screening of opportunities (Schwenk & Shrader, 1993). Further studies that examined the nature of business planning activities undertaken by small firms suggest that a relationship exists between enhanced sales growth and the implementation of sophisticated business planning techniques (Berman, Gordon & Sussman, 1997). In a study of 65 fast growth family owned businesses, the majority of companies had formal business plans. These were found to be sufficiently detailed to allow the company to control management compensation against performance benchmarks. Such firms regularly shared information with their employees and linked their company performance to business goals. Such firms were more likely to seek differentiation and innovation in products or services rather than competing on price (Upton, Teal & Felan, 2001). A relationship exists between the size of the business venture and the level of formal planning activity that takes place. Not surprisingly the larger an organisation becomes the more likely it will engage in formal business planning. Larger firms tend to employ more professionally educated managers who may encourage the preparation of business plans. However, even though the entrepreneur may not possess a formal business plan, he or she is still likely to be engaged in informal or “intuitive” business planning (Mazzarol, 2001). As the venture grows in size or seeks to develop new markets or raise external funding, the necessity for a formal business plan and related planning process increases.efmd 35th Entrepreneurship, Innovation and Small Business (EISB) Conference, Barcelona, Spain. 12-14 September 2005.

Strategic Vision Not Strategic Planning Bhide (2000) found that formal planning among successful entrepreneurs was rare, at least in the early stages of their business development. Only 28 percent of the successful entrepreneurs whom he studied had prepared a full-blown business plan prior to the launch of their new venture. Forty-one percent had not prepared any formal plan at all and 26 percent had only a rudimentary “back of the envelope” plan (Bhide, 1994). Of more importance was the ability of the entrepreneur to “hustle”, using their selling skills and communications ability, to secure strong market positions in industries where possession of proprietary assets were not the main basis of competition (Bhide, 1994; 2000). A study by Ernst & Young (2004) of 135 winners of the Australian Entrepreneur of the Year Award found that the majority (72%) considered that their greatest contribution to their business venture was the ability to provide vision and focus. The most common motivation for these entrepreneurs in launching their venture was to create a business that would fulfil their vision of the future. According to Ernst & Young (2004): A strong vision is an essential part of entrepreneurship but successful entrepreneurs also have the ability to plan the journey towards achieving their vision. The Entrepreneurs’ Barometer found that forty-six percent of successful entrepreneurs nominated effective strategy as the key factor to the success of their business. Eighty-five percent of the entrepreneurs surveyed by Ernst & Young (2004) were still engaged in active day to day management of their ventures and were largely optimistic about the future outlook for their firms. While only 36 percent were involved in export markets, at least half were seeking to move into global markets over the short to medium term (e.g. 2-3 years). The majority (60%) was seeking to raise external financial capital to assist with their business growth, but most were planning to use this funding to invest in the organic growth of their existing business model rather than to acquire other businesses. This suggests that these entrepreneurs had confidence in their own business models. Borch and Huse (1993) studied 660 small firms and the relationship between their internal resources and the strategic orientation of their senior management. This study found four types of strategic orientation that compare with the Miles, Snow, Meyer and Coleman (1978) typology of “prospector”, “analyzer”, “defender” and “reactor” strategic types. These four types were: i) “managerial firms” – that tended to be analyzers making use of market strategies for enhanced competitive positioning; ii) “technological firms” – prospector types that used product development growth strategies involving innovation; iii) “traditional firms” – which were likely to avoid growth and risk; and iv) “impoverished firms” – that lacked any coherent strategy (Borch and Huse, 1993).

Balancing the Strategic Triangle For entrepreneurs establishing new ventures the business planning process involves a balancing of three key elements: i) opportunity, ii) resources and iii) team (Timmons, 1999). The opportunity is usually a product of the entrepreneur’s own creativity or ability to spot a market opening within the market. There is usually a high degree of uncertainty associated with any entrepreneurial opportunity and the need to find resources to exploit it. The business plan becomes a process of communication that can assist the entrepreneur to secure needed. Efmd 35th Entrepreneurship, Innovation and Small Business (EISB) Conference, Barcelona, Spain. 12-14 September 2005.

Resources and guide the activities of the team. However, any business plan for an established and growing venture will need to address the interaction and management of three key elements: i) strategy, ii) structure and iii) resources, which form a “Strategic Triangle” (Mazzarol, 2005). A major challenge for the entrepreneur is to keep these three elements in balance. Within strategy the most important focus is likely to be on the identification of the firm’s strategic intent comprising a clear vision and mission that can be used to guide the business and unite the firm’s key stakeholders, particularly the employees (Hamel and Prahalad, 1989). Also important in the setting of this strategy is the ability of the owner-manager within the small firm to identify a growth path or growth vector that can be followed when seeking to expand the firm over time (Ansoff, 1965). This growth vector is likely to involve finding either new products for existing markets (e.g. an innovation strategy), or new markets for existing products (e.g. market expansion strategy). As the firm expands in order to follow its designated strategy its structure is likely to be forced to change. Structure comprises the firm’s configuration of human, physical and financial resources and must be kept in alignment with any strategy (Chandler, 1962). A key feature of business planning is to harmonise the relationship between the firm’s structure and strategy. The final consideration for the small business owner seeking growth is the issue of resources. Business strategy and planning is frequently associated with seeking to match resources to the business blueprint outlined in the structure and strategy. A problem for most small business owner-managers is a lack of resources. The opportunities for growth and the securing of a competitive advantage in selected markets is likely to be contingent on the capacity of the firm to assemble an appropriate mix of resources that offer value, uniqueness, uncertain imitability and no apparent substitutions (Barney, 1991). The owner-manager’s ability to leverage a network of internal and external relationships that can provide these resources is likely to be a key factor in their success (Jennings and Beaver, 1997).

Methodology The study drew a sample of 204 small business owner-managers who were enrolled in a university-based management development course designed to teach them strategic and operational management skills to assist them to grow their businesses. This target population was therefore atypical of the general small business population and had indicated a growth orientation by choosing to enrol in the course. This course lasted approximately twelve months and the sample was selected from a series of annual cohorts over a seven year period.

Sample Demographics The majority of the owner-managers selected for this study were male (88%) which is not untypical of the pattern of small business owner-managers found in most populations (ABS, 2002; Hankinson, 2000). All firms within the sample had less than 200 employees with the average being 20, and annual turnover ranged from as low as $50,000 to a high of $72 million with the average being $2.5 million to $3.5 million, placing these firms within the OECD parameters of small firms (OECD, 2004). The level of management sophistication in these firms was fairly low with an average of one professionally qualified manager employed (usually the owner-manager). Efmd 35th Entrepreneurship, Innovation and Small Business (EISB) Conference, Barcelona, Spain. 12-14 September 2005.

Strategic Intent of Owner-Managers In terms of strategic intent 85 percent of the sample indicated that they planned to increase production in the future, with 45 percent indicating that they were intending to open new stores or outlets and 77 percent indicating an intention to launch new products or services. Only 30 percent indicated an intention to commence exporting, and only 20 percent indicated intent to sell equity in their firm. The majority had experienced growth over the previous four years with annual average turnovers rising from $2.4 million to $3.4 million. Only 28 percent of these owner-managers reported having a formal, written business plan.

Questionnaire Design A questionnaire was developed from an original small business management framework proposed by Hall (1992). This framework comprises six key dimensions common to small high performance firms:

i) focus and direction; ii) customerising; iii) partnering; iv) personality; v) quality; and vi) systems. The first of these relates to the vision and mission of the firm, the second to marketing and customer servicing issues translating broadly into the concept of “customer delight” (exceeding expectations). The issue of “partnering” involves developing working relationships with customers, suppliers, employees and other stakeholders (eg. banks, accountants and industry associations). “Personality” relates to organisational culture, but focuses more on the owner-manager's personality with which the small business culture is closely aligned. The “quality” dimension concerns formal quality assurance process and “systems” involves the development within the firm of systems (eg. financial control, information databases) to make the growth process work. This framework had originally been developed via a qualitative study with small firms in the United Kingdom (Hall, 1992), but had been subsequently analysed using a quantitative methodology and a small sample of 88 owner-managers from Australia (Mazzarol, 1999). It was further refined using an additional larger sample of owner-managers producing 35 separate factor variables grouped within the six original dimensions (Mazzarol, 2002). These factors are shown in the appendix of this paper. The final questionnaire used in this study included 180 items measuring managerial behaviour and firm performance on 5-point Likert-type scales. In keeping with the original management performance framework outlined by Hall (1992) and Mazzarol (1999; 2002), each of the six dimensions was measured using 30 items grouped into five areas comprising six items in each area. As noted above, the questionnaire also included items measuring the owner-managers’ future growth intentions, levels of expenditure on training and marketing, and financial performance indicators in the form of gross income and profit figures for a four-year period. Prior to joining the university-based management development program each owner-manager was asked to complete the questionnaire and the findings were then discussed with them at a later training workshop which allowed the results to be validated from the perspective of respondent understanding of the questions.

Scale Development Six separate principal component (factor) analyses were undertaken with the original set of 180 items. This was necessary in order to maintain the original framework comprising the six broad managerial dimensions (Hall, 1992; Mazzarol, 1999; 2002). From the original sample of 204 owner-managers a final sample of 137 was selected due to the need to remove cases that contained missing or incomplete data. Each factor analysis involved 30 items and was examined prior to the procedure using measures of sampling adequacy (Kaiser-Meyer-Olkin and Bartlett’s test of sphericity) each of which provided confidence that the data was suitable for factoring (KMO scores ranged from 0.77 to 0.88) (Hair, Anderson, Tatham and Black, 1992). The procedure was undertaken using a varimax rotation to generate a simple factor structure and factors were selected that had eigenvalues greater than 1 in keeping with the principal components approach. Scale reliability testing using Cronbach’s alpha measure showed that all items within each factor were reliable (Cronbach, 1951).

Development of Planning and Growth Measures The questionnaire included an item that asked if the respondent had a formal, written business plan. This item was subsequently used to examine the second of the three initial research questions. To examine the first question relating to the managerial factors associated with growth oriented small firms a new variable was developed from a composite of several items. Within the questionnaire respondents were asked a series of questions relating to their future intentions to: i) significantly increase production levels; ii) open new locations; iii) introduce new products or services; iv) open the same business elsewhere and v) sell equity in the business. These items were recorded on a binary “Yes-No” scale. They were subsequently combined into a new item (GROWTH) that differentiated those who were positive on these items compared to those that were not. Of the original sample of 204 owner-managers 79 percent were classified as growth focused. To examine the third research question relating to the factors associated with small firms that grow faster than others, a further derived variable was created using the four years of annual turn over figures provided by each respondent. An annual average sales growth figure was estimated using these sales results that provided a measure of growth. Final results for this item (ANNUAL AVERAGE GROWTH) ranged from -295 percent to 61 percent with a mean annual average sales growth of 7 percent and a median figure of 12 percent.

Discriminant Analysis – Possession of Business, Plan A step-wise Discriminant Analysis was undertaken to assess the differences between owners who possessed a formal written business plan and those who did not. Discriminant Analysis is used to distinguish between two or more predefined groups and identifies those items that contribute most to any differences between such groups. Discriminant Analysis technique can involve one of three approaches: i) direct – all items are entered simultaneously; ii) hierarchical where order of entry is determined by the researcher; and iii) stepwise, where the statistical criteria alone determine the order of entry (Hair, et.al., 1992). A total of 71 cases were used in the model from the original 204, the remainder being removed due to missing or out of range data.

Comparison of High and Low Annual Average Sales Growth To further evaluate the differences between firms with above average annual sales growth from their counterparts with below average annual sales, a series of independent sample t-tests (two-tailed) were conducted. This separated the sample into two groups: i) firms with below average annual sales growth and ii) firms with above average annual sales growth. The cut point for this grouping was an average annual sales growth of 7 percent. The majority (69%) or 140 cases were grouped into the high average annual sales growth category, and the remaining 64 into the low average annual sales growth category.

Managerial factors associated with growth oriented small firms These findings suggest that a defining feature of growth orientation in small firms may be their culture, with the owner-manager’s ability to foster openness in the team environment and avoid seeing the emergence of the “Shadow Side” of business. This suggests that a growth orientation (as measured by a desire to expand production, introduce new products, open new premises or share equity) may be associated with owner-managers who engage openly with their employees and aim to keep issues above rather than below the level of open discussion. This finding needs to be considered in the context of the sample being pre-selected from owner-managers who already appeared to have expressed a desire to grow their businesses.

Formal Business Planning versus Informal Business Planning The possession of a documented business plan was found to be associated with strong use of support network partnerships, formal quality assurance practices and the ability of the ownermanager to lead change within their organisation through effective communication of their vision. It is not possible from these findings to determine if the owner-managers had developed a formal written business plan because of these qualities or if they had emerged as a result of them. Formal business planning and formal quality assurance measures would seem to be logically associated, and any small firm that was accredited with ISO/ASA 9001 quality assurance would need to develop formal business plans. The relationship with the support network might also be explained in terms of the need for the owner-manager to use a business plan as a communications tool when speaking to bank managers or seeking to access grants from the government. Most business support networks involve professional advisors who will usually require or at least encourage the development of a formal documented business plan.

Factors associated with faster growth.

Above average sales performance over a four-year period is not necessarily a measure of long term success, but it does provide a useful measure of growth. The findings from this analysis suggest that owner-managers who have above average sales growth may be more likely to have a clear personal vision for their business and to view value adding that might lead to premium pricing opportunities as a means of achieving such growth. The findings also point to the potential importance of owner-managers having a good capacity for environmental scanning to collect market intelligence, spot threats and opportunities and seek to get in some control of environmental influences. Their ability to forge working partnerships with employees and to balance the firm’s structure with its strategy, keeping the right mix of staff to service customer needs also seems important. Other factors that might be associated with faster than average growth are the owner-manager’s ability to develop a strong corporate image and goodwill within the market, to have good levels of innovation through employees and the willingness to take corrective action when key performance indicators (KPI) suggest that change is required. Finally, the possession of a business generating system was found to be associated with high than average annual sales growth. This business generating system was measure by having a clear sense of what products or services were selling in given markets and focusing on these. Important elements of this business generating system were having employees who were viewed as effective sales people, and having a “problem seeking, problem solving” approach to business generation. Also important within the business generating system was the allocation of resources for the development of new markets.

Conclusions.

These findings have implications for the education of entrepreneurs within small companies, suggesting that they should focus on developing managerial systems to benchmark their business against industry best practice. Entrepreneurs also need to be alert to environmental changes, committed to innovation and willing to change or take action if required. However, they should also recognise the importance of possessing a clear strategic vision for their venture, and the need to communicate this to others, particularly employees.

The possession of a formal, documented business plan is not necessarily a guarantee of successful growth within a small firm, however, as the owner-manager seeks to communicate their intentions within their wider support network it is likely that they will need to prepare such plans. Applying for government support grants or bank loans will generally require the development of a written business plan, as will the move to achieve formal quality assurance recognition.

Most small business owner-managers plan intuitively and the majority avoid commitment to formal business plans until external forces require it from them. Owner-managers seeking to grow are likely to benefit from a supportive organisational culture, where employees are willing to commit to future change and engaged actively with the owner in enhancing quality, developing new products and services, and eventually offering sufficient value adding to command a premium price. However, the personal vision of the owner-manager is likely to be a critical element in this. As noted in the literature review for this paper, the most important thing is not the drafting of a business plan, but the owner-manager’s ability to think and act in a strategic way. Too many small business owner-managers suffer from strategic myopia, a condition characterised by a short sighted focus on the daily operational matters that the ownership of a small firm demands. It is important for small business owner-managers to develop strategic thinking skills that allow them to stand back from the mundane and look holistically at their business and its environmental context.

The findings support the conceptual framework of the “Strategic Triangle” (Mazzarol, 2005) pointing to a relationship between growth and a combination of strategic, structural and resource related issues. They suggest the need for owner-managers to have a clear strategic vision for their business, the capacity to scan the environment and balance strategy and structure via team leadership, change management and culture. Their ability to secure the resources they need is likely to be associated with their leveraging of support network partnerships and cultivation of similar relationships with employees.

For policy makers and educators seeking to assist small businesses attention should be given to the development of strategic thinking skills. These can be developed via education programs that foster creativity, strategic thought, critical analysis, team work and strategic networking. While some focus should be given to planning skills, the task of drafting a plan is something that should follow the development of strategic thinking skills rather than lead it. Formal education programs in business management need to be flexible and tailored to the needs of the small firm sector, where owner-managers are typically busy and lack time to commit to lengthy courses. Furthermore, the curriculum for small business education needs to be focus less upon technical skills development (e.g. accounting or marketing skills), and more on team building, leadership, creative thinking and the ability to apply strategic management principles to the company.

The study has some limitations. It draws upon a small sample from a single country and a population that is somewhat atypical in nature. While useful, the use of annual average turnover and future expansion intentions as growth measures has some weakness. Future research should seek to capture a larger sample and perhaps track performance over time using longitudinal data sets. A more robust measure of growth and performance would be desirable that includes employees, sales turnover, profitability and capitalisation.

Distinctive Characteristics of Small Businesses as Sites for Informal Learning

Few studies have examined workplace factors that influence informal learning in small businesses and in general the studies are not framed by the characteristics of small businesses. To address this weakness in existing literature we conducted a review of literatures which examine (a) workplace factors that influence informal learning; (b) small business characteristics; and (c) factors influencing informal learning in small businesses. The several workplace factors that influence learning were categorised as job, relational and organisational characteristics. Each category was examined in relation to characteristics of small businesses.

We outline what is known about each category and what we need to learn about them as they relate to informal learning in small businesses. For each category propositions are generated that should be examined in future research. We also produce a heuristic conceptual framework that can be employed to focus and bound future research that tests a different set of propositions.

Introduction The view that continuous learning is a key factor in the economic viability and competitive advantage of organisations (Aguinis & Kraiger, 2009; Noe, Clarke & Klein, 2014) and the suggestion that managers should facilitate the learning of staff (Hughes, 2004; Warhurst, 2013) has important implications for small businesses. This is because small businesses (broadly defined here as those employing 10-49 people) constitute a very major part of the workplacelearning context, since they are both numerically significant and major providers of employment in national economies (Muller et al., 2015). Given the substantial knowledge and skills base situated in small businesses, how employees in these organisations acquire new knowledge and skills through learning processes are matters of major interest (Billett, Hernon-Tinning & Ehrich, 2003; Nolan & Garavan, 2016).

It is well documented that small businesses have a strong preference towards informal learning processes (Kitching, 2007; Nolan & Garavan, 2016b) and are significantly less likely to provide their employees with access to employer-sponsored formal training and development

(T&D) opportunities than large businesses (Devins, Johnson & Sutherland, 2004; Kotey and

Folker, 2007; Kyndt & Baert, 2013). However, although participation in formal T&D events can make important contributions to learning, it is not the primary mode by which people learn in work organisations (Manuti, Pastore, Scardigno, Giancaspro & Morciano, 2015; Noe et al.,

2014). Informal modes of learning, such as learning through solving novel work problems and learning through interaction with more knowledgeable people in the workplace, account for most of employees’ work-related learning (Burns, Schaefer & Hayden, 2005; Choi & Jacobs, 2011).

The effectiveness of informal learning is influenced by several workplace and personal factors

(Noe, Tews & Marand, 2013; Tannenbaum, Beard, McNall & Salas, 2010).

This focuses on workplace factors.

Despite the numerical and economic significance of small businesses in developed economies and their strong preference towards informal learning processes, few studies have examined workplace factors that influence informal learning in small businesses. Furthermore, these studies are generally not fine-tuned to the small business setting (Nolan & Garavan, 2016b). There is wide agreement amongst scholars (d'Amboise & Muldowney, 1988; Josefy, Kuban, Ireland & Hitt, 2015; Paolillo, 1984; Welsh & White, 1981) that small businesses are fundamentally different to large businesses. Thus, any attempt at elucidating distinctive characteristics of small businesses as sites for informal learning needs to consider fundamental differences between small and large businesses. We contend that a continued lack of careful attention to the specific nature of small businesses in studies which examine informal learning processes will impede the progress of this important research stream.

A different perspective of workplace learning is adopted by researchers who focus on the magnitude of creative change involved in learning processes (Olsen, 2016). For example,

Ellström (2001; 2010) and Fenwick (2003) distinguished between adaptive and innovative (or developmental) learning. Adaptive learning has its role primarily in formation of competencies for dealing with routine problems that are frequently occurring (Ellström, 2001; 2010). In

adaptive learning the learner has to evaluate outcomes of the problem resolution process and make minor corrections in the way methods were used to solve the problem at hand (Ellström,

2001; 2010). This would, for example, apply to work settings where employees have responsibility for continuous improvement of formalised work procedures. Thus, adaptive learning encompasses small, bounded change (Fenwick, 2003). In contrast, in innovative learning, the learner has to engage in a more active process of knowledge-based problem solving through experimentation, risk-taking and variance seeking (Fenwick, 2003). Innovative learning is necessary when employees encounter novel or unfamiliar situations at work for which no rules or procedural knowledge (‘know-how’) is available from previous experience. This mode of learning also occurs when employees question and act to transform institutionalised ideologies, routines, structures or practices (Fenwick, 2003). Thus, innovative learning stimulates transformational change and generates novel solutions that challenge existing practices

(Ellström, 2001; Fenwick, 2003).

Defining the Small Business There is wide agreement in the literature that small businesses are fundamentally different to large businesses (e.g. Curran & Blackburn, 2001; Josefy et al., 2015; Welsh & White, 1981). Penrose (1959) made this point by using the analogy that small and large businesses are as fundamentally different from each other as caterpillars are from butterflies. Even if one metamorphoses into the other, it would not simply be a larger version of the other. Furthermore, there is no certainty that metamorphosis will take place at all. Therefore, any definition of the small business needs to capture the fundamental differences between small and large businesses.

Scholars have struggled to develop a theoretically meaningful definition of organisation size and there is no established, widely accepted, definition of what constitutes a small business

(Curran & Blackburn, 2001; Josefy et al., 2015). Qualitatively, a small business can be described as a business which is independently owned and managed by the same individual(s) and which is not dominant in its field of operation (Bolton, 1971; d’Amboise & Muldowney, 1988).

However, qualitative definitions of the small business are difficult to operationalise, consequently researchers often use quantitative criteria, such as number of employees or sales turnover, to operationalise the small business as a construct. In this paper, a business is definedas small if it has 10-49 employees. This definition of ‘smallness’ corresponds with the European

Union definition of a small business (Muller et al, 2015).

However, organisational size as measured by criteria such as the number of employees or sales turnover, often leads to ‘size reductionism’ (Curran & Blackburn, 2001; Storey, 1994).

This is a tendency among small business researchers to explain almost every aspect of the phenomenon being studied by reference to the size criterion that has been selected. According to Burrows and Curran (1989), “size, whether measured in terms of number of employees, turnover, market share or whatever, is not a sufficiently robust criterion to allow ‘small firms’ to be isolated and analysed as being an economic and social specificity” (p. 530). This is not to suggest that size has no influence, but only that it is just one of a wide array of internal and external contingency factors that can shape the firm (Nolan & Garavan, 2016b). To help address these problems in defining a small business and arrive at a more satisfactory conceptualisation of the small business, we argue that research on informal learning in small businesses should focus on distinctive characteristics of small businesses that are potentially relevant to informal learning processes. Such a focus would also assist in bringing some coherence to research on informal learning in small businesses and enable comparisons to be made between countries and over time.

Critical Analysis of Prior Research After reviewing literature published between 1973 and 2002 on learning in small businesses,

Florén and Tell (2003) concluded that empirical research in this stream is sparse and that “the small-firm effect on learning needs to be further explored” (p. 56). To determine the state of research since Florén and Tell’s (2003) study, we decided to review the more recent research literature. In the literature review undertaken for this paper, we followed guidelines provided by

Callahan (2010; 2014) and Torraco (2005; 2016). The article inclusion criteria were as follows: (a) empirical articles; (b) published in peer-reviewed journals; (c) during the period 2000-2016; (d) reporting research located in small businesses (10-49 employees); that (e) include a focus on informal learning. Keywords for the literature search included: ‘small businesses, ‘small firm’,

‘small enterprise’, ‘SME’, ‘informal learning’, ‘workplace learning’, ‘learning environment’, ‘learning climate’, ‘learning culture’, ‘conditions for learning’, ‘learning orientation’, and combinations of these keywords. Four online databases were employed for the search: Business

Source Premier, Emerald, Scopus, and Google Scholar. Additionally, the following journals were searched with a view to making ‘serendipitous findings’ (Callahan, 2014, p. 273):

• Education & Training • Entrepreneurship Theory and Practice • Family Business Review • Human Resource Development Quarterly • International Small Business Journal • Journal of Business Venturing • Journal of Small Business and Enterprise Development • Journal of Small Business Management • Journal of Workplace Learning • Small Business Economics • Small Enterprise Research.

A second theme in the reviewed literature was the importance of the external organisational environment (typically denoted as the ‘business environment’, ‘market environment’, or ‘competitive environment’) in relation to informal learning in small businesses

(Coetzer & Perry, 2008; Kelliher & Bernadette Henderson, 2006; Lans et al., 2008). From this perspective, some characteristics of the external environment can act as a driving force for learning (e.g. severity of competition), or as learning triggers (e.g. technology developments)

(Coetzer & Perry, 2008). For example, in their longitudinal case study, Kelliher and Henderson

(2006) found that pressure from an important commercial partner resulted in the case study organisation adopting a new information system which served as an important catalyst for learning within the case study organisation. Similarly, Lans et al., (2008) found that the extent of interaction with external parties (e.g., consumers, suppliers) had an important influence on learning in the small businesses studied. A third theme is the critical role that owners/managers play in fostering informal learning in small businesses through strategic choices that they make and the resultant emphasis that they place on learning. The owner/manager is an important power-holder in determining the marketd/or the entrepreneurial orientation of the small business. Owners/managers who wish to strengthen their firm’s market orientation must build the strategic capability of customerconnection within the firm, while an entrepreneurial orientation involves seeking to gain a strategic advantage by supporting entrepreneurial behaviour within the small business (Lans et al., 2008). Moreover, there is a link between the entrepreneurial or market orientation of the business and the willingness of the owner/manager to foster learning in the business (Lans et al. 2008). In brief, the stronger the market and/or entrepreneurial orientation of the business, the stronger the learning orientation of the owner/manager (Chaston, Badger & Sadler-Smith, 2001).

The fourth and final theme that emerged from our analysis relates to the importance of creating conditions necessary for promoting informal learning in small businesses (e.g., an enabling ‘learning environment’ or a positive ‘learning culture’). The traditional way of promoting learning through providing employees with access to employer-sponsored training

(i.e. formal learning) is often criticised as an ‘ineffective’ approach and an ‘inappropriate’ way of conceptualising learning in small businesses (Anderson & Boocock, 2002; Billett et al.,

2003). Rather than relying on traditional ways of learning (e.g., attending training courses), small businesses should capitalise on their relative advantages and develop a ‘learning framework’ congruent with the distinctive characteristics of the small firm (Kelliher & Bernadette Henderson, 2006). Developing a ‘learning framework’ includes initiatives such as: utilising

localised learning support (Billett et al., 2003); providing incentives to learn and support for learning (Coetzer, 2006a; Coetzer, 2006b; Ehrich & Billett, 2004); leveraging the learning potential embedded in everyday work practice, such as team-based learning practices (Ahlgren & Engel, 2011; Birdthistle, 2008; Coetzer, 2007: McPherson & Wang, 2014); and expanding the learning potential of the work system by increasing the levels of autonomy and skill variety in jobs (Coetzer, 2006a). Within such a ‘learning framework’, the roles of owners, managers and other potential learning facilitators (e.g., peers, advisers, experts, family members) are viewed as being important in creating conditions that foster learning (Billett et al., 2003; Coetzer, 2006a;

Coetzer, 2006b; Dalley & Hamilton, 2000; Kelliher & Bernadette Henderson, 2006). However, not all of these actors have the capabilities and willingness to foster the learning of staff. For example, Coetzer (2006a) found that many supervisors do not view fostering employee learning

as a priority action, or they lack the required knowledge, skills and personal attributes to effectively perform their role in supporting the learning of staff. Additionally, managers may be more willing to foster the learning of some staff. For instance, Coetzer, Peter and Peter (2011) found that managers devoted most of their attention and resources towards fostering the learning of novices and neglected the learning of more experienced employees. Similarly, McPherson and Wang (2014) found that supervisors were less inclined to support the learning of employees who did not seem to assimilate the business owner’s work values and beliefs.

The empirical literature on informal learning in small business businesses that we reviewed has several weaknesses. First, our analysis identified methodological patterns that may negatively affect the quality of research on informal learning in small businesses. The majority of studies were qualitative and the case study method was the predominant method employed in these studies. Just four studies involved collection of quantitative data and only one study combined qualitative and quantitative data. All but one of the studies were cross-sectional. These methodological patterns point to an obvious need for more longitudinal, innovative and research context-specific approaches, such as the approaches recommended by Nolan and Garavan

(2016a). Second, most studies did not distinguish between types of learning (e.g., adaptive and innovative learning) and the differing conditions and approaches necessary to foster each type of learning. Furthermore, learning was often inadequately defined and the differences betweeincidental, informal and formal learning was often difficult to distinguish in the empirical work.

Third, few studies explicitly link informal learning to outcomes for the organisation or employees. This may be because of the challenges involved in measuring informal learning

(Skule, 2004). Finally, of particular significance from the perspective of this paper, the findings largely reflect how characteristics that determine differences among small businesses (i.e. small business heterogeneity) affect informal learning, rather than how characteristics that distinguish small businesses from large businesses (i.e. small business specificity) affect informal learning.

In the following sections of the paper we address this final limitation of the existing literature.

We do so by integrating literature streams on (1) workplace factors that influence informal learning and (2) distinctive characteristics of small businesses, in such a way that new frameworks and perspectives on the research topic of informal learning in small businesses are generated (Torraco, 2005; 2016).

Workplace Factors Influencing Informal Learning.

It is widely recognised that the workplace environment has a powerful influence on employees’ work-related learning (Ellinger, 2005; Maurer, 2002; Skule, 2004). Accordingly, scholars have sought to identify factors in workplace environments that foster or constrain employee learning

(e.g., Noe & Wilk, 1993; Kraimer, Seibert, Wayne, Liden & Bravo, 2011; Tannenbaum, 1997).

Although considerable literature is devoted to identifying such factors, no single approach to categorising these factors dominates the literature. In this paper we categorise these factors as job, relational and organisational characteristics. Job characteristics: There is wide agreement in the literature that the kinds of work activities individuals engage in can be a primary source of learning for employees (e.g. Billett,

2004; Ellström, 2001; Parker, 2014). Scholars frequently evoke the job characteristics model

(JCM) and demand-control model (DCM) to explain how job characteristics affect employee learning (Raemdonck, Gijbels & van Groen, 2014; Wielenga-Meijer, Taris, Kompier,

Wigboldus, 2010). Briefly, the JCM (Hackman & Oldham, 1975, 1980) describes the relations among (a) five core job dimensions, (b) three critical psychological states, and (c) personal as well as work outcomes. According to Hackman and Oldham, jobs that are likely to motivate performance and contribute to employee satisfaction exhibit five core job dimensions to a great degree: skill variety; task identity; task significance; autonomy; and feedback from the job itself.

These job dimensions produce three psychological states: experienced meaningfulness; experienced responsibility; and knowledge of results. The three psychological states, in turn, lead to positive personal (e.g., high internal work motivation) as well as work outcomes (e.g., low turnover and absenteeism). The model suggests that increasing the motivational potential of jobs by positively influencing one or more of the five core job dimensions will motivate performance among those employees who value opportunities for learning and growth (Oldham

& Hackman, 2010). That is, employees’ learning and growth needs strengths moderates the relationship between job characteristics and employees’ responses. The DCM (Karasek, 1979; Karasek & Theorell, 1990) focuses on the interaction between two dimensions: (a) degree of psychological demands of the job; and (b) degree of decision latitude. Job demands refer to a tasks mental workload and the mental arousal needed to carry out the task. Decision latitude is defined as a combination of an employee’s autonomy to make decisions on the job (decision authority) and the breadth of skills used by the employee on the job (skill discretion). Within the DCM, the active learning hypothesis predicts that a combination of high demands and high decision latitude will increase work motivation, learning, and personal growth.

In sum, the job characteristics model and demand-control model suggest that some job characteristics are related to workplace learning. Collectively, these job characteristics are referred to as the ‘job resources’ which are known to have positive effects on employee wellbeing, including stimulating personal growth, learning and development (Bakker & Demerouti, 2007). However, the mechanisms that connect these job characteristics to learning consequences are not yet well understood (Raemdonck et al., 2014; Taris & Kompier, 2005). Wielenga-Meijer et al. (2010) identified motivational, cognitive and behavioural processes as potential mediators of the job characteristics-learning consequences relationship. They theorised that job demands, task or skill variety, autonomy and feedback affect learning through motivational (e.g. drive for competence), cognitive (e.g. building a proper mental model) and behavioural (e.g. exploration behaviour) processes. After reviewing 85 empirical studies on relationships among job characteristics, learning processes and learning consequences they concluded that no relationship proposed in their model was disconfirmed. That is, evidence regarding relationships in their model was either absent or consistent with their hypotheses.

Relational characteristics: Several learning theories emphasise that learning is inherently socially constructed and contextually embedded (Ellinger, 2005). For example, social learning theory (Bandura, 1977) suggests that people learn by observing the behaviours or skills of other persons (‘models’) whom they believe to be credible. Learners must memorise the observed behaviours or skills and try them out in appropriate situations with the expectation that they result in the same positive reinforcement that the model received (Noe, 2017). Similarly, situated learning theory proposes that knowledge and skills are developed and made meaningful

by the context in which they are acquired and that situated learning emanates from performing authentic work activities guided by expert practitioners situated in a culture of practice (Lave &

Wenger, 1991). Consistent with tenets of these theories, research on workplace learning shows that the majority of employees’ learning occurs informally in the workplace itself and that learning from the other people with whom they work is a primary mode of learning (Eraut, 2007; Tannenbaum, 1997). Learning from other people in the workplace is likely to flourish within the context of good social relationships (Ellinger, 2005; Eraut, 2007). Characteristics of the interpersonal relationships that employees have in the workplace are likely to affect their learning behaviours.

For example, findings of social networks research that examines help seeking, information seeking, and feedback seeking behaviours in the workplace suggest that work environments in which employees trust and respect each other will help to foster such learning behaviours (e.g.

Borgatti & Cross, 2003; van der Rijt, Van den Bossche, van de Wiel, De Maeyer, Gijselaers &

Segers, 2013). As Borgatti and Cross (2003), note, there are ‘costs’ involved in asking others for assistance, such as admitting ignorance on a topic and incurring obligations due to norms of reciprocity. Thus, employees are more likely to seek information, feedback, and help with problem-solving in social environments characterised by trust, respect and accessibility to those with relevant expertise (van der Rijt et al., 2013).

Internal organisational characteristics: Studies have identified several organisational contextual factors that foster or constrain informal learning at work. For example, Ellinger (2005) used case study research to explore organisational contextual factors that may influence employees’ informal learning. In her study, factors that positively influenced informal learning included learning-committed leadership and management, and an internal culture committed to learning. Similarly, Skule (2004) analysed telephone survey data collected from 1 500 participants to identify organisational contextual factors that foster informal learning at work.

The analyses suggested that rewards for proficiency (e.g., higher wages, allocation of more interesting tasks, improved career opportunities) and exposure to demands from important actors

(e.g., customers, managers, colleagues) are just some of the many factors that foster informal learning. Findings of these and other studies (e.g., Ashton, 2004; Ellström, Ekholm & Ellström,

2008; Fuller, Unwin, Felstead, Jewson & Kakavelakis, 2007; Sambrook, 2005; Watkins &

Cervero, 2000) suggest that there are multiple organisational contextual factors that foster or constrain informal learning at work.

The Three Categories of Factors in the Small Business Context

In this section of the paper we examine each of the three categories of factors that influence informal learning in the context of small business. This is done through integrating primarily literatures which examine (1) workplace factors that influence informal learning and (2) small business characteristics.

Job characteristics:

There is a persistent view in the literature that employees in many small businesses have broad, discretionary roles and therefore high task or skill variety

(Kalleberg & Van Buren, 1996; Wallace & Kay, 2009). This may stem from small businesses being more informal workplaces with fewer documented HRM policies and procedures (e.g. job descriptions) than their larger counterparts (Storey, Saridakis, Sen-Gupta, Edwards & Blackburn, 2010). Furthermore, managers and non-managerial employees are expected to be multi-skilled, because small businesses rely on fewer personnel for multiple activities (Ghobadian & Gallear, 1997). There is also a strong theme in the literature that employees in small businesses tend to experience high levels of job autonomy (Kalleberg & Van Buren, 1996; Wallace & Kay, 2009). For example, Forth, Bewley and Bryson (2006) found that small business employees were more likely to believe that they had job autonomy than employees in larger businesses. In their study, small business employees also rated managers more highly than employees in large businesses in the extent to which they sought employees’ views, responded to employees’ suggestions, and allowed employees to influence final decisions. Arguably, employees in small businesses also experience high levels of task significance, because they can more readily see how their jobs affect the organisation (Ghobadian & Gallear, 1997). These intrinsically rewarding characteristics of jobs in small businesses (i.e. high task or skill variety, wide scope for action, and task significance) should enhance the learning potential of jobs (Oldham & Hackman, 2010).

In accordance with the above arguments, we propose the following:

Proposition 1: In small businesses, informal learning is enhanced by learning embedded in everyday goal-directed work activities, which tend to be characterised by high task or skill variety, wide scope for action, and task significance.

Relational characteristics: Literature suggests that there are distinctive relational characteristics of social environments in small businesses which have potentially important implications for informal learning. In small businesses, both the informal recruitment practices

(Williamson, 2000) and the social and spatial proximity of small workplaces (Marlow, Taylor &

Thompson, 2010), potentially contribute to forging strong ties among employees. Such strong ties could, in turn, have positive effects on informal learning. In many small businesses, recruitment of employees is done informally, with employee referral or ‘word-of-mouth’ a preferred recruitment method (Cardon & Stevens, 2004; Williamson, 2000). This method typically involves managers asking staff to help locate prospective employees. When such an approach is used, it is more likely that newcomers will be from the current employees’ familial and social milieu. Consistent with the similarity-attraction effect (Byrne et al., 1971), people employed in small businesses through the employee referral method are likely to share personal characteristics of those who recommend them. As a consequence, work groups in small businesses may tend to be homogenous. Compared to diverse groups, members of homogenous groups experience better interpersonal relations, less relationship conflict and higher satisfaction

(Thatcher & Patel, 2012). Furthermore, work groups also tend to be more cohesive when their members have regular, face-to-face interaction (Friedkin, 2004). This type of interaction is more likely to occur among group members when they work in the same physical space, as in small business settings which are characterised by social and spatial proximity (Marlow et al., 2010).

On the other hand, the tendency to employ family and friends may have dampening effects on intragroup constructive (positive) conflict which, in turn, could inhibit innovative learning (Jehn

& Bendersky, 2003).

There is also a view that small business managers have relatively better prospects of

cultivating positive employee relations and egalitarian cultures, primarily because of the managerial informality that characterises small businesses (Storey et al., 2010) and the regular and personalised communication that can occur between employer and employees (Tsai, Sen

Gupta & Edwards, 2007). Consistent with this view, a study of employment practices in SMEs and larger firms by Forth et al. (2006) found that levels of trust between managers and employees and rating of management-employee relations were highest in small businesses. Similarly, Tsai et al.’s (2007) results relating to attitudes to managers suggest that employees in small businesses have the closest, and the most satisfactory, relationships with managers. Through frequent and close contact with staff, employers can share their vision for the business, which should facilitate alignment of employee learning with strategic priorities of the small business. Thus, overall, small businesses seem to offer an array of relational benefits, such as close and satisfying working relationships with co-workers and owner-managers, and a ‘familial’ environment, that are difficult to replicate in large organisations (Saridakis, Torres & Johnstone, 2013; Tsai et al.,

2007). The socially and intrinsically rewarding nature of work in small businesses may help to explain why small business employees typically report higher levels of job satisfaction (e.g.,

Idson, 1990) and self-reported job quality (e.g., Storey et al., 2010).

Consistent with the foregoing arguments, we propose the following: Proposition 2: In

small businesses, informal learning is enhanced through the (a) tendency to involve family and friends as workers; (b) spatial and social proximity of employees; and (c) personal and frequent employer-employee interaction. Proposition 3: In small businesses, innovative learning is potentially inhibited by family labour and the formation of homogenous work groups which tend to evolve because owner-managers employ informal recruitment practices. Organisational characteristics: As noted, literature suggests that there are a multitude of organisational contextual factors that foster or constrain informal learning at work However, here we focus on just two organisational contextual factors that are specific to small businesses in general and which potentially influence informal learning in these settings. The structure of the organisation is a factor within the internal organisational environment that can have significant impacts on the quantity and quality of informal learning (Ashton, 2004; Ellinger, 2005). The nature of organisational structure is interconnected with firm size. As outlined in Josefy et al. (2015), large firms tend to have relatively tall, functional structures of the mechanistic type. They are generally more bureaucratic and reliant on formalisation to standardise employee behaviour through policies, procedures, rules and related mechanisms. Small firms, on the other hand, tend to have flat, simple structures of the organic type. In general, they have attributes of adhocracy (as opposed to bureaucracy), such as flexible, adaptable structures and informal working relationships. Organic structures are more conducive to informal learning, than structures that are mechanistic, because mechanistic structures can produce hierarchical and functional barriers that act as ‘walls’ to knowledge sharing within organisations (Ellinger & Cseh, 2007; Kuan & Aspinwall, 2004). Small businesses are characterised by the absence of a departmental or functional ‘mindset’, which is more likely to prevail in large organisations (Ghobadian & Gallear, 1997). On the other hand, informal learning may be negatively affected by limited opportunities for career development due to absenceof internal labour markets in small businesses (Wallace & Kay, 2009). Large businesses are likely to have more internal resources at their disposal, including access to learning and development specialists, such as a Chief Learning Officer (Strange, 2012). Managers who wish to foster the learning of staff should ideally have access to such specialistswho can provide them with practical advice and behavioural guidelines that will help managersenhance informal learning at work. Promoting informal learning is complicated and requires knowledge of the wide array of individual and workplace factors that potentially influence the effectiveness of informal learning (Tannenbaum et al., 2010). Small businesses rarely have designated human resource personnel to provide guidance on matters relating to people management practices in general, and employee learning in particular (Cardon & Stevens, 2004).Furthermore, fostering employee learning may receive less managerial attention in small businesses, because owner/managers typically perform a variety of day-to-day functions that are delegated to others in large businesses (Chadwick, Way, Kerr & Thacker, 2013; Florén, 2006).

Managerial attention is a critical organisational resource that is markedly constrained in small businesses (Chadwick et al., 2013).

In accordance with the foregoing arguments, we propose the following.

Proposition 4:

In small businesses, informal learning is constrained by lack of: (a) managerial attention to promoting informal learning; (b) specialised knowledge and skills required to foster informal learning; and (c) internal labour markets. Proposition 5: In small businesses, organic structures and adhocracy are facilitative of informal learning.

There are undoubtedly several other propositions relating to factors that influence informal learning in small businesses that researchers may wish to test. For these researchers we have developed a heuristic conceptual framework (Table 3) which can help to focus and bound their research. The framework was generated through integrating the theoretical and empirical works of authors referenced previously.Limitations The foregoing review is limited by its scope. First, we by no means argue that we have identified all relevant small business characteristics, nor that we have fully explored the potential effects of each characteristic on informal learning. Second, we have not examined potential effects on informal learning of external environmental factors specific to small businesses (e.g. government-backed initiatives to promote learning in small businesses). Third, while we recognise the heterogeneity of small businesses, our review did not consider factors that determine differences among small businesses, such as the industry sector. For example, small businesses that provide knowledge intensive services are likely to employ more formal models of human resource management compared to small businesses that provide standardised and simple services (Boxall & Purcell, 2016). Finally, as noted, personal characteristics (e.g.

feedback-seeking orientation) also influence informal learning, but were excluded from the review. Arguably, personal characteristics are peripheral to advancing knowledge on factors that influence informal learning in small businesses.

Conclusion

Despite the numerical and economic significance of small businesses in developed economies and their strong preference towards informal learning processes, few studies have examined workplace factors that influence informal learning in small businesses. Furthermore, these studies are typically not framed within the context of distinctive characteristics of small businesses. Thus, small business characteristics are insufficiently accounted for in findings of the small body of existing research. We contend that a lack of careful attention to the specific nature of small businesses in studies which examine informal learning processes will impede the progress of this important research stream.

Numerous interesting opportunities for future research exist within this research stream, just some of which are enunciated by our propositions. Other interesting lines of inquiry include comparative studies that examine how job, relational and organisational characteristics affect informal learning in small businesses located in different national contexts. Similarly, comparative studies of the effects of job, relational and organisational characteristics on informal learning in micro, small and medium-sized enterprises would be a potentially fruitful line of inquiry. Given the key role that owners/managers can enact in creating conditions that are favourable to informal learning, research which investigates how owners/managers should leverage job, relational and organisational characteristics to enhance informal learning could contribute to an understanding of learning-oriented leadership in small business contexts. We hope that researchers will be stimulated to pursue the propositions set forth in this paper and

other interesting lines of inquiry to advance our collective knowledge on informal learning in small businesses and that they will also heed our call to pay careful attention to distinctive characteristics of small businesses when designing their studies.

## Heuristic conceptual framework

Workplace characteristics that influence informal learning

Distinctive small business characteristics relevant to informal learning

Job characteristics: Broad jobs. Low specialisation. Multiple roles and responsibilities. Individuals can typically see results of work effort. Wide scope for action.

Relational characteristics: Employer-employee relationships are characterised by direct face-to-face contacts. Close, informal working relationships. Low level of managerial formality. Are often family businesses. Tend to rely on family labour.

Organisational characteristics: Flat, simple structures with few management layers. Flexible, adaptable structures of the organic type. Absence of departmental/functional ‘mindset’. Absence of internal labour markets. Lack of internal resources. Multi-tasked owner-managers. Modest management know-how and skills.

Small and Medium Sized Enterprises: Characteristics and Performance

Small and MediumSized Enterprises: Characteristics and Performance

The 4 Types of Small Businesses, and Why Each One Matters

Most of these small businesses don’t actually have employees. Almost 23 million are sole proprietorships, covering a wide range of sectors, from consultants and IT specialists to painters and roofers. While only about 15 million of the self-employed earn receipts of over $10,000, recent research shows that sole proprietorships are achieving record profit margins—and numerous indicators predict the number of these businesses will continue to grow as technology allows more geographic flexibility and a continuing number of baby boomers take steps to open their own firms. They provide income to their owners, but by definition are not job creators.Approach

Most of the analysis in this report is based on comparisons between SMEs and large firms (firms with 500 or more U.S.-based employees) or between SME exporters and SME non-exporters. In many cases, this involves direct comparisons of business statistics, such as total exports by SMEs versus those of large firms, or employment by SME exporters versus that of SME nonexporters. In the analysis of trade impediments, however, the Commission has relied on questionnaire responses to determine which of the impediments have a disproportionate (greater) effect on SMEs relative to large firms. To examine the role of SMEs in indirect exports (goods or services that are inputs into goods or services produced and exported by other firms), the Commission used inputoutput analysis.

Data Sources

The current report builds on the two previous Commission reports by drawing on a number of new data sources to provide additional details on the exports, international operations, and challenges faced by U.S. SMEs.6 For instance, the first report, published in January 2010, analyzed foreign affiliates of U.S. services SMEs using a firm-level commercial database, but noted that no official data existed on services exports disaggregated by firm size. The current report uses specially tabulated data from the Bureau of Economic Analysis (BEA) and the U.S. Census Bureau (Census) to report additional details regarding affiliate sales and cross-border exports of U.S. services SMEs.7 Also, the first report disaggregated SMEs by broad types of firms—manufacturers, wholesalers, and other firms—but did not include direct information on the types of goods exported by those firms. The current report takes this analysis one step further by presenting new information on the types of goods exported by SMEs, crossreferenced by firm type (e.g., chemicals exported by manufacturers versus chemicals exported by wholesalers or other firms), which allows a more in-depth analysis of the role of intermediaries in SME trade.

Similarly, the Commission’s second report on SMEs, published in July 2010, summarized the views of SMEs regarding export impediments that were gathered in a series of public hearings and interviews with SMEs throughout the United States. However, the report did not rank the reported trade impediments faced by SMEs, nor did it assess which barriers disproportionately affected SMEs relative to large firms.

Unit 10

# CONCEPTUAL PERSPECTIVES

# Objectives:

# As you study and work through this unit, you will be expected to:

# Justify the importance of converting ideas int business ventures

# Dscribe the procedure of starting a business

# Explain the different factors that lead to preparedness of starting in a business venture.

## 10.1 The Entrepreneurial Perspective

Entrepreneurs take ideas and convert them into business ventures. What one requires to be an entrepreneur is courage and passion. Anyone who wants to become an entrepreneur should consider the following:

* Why he/she wants to start his or her own business.
* How starting the business is likely to affect one’s personal life.
* The psychological and physical health preparedness needed, for example ability to work for long hours without harming one’s health.
* Aspects of the business that one sees as obstacles to business success, for example having enough capital, skills and qualified employees

***ACTIVITY***

For this activity, you will work in groups of five. Discuss the factors that might influence people to start their own business. Group Discussion (15 minutes).

1. Make a list of at least 7 factors that the group believe motivate entrepreneurs to start up new businesses**. 2.** Then consider if you are motivated by any of these factors**. 3.** Use this check list to determine your readiness to start a new venture.

# Consider Yes No **1** Will starting a business impact on your personal life and family members? **2** Will working long and irregular hours impact on your health? **3** Do you have the mental tenacity to work long and irregular hours?  **4** Do you have sufficient capital to start on a limited scale**? 5** Do you have sufficient knowledge about the business to start a new venture? **6** Do you have sufficient skills to start this new venture?  **7** Are there sufficient numbers of skilled people, potential staff, to support you?

Unit 11

# CORPORATE AND SOCIAL RESPONSIBILITIES

# Objectives:

# As you study and work through this unit, you will be expected to:

# Expalin the importance of corporate and social responsibilities

# Discuss economica and environmental concerns in businesses

# Design an approach as a project

This unit will examine the prospect of utilising corporate social responsibility and entrepreneurship (CSRE) as antidotes for mitigating the incidences of poverty, insecurity and underdevelopment in Africa. The paper derives its theoretical foundation from the stakeholder, instrumental and legitimacy theories, which all justify the use of CSRE for actualisation of Triple Bottom Line (i.e. the social, economic and environmental concerns of business organisations).

## Design/methodology/approach

The study used the quantitative research method relying on the use of secondary data published by institutional bodies. The quantitative method entail a systematic extraction of reliable data on corporate social responsibility (CSR), insecurity, poverty and development from the publications of Office of the Millennium Development Goals in Nigeria, CLEEN Foundation, National Bureau of Statistics and Central Bank of Nigeria, respectively. For missing years, the authors improvised using projections as well as proxies. The extracted data, which spanned a period of 13 years, were subjected to econometric tests using SPSS, on the basis of which informed conclusions were drawn.

The first econometric result indicates a negative relationship between gross domestic product and poverty. The second result indicates that there is a positive significant relationship between gross domestic product and total crime rate. The third result indicates that there exists a positive relationship between gross domestic product and unemployment rate. The fourth result indicates that there is a negative relationship between gross domestic product and industrial growth rate. The last result indicates that there is a significant positive relationship between gross domestic product and CSR.

##### **Practical implications**

In the face of dwindling financial resources in the treasury of governments, the reinvention of CSRE by private sector organisations as complementary mechanisms for combating social problems is becoming acceptable in both developed and developing nations. This unit therefore boldly recommends that policymakers reinvent CSRE as development mechanisms through a sound partnership between government, advocacy groups and business corporations in Africa.

Unit 12

# NETWORKING AND RESOURCE ACQUISITION

Objectives:

As you study and work through this unit, you will be expected to:

* Understanding the entrepreneurial perspective.
* Understand the role of entrepreneurship in economic development.
* Identifying sources of ideas for new agricultural ventures.
* Understanding methods for generating new agricultural venture ideas.

## INTRODUCTION:

Zambia and many African nations are developing countries and like most developing countries they are faced with a high rate of unemployment. Engaging in small scale enterprises has been seen as the best way to create more jobs and thus create more employment. Starting a business requires an enterprising mind, a mind that is able to notice business opportunities and exploit them.

## Sources of Ideas for New Entrepreneurial Ventures

Ideas are the building blocks in the establishment of new small scale agricultural ventures. Ideas rarely just pop into your head. You need to cultivate the skill of developing them. There are various strategies and sources you can use to develop entrepreneurial ideas:

 Keep an idea files or a note book: record any new business idea that comes to your mind as and when you encounter it.

 Newspapers and Magazines: read newspapers and magazines regularly and cut out and keep any interesting business ideas.

 Trade journals: identify business journals to which you can subscribe.

 Friends, family members and relatives: discuss your business ideas with them and allow their perspective to develop the idea further.

 Interact with other entrepreneurs: evaluate their businesses to see which ideas could work in your case.

***Activity***

Group Discussions (10 minutes)

Work in groups of five and brainstorm around these issues:

1. Outline the types of ideas you can get from other entrepreneurs, family and friends, trade journals and magazines. **2.** What other source has each of the group used in the past to source ideas? **3.** Just from your conversations with the group, have you thought of any new ideas? Dweinberger CC: BY NC SA

## Methods for Generating New Entrepreneurial Ideas

Ideas are abstract and need to be converted into reality. One needs to use specific methods to walk the dream. You also require details. The next steps once you have identified a good idea are:

 Read widely on your idea. Seek out as much background knowledge you can.

 Discuss your idea with friends and family. What impact will it have on them and on you?

 Research the details on your idea. What needs to be done to get it off the ground?

 Test ideas on a limited scale.

In this lesson we have learnt that entrepreneurship plays an important role in economic development. Namely:

 creating employment;

 raising living standards;

 Increasing national savings reserves and

 The provision of goods and services.

We have also seen that the following strategies and sources are good when identifying a business idea:

 Keep an idea files or note book.

 Read newspapers and magazines.

 Subscribe to trade journals.

 Talk to friends, family members.

 Interact with other entrepreneurs.

To develop the idea further it was advised that you,

 Read widely on your idea.

 Discuss your idea with friends and family.

 Research the details on your idea.

 Test ideas on a limited scale.

Unit 13

# CONCEPTUAL FRAMEWORKS OF ENTREPRENEURSHIP

## DEVELOPMENT OF ENTREPRENEURIAL MIND SET

The Role of Entrepreneurship in Economic Development

Small scale businesses play a big role in economic development. They support the economy in these ways:

 Creation of employment: the economic activities of small scale businesses require people, hence the entrepreneur will create work for other people.

 Raising living standards: the entrepreneur, as well as his/her management and workers, will receive income generated from the economic activities and thus will be able to enjoy more goods and services.

 Provision of goods and services: the entrepreneur will produce agricultural products such as milk, produced by small scale and Medium enterprises. They will also provide services to the customers such as delivering milk to them.

 Contribution to savings for further investment: the economic activities will create higher incomes and hence the entrepreneur will save some money and the savings will be available for investment.

*Activity* Case Analysis (10 minutes)

In reference to Mwalimu Njuguna’s case, outline the ways in which the small scale dairy farm has contributed to economic development.

1. Review the case study video. 2. In your journal, record in what ways Mwalimu has contributed to each of the four economic development areas mentioned above
2. Within the social sciences narrative approaches have become more popular. In recent years ithas also been suggested that entrepreneurship research would benefit from the use of a narrative approach. Interest in this direction is now emerging. The purpose of this article is to illustrate and reflect upon how narrative approaches can contribute to entrepreneurship research. The article is focused on three areas: (1) The construction of entrepreneurial identities, (2) Entrepreneurial learning, (3) (Re) conceptualizing entrepreneurship. It is argued that a narrativeapproach contributes to the literature by enriching the understanding of what motivates individual entrepreneurs and the way they run their businesses. Storytelling is closely related to entrepreneurial learning and complements other approaches. Furthermore, storytelling and story-making serve as potential metaphors for conceptualizing and reconceptualizing entrepreneurship.

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Unit 14

# NARRATIVE APPROACHES TO ENTREPRENEURSHIP DEVELOPMENT

# Objectives:

# As you study and work through this unit, you will be expected to:

# Describe different approaches in entrepreneurship

# Explain the evolution process in entrepreneurship

# Mention the main actors in entrepreneurship

## Different Approaches of Entrepreneurship.

**Entrepreneurship as a mental act.**

Mises(1949) looks at entrepreneurship from the point of view of the particular outcome which the actor aims at. Action seeks to change the future. Entrepreneurship is the comparison of the forecasted future state of the world which the actor expects to occur in the absence of his specific action with the newly made and previously-unnoticed or unforeseen forecasted future state of the world which the actor expects to result from his specific action, and the taking of the specific action by the entrepreneur to achieve his preferred future state of the world. Entrepreneurship consists in the creation of a previously-unperceived opportunity for profit and the alertness to that previously untapped opportunity, and then the taking of action to achieve the opportunity.

Misses solved the entrepreneurial task by introducing human action. Besides the agents‟ attempt to calculate economic problems, they are also alert to opportunities. Once an economic agent recognizes a market opportunity, he acts on it to improve his position. Opportunities are abundant in a situation of disequilibrium and there is the ability of human action to every economic agent.

**2.3 Evolution**.

A lot of issues are addressed that burn down to questioning the phenomenon of innovation endowment (resources, capabilities) competencies (including experience)) and non-individual, environmental factors subsuming the economic situation. The latter gives us the notion of feedback effects. The economic agents‟ decisions are influenced by economic factors (economic situation) and in return influence economic factors by their actions, e.g. by the decision to establish a firm (Becker, 1993).

**2.4 Actors.**

Entrepreneurial spirit, human capital and venture capital are an entrepreneur‟s individual endowment which can be used to act towards establishing a business venture. The entrepreneurial component can be thought of as the residual of the agent‟s (entrepreneur‟s) individual endowment which withdraws itself from empirical measurability (Mises, 1949).

2.5 **Human capital**.The human capital approach, constituted by Theodor W. Schultz and elaborated by Becker (1993) among others allows for an empirical application. It borrows from optimal investment theory by highlighting income distribution. The theoretical concept is basically derived from investment theory in physical capital using marginal analysis, agents decide in a dichotomous way; if they expect the returns of going entrepreneurial will be higher than being an employee, they will decide to become an entrepreneur (Schutz, 1971).

3. Entrepreneurship Theories

3.1 **Cantillon's theory (1755).**

This theory does not view the entrepreneur as a production factor as such, but an agent that takes on risk and thereby equilibrates supply and demand in the economy. In a neo-classical framework, this function resembles that of the optimizing residual claimant, e.g., the business owner who rents labour and capital from workers and land owners in a world of uncertain demand or production.

3.2 **Marshall’s approach to entrepreneurship.**

(Marshall, 1949). Marshall is an equilibrium creating entrepreneur. To Schumpeter, the crucial fact about the modern corporation is that its managers cannot fill the strong social role played by the entrepreneur. (Schumpeter, 1942).The Neo-classical theory and thereby the „Marshallian‟ analysis tries to explain equilibrium conditions in the markets under the assumptions of perfect knowledge and information, perfect competition (existence of many firms), existence of homogenous goods, and free entry and exit. Marshall's main concerns and at the same time goal is to show that markets clear under the perfect competition assumptions and there are no excess profit opportunities and hence there is no exploitation of labour in production process since everyone earns his marginal contribution to production and national income. Marshall Use’s small changes (innovations) in the market process by many small competitors and confusingly indicates that large scale production is essential for economic progress and economic innovation (Schumpeter, 1942). Marshall tried to create equilibrium by having many players in the market, hence perfect competition and not monopolist market. His theories consider many „great men‟ who establish equilibrium in the supply and demand in the market for goods and services. Marshallian analysis gives small contributions from a very large number of modest entrepreneurs‟ lead economic progress.

The Social Enterprise School.

Entrepreneurship is viewed as “social enterprise” initiative. This refers to any organization, in any sector, that uses earned income strategies to pursue a double bottom line or a triple bottom line, either alone or as part of a mixed revenue stream (as a social sector business) that includes charitable contributions and public sector subsidies.” Social Enterprise School centers on earned-income activity by nonprofits, but also includes market based solutions to social problems as well as businesses that generate profit that is donated to a social venture or purpose. 3.4 Schultz Approach (Schultz, 1975) Argues that entrepreneurship is closely connected to situations of disequilibria and that entrepreneurship is the ability to deal with these situations. In disequilibrium, agents are acting sub-optimally and can reallocate their resources to achieve a higher level of satisfaction. Entrepreneurship is the ability to coordinate this reallocation efficiently, and it follows that agents have different degrees of entrepreneurial ability. Schultz argues that, in disequilibrium, individuals know that opportunities to increase satisfaction exist but the reallocating process requires time. A better allocation of resources can be achieved either by experimenting (trial and error) or by investing in human capital. Schultz (1975) argues that entrepreneurship exists in all aspects of life. Thus, housewives and students are entrepreneurs when reallocating their time for housework or student activities. Furthermore, since entrepreneurship is an ability that can be augmented by investment, Schultz argues that a market for entrepreneurship exists and that it is possible to analyze entrepreneurship within the conventional supply and demand framework (Hebert and Link, 1988). Kirzner's "alert" entrepreneur (Kirzner, 1997) While in Neoclassical analysis (Marshall) the main focus is the conditions necessary to sustain an equilibrium, and Schumpeter's focus was to explain the progress in capitalistic system by using innovator entrepreneur's destructive creation, Kirzner- representing the Neo-Austrian approach to entrepreneurship- focused on answering the question of whether a market economy works and, if it does so, what is the process that leads the economy towards an equilibrium? Kirzner claims that initially the economy is in disequilibrium and the competition among 'alert' entrepreneurs leads to equilibrium. Unlike Neo-classical economists, Kirzner realizes that markets are not always clear, there is no perfectly informed representative agent and for change to occur the entrepreneurs need incentives and this incentives comes from the difference among agents in terms of information and knowledge. According to Kirzner, an improvement in the technique of production or a shift in preferences leads to change (disequilibrium) in the market where initially there was equilibrium. If there is equilibrium in the market there is nothing for the entrepreneur to do and no exchange and profit opportunities for them since everybody will be able to carry out his initially determined exchange plans. But whenever the change has occurred, some planned activities will not be realized. Kirzner states, there is no room for entrepreneurial discovery and creativity: the course of market events is foreordained by the data of market situation and for the system to create profit opportunities for entrepreneur there is need for an exogenous shock to the system. Kirzner argues that the economy is in a constant state of disequilibrium due to shocks constantly hitting the economy. Furthermore, economic agents suffer from "utter ignorance"--they simply do not know that additional information is available. In this world, the alert entrepreneur discovers and exploits new business opportunities and eliminates (some of the) "utter ignorance" and thus moves the economy toward equilibrium, which is the state where no more information can be discovered. Kirzner's analysis of entrepreneurship identifies a disequilibrium that can only be corrected (to equilibrium) by alert entrepreneurs who produce and exchange, but the emphasis is on the exchange opportunities and progress that comes mainly from this part. He postulates that entrepreneurial progress does not depend on a “great man" but it does depend on many great men, many players in the business arena. Profits from an entrepreneurial venture may not usually be very large and in some cases before the break-even point is established, the returns maybe negative. Since there is a lot of uncertainty in the business environment, profits is always a speculative affair by the entrepreneurs and therefore an entrepreneurship is an act of risk taking. Seeing risk and grabbing them may be considered too certain and requires an extra talent of people who can see the extra ordinary things. This scenario may therefore negate Kirzner theory. 3.6 Schumpeter (1999): the discovery and opportunity theory of entrepreneurship (equilibrium destruction theory) Schumpeter looks at entrepreneurship as innovation and not imitation. Schumpeter's innovator as an economic and social leader does not care much about economic profits and only joy he gets from being an innovator and being a server to his society. Schumpeter‟s entrepreneur is an innovator in the entrepreneurship arena. In the Schumpeterian theory, the entrepreneur moves the economy out of the static equilibrium. Marz (1991), states that "Schumpeter hardly denied that the process of accumulation is the ladder to social power and social prestige; but he thought the very mainspring of the exercise of the entrepreneurial function is the powerful will to assert economic leadership. The joy of carrying through innovations is the primary motive, the acquisition of social power a subsidiary to it. The entrepreneur is not (necessarily) the one who invents new combinations but the one who identifies how these new combinations can be applied in production. This line of reasoning implies that a business owner is considered an entrepreneur only if he is carrying out new combinations." The entrepreneur moves the economic system out of the static equilibrium by creating new products or production methods thereby rendering others obsolete. This is the process of "creative destruction"(creating uncertainty) which Schumpeter saw as the driving force behind economic development (Schumpeter, 1949). 3.7 Knight’s Approach (Knight, 1971) According to Knight, the main function of the entrepreneur is to assume the uncertainty related to these events, thereby shielding all other stakeholders against the entrepreneur. It could be argued that the innovating role of the entrepreneur was already identified or at least mentioned by Marshall. Knight views an entrepreneur in terms of Risk, Uncertainty and Profit. Knight recognized the distinction between risk and uncertainty. The latter is uninsurable since it relates to unique events, e.g., a shift in consumer taste. According to Knight, the main function of the entrepreneur is to assume the uncertainty related to these events, thereby shielding all other stakeholders against it. i.e., the entrepreneur exercises judgment over these unique situations, the uncertainty in the economy, and functions as an insurance agent. Knight elaborated his theory in the paper; “Profits and Entrepreneurial Functions” from 1942 (Knight, 1942, 1971). Knight explicitly argues that entrepreneurs are owners of companies, i.e., residual claimants, and thus receive profits. In order to earn a positive profit, the entrepreneur carries out three tasks (ibid): (1) he initiates useful changes or innovations; (2) he adapts to changes in the economic environment; and (3) he assumes the consequences of uncertainty related to the company. Hence, in this later .It can be argued that the Knightian theory of entrepreneurship is a refinement of the theory by Cantillon (Hebert and Link, 1988). The latter also argued that entrepreneurship is closely connected to risk/uncertainty but did not recognize the important distinction between the two. However, the „Cantillonian‟ entrepreneur is also an arbitrageur who ensures that the economy is in equilibrium-a function which is not entrusted.

Neoclassical Constraints An economy cannot be static and therefore the state of static equilibrium is unrealistic. Large profits in the entrepreneurial situation are also not easy to come by. The wholesome application of the neoclassical theories is also unrealistic.

Biological Theory of Entrepreneurship According to Eagly (1995) several of the academic theories of gender differences offer explanations based on deeply seated cultural or even biological differences between men and women. The practitioner literatures are also particularly likely to emphasize gender differences, construing them as core aspects of what it means to be a man or a woman in the entrepreneurial process. However, other especially rolebased theories emphasize that gender differences in behavior should be expected to change along with other social changes. Moreover, even theories of more stable gender differences generally also admit the co-existence of more malleable gender differences (Udry, 2001). Risk has long been a central concept in the entrepreneurship literature suggested by Adam Smith and J.S. Mill (Schumpeter, 1999) Entrepreneurial activities are frequently assumed to involve risk-taking, especially relative to managerial activities within established corporations. However, research has failed to consistently find risk-taking propensity to be a trait distinguishing entrepreneurs from others (Brockhaus, 1980; Aldrich and Wiedenmeyer, 1993; Gartner, 1989). A more promising recent line of research has suggested that entrepreneurs differ in cognitive style from others and that they may be more likely to make particular cognitive errors (Baron, 1998; Kahneman and Lovallo, 1994; Palich and Bagby, 1995), especially errors of overconfidence (Busenitz and Barney, 1997, Cooper, Dunkelberg & Woo, 1988; Manimala, 1992). Psychologists have documented moderate and consistent levels of differences between men and women in risk-taking behaviors. An analysis of 150 studies examining such differences found some evidence of a temporal trend toward smaller differences, but still found that men were significantly more likely than women to engage in 14 of 16 types of risky activities. Their results showed that “males took more risks even when it was clear that it was a bad idea to take a risk,” and that females “seemed to be disinclined to take risks even in fairly risky situations or when it was a good idea,” leading to the speculation that “men and boys would tend to encounter failure or other negative consequences more often than women and girls” and that “women and girls would tend to experience success less often than they should” (Byrnes et al., 1999, p.378).

Psychologists‟ view explains why women are risk averse and are skeptical into venturing in unfamiliar territories as regards business operations. Risk taking is one the entrepreneurial competencies that can propel a business to growth and innovation that ultimately may make a business enterprise to be successful. Risk averseness may contribute immensely to business failure and collapse. This might explain why women enterprises fail within five years of their establishment/start up. Powell and Ansic (1997) studied business decision-making and their research suggested that women prefer lower risks than men, especially in financial contexts. Their own experimental study of business students showed that women preferred less financial risk than men across a variety of framing scenarios. These views are consistent with those of Sexton and Bowman-Upton (1990), whose study suggested a lower preference for financial risks among female than among male entrepreneurs. It is also consistent with a perspective that views financial leverage as risky, women are also less likely to apply for a loan and are more likely to use personal assets to finance the enterprise or as collateral (Van Auken, 1999; Sexton and Bowman-Upton, 1990). This situation is similar to the Kenyan situation where women are more comfortable with the merry-go –round funding and micro-financing as opposed to borrowing from commercial banks as this is perceived to be less risky.

Practitioner-oriented entrepreneurship writers have frequently commented that women entrepreneurs perceive or evaluate risk differently than men, suggesting that women may be less likely to voluntarily undertake very high-risk business activities (Scollard, 1989, 1995). It has also been suggested that women may be less willing to undertake activities-such as raising external financing-that put them at risk of losing control of their business to outside stakeholders (Stolze, 1989, 1995). Scollard suggests that small elite groups of women entrepreneurs approach risk-taking in a manner similar to men, but that on average, women entrepreneurs are much less willing to undertake substantial business risks. She suggests that men build businesses of all sizes, but most women build only very small businesses, with a few building large firms: “A chasm divides the two ends of the spectrum. That chasm is the fear of risks (Stolze, 1995: 78).” Sociological Theories of Entrepreneurship.

Entrepreneurial ventures are clearly social entities from the very beginning, because even solo ventures implicitly involve a choice not to share ownership with others in the founding process. How a venture begins and whether others are recruited to join the effort can have lasting consequences for its performance and survival. Enterprises can be formed as a result of teams. Three principles underlying team formation may be distinguished: choice on the basis of homophily, purposive choice, and choice constrained by context or opportunity structure (Ruef 2001). Homophily refers to the tendency of people to associate with others similar to themselves, such as choosing others on the basis of gender or ethnicity. Purposive choice reflects people‟s tendencies to choose others who possess valuable skills, such as education or experience. Finally, opportunity structures set a context within which the first two principles operate. Founders cannot choose someone whom they have not met or have no way to reach, such as a person who works in another organization or lives in another city (Ruef et al. 2002). Entrepreneurship has a psychological contract involving a give and take „transactionionary‟ relationship in form of teamwork involving two or more individuals who jointly establish a business in which they have an equity (financial) interest. These individuals are present during the pre-start-up phase of the firm, before it actually begins making its goods or services available to the market.” By this definition, a person must be involved from the beginning and also must have an equity stake in the venture to be considered a member of the team. Much of the literature is based on the assumption that teams are a deliberate choice of a lead entrepreneur or set of founders (Kamm et al. 1990: 7). Bird (1989) postulate that there are psychological benefits derived from relationships between team members Unlike a solo entrepreneur, who must bear the burden of making decisions and facing their consequences with no one else to blame, entrepreneurial teams spread the responsibility across individuals. Having to defend decisions to other individuals also having an equity stake in the venture can make team members more confident in their decisions. Francis and Sandberg (2000: 6) noted that friendships “may hold teams together and stimulate heroic efforts during difficult times.” The Biological perspective of entrepreneurship involves a psychological satisfaction and differences in behaviors in their exhibited by different gender in their endeavors as entrepreneurs. Strategic Orientation and Resource.Recombination Innovative resource has been suggested to be the result of a high alertness to new opportunities (Zahra & Wiklund, 2000). The ability to identify and commit oneself to new opportunities has been seen as key entrepreneurial features of individuals (Casson, 1982; Kirzner 1973; Knight, 1942; Schumpeter, 1934) and firms (Stevenson 1983; Wiklund, 1998; Zahra, 1991). Stevenson (1983) suggests that entrepreneurial firms base their strategies solely on opportunities that exist in the environment, using opportunities as a starting point for developing strategies. They tend to pursue new opportunities without regard to resources currently controlled, identifying the resources necessary to exploit an opportunity after they have assessed a new strategy. Administratively managed companies, on the other hand, tend to look more at the resources they already control when developing strategies. They may be aware of the opportunities in the environment but tend to think in terms of how to best utilize and exploit the resources they already control as efficiently as possible in order to exploit new opportunities.

Recent Theories.

Recent theories of entrepreneurship build on the works described above. Shane and Venkataraman (2000) state that "entrepreneurship involves the nexus of two phenomena: the presence of lucrative opportunities and the presence of enterprising individuals" (Shane and Venkataraman, 2000). Their theory is inspired by the „Kirznerian‟ entrepreneurial discovery process but they emphasize that prior information is needed to complement the new information in the discovery of business opportunities. In this respect, they are similar to Schultz who argues that human capital is an important determinant of entrepreneurial ability. Casson (2003) tries to encompass both the Schumpeterian and the „Knightian‟ definitions by arguing that entrepreneurs are individuals who specialize in decision making. The Schumpeterian entrepreneur applies information about inventions to create new combinations and is ultimately the one who decides if the new combinations are profitable. Modern theories of entrepreneurship.

New classical growth models do not derive growth and that they do not succeed in bringing population and households into the scene. To break through the development trap, a mathematical concept- „open set‟ is used. The approach of the open set unleashes the power for unlimited growth. In addition to productive entrepreneurs, it also describes the behaviors of those unproductive and destructive ones. These latter ones are responsible for many financial crises, including the current mortgage-back crisis. ( Hak Choi, Nov.2008). The theory of entrepreneurship and the economic theory of the firm thus have much to learn from each other. A good theory of entrepreneurship should explain the conditions under which entrepreneurship takes place: the concept of entrepreneurship as judgment provides the clearest link between entrepreneurship, asset ownership, and economic organization. Similarly, the economic theory of the firm can be improved substantially by taking seriously the essential heterogeneity of capital goods and the subsequent need for entrepreneurial experimentation. 5.2 Management Economic Theories Management practices can facilitate such resource recombinations. Top management can design several aspects of the firm in more or less entrepreneurial ways (Brown & Eisenhardt, 1998; Eisenhardt & Martin, 2000). A framework can be developed that addresses the degree of entrepreneurship in firm‟s management practices along several different dimensions. A company‟s management practices range along a spectrum from highly entrepreneurial to highly administrative. A “promoter” characterizes the entrepreneurial side of the spectrum and a “trustee” characterizes the administrative side (Stevenson, 1983; Stevenson and Gumpert, 1985; Stevenson and Jarillo, 1986; 1990). The promoter‟s sole intent is to pursue and exploit opportunities regardless of resources currently controlled, while the trustee aims to efficiently use the resources currently controlled. Stevenson‟s original description of entrepreneurial management consists of six different dimensions: Strategic Orientation, Commitment to Opportunity, and Commitment to Resources, Control of Resources, Management Structure and Reward Philosophy (Brown et al., 2001). The Entrepreneur in Economic Modeling. The economic models focused on the Knightian ideas of risks bearing, individuals are modeled as being heterogeneous with respect to risk aversion (Kanbur, 1979). Other discourse assumes that individuals have identical abilities, but differ in their perception of the risks involved in owning a business; the overly optimistic individuals become entrepreneurs (Meza and Southey, 1996). Entrepreneurial skills are a sort of human capital that can be acquired through practices such as education. While many of the general theories of entrepreneurship from the previous sections focus on a role of the entrepreneur that goes beyond that of business owner or an input in the static production function, most mathematical models of entrepreneurship treat it exactly as this. The endogenous Growth theory models supports Schumpeterian models that the reward and inducement to innovations and risk taking in entrepreneurial activities is profit (Aghion and Howitt, 1997). Application of Entrepreneurship to Developing Countries. This section critically analyses the theories with particular reference to the theories application to the Kenyan entrepreneurships. 6.1 Similarities of some theories and their application to Kenya’s context. The interest of any developing nation today is surely to maximize entrepreneurship among its people. Defenders of the market economy tend to point to certain nations which they believe represent a successstory for free markets. They point to places like Hong Kong, Switzerland, Taiwan, South Korea, Japan, Singapore, and the United States etc. The odd thing about this list is that many on it have a system that departs a long way from free-market capitalism. Some are or have been highly authoritarian states with pervasive central planning (e.g. Japan, Taiwan and Singapore). Such states certainly are among the world's economic success stories of recent times but free-market capitalism is scarcely what they have in common. What they do have in common, however, is sufficient freedom to offer the prospect of relatively huge profit to entrepreneurial individuals. They also provide a climate (including real concessions) wherein business optimism can reach even new heights (Gilder, 1980). The similarities between Kirzner's and Schultz' theories on one hand and Schumpeter's on the other also appear substantial, especially with respect to the tasks performed by the entrepreneur. All three theories recognize that the entrepreneur identifies or discovers business opportunities. While Schultz defines opportunities generally, these are characterized more narrowly by Schumpeter as innovations, which move the economy away from equilibrium. Under Kirzner's and Schultz' disequilibrium assumption, opportunities arise when information is revealed. Individuals react to these opportunities by changing behavior and acting differently. This process can be compared to the Schumpeterian innovative process that also involves doing things differently. (Kirzner, 1985, 1997). Kenya‟s entrepreneurs also exploit available opportunities, are risk takers and innovators to some extent although Schumpeter (1999) and Drucker (1985) would classify them as creative imitators and imitators respectively. Kenya being free market capitalism, it can only borrow the concept of huge profits as an antecedent to entrepreneurial innovation and start up of entrepreneurial venture. In such cases what commonly happens is that the huge profits achieved are ploughed back into the business as capital for expansion. The business grows, becomes bureaucratized, loses its initial advantage as competitors copy its methods and ends up again as a very ordinary enterprise with very ordinary profits. Even so, of course, the generation and deployment of capital entailed in this process is very beneficial to the national economy concerned. Enterprises are delicate adventures and without the support of the government new enterprises cannot take off. Markets are unstable and unpredictable and the government should be perceived to be business supportive rather one that stifle business. The Kenyan government should provide an enabling environment to entrepreneurs with a view to inculcating entrepreneurial culture in Kenya. This can be done through review of the education curriculum, giving subsidies to the entrepreneurs, establishing pro business policies and finally initiate mechanisms that are credit borrowing friendly in the women fund and the youth fund to make it more accessible to the intended users. Application of the theories to Africa’s entrepreneurship. Theories of entrepreneurship are mainly designed to answer the questions: (i) how does a market system work? (ii) What is the relationship between entrepreneurship and profit? Marshallian theory which indicates the existence of perfect information and perfect competition assumptions fails to answer both questions accurately because Kenya‟s economy is not in a state of static equilibrium, it keeps on changing, hence a dynamic orientation. The Marshallian model indicates the non-existence of excess profits and does not distinguish entrepreneurship from routine production process. The Schumpeterian analysis is the closest to the reality regarding the work of Kenya‟s capitalistic market system and creation of profit. He also gives great importance to individual innovations. Kenyans being individualistic people, Schumpeter‟s‟ theory fits well into the country‟s economic context.

Although many economists accept the idea that entrepreneurs are innovators, it can be difficult to apply this theory of entrepreneurship to less developed countries (LDCs). Often in LDCs, entrepreneurs are not truly innovators in the traditional sense of the word. For example, entrepreneurs in LDCs rarely produce brand new products; rather, they imitate the products and production processes that have been invented elsewhere in the world (typically in developed countries). This process, which occurs in developed countries as well, is called "creative imitation" (Drucker, 1985). Drucker’s term appears initially paradoxical; however, it is quite descriptive of the process of innovation that actually occurs in LDCs. Creative imitation takes place when the imitators better understand how an innovation can be applied, used, or sold in their particular market niche (namely their own countries) than do the people who actually created or discovered the original innovation. Thus, the innovation process in LDCs is often that of imitating and adapting, instead of the traditional notion of new product or process discovery and development (Hak choi, 2008). Throughout the evolution of entrepreneurship theory, different scholars have posited different characteristics that they believe are common among most entrepreneurs. By combining the above disparate theories, a generalized set of entrepreneurship qualities can be developed. In general, entrepreneurs are risk-bearers, coordinators and organizers, gap-fillers, leaders, and innovators or creative imitators. Although this list of characteristics is by no means fully comprehensive, it can help explain why some people become entrepreneurs while others do not. The theories of entrepreneurships attempts to link entrepreneurship and profits. However, researchers like Schumpeter and Marshall who view an entrepreneur as an innovator fail to link the process of innovation and entrepreneurship in a situation whereby a new product/process/service has been introduced and profit is not realized. The gurus of innovation argue that an experiment may fail but one has to keep on trying until success is realized. The theorists in entrepreneurship fail to classify this type of an innovator who experiments and may one day succeed in making profits because entrepreneurship is about commitment, patience and risk taking. The models also fail to take cognizance of the break-even concept- that not all businesses realize profits immediately at start-up points. Some take time before the break-even point is met and final profits realized. The question therefore asked is “when should we start categorizing an innovator as an entrepreneur?” While it is recognized that information grants an entrepreneur the power to seize a profitable opportunity from the theories of Schultz, Shane and Venkataranam, the models fail to outline mechanisms of accessing this information and its final implementation to the process of yielding profits. Yet still, information „per se‟ can not yield a business venture. A case in point is the Kenyan university or polytechnic graduate who looks for formal employment but has a wealth of knowledge in entrepreneurship, but due to cultural practices, government policies, banking policies and the stereotype on entrepreneurships is unable to tap the information he/she has to commercialize the theories and venture into entrepreneurial practice. The Schumpeterian analysis is the closest to the Kenya situation. Kenya being a free market economy whose citizens are very individualistic, they can borrow a lot from Schumpeter’s approach, although this approach over emphasizes on the individualistic aspect and ignores the existence and success of family businesses in Kenya which reveals that generations, previous failures, team work can be an anecdote to innovation Schumpeter’s approach also ignores the existence of culture and biological influence to start up and success of innovation espoused in the biological, social and sociological schools. Research has revealed that innovation culture is a prerequisite to entrepreneurship and innovation is part of risk taking. Risk averters can never be entrepreneurs but optimistic risk bearers make it to be innovators. This is not explained by Schumpeter. Knightian and Kirzner entrepreneurships may be applied after business start-up, but what happens before the business start-up is not mentioned.

Say’s theory exists before and after business start-up, entrepreneur as the manager. The Knightian entrepreneur is an insurance agent, he equilibrates when there is an economic shock like what happened in the year 2008 to 2009 due to existence of global economic meltdown through providing goods and services needed. Kirzner moves the economy into equilibrium that is non- existent. Economies are never static and therefore equilibrium point can never be attained. While the modern theories try to capture the power of unlimited growth by using mathematical models to explain entrepreneurship behaviour; the study of organizational behaviour reveals that human behaviour is complex and unpredictable that cannot be explained by a model which tends to simplify and omit certain aspects of behaviour such as emotions which may not fit well in a model. If Kenya‟s entrepreneurs can borrow from some theories and development of entrepreneurship in the developed countries through improving on the various policy areas and their entrepreneurial culture then Kenya can be an economic hub not only in the East African region but also in Africa.

How does stigmatization affect entrepreneurs and shape their actions as ventures fail? Our evidence presents a “collective story” or a research account of a group, stigmatized entrepreneurs, whose narratives have yet to surface in the entrepreneurship literature (Richardson, 1990). This collective story can be divided into three episodes that roughly correspond to the conventional narrative structure of a transformational tale – complication of situation, climax, and resolution (Selden and Fletcher, 2010). The first episode (complication of situation) we call “anticipating failure”. It represents the time period wherein entrepreneurs begin to see venture failure as likely because of the serious, seemingly irresolvable difficulties being experienced (partnership issues, financial losses, and legal problems). The second episode (climax) we label meeting failure and it covers the months within which failure actually unfolded. During this episode entrepreneurs were busy with discontinuing businesses, declaring bankruptcy, dissolving partnerships, and so forth. The third episode we mark as transforming failure (resolution) and it entails entrepreneurs moving beyond the stigma they experienced due to venture failure. This third episode illustrates change brought about by an epiphany in the collective story – entrepreneurs had deep insights about the meaning of their failures that ultimately transformed it into a positive life experience. This positive transformation was an unexpected finding given existing research on entrepreneurial stigma that describes it as deeply discrediting of entrepreneurs (Ucbasaran et al., 2013); leading to exile (Cardon et al, 2011) and negative discrimination with regard to future employment prospects and access to resources (Cope, 2011; Shepherd and Haynie, 2011). In contrast, our entrepreneurs viewed failure, ultimately, as a positive life experience and acted on insights from epiphanies, trying to create change so that other entrepreneurs might avoid failure and escape stigmatization. Epiphanies can be revealed by narrative research and provide a nuanced understanding of how a particular phenomenon is experienced and given meaning (Denzin, 1989). The following subsections present these episodes and describe associated themes. It is important to note that there was some variation in how participants progressed through the three episodes although the majority of entrepreneurs moved through the episodes as outlined. Substantive variations are noted in the discussion below. We also describe how themes affected entrepreneurs’ actions, behaviors, and decisions.

## First Episode: Anticipating failure

Anticipating failure began when entrepreneurs started seeing the problems their ventures had as insurmountable. Participants unanimously described this episode as a demanding and highly stressful time. Entrepreneurs tried to prevent the venture from failing but most described reaching a point when failure seemed inevitable. This recognition was so “overwhelming” and “stressful” that it triggered serious personal consequences for some including panic attacks (Ian, Tania), hospitalization (Caleb, Ian) and even suicidal thoughts (Tania). The two themes that surfaced in this episode were clearly about stigmatization and we label them “castigating self” and “expecting negative judgment”.

### Stigma themes

The castigating self theme involved entrepreneurs criticizing and negatively judging themselves when the failure of their ventures began to seem inevitable. This was clearly selfstigmatization because participants mentally but continually applied negative labels and descriptions to themselves when anticipating failure. For example, Ken stated: “I was beginning to feel like a loser – like a failure.” David thought of himself as a “stupid” person and described himself as a “bad boy” who was about to “lose Mum’s money” (her investment in his business) because of his stupidity. Similarly, Tania reported thinking of herself as a failure even before her business collapsed. She described herself as stupid saying “I was dumb and stupid because I didn’t know what I was doing…I wasn’t business savvy… and I didn’t have any business ownership or management experience”. She denigrated herself for having “started something that I could not make work”. She further castigated herself by thinking “failure is a bad thing because there hasn’t been much failure in my family”. Jana described being “harder on me” than anyone else was when she realized her venture might fail. The majority of entrepreneurs blamed themselves for their ventures being on the brink of collapse and castigated themselves for disappointing family members. This can be seen in Ian’s comment, “I was letting people down, particularly my family…..I had convinced my wife that I could run the business successfully and that it was worth giving up relatively secure job in the bank”. Caleb made an analogous comment when he stated “I felt I wasn’t doing enough, I felt the pressure of my wife and kids and that was hard to live with because I tried to perform in order to protect them”. Edward felt “guilty” and found potential venture failure “hard to live with” because there were some days he was not “even able to afford to give lunch money to my kids when they went off to school”. The expecting negative judgment theme showed participants’ perceptions of others’ harsh opinions and poor treatment when their ventures were at risk of failure. Although we report entrepreneurs’ perceptions, this theme conveys social stigmatization because it indicates expectation of treatment by others. Not surprisingly, entrepreneurs expected to be treated negatively by creditors. For instance, Nigella said she expected unpleasant reactions from creditors she could not afford to pay as her business failed. She described “feeling threatened by” and being “nervous for weeks about” these creditors. Similarly, Larry “expected a lot of backlash” from businesses that were not paid as his business was failing. Bob also expected that “bankers and other people who control credit” would “look at me in a different light” and judge him as someone who “didn’t pay the bills”. Creditors were not the only group that entrepreneurs expected negative judgments from. They also expected prospective employers to perceive them unfavorably. Tania offered a good illustration of this when she described worrying about her employment prospects should her business fail. She said that a “failed business” would “not look good on my CV (resume) when I applied for a job”. Bob also became concerned about prospective employers stating that venture failure “would not put me in good shape in the future for earning money”. Poignantly, entrepreneurs were also expecting negative judgments from family members. Tania expressed this by saying she feared her husband would “turn against her” due to the setback the failed business presented for their joint standard of living.

Stigma affecting actions, decisions, behaviors

Castigating self and expecting negative judgment affected entrepreneurs’ actions, decisions and behaviors in this first episode of anticipating failure. In particular, entrepreneurs delayed or tried to avert impending failure as described by Paula. She admitted delaying the decision to end her venture because she was trying to avoid being stigmatized as a failed entrepreneur. She felt that the decision to close the business would damage her reputation and she wanted to continue enjoying her status of “successful” and “internationally recognized” entrepreneur. Paula stated that she “lost the house, the car, and everything else” and said the extent of this financial damage could have been minimized if she had “given up the business three years before”. In the same way, Edward described how he “poured money into the business and tried to keep it going” in an effort to “save face”. Edward stated: “We lost about $450,000 but we could have come out of it probably only losing $150,000 if I hadn’t been trying to save face”. Entrepreneurs engaged in behavior to cover up the fact that their ventures were at serious risk of failure. Specifically, entrepreneurs tried to keep their ventures’ precarious positions secret from others because they feared being stigmatized. For example, Bob cited a “stigma of failure” as the reason he kept “ninety-nine percent of the negative information” regarding the state of the business as a “secret”, even from his wife. He talked about the stigma of failure involving a loss of “pride”; he envisioned his friends as saying “poor Bob” and he wanted to avoid this if at all possible. He said loosing pride was almost as serious in his mind as “losing money” and the ability to “get credit and do something again in this small town”. Nigella also talked about keeping the state of her troubled business secret. She stated that “for ages” she didn’t tell her “closest friends” that her business was on the brink of failure; despite the fact that they were almost all “business women”. She didn’t tell these friends that she “couldn’t even afford Christmas dinner” because of the financial losses she was experiencing. Several entrepreneurs went beyond keeping secrets and actually lied in order to cover up the impending venture failure. David described having “tentacles of lies and deceit” running though “all his relationships” that formed a “little bubble protecting me when things started going wrong with the business”. He admitted also lying to his wife to cover up the likely failure of the business. In a similar fashion, Jana spoke of “making up stories” that covered up the tenuous state of her business. She said she did this, in part, to “keep [her] image” of a successful entrepreneur intact.

Finally, entrepreneurs shunned professional help and potential social support as the venture started to show signs of failure. Matt said he felt “grief” when his venture looked likely to fail but stated he was “not very good about admitting vulnerability and seeking help”. He was concerned that “seeking help has a stigma about it”. Bob acknowledged that if he had shared the issues plaguing the business with someone then it “might have been easier to deal with the challenges” but he did not do so at the time. Entrepreneurs also tended to shun personal relationships thereby missing out on social support when they faced the potential failure of their ventures. For instance, Nigella “stopped dating” because she believed that she “didn’t have anything to offer anyone and didn’t feel attractive anymore.” She even avoided shopping because she worried that creditors who she was not able to pay would approach her and criticize her for spending money that should be paid to them. David stated: “I stopped going to church because people there knew about me and my business.” This finding provides a somewhat unexpected and finer grained understanding of the social distancing entrepreneurs engaged in due to venture failure than previous research. Past studies suggest that entrepreneurs distance themselves socially after the failure of their ventures (Singh et al., 2007; Cope, 2011) but current findings suggest this distancing begins before actual failure. In sum, evidence from this first episode in entrepreneurs’ collective story shows that the stigma of entrepreneurial failure arises earlier than has been revealed in previous research. Scholars have argued that stigma surfaces at the time of actual venture failure (Politis and Gabrielsson, 2009) but our participants described in some detail how stigma surfaced prior to actual failure. Like Shepherd et al. (2009), we find that the negativity associated with failure surfaces in anticipation of it. Importantly, current evidence shows how the experience of stigma can contribute to venture failure in that it affected entrepreneurs’ actions, decisions, and behaviors in ways that likely exacerbated ventures’ problems. As such, stigma shaped outcomes for entrepreneurs and their ventures.

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