

Business Creation Stability: Why is it so Hard to Increase Entrepreneurship?

Paul D. Reynolds
Aston Business School, Birmingham, UK
pauldavidsonreynolds@gmail.com



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Paul D. Reynolds
Aston Business School, Birmingham, UK,
pauldavidsonreynolds@gmail.com

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Abstract

The substantial diversity among countries in the level of business creation is accompanied by a high level of year-to-year consistency for individual countries. It would appear that the national value structures are relatively stable over time, are related to a wide range of national characteristics, and have a major impact on the readiness of individuals to pursue business creation. Countries with a strong emphasis on traditional rather than secular-rational values and an emphasis on self-expressive rather than survival values have more adults ready for entrepreneurship. This leads directly to a higher national prevalence of nascent entrepreneurs and new firm owner-managers; more business creation is followed by greater economic growth. The difficulty in adjusting these national values may be the reason that the multitude of policy initiatives to increase entrepreneurship have met with limited success.

1

Introduction

Business creation is good! Good for the economy and good for the successful entrepreneurs.¹ New businesses are associated with job creation, improved productivity, innovations, and structural adaptation.² Further, they provide important career options for millions of people³;

¹Several summaries of the extent of “entrepreneurial” contributions have developed [Parker, 2005], including a review of 57 studies provides an overview of research indicating new and small firms area, but not the only source, of contributions [van Praag and Versloot, 2007]. While the conclusions support the nature of the contributions, the measures of “entrepreneurship” comingle new firms, self-employment, and small firms, complicating inferences related to the stage in the firm creation process.

²The initial claims regarding the contributions of small firms [Birch, 1981] misspecified the source of the impact; small firms are not the critical agents, the major source of impact are new firms. Assessments of small versus large firms [Brown et al., 1990, Parker, 2001] or the “self-employed” versus employee firms [Henrekson and Sanandaji, 2014] find few advantages for small firms. Subsequent assessments, focusing on new firm creation, or new entries in established markets, have found much more consistent evidence of the positive impact on net job creation (Acs and Armington, 2004; Haltiwanger et al., 2010, Table 1, p. 46); sector productivity (Aghion et al., 2009; Foster et al., 1998, 2002, 2005); and innovation [Audretsch, 1995].

³As many as 220 million may be involved with start-up ventures and 236 million managing firms less than 3.5 years old [Reynolds, 2012].

established business owners are more satisfied with their careers than wage and salary workers.⁴ It is no wonder that efforts to promote entrepreneurship and new firms are found everywhere in city, regional and national politics, save for a few command economies, such as North Korea. In many countries substantial public resources are devoted to encouraging more citizens, especially young adults, to pursue business creation.

While much attention has been given to the dramatic global diversity in business creation — some countries have over 10 times the activity of others — there has been less attention to the year-to-year consistency found in individual countries. This stability has occurred despite considerable government efforts in many countries to increase the level of activity. This leads to a major question:

What accounts for the high level of temporal stability in business creation?

The answer has considerable implications for policies oriented toward increasing new firm creation.

There has been research studying the high level of stability in the relative amount of activity across regions within countries, including the prevalence of new firm and new branch establishments across 382 labor market areas the United States over 12 years (1976–1988),⁵ the prevalence of self-employment across 174 counties in the United Kingdom over 90 years (1921–2011),⁶ and the prevalence of self-employment across 91 planning regions of Germany over 90 years (1925–2008). The German study covers 85 years that included a major depression, the World War II devastation of the infrastructure and subsequent rebuilding as well as a partitioning into Eastern and Western regions with dramatically different economic policies.⁷ In all three cases, regions at

⁴Most assessments are based on comparisons of the self-employed with those working for salaries and wages. A recent assessment of 15 European countries finds the self-employed much more satisfied with their work, but less satisfied with career security [Millan et al., 2011].

⁵Reynolds and Maki [1992], Appendix A-4.

⁶Fotopoulos and Storey [2014].

⁷Fritsch and Wyrwich [2014].

the top and the bottom of the rank orders appear in the same positions over time. There is, however, less assessments at the national level that involves harmonized measures of participation in business creation.

This pervasive pattern suggests that some stable national characteristics — or basic institutional features — are affecting individual decisions to participate in the firm creation process. The central challenge, then, is how to identify national factors that are both relatively stable and likely to have a major effect on decisions to participate in business creation.

The conceptual model and strategy for assessment is presented in Figure 1.1. The first important feature is the emphasis on the two initial stages of the firm life course. The initial, pre-profit stage, where nascent entrepreneurs are working to implement a profitable new firm is separated from the owner-managers of new firms, those ventures profitable for up to three and a half years. As the prevalence of these two stages have a modest association they are treated separately where appropriate.⁸

The second important feature of the model is the three stage process. It is assumed that national (or contextual) and individual factors affect individual readiness for entrepreneurship. The second stage focuses on the relationship between readiness for entrepreneurship and the impact on participation in the nascent or new firm phase of the firm life course. The third stage attends to the national level of activity, represented by the prevalence of adults in firm creation.⁹

The third feature of Figure 1.1 is a summary of the three phase strategy for analysis. The approach is from the outside in, so to speak.

⁸For the 93 countries in this analysis, the two prevalence rates have a correlation of 0.76, which implies that the prevalence of nascent entrepreneurs could predict 60% of the variation in the prevalence of new firm owners, leaving about 40% unexplained — or unpredicted. As shown in the following analysis, the factors predicting the prevalence of the two stages are somewhat different. Further, the variation in the ratio of new firm prevalence to nascent venture prevalence is considered to reflect variation in success at completing the firm creation process. Accounting for the variation in the proportion of nascent ventures that become profitable new firms, a very important issue, will not be discussed in this analysis.

⁹This model was developed on the basis of several prior assessments with a smaller number of countries Reynolds [2011, 2012].

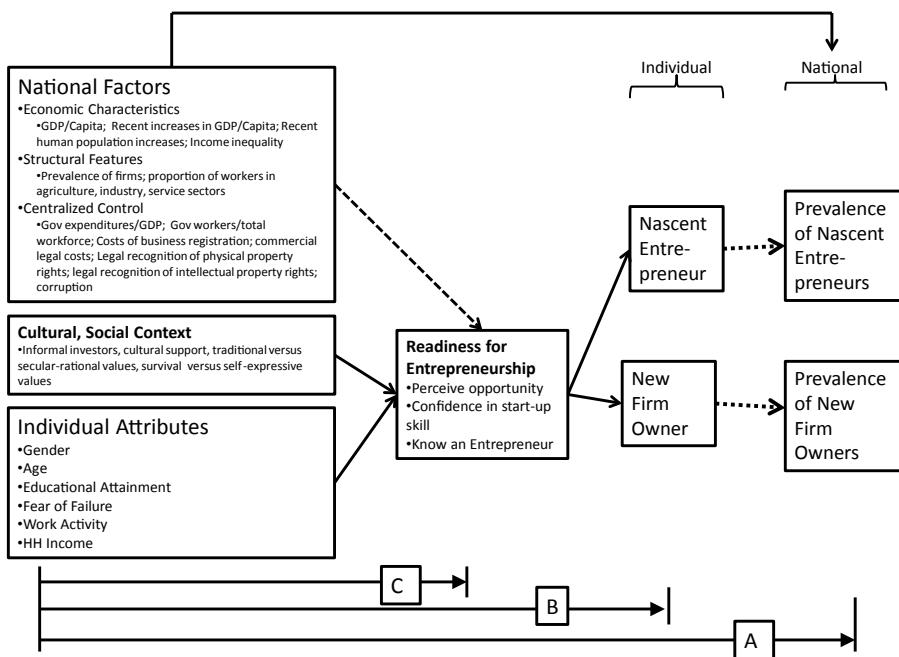


Figure 1.1: Conceptual model and strategy for assessment.

The first phase is to consider national attributes, national factors and the cultural and social context that may affect the prevalence of adults involved in the first two stages of business creation.¹⁰ The unit of analysis for this phase is the individual country and the dependent variables, prevalence of active participants, are national attributes. This is represented by the A arrow at the bottom of the model.

The second phase of the analysis is to consider the national and individual attributes associated with participation in the firm creation process. This assessment, represented by the B arrow, utilizes multi-level modeling to incorporate both national features and personal attributes in predicting whether or not individuals are involved in the first two

¹⁰The choices of variables included in the conceptual model reflect a combination of factors expected to be significant and, particularly regarding individual attributes, those available in the existing data sets.

stages of the business life course. It turns out that an individual's readiness for entrepreneurship has a major impact on participation.

This leads to the third phase, considering the national and personal attributes that lead to greater readiness for entrepreneurship, represented by the C arrow. It is this final phase where one of the more stable and significant national features — such as the country's value structure — has a major impact. These values have a strong association with perceived readiness for entrepreneurship.

The assessment utilizes two types of data on 93 countries, which represent all major regions of the world and the majority of the global population.¹¹ Data on business creation, represented by prevalence rates of those active in each country are taken from the Global Entrepreneurship Monitor [GEM] project. The information is based on responses of representative samples of individuals. Data from 1.7 million individuals was assembled from annual surveys from 2000 through 2012; for some countries there is annual data for all 13 years.¹² The second type is data on national attributes which are assembled from a wide

¹¹Some recent analyses utilizing GEM data have grouped countries as factor, efficiency or innovation driven (Kelly et al., 2010), based on classifications develop in The Global Competitiveness Reports [Schwab and Sala-i-Martin, 2012]. The implementation of the classification procedure is somewhat flexible, as different criteria are employed in making decisions about different thresholds and uncertainty about application has resulted in a shift from three to five categories. The major goal of this scheme appears to be maintaining the credibility of the overall competitive index, rather than provide a framework for understanding factors affecting national economic wellbeing. This is similar to efforts to distinguish countries and the business creation process based on the level of economic development, measured by GDP per Capita [Wennekers et al., 2005]; this assuming the process varies for countries with low, intermediate, and high levels of development. Any strategy that involves separate treatment of different kinds of countries will complicate direct comparisons based on more precise measures.

¹²The GEM national data is processed by consolidating and harmonizing all responses to individual items in a single file covering all years. This compensates for year-to-year adjustments in some details of the interview procedures and item response alternatives. The transformations to determine those respondents that qualify as nascent entrepreneurs or new firm owners are then applied to the multi-year harmonized file, ensuring that the same criteria are used for all years of data collection. For some countries and some years, the resulting prevalence rates are different from those in the published GEM global reports.

range of databases with varying degrees of completeness, consistency and reliability.¹³

While many inferences about causal processes are included in the assessment, all data analysis is cross-sectional, representing attributes of countries, characteristics of individuals, and participation in business creation from the year 2000 through 2012. This is for two reasons. First, there is considerable diversity in the number of years for which measures of business creation are available, for one third of the 93 countries data is only available for one year. In order to maximize the range of national diversity, all countries are included in the analysis. However, as will be seen in the assessment of relatively stability, there are only a few countries without substantial year to year consistency. Consolidating estimates across these 13 years increases the level of precision for the national estimates. Estimates of participation in business creation are based on the average value for all years for which data was available.¹⁴

The second major reason is the lack of temporal precision for most independent variables, the national attributes. In some cases, such as the legal system adopted for a country, the characteristic reflects a fundamental attribute that may be stable for centuries. Others, such as gross domestic product (GDP) per person corrected for purchasing power parity, are accurately estimated on an annual basis. But for some of the most important aspects, such as the size of the human population or the level of educational attainment, it is not possible to assemble precise annual measures for individual countries. Gross measures representing a decade are all that are available for many national features at this time. As temporal precision in the measures of both business creation and national attributes improves, analyses utilizing precise time lags will be possible and should increase confidence in causal inferences.

On the other hand, the phenomena of focus — business creation activity — is a major human activity with robust characteristics. The

¹³The sources and processing are discussed in detail in Appendix B.

¹⁴The 2000–2012 average is based on first computing the values for each year and then taking the average across years; this avoids the possibility that years with larger samples may have more impact on the national averages.

result is an effort that utilizes imperfect measures to develop an approximate answer to an important question.

An overview of the substantial diversity in national business creation sets the context for the assessment. The relationship between a widely used measure of economic development, GDP per capita, and subsequent levels of business creation is examined; it is clear that there is much less business creation among wealthy countries. Attention to the relationship between business creation and subsequent economic growth indicates that, once again, firm creation has a significant association with economic growth; this justifies attention to the business creation process. A discussion of within country stability in business creation focusing on the 51 countries with five or more years of data on the prevalence of business creation, provides an overview of the basic issue being addressed.

This background provides a basis for consideration of those national factors that may predict the prevalence of business creation, represented by the “A” arrow in Figure 1.1. National attributes are then used to develop linear additive models of factors affecting participation in start-up ventures and management of new firms. These models are relatively successful, explaining over 80% of the variation among 93 countries. These models do not, however, provide details about the intervening processes.

The second analysis involves the use of multi-level modeling to identify those individual and national factors that appear to affect individual participation in the business life course; attending to the relationship illustrated by arrow “B” in Figure 1.1. The units of analysis are the 1,572,402 individuals 18 to 64 years old from 93 countries.¹⁵ The major result is that readiness for entrepreneurship is a critical personal attribute associated with involvement in business creation.

The third phase, reflecting the relationship illustrated by arrow “C” in Figure 1.1, again uses multi-level modeling to explore the impact of national factors and personal attributes on the major aspects of readiness for entrepreneurship — perception of opportunity, confidence in

¹⁵Missing data on GDP per capita for the year 2000 for West Bank/Gaza reduced the count to 92 for some assessments.

personal skills to start a business, and participation in entrepreneurial networks. National values turn out to have a major impact on these aspects.

Attention to national values indicates they are highly related to the majority of national characteristics.¹⁶ The 93 GEM countries in the analysis have somewhat different national value profiles; these profiles have a systematic relation to the level of business creation. National values, in turn, appear to be related to whether or not a country has inclusive institutions, which encourage all to participate and share in economic growth, or extractive institutions, which facilitate appropriation of most national wealth for a privileged few.

The final result is a more complete understanding of both the critical national features and the underlying processes affecting participation in business creation. The major policy implication, that substantial increases in business creation will require a sustained multi-faceted approach — perhaps for decades — are discussed in the conclusion.

¹⁶As shown in Tables 9.2 and 11.1.

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