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The Determinants of Entrepreneurship in  
Developing Countries

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**DEPARTAMENT D'ECONOMIA – CREIP**  
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# The Determinants of Entrepreneurship in Developing Countries\*

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## Abstract

*We address the question of what determines entrepreneurship in developing countries. In particular, because of the influence that this may have on the design of entrepreneurship policies, our main concern is whether the determinants of entrepreneurship are the same and/or have the same impact in developed and developing countries. To this end, we discuss the arguments put forward in the literature in support of the existence of differences in the determinants of entrepreneurship between developed and developing countries. We also analyse the results found in empirical studies on the determinants of formal firm entry (following the World Bank, our proxy of entrepreneurship) in developing countries and compare these results with those typically found in developed countries. Our main conclusion is that policy makers in developing economies should be careful when using evidence from developed countries to design entrepreneurship-promoting policies.*

Key words: entrepreneurship, developing countries.

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## 1. Introduction

Entrepreneurship is key to the growth and development of nations.<sup>1</sup> New businesses directly affect economic performance by creating new jobs and/or products. However, they may also have important indirect effects: improvements in efficiency and productivity, price reductions, structural transformation, generation of new markets and innovations, greater variety of products, increased division of labour, etc. Further, the economic impact of entrepreneurship is generally not limited to the industry in which the start-up operates and/or to the region in which the entry occurs. Rather, the externalities associated with entrepreneurship spill over close-by industries and regions (Acs and Amorós, 2008).

This has motivated a number of investigations on what determines entrepreneurship (Parker, 2009). However, most of these studies provide evidence from Western Europe, North America and Japan. The determinants of entrepreneurship in developing countries, on the other hand, have been studied much less. In this paper we review this literature with the aim of addressing the question of whether the determinants of entrepreneurship are the same and/or have the same impact in developed and developing countries.

This review may help to mitigate the risk of applying policies that may not be suitable for developing countries because they are based on evidence from developed countries. It has been shown that when the same study is carried out in developed and developing countries the outcomes are usually different.<sup>2</sup> In addition, because of the considerable regional differences that exist in developing countries, this review may provide insights into entrepreneurship in (the less developed regions of the) developed economies (Bruton *et al.*, 2008; Naudé, 2011). Ultimately, this review seems necessary because of the role that developing countries are to play in the world economy, since it

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<sup>1</sup> Entrepreneurship can promote growth and development through a variety of channels (see, however, Naudé 2011 for a critical view). We should mention, among others, the role of new firms in enhancing regional job growth (Ghani *et al.*, 2011), commercialising innovations (Audretsch *et al.*, 2006), discovering the competitive advantages of a nation (Hausmann and Rodrik, 2003), increasing structural transformation by absorbing surplus labour from traditional sectors, providing innovative inputs, promoting specialization, raising productivity and employment (Gries and Naudé, 2010), and leading to gap-filling and input-completing activities (Acs and Amorós, 2008).

<sup>2</sup> Ghani *et al.* (2014) and Glaeser and Kerr (2009), for example, built similar models with data from India and the US to explain the spatial distribution of entrepreneurship. They found that the variables that account for firm distribution in India also account for firm distribution in the US, but to a lesser extent. Similarly, Fritsch *et al.* (2006: 304) identified the variables that influence the chances of survival of new businesses in West Germany and Fritsch (2004) did the same for East Germany. Estimates show that the model leads to a much lower share of explained variance in East Germany and fewer factors have a statistically significant impact on the survival of new firms, thus suggesting that the “survival of new businesses in East Germany is subject to erratic influences to a greater extent than is true in the West” (Fritsch *et al.*, 2006: 304).

is widely assumed that they will noticeably increase their share of output over the next decades (Wilson and Purushothaman, 2006).

[Insert Table 1 about here]

To perform our analysis of the determinants of entrepreneurship in developing countries, we first need to define both what our measure of entrepreneurship is and what a developing country is. However, to provide such definitions is not a simple task. As Table 1 illustrates, several measures of entrepreneurship have been proposed in the empirical literature. In fact, the same nomenclature is often used to refer to rather different phenomena. Following the proposal of the World Bank Group Entrepreneurship Survey, here we concentrate on those studies analysing registered or formal firm entry. Despite the limitations of this measure for certain analyses of entrepreneurship (see e.g. Acs *et al.*, 2008), it has the key advantage of allowing for comparisons “across heterogeneous legal regimes and economic systems” (Klapper *et al.*, 2010: 130).

As for the definition of what a developing country is, we use Porter’s (2003) taxonomy, which is based on the sources of competitive advantage (see Xavier *et al.*, 2012). In particular, we consider developing countries to be those that are in both the factor and efficiency-driven stages of Porter’s (2003) classification. These are countries where the sources of competitive advantage arise essentially from low-cost labour and access to natural resources (factor-driven stage) as well as from producing standard products and services (efficiency-driven stage).<sup>3</sup> Examples of the former include India and Vietnam, whereas examples of the latter include Argentina, Brazil, and South Africa.<sup>4</sup> Notice that in our analyses we have excluded transition economies, for their peculiarities make them very different from other developing countries.<sup>5</sup>

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<sup>3</sup> Firms in countries in the “factor-driven stage” produce commodities and simple products designed in more advanced countries, and they often have limited roles in the value chain —since technology is mainly assimilated through imports, foreign direct investment and imitation. As the income level increases, the size of the agricultural sector decreases, and manufacturing and services become more important. This is when countries join the “efficiency-driven stage”, where infrastructure quality improves, as do the procedures for starting a new firm. Technology and design still come largely from abroad, but they are usually improved through national effort.

<sup>4</sup> Although Taiwan is in neither the factor- nor the efficiency-driven stages, we have considered it as a developing country. We make this exception because entrepreneurship studies on Taiwan classify it as such (Lay, 2003) and because it has features that make it different from developed countries (Wang, 2006).

<sup>5</sup> For an analysis of entrepreneurship in transition countries, see e.g. Alexandrova (2004) for Bulgaria, Roberts and Thompson (2003) for Poland, and Rinaldi (2008) and Yang and Temple (2012) for selected industries of Russia and China, respectively.

Lastly, given our interest in the determinants of entrepreneurship, we have concentrated on those studies that report some sort of regression analysis. This means that, interesting as they might be, descriptive and case studies are not covered.<sup>6</sup> In particular, we focus on those studies that analyse the creation of formal firms that employ paid workers (thus excluding studies on self-employment). This means that our conclusions may not completely hold for countries in which the informal sector represents a substantial share of the economy (e.g, Sub-Saharan African and some Latin American countries, according to the estimates reported by Schneider *et al.*, 2010). Neither do we cover studies of high-growth firms and venture capital markets, since the sectors in which these entries usually occur are typically of minor importance in developing countries.<sup>7</sup>

The outline of the paper is as follows. In Section 2 we address the question of whether there should be any differences in the determinants of entrepreneurship between developed and developing countries. We provide supportive descriptive statistics on the existence of differences in the levels of entrepreneurship and in some of its determinants, and discuss the arguments put forward in the literature to explain such differences. In Section 3 we analyse the empirical evidence on the determinants of entrepreneurship in developing countries and compare this evidence with that from developed countries. Section 4 concludes with a summary of our main findings and a brief discussion of what policy implications may be extracted.

## **2. Differences in the determinants of entrepreneurship between developed and developing countries: Theoretical arguments**

### **2.1 Entrepreneurship and its determinants in developed and developing countries**

Differences in the levels of entrepreneurship between developed and developing countries are difficult to assess empirically.<sup>8</sup> First, entrepreneurship has different economic, statistical and legal definitions. Second, even within a common definition, there are significant differences in the quality of information records across countries. Bearing in mind these caveats, Table 2 shows that there are clear differences in the level of entrepreneurship (proxied by the number of newly registered companies with limited liability per 1,000 working-age people) between countries with different levels of

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<sup>6</sup> See e.g. the 2008 special issue of *Entrepreneurship, Theory and Practice*, 32(1).

<sup>7</sup> See e.g. the 2010 special issue of *Small Business Economics*, 34(1).

<sup>8</sup> There are three major sources of (roughly) comparable data on entrepreneurship around the world: the World Bank Group Entrepreneurship Survey (WBGES, Klapper *et al.*, 2010), the Global Entrepreneurship Monitor (GEM, Reynolds *et al.*, 2005) and the distributed micro-data base built by the World Bank from business registers and surveys from different countries (Bartelsman *et al.*, 2004).

income. If we compare the two extremes of the income distribution, for example, nearly seven more new concerns are created per working-age population in high than in low income countries. But even if we compare more homogeneous countries, such as those with upper- and lower-middle levels of income, the differences in new business density are not negligible (2-3 new firms).<sup>9</sup> Such differences suggest that the economic mechanism behind the creation of new firms in these countries is likely to be different.<sup>10</sup>

[Insert Table 2 about here]

Thus, figures in Table 2 indicate that the determinants of entrepreneurship and/or their impact may differ in developed and developing countries. But what are these determinants? What determines entrepreneurship? We use the eclectic theory of entrepreneurship to answer these questions because it has proved to be a useful framework for analysing not only the determinants of entrepreneurship (Verheul *et al.*, 2002), but also the differences in these determinants across countries (van Stel *et al.*, 2007; Freytag and Thurik, 2007; Wennekers *et al.*, 2005).

According to the eclectic theory, entrepreneurship is the result of a complex individual decision based on both opportunities and personal characteristics. This decision involves assessing alternative types of employment (e.g., self employment versus wage employment) in a process mediated by the individual's risk-reward profile. Thus, given a particular institutional setting (defined essentially by macroeconomic conditions, government regulations and knowledge generation structures), the aggregate of these individual decisions results in a demand and supply function of entrepreneurship. On the one hand, the demand for entrepreneurship arises from the opportunities of starting a firm, which in turn may originate from the consumer's side (demand characteristics such as size, stability and diversity) and/or the firm's side (e.g., barriers to entry and exit, size, age, technological regime and intensity, outsourcing,

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<sup>9</sup> Notice that these differences are even greater if business density is used as a proxy for entrepreneurship (number of existing registered companies with limited liability per 1,000 working-age people), for business density is much higher in developed countries than in developing countries (Klapper *et al.*, 2010). Also, these differences cannot be attributed to the characteristics of the statistical source, for although the GEM data tend to report higher levels of entrepreneurship in developing economies than the WBGE Survey, it also reports lower levels for developed countries. Still, these sources are likely to be capturing different aspects of entrepreneurship (Acs *et al.*, 2008).

<sup>10</sup> The convex relation between income and business density that emerges from Table 2 has been previously reported in a number of studies (Klapper and Love, 2011a and 2011b). Acs *et al.* (2008), for example, find that the World Bank entry rate shows a positive linear relationship with economic development, while the Complex Global Entrepreneurship Context Index has a positive, S-shaped relationship with development. In terms of Porter's (2003) classification, this means that entrepreneurship increases with income in the factor-driven stage but not in the efficiency-driven stage, as necessity entrepreneurship decreases and innovation comes from the outside. In the innovation-driven stage, however, entrepreneurship increases again (new innovative start-ups in high income countries).



and the diversity and complexity of the productive structure [Porter, 2003], including such business environment characteristics as the quality of input conditions, rivals' strategy, and the availability and quality of local suppliers and related industries). On the other hand, the supply of entrepreneurship is determined by the opportunity cost of starting a new firm and such characteristics of the population as age structure, resources and abilities of individuals, attitudes towards entrepreneurship, culture, individual skills, unemployment, income disparity, education, ethnic background, etc.

However, do these factors differ between developed and developing countries? In Table 2 we report, for different levels of income, the mean values over the decade 2000-2010 of a set of indicators related to the industrial structure and the infrastructure (supply factors) as well as the cost-and-time of doing business and the population (demand factors). These figures show that developed countries have a high-income level (their average GDP *per capita* is nearly 35 times the average GDP *per capita* of low income countries) and a highly educated population, which is growing slightly, ageing, and located mainly in urban areas. Also, the industrial structure shows a high share of services. Developing countries, on the other hand, are poorer and the demand for goods and services is weaker and less diverse. The population is growing, but it is more concentrated in rural areas (so the agricultural sector is larger). Lastly, they have worse infrastructures and both the time required to start a business and its costs are very high.

## **2.2 Why should (some of) the determinants of entrepreneurship in developed and developing countries be different?**

All in all, we find notable differences in (some of) the determinants of entrepreneurship in developed and developing countries. What remains to be analysed is whether these determinants and/or their impact are the same in developed and developing countries. Below we discuss the arguments put forward in the literature in support of the existence of differences in the determinants of entrepreneurship between developed and developing countries. We first analyse the institutional setting (macroeconomic stability, public policies and knowledge) and then demand (industrial structure and income) and supply factors (income and financing).<sup>11</sup> We leave for the next section the analysis of the empirical evidence.

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<sup>11</sup> Notice that we have not considered cultural factors because they are generally not available for the empirical analysis (Verhuel *et al.*, 2002). As for other possible factors, a caveat is in place: the fact that they have not been considered in the extant literature does not necessarily mean that they are common to and /or are expected to have the same impact in developed and developing countries (some factors may e.g. not have been considered simply because the appropriate differentiating argument has not been found

### **2.2.1 Macroeconomic stability**

Macroeconomic instability and the intense cyclical variations that characterize (most) developing countries may induce patterns of entry that are different from the ones observed in developed countries. Such macroeconomic volatility adversely affects investment projects because of the difficulties in anticipating the evolution of key variables (Katz and Bernat, 2011). Moreover, when uncertainty is high, decisions are taken on a shorter-term basis and firms demand a greater return on their projects. Economic downturns also have long-term consequences both in terms of the attrition of human capital, which may inhibit new firm formation in the following years (Stiglitz, 1998). Lastly, as Caballero and Hammour (2001) point out, recurrent crises are an obstacle to creative destruction because of the resulting tight financial-market conditions.<sup>12</sup> In sum, fewer entries are expected in a volatile macroeconomic environment. These entries also tend to be initially smaller than in developed countries and restricted to low-tech activities and/or activities that are highly profitable in the short term.

### **2.2.2 Public policies**

Firm entry may be encouraged by public programs, but in developing countries these are usually under-developed and/or are quite inefficient (see e.g. Carbonell, 2005, for the case of Latin America). Governments also have a major role in providing basic infrastructures (roads, energy, water supply, ports, telecommunications, etc.), but these investments are usually insufficient in most developing countries (Alcorta and Peres, 1998). Lastly, because of the difficulties of establishing a long-term industrial policy (due e.g. to the political turmoil that many developing countries face), entries are expected to closely reflect the comparative advantage of the country, typically linked to natural resources or labour intensive industries.<sup>13</sup>

Public regulations also influence the choice between entering the formal or informal sector, since entrepreneurs are likely to operate informally in order to avoid

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yet).

<sup>12</sup> The origin of instability may also differ between developed and developing countries. In particular, financial crises and recessions in developing countries arise mostly from fluctuations in international demand and worldwide credit constraints (Heymann, 2010).

<sup>13</sup> Macroeconomic instability may also affect public policies. For example, high macroeconomic volatility may undermine the institutionalization of industrial policies and prevent the consolidation of national firms, as the profitability of activities depends on the exchange rate, credit conditions, etc. Similarly, volatility may impact tax compliance, so the government may not have a stable base of resources to undertake public programs and/or provide public services.

bureaucracy, taxes, and product, market and labour regulations (Gërkhani, 2004).<sup>14</sup> Notice, however, that the informal sector may also encourage formal entry by acting as a “stepping stone”: entrepreneurs may first enter the informal sector to “test the water” before deciding whether or not to enter the formal sector (Bennett, 2010). In any case, the informal sector represents a considerably higher percentage of GDP in developing countries, where it is mainly a marginal activity with low income and little accumulation and characterized by labour intensity and low technology.<sup>15</sup>

Lastly, changes in the regulatory framework may have different impacts on developed and developing countries. For example, as firms in poorer countries have fewer capabilities and resources, they derive less benefit from trade liberalization measures and are less able to capture the benefits of network operation. Moreover, liberalization measures may have unequal effects on regions and industries in a single country (see e.g. Aghion *et al.* 2005 for an analysis of the Indian reforms in 1991).

### **2.2.3 Knowledge**

Knowledge systems in developing countries usually have acute deficiencies that prevent technology-based firms from emerging. In Latin America and the Caribbean, for example, science and technology institutions are weak, rigid and face severe financial restrictions; links and interactions between government support organisations, firms and academia are tenuous; research and services do not match the demand; investment in human capital is low; and public policy is only partially effective (Alcorta and Peres, 1998). In particular, since only a few entrepreneurs have a college education, most do not start high-growth business (for Latin America see Kantis *et al.*, 2005).

Innovative entry may also be limited by the industrial structure (see below for a specific analysis). For example, in low- and middle-income countries, industry concentrates on activities characterized by routinised technological regimes, in which technical knowledge is carried by incumbent firms. Moreover, incumbents may enjoy advantages by incorporating technical progress regardless of whether the relevant knowledge is

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<sup>14</sup> Interestingly, Ghani *et al.* (2014) find that the variables that explain firm entry in the Indian organized manufacturing sector are not relevant in the unorganized sector and vice versa. Also, in the unorganized sector, population and agglomeration effects have a much greater role, whilst strict labour regulations discourage entrepreneurship in registered manufacturing.

<sup>15</sup> In 2005 the informal sector was about 13.5% for OECD countries; 17.5% for East Asia and Pacific; 20.8% for other high income countries; 25.1% for South Asia; 27.3% for Middle East and North Africa; 34.7% for Latin America and the Caribbean; 36.5% for Europe and Central Asia and 38.4% for Sub-Saharan Africa (Schneider *et al.*, 2010).

external or internal to the firm (Burachik, 2000). This contrasts with advanced countries, where small, new firms enjoy an innovative advantage if the relevant knowledge is codified and external to incumbent firms. Thus, firms mainly innovate by imitating or incorporating knowledge developed by other organizations, while innovative entry is an infrequent phenomenon. However, firms from these countries can also learn from the experience of developed ones. If this is the case, entry may be delayed and firms are more prone to copying practices adopted by others instead of relying on their own innovativeness (Lévesque and Shepherd, 2004). Finally, the clusterisation of knowledge generation is also greater in developing countries, since most innovations in developing countries tend to be generated abroad and then transferred to multinational firms located in the capitals of these countries.<sup>16</sup>

#### **2.2.4 Industrial structure**

Developing countries have an industrial structure that is usually less diversified, less dense, less sophisticated and more fragmented than in developed economies, while it is more specialized in natural resource-intensive goods and scale-intensive industrial commodities. These features may affect entrepreneurship rates and profiles in different ways.

Firstly, the lack of diversity generates fewer business opportunities for new firms based on knowledge and product differentiation. In particular, the type of professional experience, skills and networks of relations that individuals can build up before becoming entrepreneurs are conditioned by the industrial structure (Kantis *et al.*, 2005). Secondly, a weaker and less dense industrial structure may constrain entries in some industries in which potential entries may act as clients, suppliers or competitors. It may also limit the benefits from agglomeration, for there may not be enough related firms to create the conditions required for external economies to arise. Thirdly, an incomplete economic structure raises high barriers to entry. For example, suppliers may not be willing to take the risk of specialising in specific inputs for a small number of customers, which forces firms to rely on foreign suppliers and/or enter into the market in a more integrated way. Barriers to exit may also be higher, since the chances of reselling specific assets in case of failure are lower. Finally, as the complexity of the productive structure decreases, the ability to reallocate resources to new activities diminishes in the face of a permanent shock, which can negatively impact on entry decisions.

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<sup>16</sup>The model by Aghion *et al.* (2005), for example, predicts that innovation will increasingly be concentrated in regions that are initially better positioned and closer to the technological frontier.

### **2.2.5 Income**

A lower GDP may influence entrepreneurship through both demand and supply. On the one hand, in poorer countries there are fewer business opportunities and the demand for goods and services is smaller, unstable and less diverse, so the entry rate is expected to be lower. Also, lower income not only discourages entry but also forces new ventures to be less complex, less knowledge intensive and less export-oriented (Kantis *et al.*, 2005). On the other hand, the supply of entrepreneurs is lower, since the share of people with access to information, education, business networks and financial resources is limited. Moreover, although entrepreneurship may allow individuals to escape from poverty, low-income people are less able to create formal, dynamic firms. Business projects are conceived in less fertile environments (family, education system and work experience) and contact with the business world is limited. Lastly, long-term unemployed individuals may not have the ability, financial resources and/or social capital to start a new business.

It is also interesting to note that both the level and the distribution of income may have effects on entrepreneurship. In an analysis of developed countries, Reynolds *et al.* (1999) find that income disparity is strongly associated with higher levels of firm start-ups. The reason for this is that income disparity may give rise to more markets for unique goods and services as well as to pools of financial resources. However, this may not be the case in developing countries, where income disparities are indeed higher. A highly inequitable social structure may erode trust and communication between different population groups, affecting social networks and limiting social capital (Kantis *et al.*, 2005). Moreover, the existence of a small elite may impede entrepreneurial initiatives that are external to it (Naudé, 2011).

### **2.2.6 Financing**

Lower income levels in developing countries are also generally accompanied by lack of funding (both due to lack of personal savings and reduced access to external capital). In particular, firms in these countries have less access to credit and have to deal with a more limited financial system.<sup>17</sup> As Stiglitz (1998; 2010) points out, severe economic downturns can undermine the strength of the financial system and higher fluctuations can raise the cost of capital, while macroeconomic stability and long-term development require sound financial markets, since they contribute to a more efficient allocation of resources and boost productivity gains.

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<sup>17</sup> In developed countries, each adult has an average of 3.2 accounts and 81% of adults are banked; in developing countries, there are 0.9 accounts per adult and 28% of adults are banked (Kendall *et al.*, 2010).

In many developing economies there is a dualistic structure in which a sub-set of large firms makes considerable use of international and equity financing, while SMEs suffer from insufficient funding opportunities. In particular, formal financial systems generally fail to help most enterprises because of widespread informality and the fact that those firms that do have access to formal finance are heavily dependent on commercial bank financing. Bank financing is very short-term in nature and therefore not of great use for long-term investment projects (Peachey and Roe, 2004). In addition, banks usually do not lend money to start-up companies on the basis of a feasible work plan, but only if they can ensure the return of the credit through guaranties. Further, investment capital is usually scarce, due to the inadequacy of capital markets and the lack of venture companies. As a result, it is often more attractive for the banking sector to finance public deficits instead of private firms (see e.g. Günalp and Cilasun 2006 for Turkey). In sum, financing constraints will either deter entry or cause new firms to enter at suboptimal scales. They also limit the creative destruction process and encourage entries in more conservative sectors. Without adequate financial development, talented individuals may not be able to become entrepreneurs, leaving entrepreneurship for the untalented wealthy (Bianchi, 2010).

### **3. Determinants of entrepreneurship in developing countries: evidence and comparison with developed countries**

Two groups of empirical studies can be distinguished that provide comparative evidence on the determinants of entrepreneurship in developed and developing countries. The first group seeks to assess the impact of the business environment on entrepreneurship using cross-country data. The second group consists of a set of studies that regress industry and/or regional variables on entrepreneurship using data from a single country. Below we discuss each group of studies in detail.

#### **3.1 Cross-country analyses on the determinants of entrepreneurship**

Cross-country analyses on the determinants of entrepreneurship have focused on the impact of governance indicators (see, in particular, Aghion *et al.* 2007, Klapper *et al.* 2006, Klapper *et al.* 2010, and Klapper and Love 2011b).<sup>18</sup> The results from these studies are summarised in Table 3. Although the findings are not fully consistent, they tend to show that entry is hampered by bureaucratic barriers (costs, procedures and

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<sup>18</sup> Governance indicators such as “voice and accountability”, “political stability”, “government effectiveness” “regulatory quality”, “rule of law” and “control of corruption” are typically based on the Worldwide Governance Indicators Project (Kaufmann *et al.*, 2006).

time required to start a business) and employment rigidity (especially in labour intensive industries). Also, better governance seems to encourage firms to enter markets formally. In general, financial development has a positive impact on firm entry. However, this impact may depend on the size of entering firms. Also, access to credit has a positive overall impact. Again, however, this may differ across the size distribution: access to credit increases entry rates for small firms (especially in sectors which are more dependent on external finance), while it slightly reduces the entry rates of large firms. Lastly, entry regulations (which are shown not to be strongly correlated with economic development) reduce firm creation and force new entrants to be larger.

[Insert Table 3 about here]

Interestingly, these findings have laid the groundwork for the policy advice of the World Bank, the International Monetary Fund and donor agencies (Naudé, 2009). Yet they have also been questioned, among other things, because of their use of governance indicators (see Kaufmann *et al.*, 2007 for a synthesis of the criticism and the authors' response). In particular, Naudé (2009) argues that the evidence on the relationship between these indicators and entrepreneurship is ambiguous and suffers from several methodological weaknesses. He first shows that the determinants of opportunity and necessity entrepreneurship are different and then that governance and start-up costs do not impact significantly on opportunity entrepreneurship, which is what drives economic growth. He thus concludes that entrepreneurship in emerging countries can be more effectively enhanced by proactive policy measures.

### **3.2 Country-specific analyses on the determinants of entrepreneurship**

Country-specific analyses on the determinants of entrepreneurship tend to focus on medium/large developing countries with medium-high income. They also usually take as their starting point a set of determinants that are generally found to be statistically significant in developed countries. However, the determinants considered may vary depending on the availability of data and disaggregation (by city, region, sector, etc.). Moreover, the proxy variables used may be shaped by the characteristics of the developing economies.<sup>19</sup>

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<sup>19</sup> Santarelli and Tran (2012), for example, argue that in more turbulent business environments it is more convenient to define incumbent firms as those operating for more than three years (rather than the six years that is typically used in studies of developed countries). It is also interesting to note that the inclusion of additional explanatory variables that reflect the specificities of developing countries may improve the model fit and the statistical significance of some determinants (Calá *et al.*, 2014). In contrast, Bartelsman *et al.* (2004: 7) argue that "some types of distortions in market structure and institutions might make the entry (...) process less rational (i.e., less driven by market fundamentals but more by random factors)".

### 3.2.1 Macroeconomic determinants

When macroeconomic factors are included among the regressors, they usually help to explain firm entry. In Turkey, the real interest rate (Güenalp and Cilasun, 2006) and the inflation rate (Ozturk and Kilic, 2012) have been found to have a strong effect on deterring entrants. Interestingly, Güenalp and Cilasun (2006) show that results concerning microeconomic variables are robust to the inclusion of macroeconomic variables. In particular, these variables may have a negative impact on some industries and a positive impact on others (Wang, 2006).

### 3.2.2 Industry determinants

The studies that analyse the industry determinants of entrepreneurship (summarised in Table 4) usually use an Orr-Shapiro/Khemani type model (Shapiro and Khemani, 1987). This means that entry into an industry depends essentially on the barriers to entry and industry opportunities.<sup>20</sup> Also, the unit of analysis is the manufacturing industry.

[Insert Table 4 about here]

Table 4 shows that the results are similar to those typically found in developed countries (see e.g. Manjón, 2010). In particular, profit rates and industry growth rate impact positively on entries. Also, industries that export a higher share of their output are more attractive to entrants, especially when exports are sent to protected markets (as in the case of Brazilian exports to Mercosur countries) and in low-tech sectors (Campos and Ito, 2005; Ozturk and Kilic, 2012). On the other hand, concentration levels deter entry, thus enabling incumbent firms to collude and erect strategic entry barriers. Lastly, capital intensity and scale economies provide mixed results. Notice, however, that most regressors turn out to be statistically non-significant.

The relationship between entry and exit deserves particular attention. On the one hand, exit in one period has no significant impact on entry in the next in Taiwan and Turkey. This means that exit does not make room for new entrants, so the so-called replacement effect can be rejected. On the other hand, there is evidence of a

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<sup>20</sup> Among the control variables, the most commonly used are wages and labour productivity. However, none of them seem to have any significant impact as an input price indicator, probably because many entrepreneurs do not have paid employees (Wang, 2006).



displacement effect: that is to say, entries in former periods push incumbents out of the market (Lay, 2003; Günalp and Cilasun, 2006).

### 3.2.3 Regional determinants

In general, studies in developing countries that take regional dimensions into account (summarised Table 5) find a large concentration of entrepreneurship in the capital city and a noticeable variation in both firm entries and stocks across regions (a common finding in developed countries).<sup>21</sup> In particular, several studies support the urban incubator theory, which maintains that urban centres are nurseries for new firms. In particular, agglomeration economies are more important for India's entry patterns than for the US', not only because they provide a suitable labour force and proximity to suppliers and customers, but also because of the higher availability of small suppliers ("Chinitz effect"). However, in highly populated countries like India, manufacturers avoid the high costs of urban areas, preferring locations near large population centres (Ghani *et al.*, 2014). Congestion effects are also significant in South Africa and Argentina (Naudé *et al.*, 2008; Calá *et al.*, 2014).

It is also interesting to note that the factors that promote firm entry may depend on the industry analysed. Ghani *et al.* (2014), for example, compare manufacturing to services and find that the strength of the household banking sector, the quality of infrastructure and educational level are more important for services. This means that the role of the existing incumbent employment is weaker for services, which suggests that Marshallian economies are also weaker.

[Insert Table 5 about here]

Demand variables are usually significant and show the expected sign. Profits and economic growth rate encourage entry, while wages (which can proxy demand as well as input prices) have either a positive or insignificant effect. Industrial structure variables provide mixed results. Small suppliers are found to have a positive impact on firm entry ("Chinitz effect"), but evidence on the role of SMEs as seedbeds for future start ups is weak. Lastly, studies that focus on net entry conclude that "the revolving door" effect may offset new entries with subsequent exits (Santarelli and Tran, 2012).

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<sup>21</sup> Ghani *et al.* (2014) compared estimations from a developing country (India) to those from a developed country (the US). They found that, for the US, existing city population levels, city-industry employment, and industry-fixed effects can explain 80% of the spatial variation in entry rates, while the comparable explanatory power for India is only about 30%. This shows that estimation procedures for developed economies explain just a small part of entrepreneurship in a developing country.

Socioeconomic variables tend to have a positive effect on the supply of potential entrepreneurs (e.g., age, population and availability of skilled workers). In particular, Ghani *et al.* (2014) conclude that the effect of the education of the workforce on entry rates in India is stronger than has been suggested in comparable studies in developed countries. In South Africa, both education and financial intermediation have a positive impact, but their combined impact is only half that of profits, which means that unless there is a change in the underlying structural factors that determine profit rates within regions (i.e. economic resources, worker productivity and infrastructure), the spatial patterns and inequalities in business start-ups and regional growth will persist (Naudé *et al.*, 2008). Lastly, Naudé *et al.* (2008), Santarelli and Tran (2012) and Calá *et al.* (2014) find that the unemployment rate is not a statistically significant determinant of entrepreneurship, probably because the unemployed may start new firms in the informal sector and this is not reflected in official firm entry registers.

Lastly, the size of the informal sector has been found to have considerable explanatory power. In Argentina, for example, a small informal economy encourages formal entry, but it becomes a barrier when it grows too much. Similarly, in India the variables that explain firm entry in the organized manufacturing sector are not relevant to the unorganized sector and vice versa (Calá *et al.*, 2014; Ghani *et al.*, 2014).

#### **4. Concluding remarks**

Comparatively speaking, the determinants of entrepreneurship in developing countries have been much less studied than in their developed counterparts. The limited evidence available, then, should be borne in mind when using empirical results from these studies for policy purposes. Yet, given that entrepreneurship seems to be particularly important for the growth and development of lagging countries, it is clearly worthwhile analysing the results found in the literature. In this paper we have addressed the question of whether there are differences in the determinants of entrepreneurship between developed and developing countries.

Our review of the literature reveals that researchers in this area have considered the institutional setting (macroeconomic stability, public policies and knowledge) and certain demand (industrial structure and income) and supply factors (income and financing) as the main differential drivers of entrepreneurship in developed countries. However, this does not mean that these are the only factors worth considering. In fact,

the empirical evidence suggests that more attention should be paid to factors that are usually not considered by the studies that focus on developed countries.

This evidence consists essentially of a number of cross-country comparative studies on the determinants of entrepreneurship and a few single-country studies focusing on industry and regional determinants. The former tend to conclude that the lower levels of entrepreneurship in developing countries are largely explained by more bureaucracy and worse governance structures, whereas the latter are less consistent in their findings. Still, industry-specific determinants of entrepreneurship for developing countries largely replicate those found for high income countries (although the statistical significance of these variables tends to be weaker than in studies on developing countries). Regional determinants, on the other hand, seem to provide mixed and often opposite effects to those found in developed countries. It remains to be determined whether this is due to the different quality of the data (possibly better for more aggregated units such as industries) or differences in the heterogeneity of the units (perhaps associated to the structural heterogeneity between core and peripheral regions or may be simply reflecting the size of the administrative units).

Our findings suggest two issues for future research. First, improvements in the quality of the data may encourage more studies to be conducted on developing countries at geographical levels homologous to those used for developed countries. Second, comparable studies for developed and developing countries using an analogous set of regressors are also needed, particularly with firm-level data. All in all, a better understanding of the conditions that encourage entrepreneurship in developing countries probably requires detailed country studies using explanatory variables that reflect the specificities of these economies. In the meantime, policy makers in developing economies should be careful when using evidence from developed countries to design entrepreneurship-promoting policies.

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Table 1: Measures of entrepreneurship

Measure	Definition	Source
Nascent entrepreneurship	Percentage of adult population that have taken action to create a new business in the past year but have not paid any salaries for more than 3 months.	GEM
New business start-ups	Percentage of adult population that own or manage a new business from 3 to 42 months old.	
Total entrepreneurial activity (TEA)	Nascent entrepreneurship + New business start-ups. Also called "Early-stage Entrepreneurial Activity Index" (EA).	
Opportunity-based entrepreneurs	Entrepreneurs who have taken action to create a new venture in pursuit of perceived business opportunities.	
Necessity-based entrepreneurs	Entrepreneurs who have taken action to create a new venture because of the lack of better employment alternatives	
Entry density	Number of newly registered limited-liability firms per 1000 working age population.	WB Group Entrepreneurship Survey (WBGES)
Entry rate	New firms over the total number of lagged registered businesses.	
Business density	Number of existing registered companies with limited liability per 1,000 working age population.	
Entry rate	Number of new firms as a ratio of the total number of incumbent and entrant firms in a given year.	Distributed micro-data analysis (Bartelsman <i>et al.</i> 2004)
Complex Entrepreneurship Context index	Based on 26 variables that measure entrepreneurial activity, strategy and attitudes for 54 countries across 2003–2006.	Acs <i>et al.</i> (2008)

Source: authors

Table 2. Business density and determinants of entrepreneurship by income level

	Income level				
	High	Upper middle	Lower middle	Low	World
<b>Entrepreneurship</b>					
New Business Density (Number of newly registered companies with limited liability per 1,000 people aged 15-64)	6.95	3.32	0.94	0.21	3.57
<b>Industrial structure</b>					
GDP per capita, PPP (constant 2005 international \$)	32,041	6,713	2,607	936	8,809
Agriculture, value added (% of GDP)	1.56	8.20	18.15	29.70	3.19
Industry, value added (% of GDP)	25.77	37.23	32.50	23.23	27.51
Services, etc. value added (% of GDP)	72.65	54.57	49.35	47.08	69.27
Employment in agriculture (% of total employment)	3.97	36.82	51.01	s/d	33.78
Employment in industry (% of total employment)	25.37	23.90	17.97	s/d	22.04
Employment in services (% of total employment)	70.36	39.21	30.28	s/d	43.92
High-technology exports (% of manufactured exports)	20.86	19.83	12.82	2.90	20.30
Research and development expenditure (% of GDP)	2.37	0.84	0.52	s/d	2.09
<b>Infrastructure</b>					
Access to electricity (% of population)	99.17	74.13	81.59	22.99	67.27
Road density (km of road per 100 km <sup>2</sup> of land area)	55.99	16.81	48.92	na	30.93
<b>Cost of doing business</b>					
Cost of business start-up procedures (% of GNI per capita)	14.43	19.89	67.37	225.83	68.95
Time required to start a business (days)	23.94	48.09	46.56	51.73	42.21
<b>Population</b>					
Literacy rate, adult total (% of people aged 15 and +)	98.31	92.10	69.13	59.41	82.74
Population density (people per sq. km of land area)	32.13	40.89	100.29	47.78	49.85
Population growth (annual %)	0.71	0.76	1.59	2.16	1.20
Urban population (% of total)	76.42	54.02	37.45	26.29	48.75
Age dependency ratio, old (% of working-age population)	21.92	11.02	7.62	6.31	11.29
Source: mean values constructed by the authors using data from the World Bank Group Entrepreneurship Survey (2004-2012 means) and World Development Indicators Database (2001-2010 means). The World Bank classifies countries into four groups according to 2010 GNI per capita: low income, \$1,005 or less; lower middle income, \$1,006-\$3,975; upper middle income, \$3,976-\$12,275; and high income, \$12,276 or more.					

Table 3: Empirical studies using World Bank cross country data

	Klapper <i>et al.</i> (2010)			Klapper and Love (2011b)	Klapper <i>et al.</i> (2006)	Aghion <i>et al.</i> (2007)	Naudé (2009)
	Panel data (GLS) (country data)			OLS (country data)	Tobit and IV (country data)	Diff-in-diff (firm level data)	Panel data (RE GLS) (country data)
	76 countries WB Group Entrepreneurship Survey (WBGES)			95 countries (WBGES)	23 countries (Amadeus database)	16 countries (WB Distributed micro-data)	60 countries (GEM)
	Entry rate	Entry density	Business density	Entry density	Entry rate	Entry rate	Opportunity entrepreneurship
<b>Entry costs and procedures</b>	ns	-	-	-	-	weak	ns
<b>Rigidity of employment</b>	ns	ns	ns	ns	-	-	
<b>Governance</b>	+	ns	+	+			ns
<b>Access to credit</b>	ns	+	ns	ns	+	+	+
<b>GDP per capita</b>	ns	+	+	+			ns
<b>Tax rate</b>				-			

Source: author. ns: non-significant.

Table 4. Determinants of firm entry at the industry level

Variable	Ozturk and Kilic (2012)	Campos and lootty (2005)	Kaya and Uçdogruk (2002)	Lay (2003)	Günalp and Cilasun (2006)	Wang (2006)
	Tobit model	GLS (Panel data)	Dynamic panel data	SUR; 3SLS; FIML; GLS (Panel data)	Dynamic panel data (GMM)	OLS; Panel data (Pooled)
	Turkey Entry	Brazil Entry	Turkey Entry	Taiwan Entry	Turkey Entry	Taiwan Entry
<b>Opportunity</b>						
Profit rate	+		+	ns	+	
Industry growth rate	ns	ns	+	ns	+	+
Export rate	-	+			ns	
Import rate	+					
<b>Barriers</b>						
Concentration	ns	ns	-		-	
Sunk costs	ns				ns	
Capital intensity		ns	-	+/-	ns	
Advertisement intensity			ns		ns	
Scale economies/MES		ns		-	+	
<b>Controls</b>						
Wages			ns	ns		ns
Entry/Exit	-				ns	
Industry employment						+
Labour productivity	+		-			
Productivity differentials			+			
<b>Macroec.</b>						
Inflation rate	-					
Economic growth rate						ns
Unemployment						+
Real interest rate						ns
Past entry			-		+	
Past exit				ns	ns	

Note: ns: non significant

Source: author. ns: non-significant.

Table 5. Determinants of firm entry at the regional level

		Ghani <i>et al.</i> (2014)		Calá <i>et al.</i> (2014)	Santarelli and Tran (2012)	Naudé <i>et al.</i> (2008)
		Weighted linear regression (Panel data)		Panel count data models	Panel data (FE;GMM)	OLS; Tobit
		India		Argentina	Vietnam	South Africa
		organized	unorganized			
Demand	Population	+	+			
	Economic growth rate			+	+	
	Profits					+
	Wages			ns	+	
Industrial Structure	Share of SME			+	ns	
	Incumbents/ Incumb. Employment	ns	-	-		
	Industrial tradition			-		
Socio economic	Education	+	ns	ns	+	+
	Age profile	ns	+			
	Immigration/Migration			ns		
	Population	+	+			ns
	Unemployment			ns	ns	ns
Urbanizat./ Agglom.	Population density	-	ns	+	ns	ns
	Population density <sup>2</sup>			-		
	Share of urban population				+	
	Economic size (GVA)					-
Agglom. economies	Labour market effect		+			
	Input/supplier strength	+	+			
	Output/customer strength	+	+			
	Small suppliers	+				
Credit	Banking environment	ns	+			
	Number of banks					+
Other	Infrastructure	ns	+			
	Labour laws	-	ns			
	Distance to big cities	-	ns			
	Informal sector			+/-		

Note: ns: non significant

Source: author. ns: non-significant.