Extract from 'Entrepreneurship is not a binding constraint on growth and development in the poorest countries' (Naudé, 2011)

I started out by noting that entrepreneurship scholars are convinced that entrepreneurship is central to growth and development. A finer reading of their arguments suggests that the position is more ambiguous. Despite professing that entrepreneurship matters for growth (and per implication development) entrepreneurship scholars tend to see only a particular type of entrepreneurship – that associated with product and process innovations – as important for growth. And this type of entrepreneurship is in their view more likely to be found in countries in an advanced stage of development (producing on the production possibilities frontier). As per implication they may be concurring that entrepreneurship is not a binding constraint on development in the poorest countries.

The major conceptual approach toward defending the role of the entrepreneur in economic growth has been to see the entrepreneur as a conduit for innovation. This has its origins in Schumpeter's description of the essential contribution of the entrepreneur as someone who causes continual disequilibrium in economy through 'creative destruction', that is radical innovation which leads to more efficient allocation of production factors and thus productivity improvements. This 'radical innovation' is seen to be more important that 'replicative' innovation for economic growth, although it is 'replicative' entrepreneurship that dominates in developing countries (see, e.g., Baumol et al., 2007).

That the entrepreneur's essential contribution to economic growth is through innovation is confirmed in the most recent (economic) entrepreneurship literature. This literature is essentially an attempt to incorporate Schumpeter's insights into the literature on endogenous economic growth. In this literature, which has extended the work of Solow (1956) wherein a large part of the variation in cross-country growth rates could not be explained by traditional production factors such as capital and labor alone, and wherein technological change was exogenous. By endogenizing technological change, entrepreneurs are here seen as a 'knowledge filter' that commercializes innovations. In the words of Audretsch et al. (2006, p. 5) 'entrepreneurship makes an important contribution to economic growth by providing a conduit for the spillover of knowledge that might otherwise have remained uncommercialized.'

In most developing countries, where production takes place well within the technological frontier, the view is that economic growth is not 'innovation driven' and that replicative entrepreneurs abound. Such entrepreneurs are however apparently not terribly important for economic growth. As put by Baumol et al. (2007, p. 3):

> '… replicative entrepreneurship is important in most economies because it represents a route out of poverty, a means by which people with little capital, education, or experience can earn a living. But if economic growth is the object of interest, then it is the innovative entrepreneur who matters.'

This resonates with Banerjee and Duflo's (2007) call not to 'romanticize the penniless entrepreneurs.'

Because radical innovations are not essential in poor economies to move the production and technological frontier outwards as in developed economies, the implication is, as in development economics, that entrepreneurship is not a binding constraint on economic growth and development. Indeed, small businesses owners, who 'dominate the economic life of most developing nations' (Gollin, 2008, p. 219) are in this literature not even considered to be entrepreneurs.

Pahn, Venkataraman, and Velamuri (2008) come to a broadly similar conclusion, namely that in poor economies entrepreneurs are not the binding constraint. They are not the ones who are essential for 'kick-starting' growth. As Pahn et al. (2008, p. 325) concludes:

> '…studies of entrepreneurial regions across the world…have underscored the critical role of governments at different levels in the emergence of these regions…the magnitude of government influence, which is significant in the early stages of development, seems to decline in later stages relative to other factors….The explanations for this vary from the traditional factor substitution wherein government kick-starts the development of a sector, which then becomes attractive for private capital to accumulate, to the post-modern institutionalization, in which the development of such institutions as intellectual property regimes engender capital accumulation.'

Thus, they find that in early stages of development, governments need to address more binding constraints on development such as market failures and institutional weaknesses. Their recognition of the importance of the government in addressing market failures, kick-starting growth, and the importance of institutional foundations or prerequisites for growth, is entirely consistent with both the early development economics literature, for instance Hirschman (1958) on linkages, Rosenstein-Rodan (1943) on the need for a 'big push', and also consistent with the more recent development economics literature on the need for good institutions (e.g., Rodrik, 2000, Rodrik, 2008).

While there is therefore a convergence in the thinking of development economists and entrepreneurship scholars on the importance of institutions, the heterogeneity of institutions, and the myriad ways in which it may interact and impact on entrepreneurship – and be influenced by entrepreneurship – suggests through the need for 'many recipes' to growth and development that there may indeed be cases where the institutions–entrepreneurship nexus is a constraint.