

## Theories of Entrepreneurship

The accumulation of factors of production per se – be they knowledge, physical or human capital – cannot alone explain economic development. They are necessary inputs in production, but they are not in themselves sufficient for economic growth to occur.

Human creativity and productive *entrepreneurship* are needed to combine these inputs in profitable ways, and hence an institutional environment that encourages free entrepreneurship becomes the ultimate determinant of economic growth.

### **Entrepreneurship**

Entrepreneurship is the practice of starting new organizations or revitalizing mature organizations, particularly new businesses generally in response to identified opportunities. Entrepreneurship is often a difficult undertaking, as a vast majority of new businesses fail. Entrepreneurial activities are substantially different depending on the type of organization that is being started. Entrepreneurship ranges in scale from solo projects (even involving the entrepreneur only part-time) to major undertakings creating many job opportunities. Many "high-profile" entrepreneurial ventures seek venture capital or angel funding in order to raise capital to build the business. Angel investors generally seek returns of 20-30% and more extensive involvement in the business. Many kinds of organizations now exist to support would-be *entrepreneurs*, including specialized government agencies, business incubators, science parks, and some NGOs.

### **The Entrepreneur**

Entrepreneurs have many of the same character traits as leaders. Similarly to the early great man theories of leadership; however trait-based theories of entrepreneurship are increasingly being called into question. Entrepreneurs are often contrasted with managers and administrators who are said to be more methodical and less prone to risk-taking. Such person-centric models of entrepreneurship have shown to be of questionable validity, not least as many real-life entrepreneurs operate in teams rather than as single individuals. Still, a vast but now clearly dated literature studying the entrepreneurial personality found that certain traits seem to be associated with entrepreneurs:

- David McClelland (1961) described the entrepreneur as primarily motivated by an overwhelming need for achievement and strong urge to build.
- Collins and Moore (1970) studied 150 entrepreneurs and concluded that they are tough, pragmatic people driven by needs of independence and achievement. They seldom are willing to submit to authority.
- Bird (1992) sees entrepreneurs as mercurial, that is, prone to insights, brainstorming, deceptions, ingeniousness and resourcefulness. They are cunning, opportunistic, creative, and unsentimental.
- Cooper, Woo, & Dunkelberg (1988) argue that entrepreneurs exhibit extreme optimism in their decision-making processes. In a study of 2004 entrepreneurs they report that 81% indicate their personal odds of success as greater than 70% and a remarkable 33% seeing odds of success of 10 out of 10.
- Busenitz and Barney (1997) claim entrepreneurs are prone to overconfidence and over generalisations.

- Cole (1959) found there are four types of entrepreneur: the innovator, the calculating inventor, the over-optimistic promoter, and the organization builder. These types are not related to the personality but to the type of opportunity the entrepreneur faces.

### **Characteristics of an Entrepreneur**

- The entrepreneur has an enthusiastic vision, the driving force of an enterprise.
- The entrepreneur's vision is usually supported by an interlocked collection of specific ideas not available to the marketplace.
- The overall blueprint to realize the vision is clear, however details may be incomplete, flexible, and evolving.
- The entrepreneur promotes the vision with enthusiastic passion.
- With persistence and determination, the entrepreneur develops strategies to change the vision into reality.
- The entrepreneur takes the initial responsibility to cause a vision to become a success.
- Entrepreneurs take prudent risks. They assess costs, market/customer needs and persuade others to join and help.
- An entrepreneur is usually a positive thinker and a decision maker.

### **Contributions of Entrepreneur**

1. Develop new markets. Under the modern concept of marketing, markets are people who are willing and able to satisfy their needs. In Economics, this is called effective demand. Entrepreneurs are resourceful and creative. They can create customers or buyers. This makes entrepreneurs different from ordinary businessmen who only perform traditional functions of management like planning, organization, and coordination.
2. Discover new sources of materials. Entrepreneurs are never satisfied with traditional or existing sources of materials. Due to their innovative nature, they persist on discovering new sources of materials to improve their enterprises. In business, those who can develop new sources of materials enjoy a comparative advantage in terms of supply, cost and quality.
3. Mobilize capital resources. Entrepreneurs are the organizers and coordinators of the major factors of production, such as land labor and capital. They properly mix these factors of production to create goods and service. Capital resources, from a layman's view, refer to money. However, in economics, capital resources represent machines, buildings, and other physical productive resources. Entrepreneurs have initiative and self-confidence in accumulating and mobilizing capital resources for new business or business expansion.
4. Introduce new technologies, new industries and new products. Aside from being innovators and reasonable risk-takers, entrepreneurs take advantage of business opportunities, and transform these into profits. So, they introduce something new or something different. Such entrepreneurial spirit has greatly contributed to the modernization of economies. Every year, there are new technologies and new products. All of these are intended to satisfy human needs in more convenient and pleasant way.
5. Create employment. The biggest employer is the private business sector. Millions of jobs are provided by the factories, service industries, agricultural enterprises, and the numerous small-scale businesses. For instance, the super department stores like SM, Uniwide, Robinson and others employ thousands of workers. Likewise giant corporations like SMC, Ayala and Soriano group of

companies are great job creators. Such massive employment has multiplier and accelerator effects in the whole economy. More jobs mean more incomes. This increases demand for goods and services. This stimulates production. Again, more production requires more employment.

### **Advantages of Entrepreneurships**

Every successful entrepreneur brings about benefits not only for himself/ herself but for the municipality, region or country as a whole. The benefits that can be derived from entrepreneurial activities are as follows:

1. Enormous personal financial gain
2. Self-employment, offering more job satisfaction and flexibility of the work force
3. Employment for others, often in better jobs
4. Development of more industries, especially in rural areas or regions disadvantaged by economic changes, for example due to globalisation effects
5. Encouragement of the processing of local materials into finished goods for domestic consumption as well as for export
6. Income generation and increased economic growth
7. Healthy competition thus encourages higher quality products
8. More goods and services available
9. Development of new markets
10. Promotion of the use of modern technology in small-scale manufacturing to enhance higher productivity
11. Encouragement of more researches/ studies and development of modern machines and equipment for domestic consumption
12. Development of entrepreneurial qualities and attitudes among potential entrepreneurs to bring about significant changes in the rural areas
13. Freedom from the dependency on the jobs offered by others
14. The ability to have great accomplishments
15. Reduction of the informal economy
16. Emigration of talent may be stopped by a better domestic entrepreneurship climate

### **Theories of Entrepreneurship**

The entrepreneur and entrepreneurship should take center stage in any effort to explain long-term economic development. The Economic theory, however did not lay proper attention to the entrepreneur and to the entrepreneurship.

“The theoretical firm is entrepreneurless”.

If entrepreneurship remains as important to the economy as ever, then the continuing failure of mainstream economics to adequately account for entrepreneurship indicates that fundamental principles require re-evaluation. *Entrepreneurial Economics* is the study of the entrepreneur and entrepreneurship within the economy. The characteristics of entrepreneurial economy (regional or national level) are high level of innovation combined with high level of entrepreneurship which result in the creation of new ventures as well as new sectors and industries.

Mainstream economics does not include much discussion on entrepreneurship though it assigns an important role to the entrepreneur. This is not by chance, but because entrepreneurship is difficult to analyse using the traditional tools of economics e.g. calculus and general equilibrium model. Entrepreneurship is referred to in the mainstream theory; different economists assign different important roles to the entrepreneurs but the coverage is much less as compared to the important role entrepreneurs play in the economy and in the economic theory. The reason for that is that the construct of equilibrium models, which is central to mainstream economics, is exactly what by definition excludes entrepreneurship. Joseph Schumpeter and Israel Kirzner have argued in their writings, that entrepreneur does not tolerate equilibrium. According to Baumol, mainstream theory has ignored entrepreneurship not because it does not fit here, but because the tools available to the economists, the general equilibrium model etc. cannot ensure a comprehensive analysis of the entrepreneur without adding more tools to the toolkit the economists are at ease with.

The various concepts and theories propounded by researchers seem to indicate that the developing entrepreneurs in a society depend upon closely interlinked economic, social, religious, cultural and psychological variables.

Prof. Frank Knight, (Risk Uncertainty & profits, 1921) Hawley, A C Pigou and others opine that the entrepreneurs bear the uncertainty & risk of production. The theory alone is unable to explain the occupational choice question. Thus, in order to build a development model of entrepreneurship it is necessary to look at some of the other characteristics that help explain why some people are entrepreneurs; risk may be a factor, but it is not the only one.

Schumpeter's concept is a synthesis of three different notions of entrepreneur i.e. a risk bearer, innovator and a coordinator cum manager. He assigned the role of an innovator to the entrepreneur and not to the capitalist. Capitalists supply capital and entrepreneurs constantly innovate and are usually the large-scale businesspersons. He (1934, p. 78) stated that 'whatever the type, everyone is entrepreneur only when he actually carries out a new combination and loses that character as soon as he has built up his business, when he settles to running it as other people run their business'.

Entrepreneur has been perceived as some one who breaks an existing equilibrium, maybe by innovations, a chaotic, unpredictable economic process, which cannot be modeled using the equilibrium based analytical methods used in mainstream economic theory.

There are two types of theories termed as gap filling theories; the sociological approach, which suggests that as a result of withdrawal of status, some social classes will work to fill the void and be more entrepreneurial. The other is an economic approach which implies entrepreneurs fill up the gaps in the market.

Following the Schumpeterian line of thought (entrepreneur as an innovator), Leibenstein postulates that the entrepreneurs are gap-fillers i.e. they have the ability to perceive where the market fails and to develop new goods or processes that the market demands but which are not currently being supplied. This can be regarded as a special kind of innovation. He postulates that entrepreneurs have the special ability to connect different markets and make up for market failures and deficiencies. Additionally, drawing from the early theories of J.B. Say and Cantillon, Leibenstein suggests that entrepreneurs have the ability to

combine various inputs into new innovations in order to satisfy unfulfilled market demand (Leibenstein, 1995).

Peter F. Drucker (1985) defines an entrepreneur as a person who looks out for any changes, responds to it and exploits the opportunity generated by the change. It may mean provision of a new business, new product or a new service. He feels that a resource becomes an economic resource only when somebody finds a use for it. Some thinkers suggest that the entrepreneurs are to be found in the social sectors e.g. NGOs as well, and are called Social entrepreneurs. They are an agent of change and help increase the standard of living. Some other thinkers have identified Intrapreneurs, who perform all the functions of entrepreneurs, but are not the risk bearers as they are employed in some organizations. These people innovate, go through all the labor pains of creating new divisions within existing organizations, they do not bear the risk, or uncertainty, and also may not get any reward in proportion of the success of the new venture/ division but they certainly are agents of change in the organization.

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