

# The role of entrepreneurship and enterprises for local economic development

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## Abstract

Most policymakers and academics agree that entrepreneurship is critical to the development and well-being of society. Entrepreneurs create jobs. They drive and shape innovation, speeding up structural changes in the economy. By introducing new competition, they contribute indirectly to productivity. Entrepreneurship is thus a catalyst for economic growth and national competitiveness.

The paper presents the theoretical framework of links between the entrepreneurship, enterprises and local economic development through two conceptual models established recently. The rest of the paper presents the importance and measures to be taken to promote entrepreneurship and enterprises at a local level as well as several possible programs that may be included in local economic development strategies so as to support the entrepreneurship and development of small and medium enterprises given the fact that there are crucial factors impacting the economic development of certain locality.

**Keywords:** Entrepreneurship, Entrepreneurial society, Small and Medium Enterprise, Local Economic Development.

## 1. Introduction

Entrepreneurship and small business are related but far from synonymous concepts. On the one hand, entrepreneurial activity (defined for instance as behavior concentrating on opportunities) may occur in both small and large businesses but also outside the business world. On the other hand, small businesses can be a vehicle for both Schumpeterian entrepreneurs introducing new products and processes that change industry as well as for people who simply run and own a business for a living). On the other hand, small businesses can be a vehicle for both Schumpeterian entrepreneurs introducing new products and processes that change industry as well as for people who simply run and own a business for a living.

During the first decades of the last century, small businesses were both a vehicle for entrepreneurship and a source of employment and income. This is the era in which Schumpeter (1934) wrote *The Theory of Economic Development*, emphasizing the role of the entrepreneur as prime cause of economic development. He describes how the innovating entrepreneur challenges incumbent firms by introducing new inventions that make current technologies and products obsolete.

During the post-war years small business still mattered. It was obvious that this was less on the grounds of economic efficiency but more for social and political purposes. In a time when large firms had not yet gained the powerful position of the 1960s and 1970s, small businesses were the main supplier of employment and hence of social and political stability, were convinced that the future was in the hands of large corporations and that small business would fade away as the victim of its own inefficiencies.<sup>1</sup>

## 2. Linking entrepreneurship, enterprises and local economic growth

Most economic, psychological and sociological research points to the fact that entrepreneurship is a *process* and not a static phenomenon. Entrepreneurship is more than just a mechanical economic factor. Entrepreneurship has to do with *changes* and is also commonly associated with *choice*-related issues.

According to Schumpeter, "Everyone is an entrepreneur when he actually carries out new combinations". Finding new combinations of factors of production is a process of entrepreneurial discovery that will become the engine that drives economic development.

These new combinations constitute better ways to meet existing demand or create new products, often making current technologies.

The hypothesis that entrepreneurship is linked to economic growth finds its most immediate foundation in simple intuition, common sense and pure economic observation: activities to convert ideas into economic opportunities lie at the very heart of entrepreneurship. Entrepreneurship is a source of innovation and change, and as such spurs improvements in productivity and economic competitiveness.

Entrepreneurship is closely associated with knowledge and flexibility, two factors that have gained new significance as a source of competitiveness in an increasingly globalized world economy.

Recently there are established two conceptual models showing the relation between entrepreneurship and national and local economic growth which will be presented below.

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<sup>1</sup> Martin Carree and Roy Thurik, "Understanding the role of entrepreneurship for economic growth" ISSN 05-14, December 2005, p.1-2

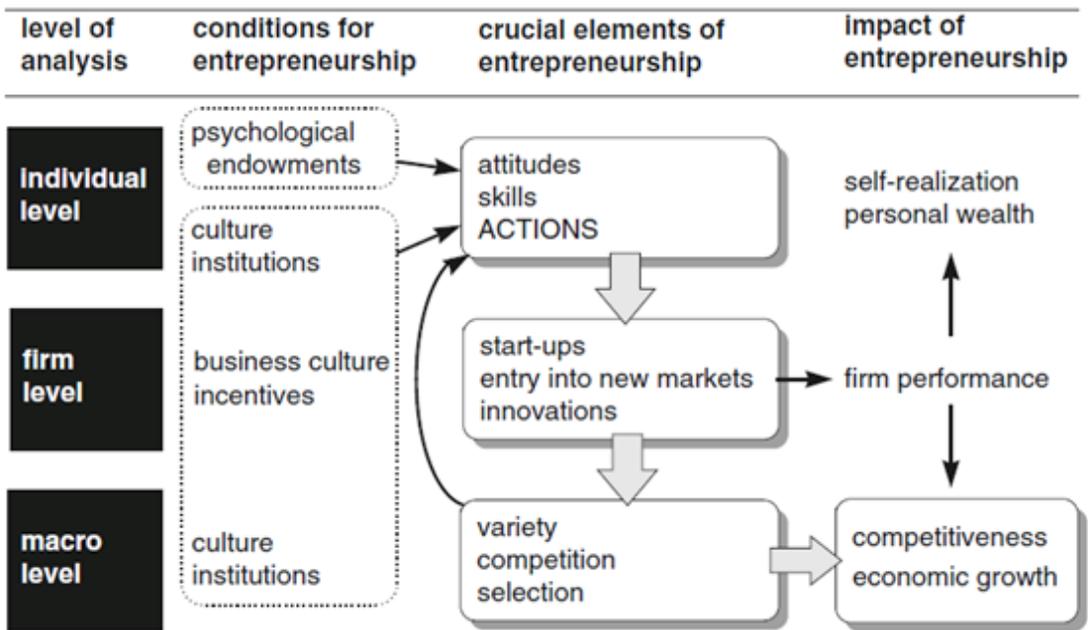


Fig. 1 The model of relations between the entrepreneurship and economic growth/economic development<sup>2</sup>

The model distinguishes between three levels of analysis: *the individual level, the firm level and the macro level.*

Entrepreneurial activity originates at the individual level and is always traceable to a single person, the entrepreneur.

Entrepreneurship is, hence, induced by an individual’s attitudes or motives, skills and psychological endowments. Yet the individual entrepreneur is not undertaking entrepreneurial activities in a timeless and spaceless vacuum, but is affected by the context in which he or she is acting. Therefore, entrepreneurial motives and actions are influenced by cultural and institutional factors, the business environment and macroeconomic conditions.

While entrepreneurship originates at the individual level, realization is achieved at the firm level. Start-ups or innovations are vehicles for transforming personal entrepreneurial qualities and ambitions into actions.

At the macro level of industries and national economies, the sum of entrepreneurial activities constitutes a mosaic of competing experiments, new ideas and initiatives. This competition leads to variety and change in the market – that is, a selection of the most viable firms, their imitation and a displacement of obsolete firms.

<sup>2</sup> Source: M. A. Carree & A.R. Thurik – The impact of Entrepreneurship on Economic Growth, p. 586

Entrepreneurial activity hence expands and transforms the productive potential of the national economy by inducing higher productivity and an expansion of new niches and industries. Processes at the aggregate level are, in turn, linked to the individual layer, obviously including important feedback mechanisms for individual entrepreneurs. Entrepreneurs can learn from both their own and others' successes and failures, which enables them to improve their skills and adapt their attitudes.<sup>3</sup>

The model of relations between the entrepreneurship and economic growth, i.e. local economic development may be presented through a Conceptual Framework of GEM (The Global Entrepreneurship Monitor)<sup>4</sup>

Traditional analyses of economic growth tend to focus on large corporations and neglect the innovations and competition that small start-ups contribute to the overall economy. Unlike most studies, the conceptual model behind GEM takes a comprehensive approach and considers the economic contribution of all businesses within a country. Specifically, GEM considers that national economic growth is the result of two parallel sets of interrelated activities.

- Those associated with established firms (as shown in the top part of Figure 2)
- Those related directly to the entrepreneurial process (as shown in the bottom part of Figure 2).

This model takes a slightly different angle and analyses the success of large firms advancing market opportunities for small firms and the role of entrepreneurship in the enterprise creation/growth process as the main mechanisms driving macroeconomic growth along with their complementary nature.

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<sup>3</sup> M. A.Carree & A.R. Thurik "The impact of Entrepreneurship on Economic Growth, p.586-587.

<sup>4</sup> **GEM** - The Global Entrepreneurship Monitor (GEM) is a not-for-profit academic research consortium that has as its goal making high quality information on global entrepreneurial activity readily available to as wide an audience as possible. GEM is the largest single study of entrepreneurial activity in the world. Initiated in 1999 with 10 countries, GEM 2010 conducted research in 59 economies all over the world.

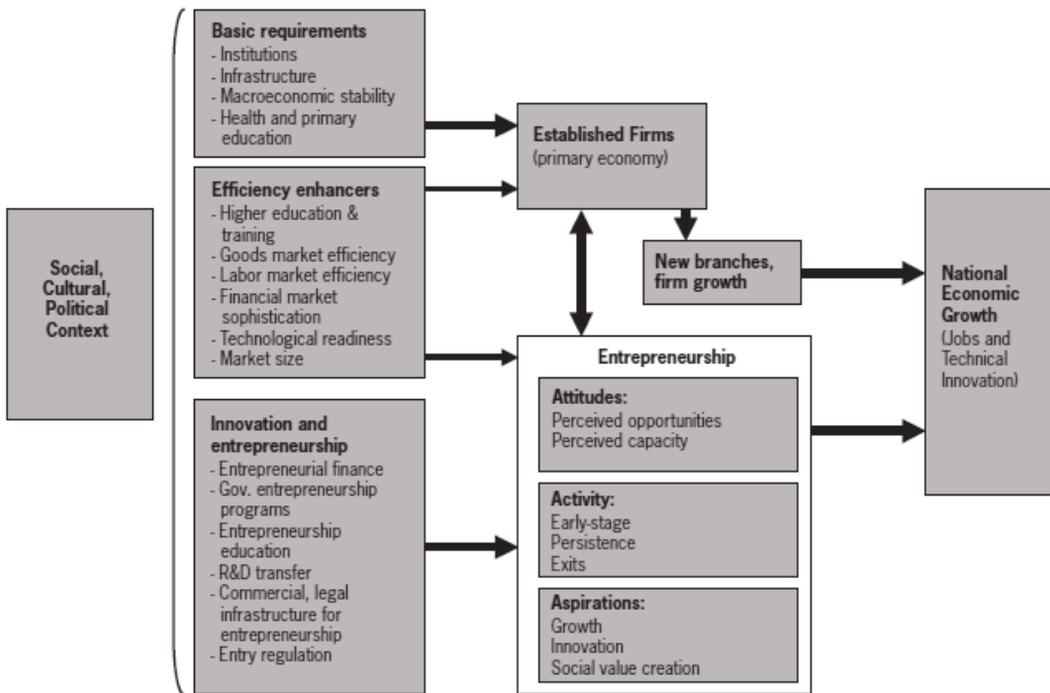


Fig. 2. GEM Conceptual Model<sup>5</sup>

The top portion of the Figure focuses on the role of large established enterprises. Depending on national framework conditions, large firms, generally integrated into international trade markets, can promote self-expansion and maturation. The economic success of large enterprises tends to create new market opportunities for SMEs through technological spillovers, spin-offs, an increase in domestic demand for goods and services, an integration of SMEs in supplier networks, and so forth. Yet whether domestic firms are able to seize these opportunities depends largely on the existence of a competitive and vibrant SME sector.

The lower portion of the Figure highlights the second mechanism driving economic growth: the role of entrepreneurship in the creation and growth of firms. The entrepreneurial process occurs in the context of a set of framework conditions. It further depends on:

- The emergence and presence of market opportunities;
- The capacity, motivation and skills of individuals to establish firms in pursuit of those opportunities.

<sup>5</sup> Source: GEM: Global Entrepreneurship Monitor, 2008 Executive Report, Babson College Ewing Marion, Kauffmann Foundation, London Business School, p. 7.

These two factors will be affected by other factors that jointly constitute the group of factors for a company to be entrepreneurial such as:

- Infrastructure
- Demography
- Education and training
- Culture.<sup>6</sup>

While the process of large established enterprises tends to create profit opportunities for small and new firms, these firms can also affect the success of large enterprises. For instance, by being competitive and reliable suppliers, SMEs provide a competitive advantage for large firms in global arenas.

*Both conceptual models introduced above refer to the importance of the individual level – that is, the attitudes, skills and actions of individual entrepreneurs. This indicates that policies for boosting entrepreneurial capacity should not focus solely on macroeconomic conditions or access to finance, the most frequently used policy tools to promote entrepreneurship.*

Although such policies are doubtless important for broadening the base of individuals with incentives to start up a business and with access to the necessary means, these policies alone will not suffice. Rather, the founding and development of firms depend to a large extent on the entrepreneurial qualities of the individual entrepreneur.

### **3. Fostering and promoting entrepreneurship and enterprises at a local level**

A comprehensive approach to the promotion of entrepreneurship at a national and local level rests on two primary pillars:

- a) *Strengthening of entrepreneurial skills*
- b) *Improvement of the entrepreneurial framework conditions*

These two pillars should be considered as an interlinked set of policies for the following reasons:

- *on the one hand*, entrepreneurs do not act in a vacuum, but whether and how they use their skills and motivations to transform business ideas into profit opportunities is shaped by existing framework conditions
- *on the other hand*, entrepreneurial behavior can always be traced back to individuals and their entrepreneurial attitudes, skills and motivations. Experience shows that when these attitudes and skills exist, adverse framework conditions cannot totally suppress them, and individuals will seek to find ways that allow them to capitalize on their ideas.

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<sup>6</sup> GEM: Global Entrepreneurship Monitor: 2004, Executive Report, Zoltan J.Acs, Pia Arenius, Michael Hay, Maria Minniti, Babson College and London Business School, 2005, p.14

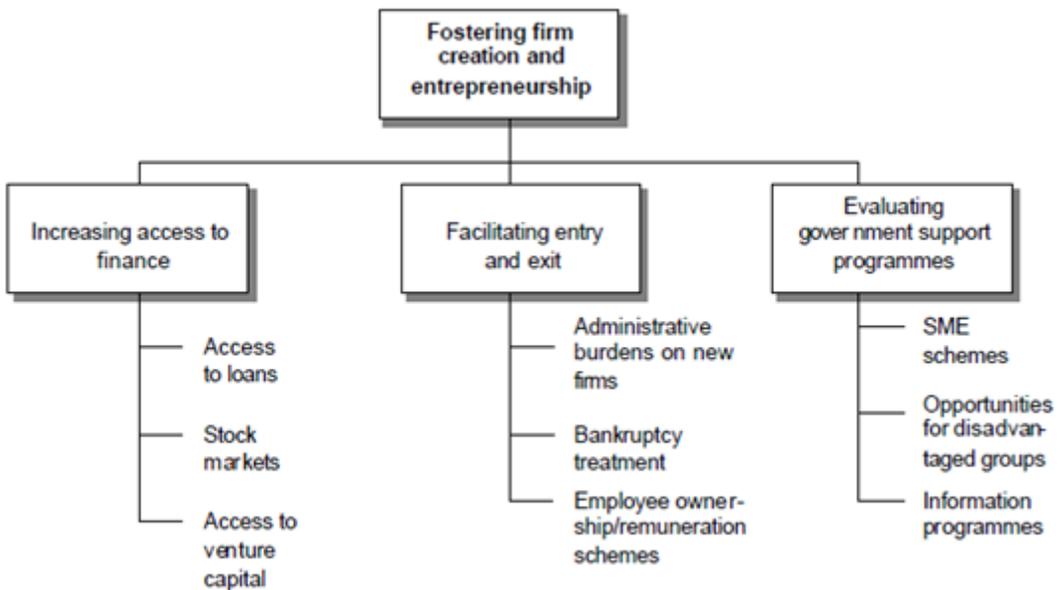
*a) Strengthening of entrepreneurial skills*

Individuals are widely recognized as the primary agents of entrepreneurial activity. Since the origin of any innovation, start-up or entrepreneurial decision is traceable to a single person, one approach to *fostering* entrepreneurship is to *strengthen the entrepreneurial traits of individuals*.

*b) Improvement of the entrepreneurial framework conditions*

It is known that in a stable macroeconomic environment, local physical infrastructure, tax level, quality of institutions, primary education and health, are factors which influence any economic activity, and policy issues that directly affect entrepreneurship.

There are three policy domains as significantly important for entrepreneurial activities: *increasing access to finance, facilitation of entry and exit of firms and government support schemes for SMEs*. The following figure presents a slightly adapted framework of policies for fostering entrepreneurial activities at a local and national level.



*Fig. 3 Main policy domains for fostering entrepreneurial framework conditions*

A friendly environment for starting-up and developing businesses is the center of accomplishment of *sustainable economic development objectives, increase of employment at a local and national level and achievement of social objectives*.

In order to accomplish these objectives, the national government together with the local government and other relevant actors must try to meet objectives and

recommendations of the *European Charter for Small Enterprises*<sup>7</sup> which includes ten key areas:

1. Education and training for entrepreneurship;
2. Cheaper and faster start-up;
3. Better legislation and regulation
4. Availability of skills;
5. Improving online access;
6. Getting more out of the Single Market;
7. Taxation and financial matters;
8. Strengthening the technological capacity of small enterprises;
9. Making use of successful e-business models and developing top-class small business support;
10. Developing stronger, more effective representation of small enterprises' interests at Union and national level.<sup>8</sup>

Meeting recommendations of the European Charter for Small Enterprises will influence *Establishment of entrepreneurial society*.

*Building an entrepreneurial society involves everyone. Attitudes towards entrepreneurial initiatives and entrepreneurial failures should be more positive. To achieve this, important are those on whom today's and future entrepreneurs depend.*

Building an *entrepreneurial society* should be based on three main pillars:

- *Reducing barriers for business development and growth;*
- *Balancing risk and reward for entrepreneurs;*
- *Building a society which appreciates entrepreneurship and more positive attitudes towards entrepreneurship.*

Entrepreneurship is recognized as something worth to be promoted, because entrepreneurial skills and attitudes provide benefits to society. To appreciate entrepreneurship, society must value and celebrate successful entrepreneurs and tolerate failure. Positive attitudes towards entrepreneurship are particularly important among those on whom today's and future entrepreneurs depend, such as schools, universities, investors, local communities, regions, business organizations, business advisers and the media. One way to encourage these positive attitudes is by providing successful models and their presentation.<sup>9</sup>

<sup>7</sup> "European Charter for Small Enterprises" was adopted by the EU General Affairs Council on 13 June 2000.

<sup>8</sup> <http://www.unescochair.uns.ac.rs/sr/docs/smallEnterprises.pdf>

<sup>9</sup> Prof.dr.Isak Mustafa: "Ndërmarrja në biznesin b ashkëkohor", The Center of Small Business, "Eureka" Peja, Prishtina, 1997 , pg. 266-268.

What distinguishes a developing economy from a declining economy is not so much the unemployment rhythm as it is the spirit of innovation. The local development strategy is able to contribute to creation of supportive means in opening new jobs or attracting investments, and, it can go even further, by transforming the climate of failure, idleness and fatality into a climate of trust, initiative and active planning for the future.

The main difference between the developing economy and a declining economy lies on the dynamism and ability to renovate, organize, communicate and adjust to new circumstances; in a few words, this may be called *entrepreneurship*. For this reason, local development policies should be focused not so much on creation of new jobs as on creation of an “*environment*” that favors spread of entrepreneurship values, a factor which favors the increase of employment and improvement of living standards.

In addition to the direct economic effects of making new services and products available and creating employment, the SME has several equally important effects on the functioning of transitional societies that move through more indirect channels. The development of this sector is essential to create the political and social ‘environmental conditions’ necessary to allow desirable changes to occur elsewhere in the system.

The SME sector must simultaneously absorb resources and workers from the large enterprise sector and at the same time help to create a labour market situation in which the process of reorientation and fundamental reorganization of the large enterprise sector can be carried through without threatening social peace.

*One surprising conclusion that does seem to emerge from this now decade-long experience is that the small enterprise sector is not by itself enough to create successful economic growth. Unless the surrounding large enterprises have been successfully commercialized (meaning that privatization has either been delayed or done in a way that does not sever their already existing working relationships) and overall demand conditions are not severely restrictive, no significant and sustained SME growth can be expected.*

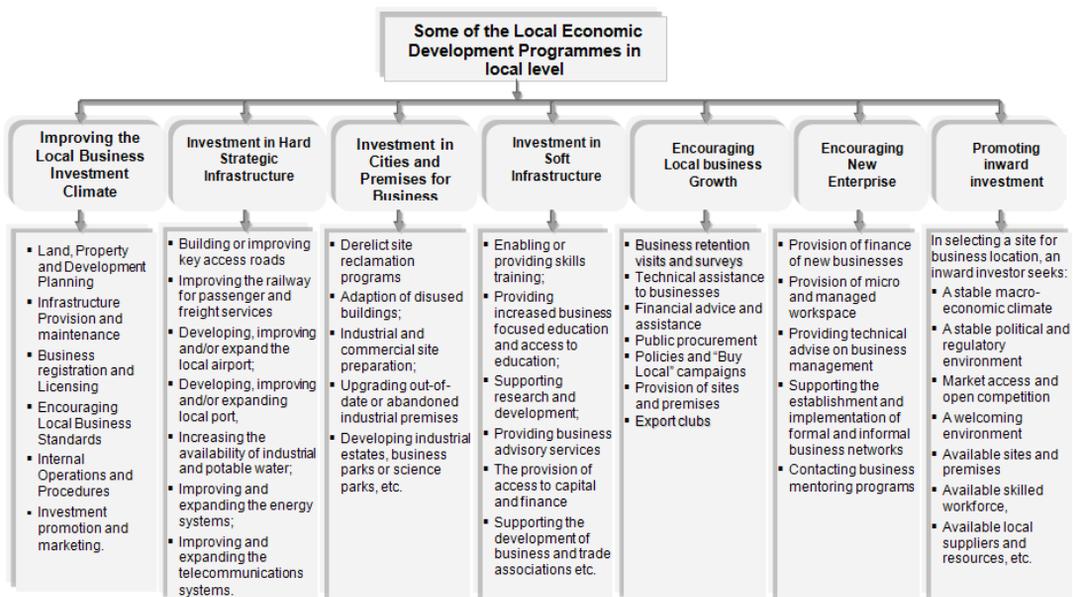
The SME sector needs the large enterprise sector as a source of inputs, a market for its output and also as source of individual entrepreneurial leadership.

In many contemporary systems, the economic system of large firms and small firms interact in very complex relationships which confer reciprocal advantages.

Once local economic assessment is completed and the vision, purposes and objectives are determined, the community should decide about programs and key areas of intervention and this will become the main part of the strategy. There are many options in use, but their selection is limited to the needs and sources of each locality.

One of the most effective ways of facilitating entrepreneurial climate and job creation is to develop Local Economic Development Programmes that improve the local business enabling environment and support the micro, small and medium sized enterprise. Thereafter the selection will be depending upon the results of the local economy assessment.

Programme areas of intervention for local economic development are presented in details in the following figure:<sup>10</sup>



*Fig. 4. Some of the Local Economic Development Programmes<sup>11</sup>*

## Conclusion

Entrepreneurship is the driving force for initiating business ideas, mobilizing human, financial and physical resources, for establishing and expanding enterprises, and creating jobs. The vast majority of jobs in all countries are generated by small and medium-sized enterprises in the private sector, including cooperatives; all these businesses contribute significantly to providing new employment for young people.

On the basis of two new conceptual frameworks linking the actions of individuals to the realm of macroeconomics we can conclude that a comprehensive approach

<sup>10</sup> World Bank, "Local Economic Development: "A Primer Developing and Implementing Local Economic Development Strategies and Action Plans" by Gwen Swinburn Soraya Goga & Fergus Murphy, Janar, 2005, p. 30-40.

<sup>11</sup> Source: World Bank, "Local Economic Development: "A Primer Developing and Implementing Local Economic Development Strategies and Action Plans" by Gwen Swinburn Soraya Goga & Fergus Murphy, January, 2005, p. 30-40.

to the promotion of entrepreneurship and enterprise rests on two primary pillars: strengthening of entrepreneurial skills and improvement of entrepreneurial framework conditions. These two pillars should be considered as an interlinked set of policies. Entrepreneurs do not act in a vacuum, but whether and how they use their skills and motivations to transform business idea into profit opportunities is shaped by existing framework conditions. Entrepreneurial behavior can always be traced back to individuals and their entrepreneurial attitudes, skills and aspirations. Experience shows that when these attitudes and skills exist, adverse framework conditions cannot totally suppress them, and individuals will seek to find ways that allow them to capitalize on their ideas.

Based on the diagnosis of the comparative advantages and of the resource bottlenecks of each space, local stakeholders frequently with participation of outside external experts define and establish a comprehensive strategy in a bid to fulfill the potential. These strategies are usually articulated around four main axes:

- The improvement of the competitiveness of local firms;
- The attraction of inward investments;
- The upgrading of human capital or labour skills;
- The building of infrastructure.

The basic aim is to create a comprehensive and balanced local strategy that will embed economic activity in a particular territory.

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