

The Economics of Entrepreneurship

Second Edition

This second edition of *The Economics of Entrepreneurship* is an essential resource for scholars following the current state of this fast-moving field, covering a broad range of topics in unparalleled depth. Designed to be used both as a textbook for specialist degree courses on the economics of entrepreneurship, and as a reference text for academic research in the field, the book draws on theoretical insights and recent empirical findings to show how economics can contribute to our understanding of entrepreneurship. New topics, such as crowdfunding, entrepreneurship education and microenterprise field experiments, appear for the first time, while existing treatments of topics like regional entrepreneurship, innovation and public policy are considerably deepened. Parker also discusses new empirical methods, including quasi-experimental methods and field experiments. Every section – indeed every page – of the new edition has been updated, resulting in a rigorous scientific account of entrepreneurship today.

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The Economics of Entrepreneurship

Second Edition

SIMON C. PARKER

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Contents

	<i>List of Figures</i>	page xvi
	<i>List of Tables</i>	xvii
	<i>Preface</i>	xix
1	Introduction	1
	1.1 What Economics Adds to the Study of Entrepreneurship	2
	1.2 Coverage and Structure of the Book	5
	1.3 Defining and Measuring Entrepreneurship	6
	1.3.1 New Venture Creation and Nascent Entrepreneurs	7
	1.3.2 Small Firms	10
	1.3.3 Self-Employment/Business Ownership	11
	1.3.4 Billionaires	17
	1.3.5 Habitual Entrepreneurs	17
	1.3.6 Appraisal	18
	1.4 International Evidence about Entrepreneurship Rates in Developed Countries	19
	1.5 The Transition Economies of Eastern Europe	22
	1.6 Developing Countries	26
	Part I Selection	29
2	Individual-Level Theories of Entrepreneurship	31
	2.1 ‘Early’ Theories of Entrepreneurship	32
	2.1.1 Arbitrage and the Bearing of Risk and Uncertainty	32
	2.1.2 Co-Ordination of Factors of Production	34
	2.1.3 Innovation and Creative Destruction	34
	2.1.4 Leadership and Motivation	36
	2.2 The Occupational Choice Model of Entrepreneurship I: Homogeneous Agents	37
	2.2.1 Definitions of Risk Aversion and Risk	38
	2.2.2 A Simple Static Model	40
	2.2.3 Dynamic Models	42

2.3	The Occupational Choice Model of Entrepreneurship II: Heterogeneous Ability and the Lucas (1978) ‘Span of Control’ Model	45
2.3.1	The Model	45
2.3.2	Criticisms of the Lucas Model	48
2.3.3	Extensions of the Lucas Model	49
2.4	The Occupational Choice Model of Entrepreneurship III: Heterogeneous Risk Attitudes and the Kihlstrom and Laffont (1979) Model	56
2.5	The Very Existence of an Entrepreneurial Option	61
2.5.1	Theory of the Firm Considerations	61
2.5.2	Small Firms, Family Businesses and Social Enterprises	63
2.6	Entrepreneurship, Workplaces and Incumbent Firms	69
2.6.1	The ‘Small Firm Effect’	69
2.6.2	Intrapreneurship	70
2.7	Serial Entrepreneurship	72
2.8	Conclusion	78
3	Regional- and Macroeconomic-Level Theories of Entrepreneurship	81
3.1	Theories Explaining Regional Differences in Entrepreneurship	81
3.2	Macroeconomic Theories of Entrepreneurship and Growth	88
3.2.1	Wealth-Based Theories	88
3.2.2	Technology-Based Theories	95
3.2.3	Knowledge-Based Theories	97
3.3	Entrepreneurial Theories of the Business Cycle	101
3.3.1	Creative Destruction and Business Cycles	101
3.3.2	Innovation and Implementation Cycles	102
3.3.3	Models of Production under Asymmetric Information	106
3.3.4	Concluding Remarks	114
3.4	Conclusions	116
4	Empirical Methods in Entrepreneurship Research	118
4.1	Some Useful Regression Methods	119
4.1.1	Omitted Variable Bias	120
4.1.2	Sample Selection Bias	121
4.1.3	Endogeneity and IV	123
4.2	Cross-Section Binary Models of Occupational Choice	125
4.3	Extensions of the Cross-Section Binary Model	128
4.3.1	The Inclusion of Relative Incomes	128
4.3.2	Multiple Occupational Choices	129
4.3.3	Bivariate Probit Models	131
4.3.4	Non-Binary Occupational Choices	132
4.3.5	Heteroscedastic Probit	133
4.4	Experimental and Quasi-Experimental Methods	133
4.4.1	Field and Laboratory Experiments	134
4.4.2	Difference in Difference (DD) Methods	136

4.4.3	Regression Discontinuity (RD) Methods	138
4.4.4	Propensity Score Matching	138
4.5	Time-Series Models	139
4.6	Panel Data Models	141
4.7	Entrepreneurial Duration Models	144
4.8	Extensions to Standard Regression Models	145
5	Individual-Level Determinants of Entrepreneurship	147
5.1	Financial and Non-Financial Incentives	148
5.1.1	Financial Incentives: Relative Earnings	148
5.1.2	Desire for Independence and Job Satisfaction	151
5.2	Human Capital	155
5.2.1	Age	156
5.2.2	Experience	157
5.2.3	Formal Education	162
5.2.4	Entrepreneurship Education Courses	166
5.3	Social Capital, Social and Business Networks and Entrepreneurial Teams	168
5.3.1	Social Capital and Social Networks	169
5.3.2	Business Networks	173
5.3.3	Entrepreneurial Teams	175
5.4	Risk Attitudes, Over-Optimism and Other Psychological Traits	178
5.4.1	Risk Attitudes and Risk	178
5.4.2	Over-Optimism and Overconfidence	185
5.4.3	Other Psychological Trait Variables	192
5.4.4	Genetics Studies	196
5.5	Marital Status, Health and Industry Factors	198
5.5.1	Marital Status	198
5.5.2	Entrepreneurship and Health	200
5.5.3	Industry Characteristics	203
5.6	Family Background	204
5.7	Nascent and Habitual Entrepreneurship	210
5.7.1	Characteristics of Nascent Entrepreneurs	210
5.7.2	Venture Development Paths of Nascent Entrepreneurs	213
5.7.3	Characteristics and Performance of Habitual Entrepreneurs	218
5.8	Incumbent Firm Characteristics	222
5.8.1	Evidence on the Small Firm Effect	222
5.8.2	Workplace Peer Effects	224
5.8.3	Evidence on Intrapreneurship	225
5.9	Conclusion	227
6	Evidence on Regional and Macro-Level Determinants of Entrepreneurship	231
6.1	Entrepreneurship at the Regional Level	231
6.1.1	Pronounced and Persistent Regional Differences	231
6.1.2	Differences in Regional Conditions	233

6.1.3	Regional Firm Entry and Exit Rates	236
6.1.4	Geographical Immobility of Entrepreneurs	238
6.1.5	Knowledge Spillovers as an Entrepreneurship Attractor	240
6.2	Entrepreneurship at Less Aggregated Geographical Levels	244
6.2.1	Entrepreneurial Clusters	244
6.2.2	Cities and Entrepreneurship	246
6.2.3	Neighbourhoods and the Impact of Big Box Stores	249
6.2.4	Public Policy Implications	249
6.3	Economic Growth and Entrepreneurship at the Regional Level	250
6.3.1	Regional Income Growth and Entrepreneurship	250
6.3.2	Regional Employment Growth and Entrepreneurship	252
6.4	Productivity, Macroeconomic Growth and Entrepreneurship	254
6.4.1	Productivity and Entrepreneurship	254
6.4.2	Macroeconomic Growth and Entrepreneurship	256
6.4.3	Economic Development	258
6.5	Business Cycles, Recessions and Entrepreneurship	261
6.5.1	Entrepreneurship and the Business Cycle	261
6.5.2	Unemployment	267
6.6	Conclusion	271
7	Ethnic Entrepreneurship and Immigration	273
7.1	Discrimination	275
7.1.1	Discrimination in the Labour Market	275
7.1.2	Discrimination in the Capital Market	277
7.1.3	Discrimination in the Product Market	282
7.2	Positive Factors	283
7.2.1	Expected Relative Returns	283
7.2.2	Ethnic Enclaves	283
7.2.3	Religion and Culture	285
7.2.4	Role Models and Inculcation of Positive Attitudes	286
7.3	Evidence on the Determinants of Ethnic Differences in Entrepreneurship	287
7.4	Immigration and Entrepreneurship	289
7.4.1	Immigrants' Entrepreneurial Propensities and Performance	290
7.4.2	The Impact of Immigration on Entrepreneurship	295
7.5	Conclusion	297
8	Female Entrepreneurship	300
8.1	Some Basic Facts about Female Entrepreneurship	300
8.2	Family Factors	303
8.2.1	Marriage and Household Production	303
8.2.2	Homeworking and Children	305
8.3	Performance of Women Entrepreneurs	308
8.3.1	The Gender Financial Performance Gap	308
8.3.2	Explanations of the Performance Gap	309

	8.3.3 Other Performance Gaps: Growth and Survival Rates	316
	8.4 Women and Entrepreneurial Finance	317
	8.5 Female Entrepreneurship in Developing Countries	321
	8.6 Conclusion	326
 Part II Financing		 329
9	Debt Finance for Entrepreneurial Ventures	331
	9.1 Background and Terminology	333
	9.1.1 Background	333
	9.1.2 Terminology	338
	9.2 Theories of Credit Rationing and Redlining	340
	9.2.1 Type I Credit Rationing	340
	9.2.2 Type II Credit Rationing, Redlining and Underinvestment	342
	9.3 Signalling, Separating Equilibria and Efficiency	348
	9.3.1 Signalling and Separating Equilibria	348
	9.3.2 Limitations of Entrepreneurial Signalling Strategies	354
	9.4 Overinvestment	357
	9.4.1 De Meza and Webb's (1987) Overinvestment Model	357
	9.4.2 Over-Optimism	360
	9.5 Conclusion	361
 10	 Venture Capital and Business Angel Finance	 365
	10.1 Venture Capital and Entrepreneurs	366
	10.1.1 Introduction: Organisation and Features	366
	10.1.2 Size of the Entrepreneurial Venture Capital Market	371
	10.2 Theory on Equity and Venture Capital Contracts	372
	10.2.1 Equity as an Optimal Financial Contract	373
	10.2.2 Explaining Salient Features of VC Contracts	374
	10.2.3 Limitations of Equity Finance	376
	10.3 Benefits of Venture Capital	379
	10.3.1 Value-Adding Activities	379
	10.3.2 Private Returns from Venture Capital	380
	10.3.3 Social Returns from Venture Capital	383
	10.4 Corporate Venture Capital	383
	10.5 Informal Equity Finance: Business Angels	386
	10.6 Conclusion	389
 11	 Other Sources of Entrepreneurial Finance	 391
	11.1 Microfinance Schemes	391
	11.1.1 Theory	392
	11.1.2 Evidence	396
	11.2 Other Informal Sources of Finance	400
	11.2.1 Finance from Family and Friends	400

	11.2.2 Other Non-Profit-Making Lending Organisations and Schemes	402
	11.2.3 Co-Operative Schemes	403
	11.2.4 Trade Credit	405
	11.3 Crowdfunding	407
	11.4 Conclusion	412
12	Wealth and Entrepreneurship	415
	12.1 The Role of Entrepreneurs in Aggregate Wealth Accumulation and Inequality	416
	12.2 The ‘Private Equity Premium Puzzle’	418
	12.3 Entrepreneurial Wealth Diversification	424
	12.4 Wealth and Entrepreneurship: Theories	425
	12.4.1 The Evans and Jovanovic (1989) Model	425
	12.4.2 The Banerjee and Newman (1993) Model	428
	12.4.3 The Aghion and Bolton (1997) Model	428
	12.4.4 Other Theories: Non-linear Entrepreneurship–Wealth Relationships	430
	12.5 Wealth and Entrepreneurship: Evidence	431
	12.6 Alternative Interpretations of a Wealth–Entrepreneurship Relationship	435
	12.7 Wealth and Performance in Entrepreneurship	442
	12.7.1 Effects of Wealth on Venture Survival	442
	12.7.2 Effects of Wealth on Venture Investment Decisions	443
	12.7.3 Wealth, Borrowing Constraints and Profitability	444
	12.8 Evidence Relating to Type II Credit Rationing	446
	12.8.1 What Does <i>Not</i> Constitute Evidence of Credit Rationing	446
	12.8.2 Berger and Udell’s (1992) Approach	447
	12.8.3 Other Evidence	448
	12.9 Conclusion	449
	Part III Performance	451
13	Entrepreneurial Venture Growth	453
	13.1 Theories of Venture Growth	453
	13.1.1 Gibrat’s Law	454
	13.1.2 Jovanovic’s (1982) Model of Industry Selection	455
	13.1.3 Innovation, Growth and Shakeouts	458
	13.1.4 Other Theories of Venture Growth	460
	13.2 Evidence about the Growth of Entrepreneurial Ventures	461
	13.2.1 Definitional and Measurement Issues	462
	13.2.2 Evidence about Determinants of Venture Growth	464
	13.3 Conclusion	469
14	Rent-Seeking, Entrepreneurial Effort and Employment Creation	472
	14.1 Rent-Seeking and Corruption	473
	14.1.1 Theory	473

14.1.2	Evidence	478
14.2	Work Effort	481
14.2.1	Work Hours and Hybrid Entrepreneurship: Some Facts	481
14.2.2	Explaining Entrepreneurs' Work Hours	484
14.3	Ageing, Retirement and Entrepreneurship	494
14.4	Entrepreneurial Learning	501
14.5	Job Creators	505
14.5.1	Evidence	505
14.5.2	The Role of Taxation	507
14.6	Job Creation by New and Small Firms	509
14.6.1	Job Creation by Small Firms	509
14.6.2	Job Creation by New Firms	512
14.7	Conclusion	514
15	Entrepreneurs' Incomes and Returns to Human Capital	518
15.1	Measurement Issues: Tax Evasion and Income Under-Reporting	519
15.2	Other Measurement Problems	523
15.3	Evidence Relating to Entrepreneurs' Relative Incomes	526
15.4	The Inequality and Volatility of Entrepreneurs' Incomes	529
15.5	Determinants of Entrepreneurs' Incomes: Theory and Methods	534
15.6	Determinants of Entrepreneurs' Incomes: Findings	536
15.6.1	Entrepreneurs' Rate of Return to Education	537
15.6.2	Other Explanatory Variables and Extensions	539
15.7	Conclusion	541
16	Innovation	544
16.1	Klepper's (1996) Model	545
16.1.1	Set-Up of the Model	545
16.1.2	Entry and Exit (Shakeouts) over the PLC	547
16.1.3	Innovation over the PLC	548
16.2	Comparing Innovation by Entrants and Incumbents	549
16.2.1	Theoretical Arguments	549
16.2.2	Evidence on Incumbent and New Firm Innovation	555
16.3	Strategic Innovation Relationships between Incumbents and Entrants	556
16.4	Innovative Employees and Incumbent Firms: Spin-Offs	559
16.4.1	Organisational Limitations of Incumbent Firms	560
16.4.2	Agency Cost Theories	564
16.4.3	Learning Theories	568
16.4.4	Conclusion	570
16.5	Inventors, Scientists and Academic Entrepreneurs	571
16.6	Conclusion	575
17	Venture Survival and Entrepreneurial Exit	578
17.1	Closure Is Not Necessarily Failure	579

17.2	Venture Survival Rates and Their Distribution	582
17.3	Theoretical Determinants of Venture Survival	584
17.3.1	The Liabilities of Newness and Smallness	584
17.3.2	Other Factors	585
17.4	Empirical Determinants of Survival	587
17.5	Conclusion	595
Part IV Public Policy		599
18	Principles of Entrepreneurship Policy	601
18.1	The Case for and against Pro-Entrepreneurship Public Policies	603
18.1.1	The Case for Pro-Entrepreneurship Policies	604
18.1.2	The Case against Pro-Entrepreneurship Policies	608
18.2	Principles of Entrepreneurship Policy Design	611
18.3	Entrepreneurship Policy Evaluation	612
19	Finance and Innovation Policies	614
19.1	Loan Guarantee Schemes	615
19.1.1	Organisation of LGSSs	615
19.1.2	Theoretical Perspectives on LGSSs	617
19.1.3	Evaluation of LGSSs	619
19.2	Subsidised Loans and Grants	621
19.2.1	Subsidised Loans	622
19.2.2	Grants	624
19.3	Policies to Promote Equity Finance	626
19.3.1	Regulatory Policies	626
19.3.2	Taxation Policies	631
19.4	Innovation Policy and Entrepreneurship	634
19.4.1	Policies Supporting the Commercialisation of Academic Research	635
19.4.2	Intellectual Property Rights (IPR) Protection	636
19.4.3	Public R&D Spending and Subsidies	637
19.4.4	Political Leadership	638
19.5	Conclusion	640
20	Regulation	642
20.1	The Regulation of Entry	642
20.2	The Regulation of Exit (Bankruptcy)	647
20.3	Property Rights and Legal Institutions	654
20.4	The Regulation of Employment	660
20.5	The Regulation of Credit Markets	662
20.6	Costs of Compliance with Regulations	664
20.7	Conclusion	666

21	Taxation, Entrepreneurship Support Programmes and Indirect Government Policies	669
	21.1 Taxation	669
	21.1.1 Income Taxes: Theoretical Issues	670
	21.1.2 Income and Payroll Taxes: Evidence	676
	21.1.3 Corporation Tax	682
	21.1.4 Wealth and Inheritance Taxes	684
	21.2 Entrepreneurship Support Schemes	685
	21.2.1 Employment Assistance Schemes	685
	21.2.2 Procurement and Affirmative Action Schemes	688
	21.2.3 Business Training	690
	21.3 Indirect Government Policies	694
	21.3.1 American Health Insurance and ‘Job Lock’	694
	21.3.2 The Size of Government	696
	21.3.3 Social Security Transfers, Trade Unions and Minimum Wages	699
	21.3.4 Fostering an Enterprise Culture	701
	21.3.5 Political and Economic Instability	702
	21.4 Conclusion	703
	<i>References</i>	708
	<i>Index</i>	847

Figures

2.1	Utility functions	<i>page</i> 38
2.2	Occupational choice with heterogeneous entrepreneurial ability	47
2.3	Lazear's Jack-of-all-trades model	51
2.4	Multiple marginal entrepreneurs	55
2.5	Types of start-ups	80
6.1	The Fritsch wave: the effects of new business formation on employment change over time in West Germany	253
9.1	The supply of and demand for loans, and credit rationing	339
9.2	Stiglitz and Weiss' credit rationing model	345
9.3	Redlining	347
9.4	The use of two-term contracts to separate hidden types	349
12.1	Value functions at $t = 1$ and convexity around \widehat{w}_1	422
13.1	Selection and survival in the Jovanovic (1982) model	457
14.1	Payoffs to entrepreneurship and rent-seeking in the Murphy, Shleifer and Vishny (1993) model	476
14.2	Work mixing in entrepreneurship and paid-employment	484

Tables

1.1	International rates of nascent entrepreneurship	<i>page</i> 10
1.2	Aggregate self-employment rates in some selected OECD countries, 1960–2013/14 ^a (per cent)	20
1.3	Aggregate self-employment rates in some selected transition economies, 1980–2014 (per cent)	23
1.4	Aggregate self-employment rates in selected developing countries, 1960s–2013 (per cent)	27
2.1	Demand- and supply-side factors influencing the ‘make or buy’ decision	64
2.2	Explanations for the Small Firm Effect	70
2.3	Strategies of serial entrepreneurs and business transfers by ability and business quality type	73
2.4	Exogenous abilities and entrepreneurial types	78
5.1	Summary of determinants of entrepreneurship	149
5.2	Costs and benefits of weak and strong ties	170
5.3	Observations about social capital and implications for entrepreneurship	170
5.4	What happens to nascent entrepreneurs?	215
6.1	Self-employment rates in the British regions, 1970 and 2000	232
6.2	Firm birth and death interactions	237
6.3	Correlations between cycles of self-employment, output and unemployment	265
6.4	Granger causality tests of VAR models: <i>p</i> -values	266
13.1	Determinants of entrepreneurial venture growth	465
14.1	Average work hours weekly in Britain by gender and occupation	482
14.2	Estimates of the determinants of entrepreneurs’ work hours	488
14.3	Entrepreneurial learning and performance trajectories	504
14.4	Characteristics of job creators	506
15.1	Selected inequality indices for UK self-employment and employment incomes	532
16.1	Innovation and entrepreneurship	550
17.1	Summary of economic determinants of venture survival	588
19.1	Features of LGSs in the UK, the USA and Canada	616
21.1	Different tax treatment of entrepreneurs	675
21.2	Summary of results on taxation	679

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Preface

This book is intended for use in graduate-level courses and as a source of reference by researchers. I have used it to teach doctoral seminars on the economics of entrepreneurship in Canada and the United States. A set of PowerPoint slides accompanies many of these chapters and is freely available from the publisher and the author. It is hoped this will simplify the life of instructors who use the book for teaching purposes.

The previous edition of this book was published by Cambridge University Press in 2009. In the eight years since then, the published literature on entrepreneurship has grown enormously. Many well-established topics have continued to attract research attention, especially (but not only) regional entrepreneurship, risk aversion and over-optimism, and the macro-institutional setting in which entrepreneurs operate. At the same time, several new topics have emerged, which had barely registered with most researchers a decade ago. These include crowdfunding, entrepreneurship education and microenterprise grant and training evaluations using field experiments.

It has also been necessary to update the book by incorporating the numerous new articles which have been published since 2008. Updates have been made to every section – indeed, every page – of the new edition. Several chapters in the previous edition have been expanded, while others have been split off into new chapters of their own. To single out just one aspect of the more substantial changes, theory on regional and macroeconomic aspects of entrepreneurship has been separated into a distinct chapter from the evidence on regional and macroeconomic aspects of entrepreneurship. At the same time, the treatment of innovation, social capital and venture capital (among other topics) has also been considerably upgraded and enhanced since the previous version. The book also discusses new empirical methods, including quasi-experimental methods and field experiments. These new methods are becoming increasingly widespread in published entrepreneurship research at the time of writing.

The spectacular growth of research in entrepreneurship is warmly welcomed, though it has posed several challenges in writing this book. It has made it more important than ever to retain the focus of this volume on economics, or at least on topics of interest to economists even if the authors are non-economists. This is not to say that the coverage of the book has narrowed; rather, I have tried to resist the temptation to incorporate material which belongs squarely in the psychology or management camps, such as cognition, entrepreneurial passion, entrepreneurial orientation and the like. I have also continued to sidestep descriptive accounts of the processes that entrepreneurs follow when starting

new ventures, as well as typologies of entrepreneurs, which are essentially descriptive as well. Mainstream economic theory relies on some form of optimisation, which rules out discussions of qualitative research contributions or reasoning based on induction or some kind of informal inference. It also rules out discussions of ‘Austrian economics’ approaches to entrepreneurship, which are critical of mainstream economics but which seem to me to lack predictive content, and which moreover appear to misunderstand the role of assumptions, especially as they relate to equilibrium, in mainstream economic theory.

The interface of the economics of entrepreneurship with psychology is more subtle and deserves special comment. Neoclassical economics has traditionally assumed full rationality of agents, which rendered detailed psychological considerations moot. More recent research has taken more of a behavioural economics stance, in which individuals make decisions while harbouring some kind of cognitive bias, such as over-optimism. I have always believed that contributions from this research stream fall well within the ambit of the economics of entrepreneurship, and so the intersection of psychology, economics and entrepreneurship does appear in this book.

If economics is applied as one type of razor to the broad literature, entrepreneurship is the other razor. For instance, in this book innovation is not discussed as an end in itself, either with regard to its determinants or as an outcome measure; but it is discussed – and in this edition secures its own dedicated chapter – as it relates to entrepreneurship. That is true both of independent (‘entrepreneurial’) and corporate (‘intrapreneurial’) innovation.

In short, this book does not claim to provide a comprehensive overview of the entire entrepreneurship literature. It confines its attention to the incentives that underpin entrepreneurial decision-making and behaviour; the strategic interactions between entrepreneurs and other agents; the performance of entrepreneurs; and the impact that entrepreneurs have on the economy as a whole. That, in brief, is the space encompassed by the economics of entrepreneurship.

Should non-economists read this book? I hope they do, as economics generates rich theory which can cross-fertilise other disciplines, as well as numerous empirical insights which can inform and enlighten across disciplinary boundaries. Moreover, agency theory, human capital theory, the economics of information and real options theory are among the economic theories which continue to influence business and management scholars. Also, a better understanding of the economics literature relating to entrepreneurship might even prevent some management scholars from trying to reinvent the wheel. For example, much has been made of opportunity recognition in management and entrepreneurship journals following Venkataraman’s famous study published in 1997. Yet economists have long recognised the importance of opportunity recognition and exploitation by entrepreneurs, with early studies including Schultz (1980), Rosen (1983) and Baumol (1990). For instance, according to Sherwin Rosen, entrepreneurship entails ‘exploiting the new opportunities that inventions provide, more in the form of marketing and developing them for widespread use in the economy than in developing the knowledge itself’ (Rosen 1983, p. 307). Separately,

Corriveau (1994, p. 2) modelled both long-run growth and output fluctuations originating in ‘the actions of entrepreneurs who seek, find and exploit profit opportunities that arise out of process innovations’. Another example is occupational choice theories, which originated in economics in the 1970s and 1980s, yet which have been reworked subsequently in some management and entrepreneurship journals as ostensibly ‘novel’ contributions.

The presentation style and format of this edition has been adjusted, with the inclusion of rigorous derivations of results rather than just the ‘summarising logic’ which the previous edition tended to favour. The previous edition often jumped straight to results, shortcutting their derivation. While that made for brevity, it reduced the ease with which technical readers could grasp the mechanisms generating the results. In many ways, the present volume is closer to my original 2004 book *The Economics of Self-Employment and Entrepreneurship*. It is hoped that several topics are now treated in the requisite depth, while providing a clear exposition of influential theories and findings and continuing to supply the all-important intuition behind them. I have also added concluding sections to most chapters, where my personal impressions about what we know, what matters and where future research is needed, are set out.

Some journals occasionally publish special issues on the economics of entrepreneurship, including one in the *Journal of Business Venturing* in 2008; several in the *Journal of Economics & Management Strategy* (2009, 2010, 2013); and one in the *European Economic Review* in 2016. However, the economics of entrepreneurship does not have a dedicated journal of its own, with work appearing in numerous and diverse economics and entrepreneurship outlets. That does in fact provide a partial rationale for this book, which aims to bring together the scattered coverage of the subject in one place. The reading I have done for this book is reasonably comprehensive up until June 2016, which was the latest date of publications listed in the Web of Science that I consulted. I am grateful to Dr Larry Plummer, who provided helpful comments on earlier drafts of Chapter 6; to Raquel Fonseca for comments on Chapter 3; and to Ketan Goswami for updating Tables 1.2–1.4. I am also grateful to Chris Harrison at Cambridge University Press for his continued support of this book, and to Phil Good, the commissioning editor for economics at the Press. Any mistakes and opinions are my responsibility alone.

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