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.

**Simon C. Parker** is Professor of Entrepreneurship at the Ivey Business School in Canada, and Research Fellow at the Institute for the Study of Labour (IZA), in Bonn, Germany. He is Field Editor for the *Journal of Business Venturing*, Co-Editor at the *Journal of Economics and Management Strategy*, and on the editorial board of the *Academy of Management Review*. He has published over eighty peer-reviewed articles in economics, entrepreneurship and management journals.
The Economics of Entrepreneurship

Second Edition

SIMON C. PARKER
University of Western Ontario
Für mein Ninchen
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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.