Latecomer Entrepreneurship: a Policy Perspective

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Latecomer Presentation1.doc

3 Key Questions

- What does entrepreneurship really mean in developing countries (DCs)?
- What policies are ‘out there’ to promote entrepreneurship – how effective are they?
- Success cases of East/South East Asia – any lessons?

Rationale

- entrepreneurship *should* be crucial for innovation and catch up
- policies mostly based on ‘Washington Consensus’ - DCs should adopt policies of the successful countries
- de Soto’s work/World Bank etc – DC gov’t bureaucracy stifles innovation
- small and medium sized enterprises (SMEs) and venture capital policies

Definitions and Functions of the Entrepreneur

- differ across economics, development economics, psychology, sociology, business and innovation studies
- Within economics definitions based on
  – Nature of employment (self)
  – Exchange functions
  – Uncertainty
  – Innovation activities
  – Resource allocation/investment
  – (Large) intra-firm activity (intrapreneurship)

Author	Definition
Richard Cantillon (circa 1730)	Entrepreneurship is defined as self-employment of any sort. Entrepreneurs buy at certain prices in the present and sell at uncertain prices in the future. The entrepreneur is a bearer of uncertainty.
Jean Baptiste Say (1816)	The entrepreneur is the agent 'who unites all means of production and who finds in the value of the products...the reestablishment of the entire capital he employs, and the value of the wages, the interest, and rent which he pays, as well as profits belonging to himself'.
Frank Knight (1921)	Entrepreneurs attempt to predict and act upon change within markets. Knight emphasises the entrepreneur's role in bearing the uncertainty of market dynamics. Entrepreneurs are required to perform such fundamental managerial functions as direction and control.
Joseph Schumpeter (1934)	The entrepreneur is the innovator who implements change within markets through the carrying out of new combinations of new/improved good/new method of production/ new market/ new source of supply of new materials or parts/new organization of industry..
Penrose (1963)	Entrepreneurial activity involves identifying opportunities within the economic system. Managerial capacities are different from entrepreneurial capacities.
Harvey Leibenstein (1968, 1979)	The entrepreneur fills market deficiencies through input-completing activities. Entrepreneurship involves "activities necessary to create or carry on an enterprise where not all markets are well established or clearly defined and/or in which relevant parts of the production function are not completely known.
Israel Kirzner (1979)	The entrepreneur recognizes and acts upon market opportunities. The entrepreneur is essentially an arbitrageur. In contrast to Schumpeter's viewpoint, the entrepreneur moves the market toward equilibrium.
Rothwell and Zegveld (1982)	Intracorporate entrepreneurship is related to the creation of a new business inside the large corporation, a phenomenon that increases in importance along with degree of concentration of industry, and particularly of the science intensive industries.

Schumpeterian Model(s)

- risk taker and innovator whose new combinations lead to creative destruction
- (1934) ‘Mark I’ (or heroic) individual entrepreneur who - temporary monopoly in an output (product) or input (process) markets and obtains ‘super’ profits from innovation *via* higher output prices and lower input costs.
- Mark II, (large firm), Schumpeter (1943) corporate research and development (R&D) laboratory - innovation as a routine function

Policies in DCs

- de Soto’s (2000) research on Government bureaucracy in DCs - a typical example
- to license a small garment shop (with one worker) in Lima Peru, de Soto’s well educated team of researchers:
  - took six hours a day for 289 days
  - cost US$1,231 in total (31 times the monthly minimum wage) and required 207 administrative steps, involving 52 government offices.
  - to obtain legal title for the small piece of land took a further 728 steps, - total of 26 months of red tape.
  - similar examples in Philippines, Egypt, Haiti, Mexico and other DCs
- entrepreneurs forced to operate ‘outside’ the capitalist system - a huge amount of ‘dead capital’ in DCs – cannot be used for borrowing, or investing etc.

Policy Response

- reform/reduce public bureaucracy - give rights to informal firms – policies taken up by World Bank, IMF, UNDP, IBRD: World Bank's 'Doing Business' database measures state of business regulations across 145 economies
- 2005 database (3rd ed): argues poor DCs impose too many barriers to business - more than 2% could be added to the growth of the 'most difficult countries to do business' if they adopted the regulations of the least difficult ones (e.g. Toronto, Helsinki); Djankov and McLiesh 2005, p3

Problems with current policies

1. no explanation of *why* bureaucracy - possible explanations:
    1. Social safety net – poverty/context leads to bureaucracy
    2. Krueger (1974) - rent extraction/curruption
    3. Incompetence (institutional)
2. no analysis of other causes of arrested development:

    Can be many other reasons (e.g. macro/trade problems, Rodrik, 2004) dev. strategy failure, war, famine, etc.
3. Gerschenkron's 1962 argument – DCs cannot 'copy' leaders
    (a) very different external circumstances
    (b) very different institutional capabilities/resources
    (c) policies/solutions must be tailored to the needs of each individual DC

growth calculations/policies misleading and naïve

SME Policies as Entrepreneurship Policies

- SME/micro-finance programmes very common – especially in high-tech - World Bank Group approved more than US$10 billion in SME programmes in five years 1998-2002 (Beck 2001).
- Main problems - (Beck 2003) - need to create an external business environment that fosters growth of *all* firms (large, medium and small) – not just SMEs – need for ‘healthy’ industrial structure
- ‘Gerschenkron’ problem again – incorrect to ‘copy/imitate’ advanced countries

Venture Capital Policies

- support for venture capital as means of increasing high techn. entrepreneurship (e.g. Brazil, Korea, India, Hong Kong)
- But (Reynolds 2003; GEM 2003), even in the case of the most developed countries, venture capital is only ever marginal source of funds for start-up investments
- Assumption that advanced country policies can be pursued in DCs is questionable

Research on Entrepreneurship in DCs

- Motivations - risk taking? profit making? entrepreneurs often come from traditional trading/business communities - (e.g. India, Pakistan, Africa, China)
- motivations - often 'non-pecuniary' - autonomy in professional and personal life – family security, financial independence
- often risk-averse (e.g. to avoid business closure) as in advanced countries – 'happy to stay small' - not always a source of innovation/growth

Embeddeness

- entrepreneurship often based on class and ethnic background in DCs - and embedded in close social/economic networks
- sometimes these networks are restrictive – preventing entry/competition/adoption of new technology (Sverrisson, 1993, Kenya and Zimbabwe)
- in other cases (e.g. China, Chan 2001; Taiwan, Schak, 2000), networks promote common values which promote innovation and growth

Evolution of informal into formal business

- overseas Chinese networks - informal business networks evolved over centuries to manage and mitigate risk-taking (Chan 2001, Chan and Chiang, 1994)
- today, formalised overseas Chinese businesses control a large proportion of formal listed equity in South East Asian economies (e.g. 80% in Thailand and Singapore).
- informality can be a ‘stage of development’ issue – informality not necessarily a ‘problem’ (de Soto)

Overseas Chinese Holdings in Listed Companies in South East Asia

	Ethnic Chinese in 1991 (millions)	Percent of population	Share of listed equity
Indonesia	5.81	3.5	73%
Malaysia	5.33	29.0	61%
Philippines	1.2	2.0	50%
Thailand	5.57	10.0	81%
Singapore	2.14	77.0	81%

Chinese holdings in listed companies not under state or foreign control, as percentage of market value of all shares in such firms.

Source: Sakura Bank, Nomura Research Institute, in: Asiaweek, Oktober, 20, 1993

Lessons from East/South East Asia?

- DCs entrepreneurs do not appear to have a ‘best practice’ face (e.g. the classic ‘heroic’ Schumpeterian entrepreneur)
- questions for successful Asian cases
  - 1. what is the entrpreneurial role of domestically-owned, local firms? (esp. in relation to technology)?
  - 2. what is the entrepreneurial role (if any) of foreign TNCs in South East Asia (where they dominate exports)?
- my research - electronics, the largest export sector

Evolution of OEM system in Korea and Taiwan - from OEM to ODM to OBM

	Technological Transition	**Market Transition**
1960s/1970s OEM *Original Equipment Manufacture*	Local Firm learns assembly process for standard, simple goods	Foreign TNC/buyer designs, brands and distributes/gains non manufacturing value added
1980s ODM *Own Design and Manufacture*	Local firm learns process engineering and detailed product design skills	As with OEM, TNC buys, brands and distributes. TNC gains non-manufacturing value added
1990s OBM *Own Brand Manufacture*	Local firm conducts manufacturing, product designs and conducts R&D for new products	Local firm has own brand, organises distribution and captures all value added

•original equipment manufacture (OEM) system - where large TNCs sub-contract production to local Asian firms – TNCs provide production and design in return for low cost assembly/manufacture

Entrepreneurial Implications

- Main technological activity not Schumpeterian/R&D-centred process – little radical innovation
- Mostly a gradual, ‘incremental’ process of catching up - improvements to existing products and processes – learning engineering and technician skills
- Main ‘innovation’ was in organisation of production (OEM/ODM system – new to the world)

Technological Progress in South East Asia

	Singapore	Malaysia	Thailand	Indonesia	Vietnam
1960s	Assembly				
1970s	Process Eng*	Assembly	Assembly		
1980s	Product Dev**.	Process Eng	Assembly	Assembly	Assembly
1990s	R&D	Product Dev.	Process Eng	Process Eng	Assembly

Notes: *Process Engineering; **Product Development

Entrepreneurial Implications

- similar story of catch up (within TNCs), local learning of technician/engineering/managmt skills - 20-30 years or so
- Major ‘innovation’ organisational – using TNCs to promote exports (not seen before on such as scale)
- some studies (e.g. in Malaysia and Thailand) show that learning within subsidiaries very difficult – ‘a struggle’ rates of progress differ – many setbacks – linkages still weak with local economy - nothing automatic

‘Entrepreneurial failure’ in Asia

- i.e. coherent development strategy but insufficient supply of capable firms and managers, then alternative (often overlooked) role for policy
- South Korean Government supported a ‘big business’ Japanese style ‘Zaibatsu’ model - created a class of entrepreneurs and managers
- Singapore, Government subsidized entry of foreign TNC subsidiaries (also Malaysia and Thailand)
- However, policies towards entrepreneurship were (implicit) components of wider strategies towards industrialisation (incl. export-led growth, macro economic stabilisation, education/technical education)

Conclusions and Policy Implications

- Asian evidence – ‘E’ role is to enable catch up, learning and ‘behind the frontier’ incremental innovation - rather than Schumpeterian or radical technological advances
- entrepreneurs (in all firms, local and foreign firms) are the main agents for acquiring technology from abroad and ‘learning’ - integrating production into international value chains, upgrading etc
- ‘latecomer entrepreneurship’ (as distinct from ‘normal’) was a distinctive feature of Asian development – a highly specialised ‘catch up’ function

Conclusions and Policy Implications

- conventional policies (implicitly?) based on a Schumpeterian model and imitate ‘E’ functions now carried out in highly advanced countries
- cannot address specific needs of individual DCs (Gerschenkron, 1962) - latecomer institutional capabilities/stage of development/context etc. must be accounted for
- other basic causes of development failure – e.g. macro instability/inward looking focus/war etc.
- E-policy must be integrated within wider dev. strategy