



ENTREPRENEURSHIP AND REGIONAL DEVELOPMENT

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Abstract: *The entrepreneurial agency is a potential vehicle for facilitating local and regional development. Entrepreneurship is a fundamental driver of economic evolution. It is also a distinctly spatially uneven process, and thus an important explanation of the uneven economic development of regions and nations. Not surprisingly, entrepreneurship is a key element of evolutionary economics (Schumpeter 1934; Witt 1998; Grebel et al. 2003; Metcalfe 2004; Grebel 2007) and has been recognized as an important element in explaining (regional) economic development (Acs and Armington 2004; Audretsch et al. 2006; Fritsch 2008). This means that the explanation of regional variations in entrepreneurship has also become an important issue. This article conceptually examines how rural entrepreneurship engages with “place” and “space” as well as the nature of entrepreneurial activities in rural areas. This paper is an inquiry into the role of entrepreneurship in evolutionary economic geography. The focus is on how and why entrepreneurship is a distinctly spatially uneven process.*

Keywords: *Economic development, Entrepreneurship, Potential, Regional variations*

Introduction:

For several decades, the determinant factors of a region’s wealth have been present in academic and political debate. The heterogeneity (and disparity) in economic welfare rates globally makes it clear that certain regions have developed capabilities over time to preserve—and even to increase—their comparative advantage in terms of GDP per capita. This leads us to think that certain regions have some idiosyncratic capabilities that are exceptional for successful economic development but that sometimes these capabilities work to the detriment of social, environmental and human development. The discovery and analysis of these regional capabilities could require a lot of time and effort to debate. And furthermore, even if we were to reach a consensus on the properties of these capabilities, extrapolating them for imitative construction and application to other regions could be a dangerous exercise, since the contexts are different and not all regions have the same absorptive capacity. Entrepreneurship and Regional Development is unique in that it



addresses the central factors in economic development - entrepreneurial vitality and innovation - as local and regional phenomena. It provides a multi-disciplinary forum for researchers and practitioners in the field of entrepreneurship and small firm development and for those studying and developing the local and regional context in which entrepreneurs emerge, innovate and establish the new economic activities which drive economic growth and create new economic wealth and employment. The journal focuses on the diverse and complex characteristics of local and regional economies which lead to entrepreneurial vitality and endow the large and small firms within them with international competitiveness. Audretsch and Keilbach (2004) argue that a region must be endowed with entrepreneurship capital that enables the channeling of innovation into the market and thereby contributes to economic growth. This channeling process is complex and obstacle-ridden. Some of the barriers are those of the market itself; others are institutional, cultural and so on. Only by overcoming these barriers can knowledge filters create value in the market and improve productivity of resources. González et al.(2009) argue that this process could trigger a virtuous cycle of development: «while region's innovation capital and entrepreneurship capital may affect the achievement of higher levels of productivity, competitiveness and economic welfare, it is also true that the level of prosperity may well affect the enrichment of innovation capital and entrepreneurship capital». Precisely, this endogenous phenomenon can explain in part the persistence of the disparity among regions in their respective levels of well-fare as well as the impact that certain regional capabilities (such as innovation and entrepreneurial success) have on their economies. The growing interest in this debate gave rise to the «Entrepreneurial Activity and Regional Development» workshop organized by the Orkestra-Basque Institute of Competitiveness, in San Sebastian on 19th-20th July 2012. The workshop brought together numerous national and international researchers to discuss themes related to entrepreneurial intention and the creation of new business in expansionary and recessionary economic periods. This special issue includes several papers that were presented during this event, which offer a rich diversity of conceptual frameworks and methods, as well as an eclectic perspective of this phenomenon. The majority of papers do share a common element; they used data provided by the GEM (Global Entrepreneurship Monitor) project, which has opened new possibilities for study.



Objective:

The main objective of this special issue is to analyze the relationship between entrepreneurial intention and entrepreneurial activity and its impact on regional development.

Data and Methodology:

This study consists of multiple individual cases embedded in three different regions, which were selected using a purposeful sampling strategy in order to obtain diverse and information rich cases

Literature Review:

This paper presents a systematic literature review. It examines how the phenomenon of 'entrepreneurship and regional development' has been addressed theoretically and empirically in the past. In this article the dominant perspectives in relation to entrepreneurship and regional development considered. This paper provides a thematic analysis of the predominant topics and synthesizes the insights of the two dominant streams of research, and uncovers a number of theoretical and empirical research gaps.

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It is widely recognized that the region has become a fundamental basis of economic and social life. The national level of observation, though still important, is no longer the uniquely privileged point of entry to our understanding of economic development and all the more so given the fact that the barriers between national economies are – in certain respects – breaking down, at least in Europe.

Definitions and Measurement of Entrepreneurship and Regional Development:

Entrepreneurship is a phenomenon that takes several forms and appears in small and large firms, in new firms and established firms, in the formal and informal economy, in legal and illegal activities, in innovative and traditional concerns, in high-risk and low-risk undertakings, and in all economic sectors (OECD, 1998).

Regional development is the provision of aid and other assistance to regions which are less economically developed. Regional development may be domestic or international in nature. The implications and scope of regional development may therefore vary in accordance with the definition of a region, and how the region and its boundaries are perceived internally and externally.



Determinants

Regional development is a dynamic phenomenon with a permanent change in business activities. This change may be caused by innovation, by decline and by the birth and death of firms. The development of the SME sector plays a critical role in spatial dynamics, as many forms of creative entrepreneurship are found in this sector. Clearly, the regional system (education, social support system, culture, accessibility etc.) plays an important role in the changing conditions for entrepreneurship. The entrepreneurial event takes shape through the interaction of two sets of factors: personal (micro) factors and environmental (macro) factors. Much of the literature on entrepreneurship has focused on the micro factors, the characteristics of an individual to become an entrepreneur and to start a new firm. These studies focus on the role of factors such as personality, educational attainment and/or ethnic origin (Lee, Florida and Acs, 2004). Personality studies have found that entrepreneurship is associated with characteristics such as alertness to business opportunities; entrepreneurial vision and proactivity (see Chell, Hawarth and Brearly, 1991). Research on personality, moreover, found that entrepreneurs exhibit greater individualism than non-entrepreneurs do (McGrath, MacMillan and Scheinberg, 1992). The key aspect of favourable entrepreneurial environments, however, is – as emphasised by Malecki (1997a) – thriving networks of entrepreneurs (see Section 5 for further details), other firms and institutions, providing capital, information and other forms of support. The theoretical notion of the Milieu introduced by the GREMI group (Groupement de Recherche Européen sur les Milieux Innovateurs) epitomises these characteristics (see Maillat, 1995). Entrepreneurial development is most likely to be successful in larger urban regions, especially in metropolitan regions, where innovativeness, an entrepreneurial climate and business opportunities are relative abundant.

Entrepreneurship and economic evolution

'Newcomers' to the economy have an important role to play in the evolution of economic systems. According to Schumpeter (1942: 83) "The fundamental impulse that sets and keeps the capitalist engine in motion comes from the newcomers' goods, the new methods of production or transportation, the new markets, the new forms of industrial organisation that capitalist enterprise creates. ... [This is a] process of industrial mutation – if I may use that biological term – that incessantly revolutionizes the economic structure from within, incessantly destroying the old one, incessantly creating a new one. This process of Creative



Destruction is the essential fact about capitalism.” By creating new variations (products, processes, business models) in the economy, these innovative new firms compete with incumbent firms, which force the latter to improve or change their production, sanctioned by liquidation if this is not done successfully (Schumpeter 1934; 1942). The creation of this variation is unevenly distributed over space. Although relatively inert, this spatial distribution of variety creation itself changes over time. These new variations are thus created somewhere, but are not diffused automatically to all places and applications in which they might be of value. A less heroic, but perhaps not less important role is played by entrepreneurs in this diffusion of new variations: they fill the gaps in the market (Kirzner 1973; 1997). Introducing existing products and practices to new contexts – via 1#0907

processes of generalization, differentiation, or reciprocation (see Nooteboom 2008) – can be a truly entrepreneurial effort that might even lead to radical innovations. Variety creation and diffusion are two important roles played by the entrepreneur in economic dynamics. For example, the formation of new technology based firms might serve the purpose of creating new – technology intensive - products or of diffusing (the use of) new technologies in society.

Variation and diffusion also feed each other (cf.Nooteboom 2008): the pursuit of entrepreneurial opportunities feeds further opportunities (Holcombe 2007). First, any change by one entrepreneur alters the economic environment and provides opportunities for additional adjustments by other entrepreneurs. Second, entrepreneurial activity is likely to create wealth and in that way increases the extent of the market. Third, the creation of market niches that did not previously exist provides opportunities for new entrepreneurs to enter and expand this market niche. Entrepreneurial opportunities come into being because of prior acts of entrepreneurship (cf. Metcalfe’s (2002) “growth of knowledge”): “Bill Gates could not have made his fortune had not Steve Jobs seen the opportunity to build and sell computers, and Steve Jobs could not have built a personal computer had not Gordon Moore invented the microprocessor” (Holcombe 2007: 61). Next to variation and diffusion, selection plays an important role in entrepreneurship, reflected in the fact that most new firms do not survive for a long time, and that even a smaller portion (often less than one out of ten start-ups) grows to some extent (Reynolds and White 1997; Stam et al. 2008).



Selection is generated by the decisions of external resource holders to allocate their resources among these firms (Aldrich 1999; Baum and Silverman 2004). New firm formation is affected by different selection environments. Most directly there is competition in product-markets: a lack of competition might indicate an opportunity (a gap to be filled) and a constraint (with too high entry barriers). Fierce competition forces firms to produce and sell efficiently, in order to survive. For new firms that need to reach a substantial size, selection in the capital and labour market are also important. They need to attract finance and human resources in competition with other organizations that need these resources in face of limited supply. Competition is often a very local process: more distant firms are less likely to compete for the same pool of human resources or product-markets than firms in proximity (Cattani et al. 2003; Baum and Mezias 1992; Sorenson and Audia 2000). Historically, the literature has often explained entrepreneurship as either the product of environments (like provision of venture capital, growing demand) or of personal attributes (like risk-taking propensity, need for achievement). Individuals are heterogeneously endowed with skills, knowledge, attitudes and preferences (values) which drive their motives and behaviour (Simon 1957; McFadden 2001). Environments are heterogeneously endowed with knowledge, institutions, resources and demand for products. The entrepreneurial process depends on entrepreneurial opportunities in the environment and enterprising individuals that identify and exploit these opportunities. When individuals identify an opportunity, they do not react automatically with establishing a new firm (assuming that they have the intention to start one): new firms are created with a sequence of processes like creating a legal entity, product development, financing (Carter et al. 1996). Given prospects of employment, education, and other circumstances differ across individuals, the population is heterogeneous with different individuals facing different opportunity costs when acting to exploit an opportunity they recognized. Entrepreneurship is the result of the interaction between individual attributes and the surrounding environment. This means that entrepreneurs are neither the lonely heroes that change the economy on their own, nor that they are determined by their environment: just like any other individual they most often reproduce their structural conditions, but they are entrepreneurial because they also transform these structures. The latter echoes the Schumpeterian view of entrepreneurs as the executors of transformative new combinations, and involves the pursuit of entrepreneurial opportunities, defined as “ideas, beliefs and



actions that enable the creation of future goods and services in the absence of current markets for them” (Sarasvathy et al. 2003: 142). Working definition of entrepreneurship in line with this view is “the introduction of new economic activity by an individual that leads to change in the marketplace” (see Stam 2008). This new activity can be perceived in reality as a new good or service that is produced by or for the entrepreneur, and that is valued by consumers who pay a price for its property rights. This excludes non-market activities (i.e. no price mechanism and property rights involved) and mere changes of contract (i.e. no new economic activities involved). Let us give three examples of what entrepreneurship is not according to this definition (and separating it from much everyday usage of the term). First, the shift from employment into self-employment by an individual does involve a change in the marketplace, but not an introduction of new economic activity. Second, the creation and introduction of a new product in a concerted effort by a large corporation that involves exchangeable individuals also does not count as entrepreneurship. Third, the creation and execution of a new terrorist strategy in which airplanes are used as missiles, involves new economic activities by a distinct group of individuals who might not be interchangeable, but does not lead to an exchange of property rights. From a theoretical perspective, an inquiry into the role of entrepreneurship in evolutionary economic geography builds on insights from evolutionary economics, cognitive theories of innovation, social network approaches, and organizational ecology. These fields reveal large overlaps in the processes they study. Within evolutionary economics (individual and collective) learning processes, inheritance of routines and feedback effects play an important role. In evolutionary economics the variance in the performance of firms is explained by heterogeneity in routines (Nelson and Winter 1982; Hodgson and Knudsen 2004). Routines can be understood as organizational skills, which cannot be reduced to the sum of individual skills, i.e. they are a collective property. However, it is still unclear what the role of individual level skills and knowledge (an individual property) is in relation to organizational routines (a collective property). We will get back to this issue in the final section of this paper. The replication of routines takes place between firms (as carriers of routines) through various mechanisms, of which one is the creation of a firm by an employee (Klepper 2002; 2007; Klepper and Sleeper 2005) through which routines (and the knowledge embedded in them) are transferred from the parent to the newly created firm. Next to the emphasis on the replication of routines, evolutionary economics’ conceptualization of economic evolution as



the emergence and dissemination of novelty (Witt 2003) moves the entrepreneur as a creator and disseminator of novelty in the economy centre stage. The emergence of novelty creates variety in any evolving system, but the generation of novelty requires heterogeneous elements as inputs to the recombination process underlying it (Witt 2004). This brings us to cognitive theories. Cognitive theories of innovation emphasise that innovation is a product of interaction between actors that have sufficiently different knowledge in order to make transformative (Schumpeterian) new combinations, but are still sufficiently proximate in a cognitive sense in order to be able to communicate at all (Nooteboom 2000). On the micro level these innovations are most likely to be realized by spin-off firms pursuing opportunities that are based on the existing knowledge base of the parent firm, but sufficiently different to exploit it outside the parent organisation. Empirical studies have shown that industries like instruments manufacturers (Audia et al. 2006) and automobiles (Carroll et al. 1996; Klepper 2002; Boschma and Wenting 2007) have emerged in this way: the successful early entrants in the automobile industry came from related bicycle producers, carriage builders, and engine manufacturers, while the successful early entrants in the instrumentation industry came for example from machine, defence, and chemicals industries (Audia et al. 2006). Organizational ecology studies populations of organizations, focusing on how they change over time, especially through demographic processes of selective replacement – organizational founding and mortality (Carroll and Khessina 2005). The evolutionary triad of variation, heredity and selection is central in the organizational ecology approach. Organizational foundings are predicted with notions like density dependence, structural inertia, niche width, and resource partitioning (see Carroll and Hannan, 2000). Organizational density is driven by organizational foundings and affects competition and legitimacy of a particular organizational form. Organizational inertia and imprinting are important mechanisms of retention. In this field new firms are often analysed as organizational products (Freeman 1986; Audia and Rider 2006; Audia et al. 2006). Finally, network studies emphasize the role of information acquisition and resource mobilization via social networks in the behaviour of individuals and groups. Key issues related to entrepreneurship are processes of opportunity identification and resource mobilization (Sorenson 2003; Stuart and Sorenson 2007). These literatures all take into account the role of entrepreneurship in creating something new, which is somehow related to the past, and is affected by and affects its context.



Regional conditions of entrepreneurship

Entrepreneurs are hardly lone individuals who rely primarily on their extraordinary efforts and talents to overcome the difficulties inherent in the formation of a new firm. The process of starting a new firm is eminently social, as information and resources are to a large extent acquired via the personal networks of the (nascent) entrepreneur. For nascent entrepreneurs the focal choice is what kind of firm to start given their location, not so much choosing a location for a given firm (Stam 2007). The social ties of the potential entrepreneurs are likely to be localized, and induce entrepreneurs to start their firm in close proximity to their homes and to their current employers (Cooper and Folta 2000; Sorenson 2003; Stam 2007; Parwada 2008). It is a stylized fact that entrepreneurs start their firm in the region where they live and/or work. The fraction of entrepreneurs working in the region where they were born is significantly higher than the corresponding fraction for dependent workers (Michelacci and Silva 2007). A study of Portuguese manufacturing firms found that entrepreneurs were willing to accept labour costs three times higher than in alternative locations to locate the new business in their current region (Figueiredo et al. 2002). There are several reasons for the locational inertia of entrepreneurs. First, they can utilize their existing (local) network to seek partners, employees, suppliers, customers, advisors and investors (Zander 2004; Michelacci and Silva 2007). This decreases search costs, but it also permits them to build upon credibility and trust developed in past relationships. The behavioral matrix of Pred (1967) is relevant here, as locational inertia can also be explained by imperfect information about alternative locations and/or limited cognitive abilities to process all information available (cf. Simon's (1957) bounded rationality). Second, more normative motivations might be at play here, as some relationships involve more than rational instrumental motivations, and continuing these relationships might only be possible when the entrepreneur stays within the region. Dahl and Sorenson (2009) conclude in their empirical study of Danish entrepreneurs, that entrepreneurs appear to value proximity to family and friends not for the help that those connections might offer to their ventures but for emotional reasons. Third, they can start on a part-time basis (often being home-based) and delay full-time commitment until the venture seems sufficiently promising (part-time entry as a real option strategy: see Wennberg et al. 2007). Third, a spouse can keep a job so that income continues to flow to the family; other aspects of a founder's life can remain the same (Hanson 2003). The full energies of the entrepreneur can then be devoted to start-up.



Earlier in this paper it has been said that entrepreneurship is the result of the interaction between individual attributes and the surrounding environment. For explaining the spatial distributions of entrepreneurship, one should thus look at spatial aspects of this interaction. With geographical we mainly refer to characteristics of particular places and spatial distance between particular actors. We can start the explanation with the availability of (potential) entrepreneurs in particular places. Several perspectives are useful here: the nature and number of organizations in a region, the regional culture, and the labour market structure in a region. Key elements are the resources, abilities and preferences of individuals. The key question is why in a given (opportunity) environment some individuals are more likely to start a firm than in another environment: for example due their willingness to incur risk, preference for autonomy and self-direction, specific human capital and experience. One important underlying factor can be found in generational effects: having an entrepreneurial family background strengthens the probability of entering self-employment. Intergenerational transmission of self-employment is an explanation for spatial differences in self-employment (Niittykangas and Tervo 2005; Vaillant and Lafuente 2007). Another starting point represents the opportunities for entrepreneurship. From this point of view, individuals in particular environments are more likely to be entrepreneurs because the availability of opportunities encourages their exploitation by starting a firm. The sources of opportunities can be manifold: for example a growing purchasing power in the region, technological change, regulatory change. Historical processes produce uneven spatial economic patterns, of both the characteristics of individuals and the 'availability' of opportunities, that condition but do not determine economic behaviour (Boschma and Frenken 2007), of which entrepreneurship is a special class. In the following sections we will review the empirical literature that relates to entrepreneurship, evolution and geography.

Spatial Aspects:

Entrepreneurship has in the past decade received a prominent position in economic theory, as it is increasingly recognized that the entrepreneurship plays a critical role in economic growth. In contrast to traditional growth theory where technological progress and innovation was regarded as an exogenous force ('manna from heaven'), modern endogenous growth theory takes for granted that innovation and entrepreneurship are endogenous forces that are driven by various actors in the economic systems and which can be influenced by smart public policy. This new theoretical framework places much emphasis



on critical success factors such as competition, vested interests, R&D, knowledge spillovers, human capital, industrial culture and entrepreneurial ability.

Growth in knowledge

New knowledge created at universities and research centres generates opportunities for entrepreneurship, especially in high tech industries. Often these organizations are not able to fully recognize and appropriate the ensuing opportunities to commercialize that knowledge. Knowledge workers in these organizations respond to opportunities generated by new knowledge with starting a new firm, and in this way appropriate the expected value of their endowment of knowledge (Acs et al. 2005;)

Culture

Culture is important in the explanation of spatial variation in entrepreneurship via its effect on the attitude and values that people acquire. Social psychologists have claimed that an individual's attitudes and traits are not inherited but are developed in interaction with the social environment. Perceptions about the desirability of becoming an entrepreneur are formed and revised given the set of information available to each person (Lafuente and Salas 1989; Saxenian 1990). Culture is a property of groups, and it seems that especially national (Uhlener and Thurik 2007), and to a lesser degree regional cultures (Davidsson and Wiklund 1997) have significant effects on new firm formation. These cultures can change over time, but they tend to be very persistent (Beugelsdijk 2007).

Industry structure

New firm formation across regions can be explained by differences in the regional composition of industries and by differences in one particular industry in specific regions. The latter would indicate that there are context-specific differences affecting entrepreneurship rates, while the former would indicate that the explanation should largely be sought in the specific industry structure of the region. The industry structure of a region affects the overall new firm formation rates in a region, as industries differ in their degree of contestability (entry barriers) and the extent to which entrepreneurial opportunities emerge (e.g. many in business services and few in mining).

Conclusion:

Entrepreneurship and regional development prompt a rich variety of research questions to regional scientists. It is a domain where industrial organization, cultural geography, location theory, business economies and technology form an intertwined nexus. From a macro or



global perspective, the region is a strategic niche in a global development. But from a micro perspective, the region is shaped by innovative actions of risk-seeking entrepreneurs. Competition, trust, network organization and public policy are ingredients for win-win situations at local level. Our review of this complex field has clearly demonstrated the linkages of the theme of 'entrepreneurship and regional development' to other research domains, such as network theory, spatial externalities, cultural-behavioral theory, innovation theory and endogenous growth theory. From a dynamic entrepreneurial and regional growth theory, the interwoven connection of entrepreneurial life cycles, industrial life cycles and (multi)regional life cycles is a fascinating research issue, not only from a theoretical viewpoint, but also from an applied modeling perspective. A particularly fascinating and policy-relevant question is then how knowledge investments and spillovers are related to dynamic spatial processes. It goes without saying that in this field still a wealth of research questions and answers are waiting to be tackled. From this perspective, there is a great need for creative combined micro-meso-macro growth analyses at a regional level.

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