



# Explaining ethnic entrepreneurship: An evolutionary economics approach

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## ABSTRACT

The cultural approaches and the economic approaches advocated by mainstream neoclassical economists and new institutional economists fail to provide an adequate explanation of the differences between ethnic groups in the rate of business formation. These approaches provide only a partial explanation, much of which is based on static, predetermined exogenous and/or endogenous factors. By comparison the old institutional economists' framework, when applied to this area, offers a more holistic explanation of differential ethnic business formation by bringing together a range of cultural and economic factors that emphasize the path dependency of activities and the dynamic evolution of behaviour and actions.

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## 1. Introduction

A growing feature of globalization has been the increase in capital and labour mobility that takes place alongside the international trade in commodities and services. In the case of the European Union, labour mobility has been facilitated by the free movement of labour across the member states usually to take advantage of higher wage rates in receiving countries (Lillie, 2007). In other migrations, for example between Africa and Europe, the cause of the move may be due to a range of factors concerning the instability of the originating country rather than one of economic choice. While much of the cross border activity is labour seeking employment some includes those who seek to establish business opportunities or become self-employed in the host countries to which they migrate. Because of necessity, in many cases, the only option will be self-employment. At the same time as the increase in labour mobility there has been a gradual movement in the developed world away from employee labour contracts to self-employed labour contracts (Blanchflower & Oswald, 1998; Dearden, 1998; Lazear, 2005). This in part is the result of changing technologies and organizational forms that operate on a looser hierarchal structure. It has also been government policy in many countries to encourage entrepreneurial activity and the development of small to medium size businesses to provide the thrust for economic growth and take up the space left by the exit of larger organizational forms.

It is therefore to be expected that for any ethnic minority group, whether already resident in a country or new entrants to a country, that a proportion, as with all ethnic groups, would be in self-employment or be entrepreneurs. The explanation for this development is the changing structure of industries, the development of new industries and the shift to external contracting through markets rather than within organizations. But this does not explain why some ethnic minority groups

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are disproportionately represented in small businesses, as entrepreneurs or self-employment (Fairlie & Meyer, 1996; Razin, 1993). Well-known examples are the South Asians in Britain; the Koreans, Japanese, and Chinese in the USA; and the Turks and North Africans in France (Barrett, Jones, & McEvoy 1996; Hillmann, 1999). In some case the members of ethnic groups choose to become entrepreneurs and are 'pulled into' self-employment while in other cases they have few other options and are pushed into setting up small businesses (Clark & Drinkwater, 2000).

There are a number of seemingly conflicting explanations given as to why some ethnic groups are more inclined to enter self-employment. These range from economic efficiency explanations to ones that draw on cultural factors or ones that emphasize the structural characteristics of the host economy (Davidsson, 1995). In this paper we will argue that such polarization of explanations is unnecessary and that, by drawing on the work of old institutional economists (e.g., Veblen, 1898) with their emphasis on path dependency and evolutionary behaviour, a more unified, but more complex socio-economic argument can be forwarded to explain the disproportionate presence of ethnic entrepreneurs relocated to host countries. The first section of the paper examines the orthodox economic explanations of ethnic minority entrepreneurial activity; the second section covers the culturalist explanations of ethnic entrepreneurial entry; the third section explains the old institutional economists' explanations of differential rates of entrepreneurial activity among different ethnic groups.

## 2. Orthodox economic explanations

In this section we examine a number of orthodox economic explanations for becoming an entrepreneur and examine how these different explanations attempt to explain differences in rates of entrepreneurial activity between different ethnic groups. The three orthodox economics approaches we discuss are the neoclassical economists approach of comparing different expected present values of earnings from different employment possibilities, the human capital approach and the new institutional economists approach with its emphasis on reduction of transaction costs in the development of institutions.

There are a number of functions that may be regarded as entrepreneurial, for example Lucas (1978) emphasized the significance of managerial ability, while Kihlstrom and Laffont (1979) highlighted the role of risk aversion. While the possession of certain attributes may predetermine whether an individual might become an entrepreneur the main argument underpinning much of the orthodox economic explanation for people choosing to become entrepreneurs, or more generally self-employed, is the difference in the expected present value of earnings from self-employment compared with the expected present value of wages from being an employee (Blanchflower, 2004; Parker, 2004). But this only explains the latent demand to become an entrepreneur. Actual entry into self-employment requires a number of barriers to be overcome that turn potential into actual.

The main barrier is access to adequate funds to establish a business which, in part, will depend on personal endowments. Preferring self-employment to wage/salary earning, according to Evans and Jovanovic (1989), mainly depends on the level of wealth and liquidity constraints faced by potential entrepreneurs. Members of ethnic groups that have access to funds through other family or clan members or because of their own wealth are in a position to become entrepreneurial. For those who have to rely on more formal financial institutions to acquire finance ethnicity may be used as a screening device as a way of rationing funds by banks and other suppliers of funds who are risk-averse institutions. This is more likely to be the case for those who are new entrants to a country and who have little collateral. For some groups where initial endowments are restricted or where access to funds is difficult then there is likely to be a lower level of entrepreneurial activity and vice versa.

While the close networks found in some ethnic groups that enable pooling of resources, particularly financial resources, for example the Sikh community, enable individuals to become entrepreneurs for many ethnic groups other structural characteristics of economies necessitate that they become self employed. Some ethnic groups do not have the informal networks to gain employment while others face discrimination of different sorts that restrict entry into the labour market. Thus there are structural problems in some economies that restrict the entry of some groups into entrepreneurship while encouraging the entry of other groups. Although concentrating on the constrained choices facing potential entrants to business, neoclassical economics, by limiting the factors influencing such choices, restricts analysis to a static set of decisions and tends to ignore changes in both endogenous and exogenous factors.

Mainstream economists have also sought to explain ethnic success or failure in terms of human capital determinants such as schooling, education, or other features that determine productivity (Chiswick, 1983). Yet where the aim has been to control for human capital determinants, unexplained differences in economic achievement between different ethnic groups remain (Darity, 1998; Darity, Guilkey, & Winfrey 1996). Sowell (1981) has claimed that differential economic outcomes across different ethnic groups are due to culture, vaguely defined, rather than market or institutional discrimination. In so doing mainstream economics explanations are faced with the cultural approach discussed in the next section. For example the relative success of the Black West Indians, compared with other Black Americans, is attributed to their distinctive cultural values (Sowell, 1981).

The human capital explanations adopt an ahistorical approach that ignores both the class background of ethnic businesses and the socio-economic environment in which they live. Therefore, those examining the success or failure of ethnic businesses stop short of explaining why ethnic entrepreneurs, who share the same racial and national backgrounds, perform differently in different countries. Foner (1979) has shown how U.S. immigration policies resulted in a different, more entrepreneurial and educated class of Black West Indians immigrating to the United States compared with England. New

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