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## How different formal institutions affect opportunity and necessity entrepreneurship



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**Abstract** The objective of this research is to deepen in the role played by formal institutions on the different types of entrepreneurship (opportunity and necessity) as well as in its relative importance. The institutions we analyze are property rights, business freedom, fiscal freedom, labor freedom, financial capital and educational capital. Our results show that, in general, opportunity entrepreneurship benefits from an improvement of these institutions, while necessity entrepreneurship is damaged. This will positively influence the relative presence of opportunity entrepreneurship that is usually considered to be of greater quality and is more clearly related to economic development in a country.

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### Introduction

Entrepreneurship research has traditionally argued that entrepreneurial activity promotes economic growth and development (Minniti, 2008). As a result, we can observe how public policies have devoted significant effort to promote entrepreneurship (Shane, 2009), especially since the beginning of the current economic crisis, as it is considered one of the drivers that can help improve this situation (Baumol and Strom, 2007; Bjornskov and Foss, 2013; Estrin et al., 2013). For instance, we can mention the European Commission's Entrepreneurship 2020 Action Plan, or, within the Spanish framework, Law 14/2013 to promote

entrepreneurship and its internationalization as examples of increasing government concern.

The above context, together with the empirical evidence that shows considerable differences in both the levels and types of entrepreneurship (see, for example, <http://www.gemconsortium.org>), has opened a stream of literature that analyzes the factors that try to explain these differences (Parker, 2004; McMullen et al., 2008; Levie and Autio, 2011). One of the most common frameworks to study this phenomenon is institutional theory (North, 1990). This theory argues that the environment determines not only individual decision to become an entrepreneur, but also the characteristics of new ventures, with a subsequent effect on growth levels and country development (Baumol, 1990; Minniti and Lévesque, 2008).

One classification that has recently acquired some importance in categorizing the types of entrepreneurship

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distinguishes between necessity and opportunity (Reynolds et al., 1999). The former builds on a difficult environment that gives limited opportunities, while the latter is related to the identification of an attractive business opportunity. Recent studies have conducted a generic analysis of the influence of the institutional environment on these two types of entrepreneurship (McMullen et al., 2008; Valdez and Richardson, 2013) as also occurs with other taxonomies (Levie and Autio, 2011; Dau and Cuerdo-Cazurra, 2014). However, these studies do not assess the impact of formal institutions on the different types of entrepreneurship, which does not allow any conjecture on their relative importance.

This is particularly important when more entrepreneurship is not always necessarily considered to be better (Shane, 2009). Some entrepreneurial activities, for example, are not related to growth and economic development (Baumol, 1990; Wennekers et al., 2005). Acs (2006) and Acs et al. (2008) argue that a country's economic development will improve when more importance is placed on opportunity entrepreneurship rather than necessity entrepreneurship. This means that as agents adopt their decisions taking into account environmental factors, an institutional context encouraging *high-quality* entrepreneurship allows entrepreneurial behavior to veer toward activities leading to greater economic growth.

The main objective of this research is to analyze and to compare the influence that the formal institutions of a country have on the different types of entrepreneurship and on their relative presence. Our contribution in this paper is twofold. First, we add some empirical evidence on the discussion on how institutions affect the different types of entrepreneurship. We conclude that formal institutions play a role in understanding both opportunity and necessity entrepreneurship. Second, and more importantly, we argue that the relative presence of opportunity and necessity entrepreneurship is influenced by the characteristics of the institutional environment, as we will discuss in the final section of the paper.

This article is organized as follows. In *Literature review* section, we provide a review of the literature on the types of entrepreneurship as well as on formal institutions. We also develop the hypotheses of our study. In *Hypotheses* section, we describe the database, variables and the methodology, while *Research method* presents the empirical results. We close the paper by discussing its main findings and implications.

## Literature review

### Types of entrepreneurship

When the literature distinguishes between different types of entrepreneurship, it uses a wide variety of terms: innovators versus imitators (Schumpeter, 1934); productive and unproductive entrepreneurship (Baumol, 1990; Baumol and Strom, 2007; Minniti, 2008); entrepreneurs with growth aspirations or without them (Autio and Acs, 2010); entrepreneurship directed toward high-growth activities (Bowen and De Clercq, 2008; Shane, 2009); and formal and informal entrepreneurship (Dau and Cuerdo-Cazurra, 2014).

As previously mentioned, one taxonomy has gained credit in the last decade derived from the seminal studies of Shane et al. (1991), Reynolds and Miller (1992) and Krueger and Brazeal (1994) and was eventually consolidated in the work of Reynolds et al. (2003). This classification distinguishes between opportunity and necessity entrepreneurs. The first is linked to the identification of good business opportunities, while the second starts a new venture because of the lack of better job opportunities. Although it is true that both types refer to new entrepreneurial activities, their effects on development and economic growth are clearly different. In previous studies, and particularly in empirical analyses based on GEM data, Reynolds et al. (2003, p. 17) find evidence that both profiles differ systematically in (1) expectations of job creation, (2) projections for out-of-country export expectations, (3) intention to replicate existing business activities versus the creation of a new niche, and (4) market share in different business sectors. Similarly, Acs and Varga (2005) show that the impact on growth and economic development of both types of entrepreneurship varies widely whereas necessity entrepreneurship does not affect economic development, and opportunity entrepreneurship has a positive and significant effect.

Other studies have also taken into account this dichotomy between opportunity and necessity entrepreneurship. Jaén et al. (2013) analyze the relationship between necessity entrepreneurship and the economic situation of a country; when it is better, job opportunities rise and, consequently, the need to start new businesses is reduced; but the context is quite the opposite for opportunity entrepreneurship. In the same vein, McMullen et al. (2008) use this classification to show that certain institutions influence one of the two types of entrepreneurship, but not the other. Finally, Wennekers et al. (2005) conclude that while opportunity entrepreneurship shows a positive relation with a country's per capita GDP and innovative capacity, necessity entrepreneurship shows a negative relation between these variables.

Other research, rather than assessing opportunity and necessity entrepreneurship separately, analyses them jointly. Acs (2006) or Acs et al. (2008) conclude that the more important opportunity entrepreneurship is in relation to necessity entrepreneurship, the larger per capita GDP and other indicators are (the percentage of exports over GDP, expenditure on R&D, or expenditure on education, to name a few examples). These indicators characterize the most developed countries, leading us to conclude that the relative level of opportunity entrepreneurship can be a good indicator of a country's economic and productive development (Acs, 2006). Liñan et al. (2013) insist on this idea, finding a positive relationship between the opportunity entrepreneurship/necessity entrepreneurship ratio and per capita GDP. In short, the larger the population involved in opportunity entrepreneurship (usually of a higher quality) rather than necessity entrepreneurship (which is often self-employment), the higher the level of the economic development of a country.

A review of the previous literature raises two interesting implications. On the one hand, when comparing the differences in entrepreneurship levels between geographic areas, it is important to separate it into its two components

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