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# Legal institutions and high-growth aspiration entrepreneurship

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### ABSTRACT

Entrepreneurship is crucial for economic growth, yet comparatively little research has examined the relationship between institutions and new firm formation. I test the impact of property rights institutions and contracting institutions on high-growth-aspiration (HGA) entrants using the Global Entrepreneurship Monitor (GEM) survey data for 2000–2005. I find that property rights are more significant for profound market expansion and rule of law is more significant for high job growth. The number of procedures to enforce a contract, the number of procedures to start a business, and the number of days to start a business are negatively correlated with all types of HGA entrepreneurship. A common law legal system is negatively correlated with entrepreneurship combining high job growth and market expansion. These findings add nuance to prior studies that tout the importance of property rights and rule of law for entrepreneurship.

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## 1. Introduction

Why do countries vary not only in the amount of entrepreneurship but also in the types of entrepreneurial activity pursued? Economists and other social scientists have been grappling with this question in various forms for over a century. Policymakers in recent decades have shown increased interest as the positive relationship between entrepreneurship and economic growth

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became well established (Acs, 1992; Oviatt and McDougall, 1994; Boettke and Coyne, 2003; Minniti and Levesque, 2008). Despite all of this attention, national differences in entrepreneurial activity remain a fertile area of research.

One explanatory factor is the legal environment. Academics have studied the effect of legal systems on investors (La Porta et al., 1997, 1998), whether laws were designed to promulgate business establishment versus rent expropriation (Acemoglu et al., 2002), the number of regulations required to start a business (Djankov et al., 2002), the extent to which rule of law was a key constraint for entrepreneurs (Desai et al., 2003), vertical versus horizontal rent expropriation (Acemoglu and Johnson, 2005), and the impact of property rights on entry (Aidis et al., 2010; Estrin et al., 2009). This paper seeks to join the conversation by exploring the relationship among property rights institutions, contracting institutions, and high-growth aspiration (HGA) entrepreneurship.<sup>1</sup>

Rule of law is a specific institution that is universal in nature (Harper, 2003; Hayek, 1960) where institutions are broadly defined as “humanly devised constraints on human interaction” (North, 1990, p. 3). These constraints, and the protection they offer to new firms, are the crux of the paper. Institutions may be considered as formal, such as property rights and rule of law, or informal, such as trust (North, 1990). Institutions matter for both new and ongoing businesses because they generally reduce uncertainty over the long term and lower transactions costs (North, 1990; Coase, 1960; Williamson, 1985). I will refer to entrepreneurial activity as new firm creation, and I will also consider the type of opportunity pursued. In particular, I am examining several kinds of high-growth aspiration entrepreneurship: high job growth (20+ jobs in five years), significant market expansion (4 on an increasing 0–4 scale of market expansion/technological innovation), or a combination of both. Because of the impact these HGA entrepreneurial activities have on economic growth they merit further study.

This paper builds directly upon the work of Aidis et al. (2010) and Estrin et al. (2009) and extends the work of Acemoglu and Johnson (2005) and La Porta et al. (1997, 1998). The first contribution is to offer a more nuanced concept of HGA entrepreneurship, as defined above. High growth should not be limited to jobs created but should include some measure relating to market expansion and technological innovation. The second contribution is to consider property-rights institutions and the protection they offer against government expropriation of rents (vertical) apart from contracting institutions which guard against horizontal expropriation of rents; within property-rights institutions, property rights are differentiated from rule of law. The third contribution is to separate rule of law from regulatory burden. This paper also tests the effect of the type of legal system (common-law versus other) on HGA entrepreneurship.

I analyze the links between institutional type and entrepreneurial activity type using the Global Entrepreneurship Monitor (GEM) survey data for the years 2000–2005 (Global Entrepreneurship Monitor Data Files, 1998–2005). The dependent variable is starting an HGA firm, which I estimate with a probit model. The key independent variables are property rights, rule of law, length of contracting procedures, and type of legal system.

This paper is organized as follows. I first discuss various theories connecting entrepreneurship and institutions and propose hypotheses. Next, I describe the data and the methodology for testing the hypotheses. I then offer results. Discussion, including avenues of future research, concludes the paper.

## 2. Entrepreneurship: opportunities and activities

One of the major issues of studying entrepreneurship is simply defining it. One generally accepted definition is that entrepreneurship is an activity that involves the discovery, evaluation, and exploitation of opportunities to introduce new goods and services, ways of organizing markets, processes, and raw materials through organizing efforts that previously had not existed (Venkataraman, 1997; Shane and Venkataraman, 2000). This definition is theoretically pleasing because it is broad enough to incorporate almost all conceivable aspects of entrepreneurship. As Shane (2003) notes, however, it is difficult to operationalize. For the purposes of this paper, I define an entrepreneur as “one who owns, launches, manages, and assumes the risks of an economic venture” (Greve and

<sup>1</sup> Acemoglu and Johnson (2005) distinguish between property-rights institutions and contracting institutions. I will define HGA entrepreneurship differently than Estrin et al. (2009), see below.

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