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Economic recession shake-out and entrepreneurship: Evidence from Spain

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Abstract This article aims to gain a better understanding of the relationship between economic recession and entrepreneurship. The process of entrepreneurship, rather than the action itself, is a complex phenomenon, and such complexity surfaces when local context conditions worsen after an economic recession. This paper addresses the issue of how the likelihood of individuals to engage in the creation of new firms is affected by a recessionary climate. Furthermore, the study focuses on how the recession-driven shake-out effect varies across local contexts (i.e., sub-national regions). The case of Spain in the critical period of 2007–2010 is examined by using multilevel logistic mediation models on individual-level and sub-national region-level panel data. The results show that entrepreneurship shrinks during economic downturns, suggesting a pro-cyclical trend. A weaker perception by individuals of business opportunities resulting from the shake-out explains, to a large extent, the lower propensity to create firms during economic recession.

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Introduction

In recent years, world economies have witnessed one of the most severe economic recessions since the Great Depression of the 1930s (IMF, 2009; Parker, 2012; Shane, 2011;

World Bank, 2009). Peripheral countries of Europe, such as Portugal, Italy, Ireland, Greece, and Spain, have been some of the most affected economies after the 2007–2009 financial crisis. A rise in the unemployment rate, limited access to financing, and a decline in the growth of gross domestic product (GDP) are noticeable consequences of this economic recession (Papaoikonomou et al., 2012; Mishkin, 2011). Although entrepreneurial activity is seen as an engine of growth, it is not exempt from shake-out effects of economic downturns (Congregado et al., 2012; Rampini, 2004).

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However, beyond the main macroeconomic indicators, how does a global crisis affect the *process* of entrepreneurship?

Most scholars agree that understanding the relationship between economic cycles and entrepreneurship is important for policy intervention in order to predict and generate more favourable conditions for firm creation (Fairlie, 2013; Koellinger and Thurik, 2012; Ghatak et al., 2007). However, this relationship warrants further research as the entrepreneurship literature provides mixed results on the effect of business cycles on business start-up rates (Parker, 2011). Moreover, little is known about the effect of sudden shocks in the economy on different stages of the entrepreneurial process (Simón-Moya et al., 2014; Santos et al., 2017). The vast majority of previous studies has analyzed such impacts by focusing on the entrepreneurial *activity* as an outcome (i.e., the action of creating a firm) rather than on the *process* itself (i.e., a continuum of steps from opportunity recognition to firm creation). Indeed, a large bulk of studies has examined such relationships at the country level. Only a few studies have emphasized the effect of a shock on the inner territories of a given country (e.g., Bishop and Shilcof, 2017; Williams and Vorley, 2014). We believe that such an impact is manifested in different forms and different levels of intensity across sub-national regions. Not all the local regions suffer the consequences of the crisis in the same manner (i.e., because local territories are naturally, physically, financially and intangibly differently endowed), neither they need one same national policy to recover from it. In fact, the entrepreneurial activity varies substantially across NUT-2 regions in Spain (González-Pernía et al., 2012). Therefore, we expect that the influence of a recession-driven economic shock on the process of entrepreneurship will be different across local contexts inside a country.

Following cognitive and planned behaviour theories of the mid 1990s, entrepreneurship can be conceived as a process involving both the opportunity perception and the subsequent action to create a new firm. An emerging research stream raised the issue of why some individuals, and not others, explore and exploit entrepreneurial opportunities. Well-known scholars emphasized the idea that entrepreneurial actions are preceded by intuition and opportunity perception (Krueger, 1993; Mitchell et al, 2002). In turbulent periods, sporadic shocks in the business cycle affect not only labor markets, but also the decisions of individuals to start up new firms (Audretsch and Acs, 1994; Highfield and Smiley, 1987). These decisions can be altered by how individuals perceive opportunities to create a new firm in a non-favourable context. In this vein, business cycle theorists hold that economic shocks can produce an ambiguous effect (Parker, 2011; Fairlie, 2013). Such shocks may allow individuals to detect and exploit new entrepreneurial opportunities prompted originally during a new recessionary context, or alternatively, economic shake-outs can discourage the detection and pursuit of new business opportunities due to pessimistic growth expectations of (would-be) entrepreneurs.

In this paper, we claim that the economic crisis affects not only the capacity of individuals to start up new firms but also their desire, ability, need and motivation to identify and exploit new business opportunities. Presumably, the response of the whole entrepreneurial process to a

recessionary economic shock (i.e., the process starting from opportunity perception and leading to the action of creating a new firm) should be heterogeneous across more or less economically advanced sub-national regions. Thus, the main objective of this paper is to provide new insights on how a recession-driven economic shake-out affects the entrepreneurial process (besides the action) at a sub-national context.

We expect to make a modest contribution by shedding light into the subject of economic recession and entrepreneurship. Furthermore, we aim at empirically testing main notions of planned behaviour and business cycle theories, by focussing on the analysis of the entrepreneurial process. We expect to contribute to the abovementioned fields of entrepreneurship in several ways. First, we study a pioneering subject by unravelling the missing link between the shakeout effect of an economic downturn and entrepreneurial action, by focussing on why and how the business opportunity perception of individuals mediates this effect. We further argue that as entrepreneurial action follows intention, at an earlier stage economic shake-out shapes opportunity perception. As a matter of fact, we merge business cycle and planned behaviour notions to propose (and test) that the advent of a severe crisis affects business intentions, which ultimately, determines entrepreneurial action (i.e., firm creation). Second, unlike other studies we analyse the shakeout effect on the entrepreneurial process at a sub-national level, since we expect such an impact to be unequal within a country. With this fine-grained analysis, a more precise academic understanding, and insights for policy making, are provided on how an economic shake-out *differently* affects entrepreneurship in wide-ranging local contexts. Third, we apply a scarcely used multilevel logistic regression method to panel data, complemented with mediation tests, to verify our novel propositions. A large and representative database is used consisting of two-level data, (i.e., individual-level information and NUTS-2 region-level data) collected from a diverse array of primary and secondary data sources. Finally, our findings provide useful guidance to policymakers for the design of local entrepreneurship programs better suited to economic turmoil.

The structure of the paper is as follows. The next section outlines the theoretical background explaining the link between the recession shakeout effect and the process of entrepreneurship and proposes the hypotheses of the study. The third section describes the methodology and data, and the fourth section summarizes the results. Finally, the study ends with our main conclusions and implications.

The missing link between an economic recession-driven shakeout effect and the *process* of entrepreneurship

An economy-wide shock is a sudden, substantial and unanticipated change in the macroeconomic context. Typically, an economic shock is characterized by a significant decline in the aggregate demand which, in turn, hurts consumer and investor confidence (Mishkin, 2006; Suarez and Oliva, 2005). A sudden shock may also weaken the self-confidence of potential entrepreneurs to engage in firm creation because

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