
Entrepreneurship in Developing Countries

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Abstract

This study offers that entrepreneurship is consistent with and even complementary to the older and more traditional development strategies. We survey the literature on entrepreneurship in developing countries which, admittedly, is wide and covers a range of issues from culture and values; institutional barriers such as financial sector development, governance, and property rights; and to the adequacy of education and technical skills. A broad literature has also developed on foreign direct investment and its positive and negative effects on technology transfer and entrepreneurship. After the collapse of the Soviet Union, a number of studies examined the development of small- and medium-sized enterprises in transition economies. As these economies moved from centralized economies to market economies, enterprise and entrepreneurship became important. Yet, other studies examine the effects of infrastructural development and the macroeconomy on entrepreneurship. With such a wide scope of issues, a framework for synthesizing the literature is needed. This study offers that the identification of the externalities which affect entrepreneurship provides a useful framework to examine the literature on entrepreneurship in developing countries.

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1

Introduction

Between 1945 and 1980 nearly 100 colonies in Africa, Asia, and the Caribbean gained their independence and began the process of initiating a development strategy for their citizens. Sadly, many of those countries experienced neither significant per capita growth nor economic development (Easterly, 2001, pp. 141–143). Indeed, moderate and extreme poverty remains a significant concern for many developing countries (Sachs, 2005, pp. 22–23).

While developing countries have used a number of policies and strategies in their development pursuits, two forms of industrial policy were particularly prominent. The first was import substitution — a process of industrialization by producing previously imported goods for the country’s domestic market. However, by the 1980s, in the face of economic crisis, many developing countries then turned to a second strategy — export promotion. However, with the exception of some countries in East Asia, neither industrial strategy has resulted in meaningful economic development. Both development approaches relied on strong state intervention and persistent market distortions to sustain their viability — thus often crowding out or thwarting altogether the traditional and important role of the entrepreneur.

2 *Introduction*

Hence, after failed attempts at development through import substitution and infant industry protection programs and somewhat mixed results from export promotion strategies, developing countries are beginning to focus on their business environments and creating an economic space which is conducive to private enterprise — both domestic (i.e., local entrepreneurs) and foreign (i.e., foreign direct investment). Indeed, the promotion of entrepreneurship and the promulgation of small- and medium-sized enterprise (SME) policy have become an important development prescription in recent years (World Bank, 2005). Entrepreneurship policy, then, joins a list which includes reforms to countries' macroeconomic, exchange rate, trade and industrial policies, and improvements in governance (Hart, 2003).

Both national governments and the major international organizations, as part of their poverty reduction, growth, and economic development programs, are beginning to focus on improving countries' business and investment environments for entrepreneurship. The World Bank and United Nations Industrial Development Organization (UNIDO), for example, have each established units to promote private sector development in developing countries and to provide technical assistance in the formulation of SME and entrepreneurship policy. In 2003, the World Bank began an initiative to measure and rank countries' business sectors and investment environments (World Bank, 2005). Additionally, a number of developing countries have recently drafted SME legislation and launched programs to assist small businesses and domestic entrepreneurs.

While a focus on entrepreneurship for development may appear to be a separate approach to development, this study offers that it is consistent with and even complementary to the older and more traditional development strategies. We survey the literature on entrepreneurship in developing countries which, admittedly, is wide and covers a range of issues from culture and values; institutional barriers such as financial sector development, governance and property rights; to the adequacy of education and technical skills. A broad literature has also developed on foreign direct investment and its positive and negative effects on technology transfer and entrepreneurship. After the collapse of the Soviet Union, a number of studies examined the development of small- and

medium-sized enterprises in transition economies. As these economies moved from centralized economies to market economies, enterprise and entrepreneurship became important (Acs and Audretsch, 1993). Yet, other studies examine the effects of infrastructural development and the macroeconomy on entrepreneurship. With such a wide scope of issues, a framework for synthesizing the literature is needed. This study offers that the identification of the externalities which affect entrepreneurship provides a useful framework to examine the literature on entrepreneurship in developing countries (Audretsch et al., 2006). These externalities have resulted from and have become embedded in countries' institutions and help to explain the level of entrepreneurship in an economy.

This survey proceeds as follows. First, we examine the evolution of development policy — beginning with the colonial period and the immediate post-colonial era. In both of these periods there was strong government intervention and a heavy emphasis on government planning for development. An important cornerstone of the post-colonial period was the use of import substitution programs. Import substitution was an attempt by developing countries to industrialize by producing goods which had been traditionally imported. Second, with the failure of import substitution, many developing countries then switched to outward-oriented strategies, beginning with many of the Asian economies. Again, export promotion relied on strong government intervention.

Third, we set out a framework to explore the literature on entrepreneurship in developing countries based on the existence of network, knowledge and demonstration, and failure externalities. Each of these types of externalities is discussed in greater detail in the following sections. Fourth, this review identifies the core policy issues to address these externalities. Internalizing these externalities, it is argued, by finding mechanisms to reward and encourage the firms and people which produce them, should increase the level of productive entrepreneurship in developing countries.

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