The gap between potential entrepreneurship and actual entrepreneurship: an inter-continental comparative analysis

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Abstract:

The aim of this paper is to analyse the difference between the rates of potential entrepreneurship and actual entrepreneurship in European and American context, trying to identify explanatory factors. For this purpose an institutional approach is used, which includes the role of various formal and informal factors related with the entrepreneurial and innovation activity. From an empirical point of view, the paper takes into account twenty countries from the European and American continent, covering the last decade. The results show, in general, the influence of the institutional framework on the gap between the incipient entrepreneurship and potential entrepreneurship, through formal and informal factors. We use data from the Global Entrepreneurship Monitor (GEM), which measures the entrepreneurial intention and nascent entrepreneurial activity, the World Bank and the Index of Economic Freedom (The Heritage Foundation).

Key words: Entrepreneurship; Business Creation; Gap; New Institutional Economics; Europe, America.

JEL codes: L26, E02, O51, O52, O54.
Introduction

The aim of this study is to analyse the differences between the rates of potential entrepreneurship and actual entrepreneurship in the European and American context, which we call entrepreneurship gap. Additionally, it also aims at identifying its determinants. From a theoretical point of view, the analysis is based on the New Institutional Economics, which provides a reference frame in this growing field of study. Empirically, this study considers a sample of twenty countries, ten European and ten of the American continent for the period 2001-2010. Main statistical sources used are Global Entrepreneurship Monitor (GEM), Doing Business, Worldwide Governance Indicators, World Development Indicators and Index of Economic Freedom.

The paper is structured into four sections, besides this introduction and conclusions. In the first section a conceptual approach is performed, trying to clarify the subject under study. The second section addresses the role of the environment in decision making about business creation from an institutional theoretical perspective. The third section focuses on empirical analysis of the gap between potential entrepreneurship and actual entrepreneurship that includes an econometric analysis.

1. Entrepreneurship: a brief conceptual approach

Although there is no unified definition of entrepreneurship in the field of research, its conceptual complexity and diversity have motivated numerous contributions at different levels (scientific, academic and political). Some contributions relate it with opportunity, others with risk and innovation. However, a very important part of the literature considers that entrepreneurship involves creating something new (Reynolds et al., 2005).

To summarize, Carree and Thurik (2010) present three approaches of entrepreneurial profile, emphasized by three authors of great influence in the current economic thought. The first profile is the schumpeterian concept of "innovator-entrepreneur". To understand its meaning is necessary to move backwards to the "Theory of economic development" published by Schumpeter in 1911, where the entrepreneur is considered as the innovator-entrepreneur and not as the capitalist-entrepreneur of neoclassical approach. In this regard, Schumpeter considers the entrepreneur as a key element of the economy and defines him/her as a person who combines productive factors and introduces innovations into the market. That is to say, entrepreneurial activity and innovation would be hardly dissociated (Grilo and Thurik, 2005). Therefore, from this Schumpeterian perspective, the entrepreneur is who causes the imbalance in the economy by introducing new combinations into the market.

A second profile of entrepreneur focuses on uncertainty, linked with the entrepreneur concept of Knight (1921). This author identifies entrepreneur as the individual who faces uncertainty in search of a future profit. In this sense, the entrepreneur will launch a new company depending on his uncertain expectations (Santos, 1997; Grilo and Thurik, 2008).
The third profile of entrepreneur comes from Kirzner (1973) that is based on Mises (1949)\(^1\). Kirzner defines the entrepreneur as the individual who seeks business opportunities that have not been identified and exploited by others, and detects expectations of a possible benefit. The existence of opportunities causes imbalance and lack thereof leads to economic equilibrium (Santos, 1997). Consequently, the individual becomes an entrepreneur when he/she finds an opportunity hitherto unnoticed, accepting the uncertainty that the product or company can bring both success and failure.

Moving through this conceptual framework, it should be noted that entrepreneurship process is composite of different phases that are based on the intention to launch a business initiative until its consolidation or abandonment. Therefore, differences between potential entrepreneurship, entrepreneurship and starting a business may be analysed from a comparative perspective. In this line, the Global Entrepreneurship Monitor (GEM)\(^2\)\(^3\), identifies potential entrepreneurship, known as entrepreneurial intention; phase in which individuals believe to have the skills and capabilities to start an economic activity. They distinguish opportunities from the environment and they are not afraid of failure. Therefore, they show their intention of launching an economic activity in the next three years, being the intentionality the first step before business creation.

The next phase in the GEM model involves the birth of the enterprise itself, i.e. incipient\(^4\) entrepreneurship. This phase includes activities that have passed the preliminary stage (potential entrepreneurship) and become in nascent initiatives that are now starting up and they have not yet paid salaries. Moreover, it also includes new initiatives that are being consolidated in an activity up to three and a half years of life (Reynolds et al., 2005).

Entrepreneurs will face several stages, but there is no rule that makes a phase inevitably leads to the next one. In this sense, it should be noted that there is a "leap" from intention (potential entrepreneurship) to action (business creation). Such step is not always achieved, and thus there is a difference between these two phenomena, that we called in this paper "entrepreneurship gap" (Figure 1).

Figure 1 Phases of the entrepreneurial process to business creation

\(^1\) Kirzner's contributions on entrepreneurship seek to link what Mises defended about the importance of market information as transmitter mechanism (Santos, 1997).

\(^2\) The Global Entrepreneurship Monitor (GEM), which is performed worldwide since 1999, is a research project on entrepreneurial, transverse and comparative nature. It is currently the larger research project that exists on entrepreneurship, both for its global breadth and the scope of its results (Reynolds et al., 2002).

\(^3\) GEM differences between activities that are starting up, which may or may not be registered, as well as activities in the consolidation phase, up to three and a half years of life, which takes into account all sectors including self employment. The results presented refer to initiatives GEM unregistered at the end of the year, as well as economic activities recorded in previous years (Xavier et al., 2012).

\(^4\) Incipient entrepreneurship from its term in english Total Entrepreneurial Activity (TEA).
Taking into account the above considerations, the entrepreneurship of a new activity may be a necessary condition for the creation of a new enterprise, but it is not always sufficient. In other words, entrepreneurship should be understood as attitudes, behaviours and actions of individuals in favour of the implementation of new activities, rather than an embodiment of the latter. In this sense, the phenomenon of business creation not only depends on the entrepreneurial intention to start a new activity, but also it depends on other contextual factors (socio-economic, organizational and institutional).

2. Institutional framework and business creation.

Institutions determine the conditions of the environment, not only for social and economic interaction but also in relation to the business creation (Baker et al., 2005; Bowen and De Clercq, 2008). In this way, institutions are critical factors that could generate direct and indirect effects on entrepreneurial activity (Acs and Szerb, 2009). Taking into account the above, the New Institutional Economics considers that institutions are a human creation that reduces uncertainty, evolve and they may be transformed by social dynamics. Moreover, institutions play an important role as incentives and/or barriers that may motivate and/or hamper individual aspirations (North 1990, 2005).

The New Institutional Economics literature has established a differentiation between formal or informal character of institutions. On the one hand, formal factors refer to government policies (tax incentives and/or administrative procedures related to business creation). In this sense, there are not only incentives but also taxes and administrative burdens that have a negative impact on the creation of a new company (Poutziouris et al., 2000). Additionally, formal factors include entrepreneurial support measures and assessment of programs addressed to business creation. Finally, there are also specific support measures such as services and economic and non-economic programs, which give support for new business (e.g. access to finance, which plays an important role) (Petersen and Rajan, 1994; European Commission, 2000).

Another formal factor that must be taken into account is labour regulations, as many studies show (e.g. Djankov et al., 2003; Klapper et al., 2006; Van Stel et al., 2007). These studies conclude that strict regulations in the labour market have a negative effect on business creation. Education also is considered a formal factor that can
influence entrepreneurial activity. In this respect, their level of education and skills allow individuals to increase self-confidence. Thus, formal factors may open new possibilities to start an economic activity (Armington and Acs, 2002; Autio and Acs, 2010; De Clercq and Arenius, 2006).

On the other hand, informal factors refer to the socio-cultural components, such as the community culture and feeling about entrepreneurship. The society attitudes towards business creation (e.g. business attractiveness, risk tolerance and intentionality) can have an effect on entrepreneurial activity. In this sense, Evan and Shepherd (2002) show that a low level of risk aversion increases the entrepreneurial intention. Moreover, it should be noted that other informal factors such as governance and corruption are relevant for entrepreneurial activity. In this regard, corruption or political instability could produce insecurity, affecting negatively the economic activity.

Taking into account all the above considerations, the specific study of differences between intention (potential entrepreneurship) and business creation (incipient entrepreneurship) assumes that there is an unequal effect of institutional factors on each of these dimensions. In this sense, certain institutional factors may have a greater or smaller influence on the decision of individuals based on the conditions of the context, both when the idea is formulated and when they decide to create a new firm. For that reason, these conditions of the entrepreneurial environment (social, political and economic factors) should be taken into consideration when analysing the international disparities in entrepreneurial activity.

3. The entrepreneurship gap: an international comparison

The comparison between rates of potential and actual entrepreneurship leads to a number of interesting observations. Firstly, it highlights the existence of a close relationship between both phenomena. In this sense, intentionality (potential entrepreneurship) is a previous condition but it does not ensure the final decision.

In general, countries may show different entrepreneurship gaps and this may be due to several explanatory factors. These factors may be institutional or of other nature, such as differences in the macroeconomic and productive context. In this sense, many entrepreneurs perceived more difficult to start a business due to the environmental conditions of crisis (Bosma and Levie, 2009), such as low product demand, low-income expectations or low level of credit provided by the banking sector. These inconveniences have increased the fear of failure of individuals. Therefore, those individuals who were already involved in an initial stage may have rethought their goals. However, entrepreneurs looking for independence and those who trust in their skills probably have not changed their minds as a consequence of the crisis.

It should be noted that recessions could also stimulate innovation, considering that these processes are propitious for changes. In this context, some countries that have been affected by the crisis might have pursued other alternatives and stimulated innovation and technological change. In this regard, the best way to do this is by strengthening their business network.

As a general observation it should be noted a relatively superior performance of potential entrepreneurship in most of the countries. However, this is not occurring with actual entrepreneurship (Figure 1). In the case of countries with low levels of GDP per capita (e.g. Latin American countries) a greater willingness to undertake an activity
oriented by necessity is observed. This may be due to the existence of the scarcity of employment options or the dissatisfaction concerning the existing alternatives (Slavica et al., 2014). In contrast, European countries, USA and Canada comparatively show lower rates of entrepreneurial activity. However, the type of enterprise that arises in these countries tends to be more oriented to the exploitation of perceived opportunities. In this respect, entrepreneurs that are oriented by opportunity are majority in countries leading by innovation. This is due to they have more and better access to international markets, happening the opposite in emerging countries (Bosma and Levie, 2009). In this sense, the European Commission (2008) states that the low propensity of European individuals towards entrepreneurial activity could be given by risk aversion to become enterprise owners. However, in American countries a greater commitment of entrepreneurs to undertake an activity is observed.

Figure 1. Comparative analysis of potential entrepreneurship and actual entrepreneurship: the entrepreneurship gap

![Diagram](image-url)

**Note:** Data are expressed as mean percentage of the adult population aged 18-64 that is the labour force of each country, related to the business process
**Source:** Based on data from Global Entrepreneurship Monitor (GEM) 2001-2010

The differences outlined above derived into significant disparities in terms of entrepreneurship gap. This gap, defined as the difference between TEA and PE rate, shows a negative value in most of the countries. Exceptions are found for United States, Finland, the Netherlands, Spain, UK and Canada (Figure 2). Particularly, developed countries show smaller differences between actual entrepreneurship and potential entrepreneurship. However, this is not the case of developing countries (Latin American
countries), which show greater gaps. In this regard, a high negative gap indicates the existence of considerable difficulties to make effective entrepreneurial intention.

Figure 2. The entrepreneurship gap: Difference between actual and potential entrepreneurship expressed in% (2001-2010)

![Entrepreneurship Gap Chart]

Note: Data are expressed as mean percentage of the adult population aged 18-64 that is the labor force of each country, related to the business process.
Source: Based on data from Global Entrepreneurship Monitor (GEM) 2001-2010

These differences may be due to the importance of institutional factors and the context, such as culture and entrepreneurial spirit, public policies, education system, degree of development of the country or evolution of the economy (Reynolds and Curtin, 2010). From this perspective, it should be considered that not all individuals with a previous intention (potential entrepreneurship) finally achieve their desires (creation of a firm). This process involves a certain delay from the intention until the final decision to start an enterprise. Because of this reason, entrepreneurship gap should include some delay when the "effervescence" and the effective entrepreneurship are compared.

4. Econometric analysis

An explanatory model of the entrepreneurship gap (GAP) is detailed below. This model considers seven independent variables. The first variable is STAB, which refers to the climate of political stability and absence of violence. This variable measures the perception of individuals about the likelihood that government could be destabilized by unconstitutional or violent processes (politically motivated violence, terrorism...). In this

5 For the purposes of this paper, it is considered a delay of one year, so that the gap is defined as the difference between the TEA of year t PE of the year t-1.
case, statistical data come from World Bank (Worldwide Governance Indicators). This variable has been included to capture the role of political stability on the entrepreneurship gap. In this sense, a positive effect of this variable is expected because this is an informal factor that promotes effective entrepreneurship. In this respect, a higher political stability contributes to reduce the risk associated with contexts of political uncertainty and/or insecurity.

The second variable (EDUC) refers to the educational environment and it measures primary and secondary education oriented to entrepreneurship. This variable refers to the subjective assessment made by national experts under the GEM model with regard to the education received by students about entrepreneurship. This variable has been included in order to capture the role of education levels on entrepreneurial activity. In line with the theoretical discussion above, this factor is expected to show a positive impact on the entrepreneurship gap.

The inclusion of a third variable (CRED) tries to capture the role of access to credit on entrepreneurship gap. Data comes from the World Bank and it measures domestic credit provided by banking sector, expressed as percentage of GDP. It should be noted that access to credit might operate in two complementary ways. One of them, more direct, is related to business needs (investment funding, daily operations, self-financing for business creation). The other way, more indirect, relates to demand and, in particular, to consumer credit. As noted in the theoretical section, it is expected this variable presents a positive effect on effective entrepreneurship.

The fourth variable included is the degree of labour freedom (LABO) that measures the lack of restrictions and regulations in labour market. Data for this variable comes from the Index of Economic Freedom (The Heritage Foundation and The Wall Street Journal) and a higher value of it could be understood as a lower presence of restrictions and regulations. According to the theoretical discussion, a flexible labour market should act as facilitator of labour contracts. In this sense, it is expected a positive effect on the achievement of entrepreneurial activity and thus a positive effect on the gap.

The fifth variable (TAX) measures the tax burden over benefits in terms of time spent (working hours) by firms to pay taxes. This variable has been introduced to capture the role of the tax burden on economic activities and it is expected a negative effect on entrepreneurship gap.

Finally, we have included a dummy variable (COUNTRY) to capture the particularities of some countries regarding to the entrepreneurial activity. This variable shows negative values for Latin American countries, as previously described. This variable has been built according to the criteria used by GEM (2008) in order to capture differences between the entrepreneurial behaviour of Latin American countries ("1") and other countries ("0").

Taking into account the above considerations, the general model is specified as follow and it has been estimated by OLS.

$$GAP_{it} = \beta_0 + \beta_1 STAB_{it} + \beta_2 EDUC_{it} + \beta_3 CRED_{it} + \beta_4 LABO_{it} + \beta_5 TAX_{it} + \beta_6 COUNTRY_{it}$$

Where i is the country (Denmark, Finland, France, Germany, Italy, Netherlands, Portugal, Spain, Sweden, United Kingdom, Argentina, Brazil, Canada, Chile, Colombia, Ecuador, United States, Mexico, Peru, Uruguay) and t is the year (2001 to 2010).
It should be noted that different specifications of the model are considered due to the presence of multicollinearity. The results of these estimates are presented in Table 1. In general, these results are consistent with the theoretical approach.

### Table 1 Results of the econometric estimates, pooled OLS
Total observations: 170 Dependent Variable: GAP

<table>
<thead>
<tr>
<th>Variables</th>
<th>I</th>
<th>II</th>
<th>III</th>
<th>IV</th>
</tr>
</thead>
<tbody>
<tr>
<td>Constant</td>
<td>0.004 (0.047)</td>
<td>0.006 (0.059)</td>
<td>0.002 (0.026)</td>
<td>0.004 (0.032)</td>
</tr>
<tr>
<td>STAB</td>
<td>0.014 (0.104)</td>
<td>0.045 (0.334)</td>
<td>0.103 (1.006)</td>
<td>0.205** (2.021)</td>
</tr>
<tr>
<td>EDUC</td>
<td>0.262** (2.271)</td>
<td>0.297*** (2.658)</td>
<td>0.256** (2.347)</td>
<td>0.303*** (2.789)</td>
</tr>
<tr>
<td>CRED</td>
<td>0.271** (2.068)</td>
<td>0.216** (2.111)</td>
<td>0.479*** (3.672)</td>
<td>0.532*** (4.190)</td>
</tr>
<tr>
<td>LABO</td>
<td>-0.249*** (-2.779)</td>
<td>-0.232** (-2.267)</td>
<td>-0.321** (-2.454)</td>
<td>-0.342** (-2.542)</td>
</tr>
<tr>
<td>TAX</td>
<td>-0.209* (-1.868)</td>
<td>-0.268*** (-4.051)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>COUNTRY</td>
<td>-0.293 (-1.031)</td>
<td>-0.420* (-1.885)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Adj R sq</td>
<td>0.50</td>
<td>0.47</td>
<td>0.48</td>
<td>0.43</td>
</tr>
<tr>
<td>Nº observations</td>
<td>170</td>
<td>170</td>
<td>170</td>
<td>170</td>
</tr>
</tbody>
</table>

Note: * p <0.1, ** p <0.05, *** p <0.01. Standardized Coefficients; t-statistics in brackets
Source: Based on data of Worldwide Governance Indicators, Doing Business, World Development Indicators, Global Entrepreneurship Monitor (GEM) and Index of Economic Freedom.

Coefficients of all estimates show the expected signs, although not all variables reach significant results. In this sense, high levels of significance are shown by the variables EDUC, CRED, LABO and TAX, which present statistically significant coefficients in all the estimates. However, the variable STAB (informal factor) only shows certain significance in the estimate IV.

Concerning the variable COUNTRY, it shows the expected behaviour and acts as control of country bias. In particular, this variable deals with the existence of strong differences in entrepreneurial activity according to the level of development of countries. While its level of significance is not high, it seems to have a great impact on the entrepreneurship gap.

In short, results show a greater impact of the variables related to access to credit (CRED), educational system (EDUC), labour freedom (LABO) and country bias (COUNTRY) on the entrepreneurship gap.
5. Conclusions

The results obtained in this study allow us to advance in the analysis of the influence of institutional factors (formal and informal) on the different patterns of entrepreneurial behaviour among countries. Similarly, it contributes to establish an analytical framework to compare these differences, considering the gap between the potential entrepreneurship and the actual entrepreneurship for a sample of twenty European and American countries. In this sense, it should be noted the existence of a "gap" between potential and actual entrepreneurship, which differs widely from one country to another. In particular, it should be highlighted the case of Latin American countries that show a great gap. From the theoretical approach, based on the New Institutional Economics, this gap could be explained by institutional factors, differences in productive structure and other factors, which influence on business creation.

According to our results, different institutional factors show important effects on the entrepreneurship gap.

In the case of access to credit (CRED), this study reveals a positive influence on the entrepreneurship gap. The results confirm the need to implement actions that contribute to facilitate access to finance for those business intentions and especially for SMEs, which generally face greater financial difficulties. Additionally, our results show that educational levels oriented to entrepreneurship (EDUC) seem to be a strong factor that encourages business creation. In this sense, an education system that includes teaching about entrepreneurial activities at different educational levels, together with effective policies to promote innovation, reveals a positive effect on entrepreneurial activity. Our results also show a negative and significant impact of taxes (TAX) on the entrepreneurship gap, hampering business creation.

However, the results obtained with respect to labour freedom (LABO) should make us reflect about the role of labour deregulation processes on the entrepreneurial activity. In this regard, we found that a greater level of labour freedom (absence of restrictions and regulations) appears associated with more negative levels of the entrepreneurship gap. This result should be analysed in depth to get a better understanding of the relationship between the regulatory framework of labour market and the entrepreneurial activity.

Bibliografía


