Entrepreneurs in Developing Countries

EE461
2/2021

Lecture 9

Chayanee Chawanote

Outline

Who are entrepreneurs?

Entrepreneur's characteristics in developing countries

Bottlenecks for entrepreneurship in developing countries

What's about Thai entrepreneur?

Who Are China's Entrepreneurs?

- Djankov, Qian, Roland, and Zhuravskaya. AER (2006)
- Data:
  - Bejing and 6 other cities surveyed in 2004-05 for both entrepreneurs and non-entrepreneurs
- Method:
  - Compare entrepreneurs with non-entrepreneurs using conditional means controlling for age, gender, education, and city dummies

Comparing entrepreneurs with non-entrepreneurs

- No important differences in cognitive scores, or excellence in education
- Entrepreneurs are more mobile, wealthier, and more willing to accept a risk-neutral gamble
- Parents of entrepreneur do not have a higher education than non-entrepreneurs, but they are wealthier
- Entrepreneurs tend to have family members/relatives involving in entrepreneurship activities
- They tend to be motivated and want to earn more.
- Non-entrepreneurs view institutional environment (complicated tax rules, inflation, macroeconomic instability) as problems more than entrepreneurs

Will you accept one of the two risk-neutral gambles?

(Yes or No)

win $10 with probability 1/2 and lose $10 with probability 1/2

win $20 with probability 1/2 and lose $20 with probability 1/2

Result: 90 percent of entrepreneurs responded yes, compared to only 57 percent of non-entrepreneurs

Different types of entrepreneurs and non-entrepreneurs

- Table 1 in the paper
- Probits of 3 different comparisons
- Multinomial logit model for entrepreneurs, non-entrepreneurs with once failed entrepreneurs, and non-entrepreneurs who were never entrepreneurs
- Multinomial logit model for entrepreneurs by opportunity, entrepreneurs by necessity, and non-entrepreneurs who were never entrepreneurs

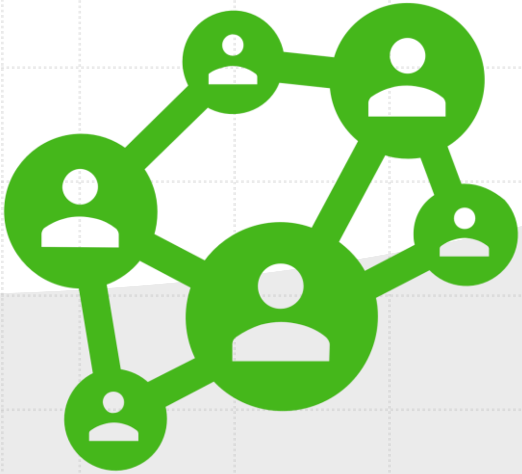
TABLE 1—DIFFERENT TYPES OF ENTREPRENEURS AND NONENTREPRENEURS

Specification	(1) Probit	(2) Probit	(3) Probit	(4) Multinomial logit			(5) Multinomial logit		
Dependent variable	E	E with positive sales growth	NE who thought of business	E	NE who failed as E	NE who never was E	E by opportunity	E by necessity	NE who never was E
Comparison group	All NE	Other E	NE who never thought of business	The other two groups			The other two groups		
Report	$dP(E)/dx$	$dP(\cdot)/dx$	$dP(\cdot)/dx$	$dP(\cdot)/dx$ $(\Sigma dP(\cdot)/dx = 1)$			$dP(\cdot)/dx$ $(\Sigma dP(\cdot)/dx = 1)$		
Father had higher education	0.005 [0.020]	−0.221 [0.077]***	−0.003 [0.081]	0.005 [0.012]	0.015 [0.020]	−0.02 [0.017]	0.005 [0.010]	−0.004 [0.001]***	−0.001 [0.009]
Father was a boss or director	0.011 [0.022]	−0.011 [0.090]	0.006 [0.064]	0.007 [0.013]	0.009 [0.021]	−0.016 [0.022]	0.001 [0.006]	0.001 [0.004]	−0.002 [0.009]
Mother was a boss or director	0.081 [0.059]	−0.167 [0.138]	0.191 [0.151]	0.035 [0.025]	0.002 [0.060]	−0.037 [0.077]	0.025 [0.014]*	−0.007 a [0.005]	−0.019 [0.015]
Mother was a party member	−0.021 [0.012]*	−0.109 [0.156]	0.093 [0.069]	−0.023 [0.015]	0.011 [0.043]	0.012 [0.043]	−0.013 [0.012]	−0.003 [0.003]	0.015 [0.014]
Family members entrepreneurs	0.012 [0.007]*	0.088 [0.032]**	0.065 [0.018]***	0.011 [0.005]**	0.026 c [0.020]	−0.037 [0.024]	0.004 [0.004]	0.002 c [0.001]***	−0.006 [0.004]
Friends entrepreneurs (from the last place of study)	0.031 [0.010]***	−0.004 [0.020]	0.078 [0.023]***	0.028 [0.006]***	0.036 c [0.009]***	−0.064 [0.003]***	0.016 [0.005]***	0.004 a,c [0.002]**	−0.019 [0.007]***

Specification	(1) Probit	(2) Probit	(3) Probit	(4) Multinomial logit			(5) Multinomial logit		
Dependent variable	E	E with positive sales growth	NE who thought of business	E	NE who failed as E	NE who never was E	E by opportunity	E by necessity	NE who never was E
Comparison group	All NE	Other E	NE who never thought of business	The other two groups			The other two groups		
Cognitive test score	0.004	−0.031	0.005	0.003	−0.002	−0.001	0.001	0.001 c	−0.003
	[0.005]	[0.038]	[0.013]	[0.003]	[0.018]	[0.020]	[0.001]	[0.001]*	[0.002]
Height	0.001	0.008	0.003	0.001	−0.005 a,c	0.005	0	0	−0.001
	[0.000]**	[0.005]	[0.002]	[0.001]	[0.001]***	[0.002]**	[0.000]	[0.000]	[0.000]
Risk loving	0.078	0.157	−0.005	0.075	0.027 c	−0.102	0.046	0.012 a,c	−0.057
	[0.006]***	[0.120]	[0.028]	[0.009]***	[0.041]	[0.049]**	[0.008]***	[0.003]***	[0.007]***
Top 10% in secondary school (self reported)	−0.007	0.118	−0.018	0.001	0.092 a,c	−0.093	−0.004	−0.001 c	0.004
	[0.010]	[0.057]*	[0.017]	[0.012]	[0.037]**	[0.044]**	[0.005]	[0.003]	[0.008]
Greed	0.141	0.134	0.032	0.072	0.008 a,c	−0.08	0.043	0.015 a,c	−0.058
	[0.027]***	[0.032]***	[0.047]	[0.011]***	[0.024]	[0.021]***	[0.009]***	[0.003]***	[0.011]***
Local population perceived favorable toward E	0.009	−0.03	0.015	0.009	0.004	−0.013	0.005	0.002 c	−0.007
	[0.008]	[0.092]	[0.049]	[0.007]	[0.023]	[0.025]	[0.007]	[0.000]***	[0.007]
Government perceived favorable toward E	0	0.035	−0.014	−0.004	−0.042 a,c	0.046	0	0	−0.001
	[0.004]	[0.021]*	[0.017]	[0.002]*	[0.005]***	[0.003]***	[0.002]	[0.001]	[0.002]
Observations	802	340	392		802			782	
Pseudo R-sqrd (R-sqrd)	0.38	0.12	0.2		0.35			0.35	

Notes: E—entrepreneur; NE—nonentrepreneur. Robust standard errors corrected for clusters at city level in brackets. Asterisks denote significance of difference from 0 at 10, 5, and 1 percent; "a" and "c" in the middle column in each multinomial logit regression denote significant-at-5-percent level difference from the same coefficients in the left and the right columns, respectively. All regressions include controls for gender, age, and education with a quadratic term; regression 3 includes controls for employment size and industry dummies. The unreported controls are jointly significant at 1-percent level.

Different types of entrepreneurs and non-entrepreneurs



- Social environment (family and friends) has an effect on thinking about becoming an entrepreneur, but risk taking and greed are necessary to be an entrepreneur (models 1 vs. 3)
- Fail entrepreneurs have worst scores on aptitude tests, but have the best self-reported performance in school and perceive the government as least favorable to business (model 4). That's why they failed.
- Entrepreneurs by necessity (model 5) are closer to entrepreneurs by opportunity than to the non-entrepreneurs who never were entrepreneurs

Entrepreneurs in the occupational transitions

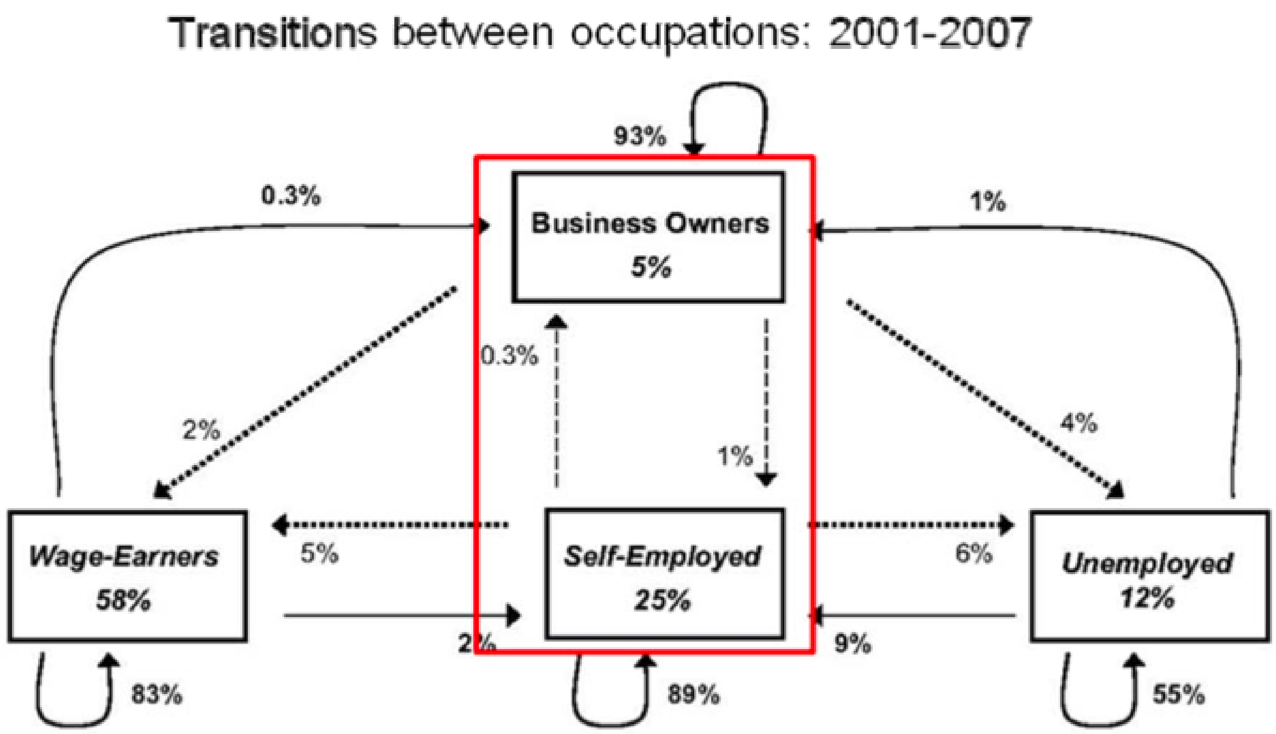


Figure 1: From Mondragon-Velez and Pena-Parga (2008)

Subsistence vs. Transformational entrepreneurs

Subsistence entrepreneurs:

- Becoming entrepreneurs as a means of earning subsistence incomes, alternative sources of income
- Most are small businesses, self-employed with family members, no labor from outside family
- Do not aim to grow into larger firms

Transformational entrepreneurs:

- Aiming to create large, potentially growing business that can provide jobs for others
- Seen as true engines for economic growth

Subsistence vs. Transformational entrepreneurs

- Many policies assume that subsistence entrepreneurship is the first step towards transformational entrepreneurship.
- “Missing middle”: a large fraction of micro-firms and some large firms, but mid size firms are less prevalent in developing countries.
- Only small number of individuals who transition from subsistence to transformational entrepreneurs.
- These two groups respond to growth opportunities differently.
- Their characteristics are also different.
- Capital market, regulatory imperfections, and labor market constraints are main hindrances that affect the transformation.

Subsistence vs. Transformational entrepreneurs:

Different characteristics

Subsistence entrepreneurs:

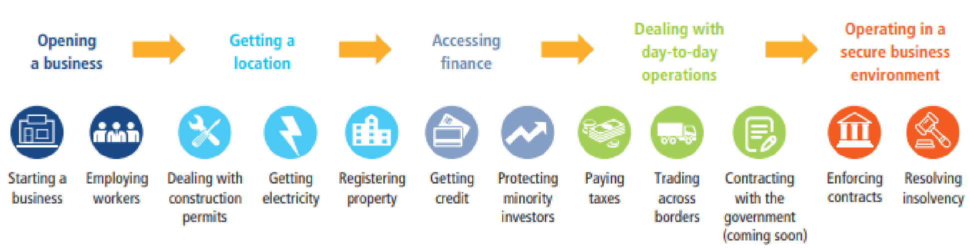
- Low human capital and strong motivation to support families (just want to survive)
- Voluntary exit to better jobs, no intention of growing their business

Transformational entrepreneurs:

- Higher human capital (higher scores on measures of IQ and the level of managerial and financial literacy)
- Higer willingness to take risks, less fear of failure and more confidence in their skills
- Study in India (Iyer and Schoar, 2008) shows that expansion strategies are also different: those who aim to build a long-term business are willing to give up short-terms profit to build reputation.

Bottlenecks for transformational entrepreneurs

- Access to capital:
  - Capital constraints for start-up firms: when there is a shock to supply of credit, if firms are credit constraints, we will see a larger impact on firm growth (e.g. increase in a demand for credits and increase significant profits)
  - Banerjee et al. (2009)'s randomized experiment on the impact of microcredit shows that the improved access to credit seems to have reduced borrowing costs and increased the profits, but it did not lead to explosive growth of businesses.



Doing business ranking is no more available.
There's still enterprise survey by WB

https://www.enterprisesurveys.org/en/enterprisesurveys

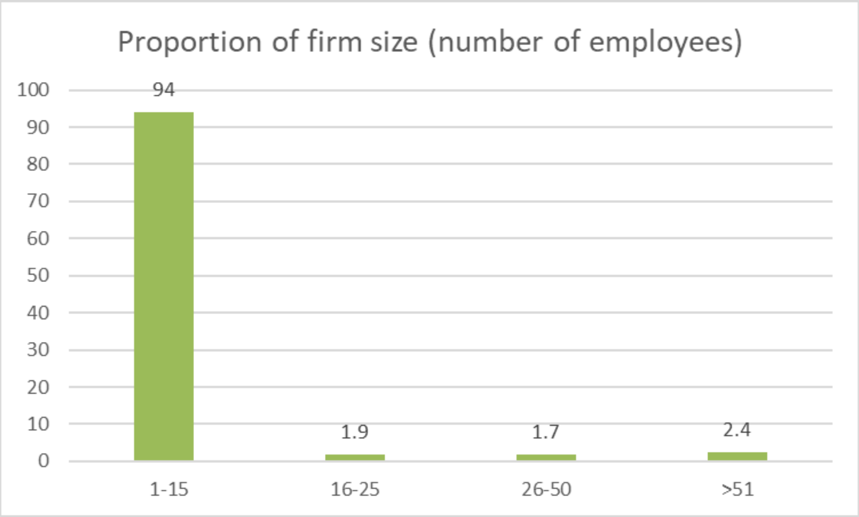
Bottlenecks for transformational entrepreneurs

- Regulation:
  - Reduction in getting business licencing time and costs to register a business increase the number of newly-licensed firms (in Peru)
  - Administrative barriers to starting a business and the cost of registering a business are negatively correlated with business density and the entry rate
  - People might prefer to stay informal, smaller firm size rather than growing into a larger firm if more regulatory are required from the government (This might lead to more rent extraction by government officials.)
  - Tight labor market regulations also increase the importance of social networks and risk attitudes, affecting the decision to start a business

What's about Thai Entrepreneur?

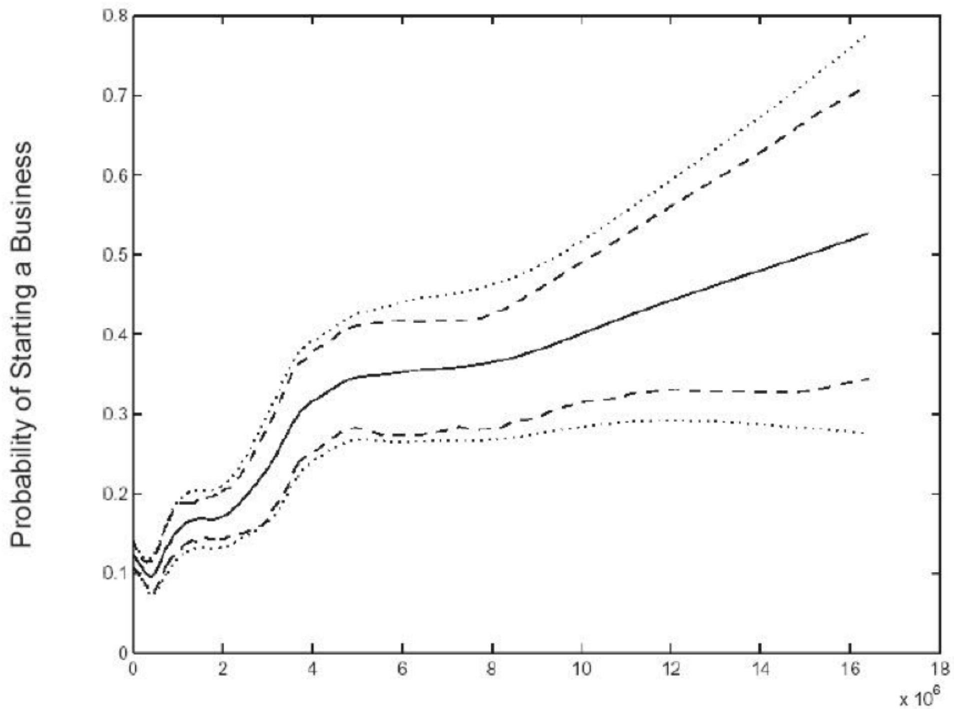
Townsend (2011, Chapter 5)

- Most firms are small in terms of number of employees
- SMEs account for over 95% (or more) of all firms
- In rural, there is a movement of households out of agriculture and into non-farm self-employment or employers. Those who move into non-farm have higher incomes, but there is within-group (nonfarm) inequality.



- Initial household wealth seems to facilitate household transition into business, and the assets of a new business are lower if the household is not borrowing. Here, there is wealth constraint.

Relationship between start-up and wealth



[Figure 5.1.2.10. Non-Parametric Relationship Between Starting a Business and wealth. Notes: y-axis indicates probability of starting a business (1992-1997), x-axis indicates prior wealth in 1992. Dashed line indicates 90% confidence interval, dotted line = $\pm 2\sigma$. Source: Paulson, Townsend and Karaivanov (2003)]

Paulson, Townsend and Karaivanov (2003) use the Townsend Thai data to measure occupation transitions. Non-parametric regressions reveal that the 1992 wealth of those still in farming helps to predict the fraction that makes a subsequent transition out of the farm and into other enterprise, 1992-1997. There are barriers to entry, for example, imperfect credit markets. This is a key feature of the constrained household choice problems.

Rural industry:
Factors affecting the existence of rural industry

Backward & forward linkage

- Export-oriented agricultural sector induces the growth of agricultural machinery manufacturing and other input-supplying activities
- Agricultural processing
- Transportation sector

Agricultural income

- Income increase will lead to more demand for goods & services
- Growth of village grocery stores is consistent with the rising-income hypothesis
- When income rises, there is a change in consumption patterns: food to non-food, durable to non-durable goods, traditional to higher-value-added goods

Rural industry:
Factors affecting the existence of rural industry

Urban demand

- Farmers in the provinces adjacent to Bangkok have the highest proportion of income from non-agricultural sector
- Proximity to the market

Effect of seasonality

- Pattern of rural labor: peak demand in wet season, low demand in long dry season
- Nonfarm capital equipment is idle during the wet season

Limited extent of the market

- Rural villages are small and infrastructure is lacking
- Most nonfarm activities fail to expand because their size and growth are limited by the market size
- Firm size tends to be larger if they are Bangkok oriented or export oriented