

# Chapter 2 1

## Entrepreneurial Motivations, Culture, 2

### and the Law 3

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The entrepreneurial spirit and what the law can do about it (first published in; Comparative Labor Law & Policy Journal, Vol. 28 No. 4, 2007) 19  
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**Abstract** Inspired by Schumpeter's seminal depiction of the entrepreneur, this chapter recasts this heroic portrait in a more rigorous theoretical framework, leveraging a model of individual value preferences by Schwartz. The entrepreneurial spirit, it is argued, consists of particular value preferences: most importantly high openness-to-change and also high self-enhancement. These hypotheses are consistent with extant empirical evidence. The upshot of this theory – especially when the stability of cultural value orientations is taken into account – is that individual propensities to engage in new venture creation may not be very susceptible to policy measures. Looking specifically at legal measures, this chapter considers measures that could be narrowly targeted to promoting entrepreneurship by making entrepreneurs even more highly motivated than what they appear to be. Recent research indicates, however, that theoretical and empirical issues, which must be resolved before such measures could be employed with confidence, are intractable at this point. 5  
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## 1 Introduction 21

Fostering entrepreneurship has become a central policy goal for economic institutions around the world, ranging from regional to national to international bodies. Underlying this trend is the belief that entrepreneurship is key for a number of desirable social outcomes, including economic growth, lower unemployment, and technological modernization.<sup>1</sup> This chapter therefore asks a simple and at the same 22  
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<sup>1</sup>See, e.g., Baumol et al. 2007; Carree and Thurik 2003, 2006; van Stel et al. 2005; Wong et al. 2005; Wennekers et al. 2005. On unemployment see Baptista et al. (2006).

27 time crucial question: What makes some people more entrepreneurial than others?  
28 A companion question follows almost immediately: Can policy makers do some-  
29 thing to promote entrepreneurship?

30 To answer these questions, this chapter returns to Schumpeter's (1912/1934)  
31 *Theory of Economic Development*. I argue that Schumpeter was right when he  
32 described entrepreneurs as special people. While there are several economic  
33 accounts of the functions entrepreneurs fulfill in the economy, Schumpeter's  
34 account remains most insightful in capturing the essential qualities that distinguish  
35 entrepreneurs from others in society. The central goal of this chapter is to recast  
36 Schumpeter's depiction of the entrepreneur in modern economic and psychological  
37 terms. A sizable body of literature has examined some psychological traits of  
38 entrepreneurs. The greatest amount of attention has been paid to entrepreneurs'  
39 attitudes towards risk and to their need for achievement. Work has also been done  
40 on entrepreneurial perception. In comparison, the motivational goals that guide  
41 entrepreneurs as they choose an entrepreneurial course of action have been rela-  
42 tively neglected. These motivational goals, or value preferences, constitute the  
43 "entrepreneurial spirit."

44 This chapter hypothesizes that beyond seeking material success the crucial  
45 element in the entrepreneurial spirit is openness to change – an interest in the  
46 different and in new experiences while deemphasizing the safe and the proven.  
47 (I also briefly explore entrepreneurs' cognitive style). What makes entrepreneurs  
48 special is their attitude toward uncertainty more than toward simple risk. Thus  
49 depicted, the Schumpeterian portrait of the entrepreneur is not entirely consistent  
50 with the standard depiction of economic actors in neo-classical economics. Yet this  
51 portrait is truer to reality. It can thus help us understand the cultural and legal  
52 institutions that bear on entrepreneurship.

53 The chapter proceeds as follows. Section "Portraits of the Entrepreneur" surveys  
54 the literature on the nature and characteristics of the entrepreneur from two per-  
55 spectives: economic and psychological. In particular, this section tries to glean the  
56 literature's view on whether entrepreneurs are special individuals or rather ordinary  
57 people channeled by circumstances to engage in new venture creation. Section  
58 "Entrepreneurial Motivations" addresses the first part of this chapter's title by  
59 putting forward a small theory on entrepreneurial motivations and arguing that  
60 these motivations constitute the entrepreneurial spirit. Entrepreneurial motivations  
61 are claimed to stem from particular individual value preferences according to a  
62 theoretical model developed by psychologist Shalom Schwartz. Based on this  
63 model, this section then derives testable hypotheses, with which Schumpeter's  
64 seminal account of the entrepreneur is highly consistent. Section "The Cultural  
65 Context" briefly discusses the cultural context of entrepreneurship, primarily  
66 to underscore the stability of informal social institutions. Section "Can Legal  
67 Measures Foster Entrepreneurship?" addresses the latter part of this chapter's  
68 title: Can law help in fostering entrepreneurship? After briefly discussing the  
69 importance and (un)likelihood of improving the general legal infrastructure, I  
70 address legal measures that regulate the birth of a new venture (i.e., entry) and its  
71 death (i.e., bankruptcy). In both cases, it appears, there is disappointingly little room

for effective intervention targeted at fostering entrepreneurship. The last section concludes here. 72  
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## 2 Portraits of the Entrepreneur 74

### 2.1 Defining Entrepreneurship 75

A well-known problem in the study field of entrepreneurship is the lack of an agreed definition for this concept. This has led to considerable disarray in the literature. In particular, it is unclear whether innovation is a necessary element for entrepreneurship, or does self-employment suffice, or whether self-employment and ownership of a small business firm are equally entrepreneurial (see Ulijn and Brown 2003). The etymology of “entrepreneurship” derives from French and German words for “undertaking” (*entreprendre*, *unternehmen*, respectively). Yet the linguistic exercise does not convey the full meaning of being an entrepreneur. 76  
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A good definition of entrepreneurship should consider the role of the entrepreneur in the economy. However, the question “what is entrepreneurship?” is usually answered by stating “what entrepreneurs do,” which oftentimes transforms into “what are entrepreneurs like.” The following describes three major roles for entrepreneurs that the economic literature has recognized and the types of persons who would perform these roles. I then briefly consider more recent discussions of characteristic features of entrepreneurs. Next, I review some personal psychological traits that have been associated with individuals’ tendency toward entrepreneurship. 84  
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### 2.2 The Entrepreneur in Economics 92

In the standard neo-classical economics of the late nineteenth century, things don’t change in the general equilibrium. There is no room for entrepreneurship. Prominent economists from the eighteenth and nineteenth centuries, including Cantillon, Smith, and Say, have nonetheless recognized the pivotal role of entrepreneurship in the economy as the source of change, development, and progress (see van Praag (1999); Hébert and Link (1989); Gartner (1990); Kao (1993)). 93  
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Schumpeter continued the work of Cantillon by developing a theory of economic development as a dynamic process of change. The entrepreneur in the Schumpeterian scheme brings about the famous “constructive destruction” by finding new combinations for production. The entrepreneur differs from other providers of resources such as land, financial capital, labor, and even from inventors who provide patents. The entrepreneur’s main function is to overcome the difficulties engendered by uncertainty (Schumpeter 1928). A central premise in Schumpeter’s 99  
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106 theory (Schumpeter 1951, p. 248) – which is the focus of this chapter – is that  
 107 entrepreneurs have special skills for innovation and for dealing with uncertainty.

108 Knight (1921) provided sound theoretical underpinnings to previous observa-  
 109 tions about the unique of role entrepreneurs have in addressing uncertainty. Relative  
 110 to the average person, the entrepreneur is particularly “venturesome,” self-confident,  
 111 and tends to act independently on her own opinion (Knight 1921, p. 269). Kirzner’s  
 112 (1973, 1997) entrepreneur resembles Schumpeter’s in that both are agents of  
 113 change in the economy. Kirzner’s entrepreneur operates primarily as a gaps-closing  
 114 arbitrageur, however, while Schumpeter’s archetypal entrepreneur innovates and  
 115 creates (Kirzner 1999). In Lazear’s (2004, 2005) theory too, the entrepreneur  
 116 differs from most other people in the population. Counter-intuitively, however,  
 117 what makes him special is that he doesn’t excel in anything in particular. He is  
 118 “Jack-of-all-trades.” Lazear and others have shown that entrepreneurs have a more  
 119 varied curriculum as students and tend to work in a greater number of jobs (Lazear  
 120 2005; Wagner 2003; Åstebro 2006). Silva (2006) argues that while entrepreneurs  
 121 tend to have a broader experience, the choice to become an entrepreneur is driven  
 122 by unobservable factors. Åstebro (2006) argues that entrepreneurs have a “taste for  
 123 variety.” Santarelli and Vivarelli (2006), in a discussion of this literature, conclude  
 124 that the reason may be *ex-ante* innate characteristics.

125 The economic literature has not delved specifically into such “taste for variety.”  
 126 However, two other personal traits of entrepreneurs have attracted some attention,  
 127 namely, a preference for non-pecuniary rewards and, more specifically, a prefer-  
 128 ence for autonomy (Hamilton 2000; Moskowitz and Vissing-Jørgensen 2002;  
 129 Kerins et al. 2004; Amit et al. 2001). Benz (2007) and Benz and Frey (2008) thus  
 130 argue that in essence, entrepreneurship is a non-profit-seeking activity. According  
 131 to Benz, entrepreneurs derive non-monetary benefits from engaging in entre-  
 132 preneurship, primary among which is greater autonomy.<sup>2</sup> Benz’s theory there-  
 133 fore rationalizes behavioral patterns of entrepreneurs that otherwise could have  
 134 been dubbed – and likely dismissed – as irrational. In a similar vein, another  
 135 common observation about entrepreneurs concerns their seeming over-optimism  
 136 (Arabsheibani et al. 2000; Bernardo and Welch 2001; Cooper et al. 1988).

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### 137 2.3 *Psychological Analyses of Entrepreneurial Attributes*

138 The notion, that entrepreneurs may have special personal attributes in comparison  
 139 to the general population, hasn’t gone unnoticed among psychologists. The litera-  
 140 ture on this subject is broad but quite unorganized, such that surveying it in full is  
 141 well beyond the scope of the present chapter (see Shook et al. 2003; Krueger 2003  
 142 for surveys). Gartner (1988) argued that entrepreneurship research should not focus

<sup>2</sup>See also Blanchflower and Oswald (1998); Blanchflower (2000); Kawaguchi (2004); Beugelsdijk and Noorderhaven (2005); van Gelderen et al. (2003); van Gelderen et al. (2006).

on entrepreneurs' individual personality but rather on entrepreneurial action (i.e., venture creation), which is more socially contextual. Yet the quest for a psychological profile of the entrepreneur continues. The little agreement that used to exist until recently in this respect was that such personal attributes have not yet been identified. Shook et al. (2003, p. 382) thus concluded that "[t]he search for an entrepreneurial personality profile was largely unsuccessful." In recent years, however, psychologists have been revisiting the empirical literature with the tool of meta-analysis such that clearer patterns are beginning to emerge.

In general, the attributes and themes studied by psychologists reflect the special qualities and roles that economists have attributed to entrepreneurs. Early work looked at three major psychological constructs that appear consistent with an "entrepreneurial personality," namely, high need for achievement, internal locus of control, and a risk-taking propensity (Korunka et al. 2003).

Need for achievement was defined by McClelland (1961) as a motivation to excel in attaining goals in competitive settings through hard work, self-challenging, and persistence. Entrepreneurs may have an image of high-achievers, yet studies show that entrepreneurs do not stand out significantly in terms of their need for achievement. Non-entrepreneurs can be equally achievement-seekers at times and entrepreneurs may not exhibit a stable high need for achievement (Rauch and Frese 2000). A recent meta-analysis of the relationship of achievement motivations to entrepreneurial behavior nonetheless finds a positive correlation between the former and the choice of an entrepreneurial career and entrepreneurial performance (Collins et al. 2004). Having an internal locus of control – a personality factor reflecting a belief that one can influence the outcomes of one's life (Rotter 1966) – has also been related to an entrepreneurial personality. The extant evidence is mixed, leading Rauch and Frese (2000) to conclude that there seems to be other variables moderating the relationship between internal locus of control and becoming a small business owner.

In line with the common depiction of entrepreneurs as risk-bearers, the corollary has been that less risk averse individuals will become entrepreneurs, while the more risk averse will prefer wage income (Kihlstrom and Laffont 1979; van Praag and Cramer 2001). A pioneering empirical study by Brockhaus (1980) failed to find support for a link between entrepreneurial action and risk-taking propensity, however. The received wisdom about such link subsequently thus was that it has not been established empirically. Evidence about entrepreneurs' higher risk propensity continues to accumulate, however. For instance, interim results from large surveys directed by economists in Russia and China, albeit without a psychological theoretical framework, indicate such high propensity (Djankov et al. 2005, 2006).

In a meta-analysis of risk propensity differences between entrepreneurs and managers, Stewart and Roth (2001) conclude that the literature as a whole in fact suggests that entrepreneurs do have a somewhat higher risk propensity than managers. Moreover, when a distinction is made between income-oriented and growth-oriented entrepreneurs – i.e., small business owners interested mostly in producing family income versus firm owners interested in profit and growth, respectively – the latter entrepreneurs exhibit a markedly higher risk propensity. While the

188 clarification of the empirical results is commendable, it should be emphasized that  
189 the theory of entrepreneurship revolves around Knightian uncertainty, not around  
190 risk. More work is needed empirically to test this proposition, for which the  
191 currently available evidence is only indirectly relevant.

192 There are numerous additional studies examining possible links between psy-  
193 chological variables and entrepreneurial personal qualities. Of these, two factors in  
194 particular may be mentioned: personality traits and cognitive factors. Traits are  
195 dimensions of individual differences in tendencies to show consistent patterns of  
196 thoughts, feelings and actions (McCrae and Costa 1990, 1997). Psychologists use  
197 the five-factor model (FFM, or “Big Five model”) as the dominant approach for  
198 representing the human trait structure (McCrae and John 1992). The model asserts  
199 that five basic factors describe most personality traits: openness to experience,  
200 extraversion, agreeableness, conscientiousness, and neuroticism.

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201 Researchers have used the Big Five model to predict individual differences in  
202 entrepreneurial attributes. Comparing entrepreneurs to managers, Zhao and Seibert  
203 (2006) find that entrepreneurs score higher on conscientiousness and openness to  
204 experience, and lower on neuroticism and agreeableness. These findings are in line  
205 with the findings on entrepreneurs’ risk propensity.<sup>3</sup> Although there is no known  
206 direct link from personality traits to entrepreneurial action, the findings suggest that  
207 individuals with this personality profile may be more attracted to engaging in  
208 entrepreneurship and may find this more satisfying than others do and/or relative  
209 to other occupations. Individuals with such personality traits may also be more  
210 successful in mobilizing support for their entrepreneurial venture from capital  
211 providers, employees, etc.

212 Kirzner’s theory of entrepreneurship postulates that alertness is the special  
213 quality distinguishing entrepreneurs from most others. Stevenson and Jarillo  
214 (1990), among others, define that entrepreneurship as an orientation toward oppor-  
215 tunity recognition. These views point to the importance of entrepreneurs’ cognitive  
216 faculties, including perception, memory, information processing, and decision  
217 making. Entrepreneurs arguably excel in cross-linking and rearranging information  
218 in ways that lead them to new projects. Research on these variables among  
219 entrepreneurs – what may be called “entrepreneurial cognition” – is still develo-  
220 ping.<sup>4</sup> Some researchers question the fruitfulness of this line of research (Alvarez  
221 and Barney 2006). Work by others, however, suggests ways for progress. Baron  
222 (2006) argues that entrepreneurial opportunity recognition may be analyzed as a  
223 specific case of pattern recognition – of “connecting the dots.” Baron 2000; Baron  
224 and Ensley 2006; see also Gaglio 2004) further argues that entrepreneurs are less  
225 likely to engage in counterfactual thinking; when they see a pattern they stick to it.

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<sup>3</sup>There is some controversy whether risk propensity is a specific combination of trait positions on the FFM or an additional, sixth, dimension of personality traits. See Zhao and Seibert (2006).

<sup>4</sup>For reviews, see Wadson (2006); Krueger (2003); Mitchell et al. (2007); see also Gaglio and Katz (2001).

If true, this particular cognitive style may allow entrepreneurs to come up with new ideas and at the same time to avoid procrastinating about them for too long.

To recap, research on the individual psychology of the entrepreneur after 2 decades is beginning to yield a clear portrait, the features of which are well-anchored in rigorous analysis. Entrepreneurs are indeed special individuals in that they tend to exhibit a particular combination of psychological attributes compatible with their role in the economy as new venture creators. Needless to say, this does not mean that all entrepreneurs exhibit these attributes equally strongly during their entire career.<sup>5</sup> Nor does this proposition deny the importance of the social context in which potential entrepreneurs emerge and operate. Finally, the focus herewith has been on individual psychological attributes. Proclivity toward entrepreneurship at the firm level – known as “Entrepreneurial Orientation” – raises additional issues not discussed here (see Lumpkin and Dess 1996, 2001).

### 3 Entrepreneurial Motivations

#### 3.1 *The Theoretical Challenge*

A comparison of the economic and psychological accounts of entrepreneurial attributes points to a peculiar discrepancy. Economists at a very early stage recognized that entrepreneurs might be driven toward new venture creation by more than a simple desire for wealth attainment. In economics, wealth attainment is a standard proxy for self-utility maximization, which, in turn, is commonly used as a first-cut approximation for rational preferences. One can therefore immediately see that postulating “autonomy”, “independence”, or “variety” as goals that entrepreneurs pursue in fact challenges basic precepts of neo-classical economics. Absent a general theory of motivations, however, simply assuming that autonomy, or other factors, operate as arguments in people’s utility functions would lead to tautology.

The budding literature on non-pecuniary motivations indicates that economic analysis of entrepreneurial motivations may lead to a more fundamental rethinking of economic theory. As the following section shows, however, Schumpeter had already foreseen both the need to account for non-pecuniary motivations and the fundamental challenge they pose to economic theory. Against this backdrop, one may note with surprise the paucity of psychological studies on entrepreneurial motivations.

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<sup>5</sup>Schumpeter (1934, p. 78) points out that “being an entrepreneur is not a profession and as a rule is not a lasting condition;...everyone is an entrepreneur only when he actually ‘carries out new combinations’ and loses that character as soon as he has built up his business, when he settles down to running it as other people run their business.”

259 While the survey in the preceding part cannot possibly be exhaustive, it covers  
260 the major psychological factors discussed in the entrepreneurship literature. The  
261 issue of entrepreneurs' motivational goals has been virtually neglected.<sup>6</sup> One strand  
262 of the literature – namely, the studies dealing with entrepreneurs' need for achieve-  
263 ment – comes close to addressing this subject. Other variables – such as personality  
264 traits, risk propensity, etc. – may correlate partially with motivational goals but they  
265 are conceptually different.

266 The upshot is that a central feature in the economic analysis of entrepreneurial  
267 behavior lacks moorings in psychology. Economists thus find themselves making  
268 behavioral propositions, which, notwithstanding their plausibility, are detached  
269 from behavioral scientific analysis. In this situation, deriving normative prescrip-  
270 tions – and in particular, recommending legal reform with a view to fostering  
271 entrepreneurship – would be questionable at best. This part therefore presents a  
272 small theory of entrepreneurial motivations that integrates current psychological  
273 theory with Schumpeter's classic economic insights.

### 274 3.2 *Entrepreneurial Values*

275 To generalize from the literature surveyed above, the debate over the nature of the  
276 entrepreneur essentially asks whether entrepreneurs are special individuals or is  
277 anyone, under certain conditions, equally likely to be an entrepreneur. In the  
278 context of motivations, this debate thus suggests our first hypothesis: People who  
279 become entrepreneurs have a particular set of motivational goals. Stated otherwise,  
280 entrepreneurs stand out in term of the issues that they consider important and worth  
281 pursuing in life. The null hypothesis therefore is that entrepreneurs' goals are not  
282 significantly different from the goals of the general population.

283 As already noted, there is evidence, gathered mostly by economists, that entre-  
284 preneurs seek autonomy more than wealth attainment. Some preliminary evidence  
285 suggests that they also seek variety. However, deriving a general hypothesis from  
286 these sporadic observations requires first a general theory of motivational goals.  
287 To this end, I use Schwartz's (1992) theory on individual-level value preferences.  
288 Values are defined as conceptions of the desirable that guide the way individuals  
289 select actions, evaluate people and events, and explain or justify their actions and  
290 evaluations. In this view, values are trans-situational criteria or goals (e.g., security,  
291 wealth, justice), ordered by importance as guiding principles in life. Values are not  
292 objective, cold ideas. Rather, when values are activated, they become infused  
293 with feeling. The trans-situational nature of values means that values transcend  
294 specific actions and contexts. Obedience, for example, is relevant at work or in

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<sup>6</sup>For the present study, I have conducted searches in both JSTOR and Econlit databases and extensive, though obviously not comprehensive, searches of internet resources. A study that bears directly on this subject and is discussed in more detail below is Fagenson (1993).



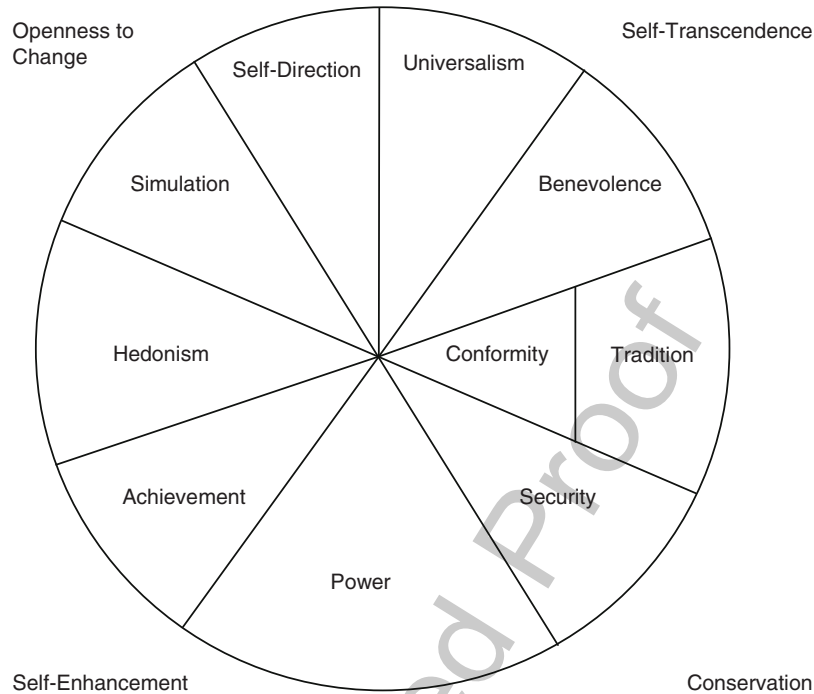
school, in sports or in business, with family, friends or strangers (Rokeach 1973; Schwartz 1992). 295  
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Milton Rokeach (1973) provided a clear definition of values as guiding principles in life and proposed a list of values that was meant to be universal and comprehensive. Schwartz and Bilsky (1987) analyzed cross-national data based on a survey instrument developed by Rokeach and confirmed the existence of certain value types in each country. Schwartz (1992, 1994) advanced a comprehensive model of individual-level values that represent universal requirements of human existence (biological needs, coordination of social interaction, group functioning) as motivational goals. Schwartz extended the Rokeach value inventory with values drawn from other cultures, including Asian and African ones. Table 1 provides definitions of the ten values types distinguished by Schwartz and value items that reflect them. 297  
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An interesting feature of the Schwartz model is the structural interrelations among value types. These value types can be drawn as segments of a circle. Figure 1 depicts this spatial arrangement. Adjacent value types are conceptually close to one another whereas opposing value types express conceptually diametrical goals in life. Thus, individuals who put a high emphasis on values of universalism (social justice, equality) would also tend to emphasize benevolence values (helpful, honest, etc.). People who emphasize universalism and benevolence would tend to de-emphasize values that belong to opposing value types (e.g., achievement versus benevolence). 308  
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The ten value types distinguished by Schwartz are organized along two bipolar orthogonal dimensions. These dimensions reflect a higher level of conceptual commonality among value types. One dimension, entitled self-enhancement versus 317  
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<b>Table 1</b> The Schwartz individual values and representative items	t1.1
<i>Self-Direction</i> . Independent thought and action-choosing, creating, exploring (creativity, freedom, independent, curious, choosing own goals)	t1.2
<i>Stimulation</i> . Excitement, novelty and challenge in life (daring, a varied life, an exciting life)	t1.3
<i>Hedonism</i> . Pleasure and sensuous gratification for oneself (pleasure, enjoying life)	t1.4
<i>Achievement</i> . Personal success through demonstrating competence according to social standards (successful, capable, ambitious, influential)	t1.5
<i>Power</i> . Social status and prestige, control or dominance over people and resources (social power, authority, wealth)	t1.6
<i>Security</i> . Safety, harmony and stability of society, of relationships and of self (family security, national security, social order, clean, reciprocation of favors)	t1.7
<i>Conformity</i> . Restraint of actions, inclinations and impulses likely to upset or harm others and violate social expectations or norms (self-discipline, obedient, politeness, honoring parents and elders)	t1.8
<i>Tradition</i> . Respect, commitment and acceptance of the customs and ideas that traditional culture or religion provide (accepting my portion in life, humble, devout, respect for tradition, moderate)	t1.9
<i>Benevolence</i> . Preservation and enhancement of the welfare of people whom one is in frequent personal contact (helpful, honest, forgiving, loyal, responsible)	t1.10
<i>Universalism</i> . Understanding, appreciation, tolerance and protection for the welfare of all people and for nature (broadminded, wisdom, social justice, equality, a world at peace, a world of beauty, unity with nature, protecting the environment)	t1.11



**Fig. 1** The structure of relations among individual values. According to Schwartz

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320 self-transcendence, opposes power and achievement values to universalism and  
 321 benevolence values. The dimension of openness to change versus conservation  
 322 opposes self-direction and stimulation to security, conformity, and tradition values.  
 323 Hedonism values share elements of both openness to change and self-enhancement.  
 324 The Schwartz model thus provides a nearly universal description of the content and  
 325 structural relations of human values at the individual level (Rohan 2000; see also  
 326 Bilsky and Koch 2002). Values have been conceptualized as the core of one's  
 327 personal identity (Hitlin 2003). Value priorities in this model relate systematically  
 328 with personality traits under the Big Five model (Roccas et al. 2002). Value  
 329 priorities furthermore have been linked to behavior in a number of studies (Bardi  
 330 and Schwartz 2003; Barnea and Schwartz 1998; Caprara et al. 2006). The path from  
 331 values to behavior is not direct and involves mediating factors, however (e.g.,  
 332 Verplanken and Holland 2002).

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333 From an economic analysis perspective, the Schwartz theory provides a com-  
 334 prehensive model of human motivations. Representing the set of conceptions of the  
 335 desirable, the distinct ten values can be seen as ten distinct arguments in indivi-  
 336 duals' utility functions. This theory thus may help in advancing the debate over  
 337 the meaning of rationality among law and economics scholars that took place at  
 338 the turn of the century. In particular, by providing a framework for generating  
 339 and testing falsifiable hypotheses, this theory may help in meaningfully integrating

non-material, non-self-utility into economic analysis. It deserves emphasizing, however, that between the two value dimensions, openness-to-change versus conservation and self-enhancement versus self-transcendence, the former is more foreign to standard economic theory.

Consider self-enhancement versus self-transcendence. Not until too long ago, a debate was raging whether “economic man” – i.e., the expected-self-utility maximizer – provides a satisfactory model for economic actors. This debate is largely over (Camerer and Fehr 2006; Rabin 2002). A large body of evidence shows that people may incur substantial costs systematically to promote other people’s interests or just “to make a point.” In such cases, the self-utility that may accrue to the actor is affected by the utility accruing to others. Stated otherwise, people regularly care about others in the society. Hence the terms “social preferences” and “other-regarding preferences” to describe such motivations.<sup>7</sup> The current debate in economics revolves around the precise content of such other-regarding preferences, namely, the ways in which actors incorporate others’ utility into their own utility function (e.g., Fehr and Schmidt 1999; Charness and Rabin 2002).

Within the Schwartz model, self-regarding and other-regarding preferences map onto the self-enhancement versus self-transcendence dimension, respectively. Self-regarding preferences comprise seeking pure pleasure to oneself, which corresponds with hedonism values, as well as other forms of attaining utility, both material and non-material, which is partially covered by achievement values. On the opposite pole of this dimension, altruistic preferences directed to particular others are conceptually compatible with benevolence values. More open-ended other-regarding preferences, postulated mainly by Charness and Rabin, are conceptually compatible with Schwartz’s universalism value.

The motivations covered by the openness-to-change versus conservation dimension are relatively less developed in economics. Theoretical work addressing the Ellsberg Paradox (Ellsberg 1961) indicates that people have an ambiguity aversion, or Knightian uncertainty aversion (distinguished from risk aversion) (Segal 1987; Halevy 2007). That is, when asked to choose among risky outcomes, people ascribe lower utilities to outcomes about which they don’t know the probability of risk levels. Empirical studies strongly confirm the existence of ambiguity aversion (Halevy 2007). This type of preference is conceptually compatible with high priority on conservation values, while lower ambiguity aversion is compatible with openness-to-change. Elsewhere I argued that from a cognitive point of view, uncertainty, ambiguity, and complexity are linked because they entail a higher cognitive load. Individual priorities on the conservation versus openness-to-change dimension further relate to different psychological constructs of cognitive style (Licht 2004).<sup>8</sup> Specifically, a higher need for cognitive closure is conceptually related to greater emphasis on conservation and vice versa. The emphasis on

<sup>7</sup>“Other-regarding preferences” is a more accurate term than “social preferences” because the latter might mistakenly connote group preferences.

<sup>8</sup>On motivated cognition, see Jost et al. (2003).

380 preserving the status quo – whether real or an imaginary ideal thereof (consider  
381 “family values”) – is especially clear in such value items as respect for tradition,  
382 honoring parents and elders, and social order. The preference for certainty and  
383 stability over ambiguity and change is also reflected in seemingly innocuous value  
384 items like cleanliness that convey a sense of clarity.

385 Within this theoretical framework, several hypotheses can now be derived about  
386 individuals’ value priorities as representations of their motivational goals and their  
387 proclivity to engage in entrepreneurship.

388 First, at a high level of generality, entrepreneurs would score higher on open-  
389 ness-to-change values than on conservation values. The role ascribed to entrepre-  
390 neurs in economic theory is that of agents of change. Whether thanks to greater  
391 uncertainty tolerance a la Knight, or to an urge for seeking new combinations a la  
392 Schumpeter, or to their superior alertness to new information a la Kirzner, entre-  
393 preneurs are expected to feel more comfortable with changing circumstances.  
394 Relative to the general population, entrepreneurs are expected to ascribe lower  
395 desirability to keeping with the “tried, tested and true,” to following what their  
396 bosses or elders tell them to do, etc. (the latter reflecting higher priority for  
397 conservation values). More specifically, one should expect to see entrepreneurs  
398 giving especially high priority to self-direction (reflected, e.g., in being indepen-  
399 dent, curious, creative, and able to choose one’s own goals) and also to stimulation  
400 (reflected, e.g., in being daring and in having a varied life).

401 Second, entrepreneurs would score higher on self-enhancement values than on  
402 self-transcendence values. This hypothesis might seem somewhat less novel than  
403 the preceding hypothesis because a central value in self-enhancement is achieve-  
404 ment. Schwartz (1992) defines the achievement value as “personal success through  
405 demonstrating competence according to social standards.” This definition is close  
406 to McClelland’s definition of the need for achievement motive. McClelland’s need  
407 for achievement construct furthermore has been theoretically and empirically  
408 linked to the Schwartz achievement value (Bilsky and Schwartz 2006). Thus, we  
409 would expect entrepreneurs more than others to consider personal success as a  
410 central goal in their life. The Schwartz model predicts that concomitantly with the  
411 greater emphasis on personal success, entrepreneurs will ascribe lesser importance  
412 to benevolence and universalism values, which constitute the self-transcendence  
413 pole. Entrepreneurs will thus be relatively less inclined to endorse other-regarding  
414 preferences.

415 To my knowledge, no study has investigated entrepreneurs’ value preferences in  
416 the Schwartz framework.<sup>9</sup> Only a handful of researchers have drawn on Rokeach’s  
417 theory to posit a link between individual value preferences and a proclivity to  
418 entrepreneurship. Rokeach postulated a distinction between terminal and instru-  
419 mental values, where the former represent preferred end-states of being or global  
420 goals in life, while the latter represent preferred modes of conduct toward such

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<sup>9</sup>Several studies attempted linking values with entrepreneurship but they suffer from serious methodological weaknesses. For a critical survey see Bird and Brush (2003).

end-states. Surveying the literature as of 1989, Barbara Bird hypothesized, based on the Rokeach theory, that entrepreneurs would have a preference for autonomy and independence as instrumental values (cited in Bird and Candida 2003). Bird further conjectured that entrepreneurs' terminal value priorities would emphasize fame, status and power, and that they may consider money primarily as a way of keeping score in an achievement "game."

Fagenson (1993) reported results from the only theory-driven study of differences in value priorities among US managers and entrepreneurs, using the Rokeach framework. Entrepreneurs scored significantly higher on terminal values of self-respect, freedom, a sense of accomplishment, and an exciting life, and also on instrumental values of being honest, ambitious, capable, independent, courageous, imaginative, and logical. Managers scored significantly higher than entrepreneurs on terminal values of true friendship, wisdom, salvation, and pleasure, and on instrumental values of loving, compassionate, forgiving, helpful, and self-controlled. The Schwartz model does not support Rokeach's instrumental/terminal values distinction. However, the Schwartz Values Survey, which was used to confirm the model, includes many value items from the Rokeach Values Survey. Mapping the Rokeach items onto the Schwartz values and higher-level value dimensions indicates that Fagenson's findings are consistent with the hypothesis advanced above. Specifically, entrepreneurs scores higher than managers on items that reflect stimulation, self-direction, and achievement in the Schwartz model.

The evidence gathered by economists lends further support the above hypotheses. Recall the studies mentioned above that demonstrate entrepreneurs' preference for autonomy. Although lacking in theoretical underpinning, the evidence, showing that entrepreneurs prefer to be their own bosses, that they like to be independent, and so forth, is consistent with higher priority on self-direction. The evidence on a preference for variety, which Santarelli and Vivarelli (2006) take to be an *ex-ante* innate characteristic, likewise is consistent with higher openness to change. Similarly, with regard to Lazear's (2005) model, the Schwartz model provides a motivational theory on *why* some people happen to be "Jacks of all trades," happen to pursue studies in several fields as well as several careers, etc., and maybe more likely to succeed as entrepreneurs as a consequence. The (hypothesized) reason is that they have a particular value preference profile.

### 3.3 Schumpeter Revisited

Although hardly neglected, Schumpeter's theory of the entrepreneurial spirit remains under-appreciated, or at least under-utilized, for informing current theoretical accounts. This section revisits Schumpeter's account of the entrepreneur and demonstrates that it is highly compatible with the theory of entrepreneurial motivations advanced above. The theory of entrepreneurial motivations thus recasts Schumpeter's theory in a rigorous analytical framework that renders the latter susceptible to empirical investigation.

462 Among the theories of the economic role of the entrepreneur, Schumpeter's  
 463 theory stands out as the most comprehensive. As noted above, Knight's theory  
 464 of the entrepreneur as a bearer of uncertainty may be subsumed into Schumpeter's  
 465 theory. Kirzner himself, in recent writings, pointed to the consistency between his  
 466 theory and Schumpeter's theory in regards with alertness to new combinations of  
 467 information. Lazear's theory is devoid of reference to motivation but is nonetheless  
 468 premised on combinations of skills and experiences that lead one to pursue new  
 469 venture creation.

470 Writing nearly a century ago,<sup>10</sup> Schumpeter's account remains insightful, rich,  
 471 and vivid. It would be a mistake to take it as romantic. Schumpeter likely appre-  
 472 ciated the entrepreneurial type ("our type," in his words). Yet the attributes he  
 473 ascribed to the entrepreneur were not merely romantic embellishments. These  
 474 attributes derive from his analysis of entrepreneurs' role in the economy. Even  
 475 today, Schumpeter's analysis is so sharp that to the extent possible, the following  
 476 section draws on his own words for the presentation of his arguments. I limit myself  
 477 to providing headlines and to suggesting some interpretation.

478 • It's the motivations, . . . .

479 Schumpeter had identified the weak points in the standard economic account of  
 480 economic agents. These lifeless agents could not bring about economic change and  
 481 development. Schumpeter (1934, p. 90) thus saw the crux of being an entrepreneur  
 482 as having an unusual set of motivations.

483 We shall finally try to round off our picture of the entrepreneur in the same  
 484 manner in which we always, in science as well as in practical life, try to understand  
 485 human behavior, viz. by analysing the characteristic motives of his conduct.

486 • Psychology can inform economic analysis.

487 In order to develop a decent account of entrepreneurial motivations economists  
 488 may draw on psychology. Schumpeter was thus reflecting an interdisciplinary mode  
 489 (and mood) of analysis, which had had more currency but later on went out of  
 490 fashion (see Lewin 1996). In an effort to preempt objections from advocates of the  
 491 strict "revealed preferences" approach, Schumpeter (1934, p. 90) nevertheless  
 492 emphasizes that his theory is testable even by the standards of revealed preferences.

493 Any attempt to [analyze the motives of entrepreneurs' conduct] must of course  
 494 meet with all those objections against the economist's intrusion into "psychology"  
 495 which have been made familiar by a long series of writers. . . [N]one of the results to  
 496 which our analysis is intended to lead stands or falls with our "psychology of the  
 497 entrepreneur," or could be vitiated by any errors in it. Nowhere is there. . . any  
 498 necessity for us to overstep the frontiers of observable behavior. Those who do not  
 499 object to all psychology but only to the kind of psychology which we know from the

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<sup>10</sup>Schumpeter wrote the first edition of *The Theory of Economic Development* in 1911 and rewrote the text in 1926 for the second German edition, which appeared in English in 1934. Schumpeter (1934, p. ix).

traditional textbook, will see that we do not adopt any part of the time-honored picture of the motivation of the “economic man.” 500  
501

- Entrepreneurs are rational agents, but their self-utility stems from other sources. 502

Practicing what he was preaching, Schumpeter’s account of the entrepreneur and her motivational goals is a masterful demonstration of constructive destruction. 503  
504  
Schumpeter (1934, p. 91) thus emphasizes that his theory belongs in the mainstream of economic analysis as it is premised on a conventional definition of rationality as self-utility maximization. 505  
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[O]ur type. . . he may indeed be called the most rational and the most egotistical of all... And the typical entrepreneur is more self-centred than other types, because he relies less than they do on tradition and connection and because his characteristic task - theoretically as well as historically - consists precisely in breaking up old, and creating new tradition. . . . 508  
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However, it is impossible to analyze entrepreneurship if self-utility is limited to material consumption and sensuous gratification to oneself. Schumpeter (1934, p. 92–93) thus foreshadowed the current debate in economics over interpreting rationality. 513  
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But [the entrepreneur’s] conduct and his motive are “rational” in no other sense. And in no sense is his characteristic motivation of the hedonist kind. If we define hedonist motive of action as the wish to satisfy one’s wants, we may indeed make “wants” include any impulse whatsoever, just as we may define egoism so as to include all altruistic values too, on the strength of the fact that they also mean something in the way of self-gratification. But this would reduce our definition to tautology. 517  
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Hedonistically, therefore, the conduct which we usually observe in individuals of our type would be irrational. This would not, of course, prove the absence of hedonistic motive. Yet it points to another psychology of non-hedonist character, especially if we take into account the indifference to hedonist enjoyment which is often conspicuous in outstanding specimens of the type and which is not difficult to understand. 524  
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- Beyond Hedonism: Achievement and Power 530

Having clarified that a conventional, hedonistic self-utility cannot explain entrepreneurship, Schumpeter moves on to make his famous argument on entrepreneurial motivations. The motivations posited by Schumpeter (1934, p. 93) read like textbook descriptions of Schwartz’s self-enhancement values – achievement and power. 531  
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First of all, there is the dream and the will to found a private kingdom, usually, though not necessarily, also a dynasty. . . Its fascination is specially strong for people who have no other chance of achieving social distinction. The sensation of power and independence loses nothing by the fact that both are largely illusions. . . Then there is the will to conquer: the impulse to fight, to prove oneself superior to others, to succeed for the sake, not of the fruits of success, but of success itself. . . And again we are faced with a motivation characteristically different from that of 536  
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543 “satisfaction of wants” in the sense defined above, or from, to put the same thing  
544 into other words, “hedonistic adaptation.”

545 • Beyond Hedonism: Self-Direction and Stimulation

546 The desire to demonstrate achievement and power (but mostly achievement)  
547 does not exhaust entrepreneurial motivations. Next, Schumpeter (1934, p. 93–94)  
548 turns to the more elusive motivations, those of openness-to-change in the Schwartz  
549 model - self-direction and stimulation.

550 Finally, there is the joy or creating, of getting things done, or simply of exercis-  
551 ing one’s energy and ingenuity. This is akin to a ubiquitous motive, but nowhere  
552 else does it stand out as an independent factor of behavior with anything like the  
553 clearness with which it obtrudes itself in our case. Our type seeks out difficulties,  
554 changes in order to change, delights in ventures. This group of motives is the most  
555 distinctly anti-hedonist of the three.

#### 556 4 The Cultural Context

557 This chapter focuses on entrepreneurial motivations as representations of the  
558 “entrepreneurial spirit.” The analysis therefore takes place at the individual level.  
559 The literature, however, has noted the importance of the social context in which  
560 individuals engage in entrepreneurial action. Schumpeter (1934, p. 91) put forward  
561 this insight long ago in his discussion of the sources of economic motivations in  
562 general, again foreshadowing insights from modern economic sociology:

563 [We should] recognise that economic motive so defined varies in intensity very  
564 much in time; that it is society that shapes the particular desires we observe; that  
565 wants must be taken with reference to the group which the individual thinks of  
566 when deciding his course of action – the family or any other group, smaller or larger  
567 than the family;. . . that the field of individual choice is always, though in very  
568 different ways and to very different degrees, fenced in by social habits or conven-  
569 tions and the like.

570 Ample research indeed documents the importance of family background, prior  
571 education, social connections and networks, and so forth for effectuating entrepre-  
572 neurial potential.<sup>11</sup> In particular, social norms in individuals’ environment have  
573 been shown to affect their choice to become entrepreneurs even for a lower income  
574 (Giannetti and Simonov 2004).

575 At the highest level of social context, there is virtual consensus in the entre-  
576 preneurship literature that culture bears a profound impact on all facets of entre-  
577 preneurship in societies (see Hayton et al. 2002; Licht and Siegel 2006 for surveys).  
578 This literature almost invariably draws on a theory of cultural value dimensions

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<sup>11</sup> See, e.g., Shane (2000); Saxenian (2002); Guiso and Schivardi (2005); Djankov et al. (2005, 2006); Gompers et al. (2005).



advanced by Hofstede (1980, 2001).<sup>12</sup> These culture-level dimensions are conceptually different from individual-level value dimensions such as those from Schwartz discussed above. Without elaboration, extant literature seems to suggest that cultures exhibiting high individualism, high masculinity, low uncertainty avoidance, and low power distance in Hofstede's model are more conducive to entrepreneurship. Much of this literature exhibits considerable methodological disarray, however (Licht and Siegel 2006). According to Hofstede (2001, p. 164), low uncertainty avoidance "implies a greater willingness to enter into unknown ventures." Other studies are consistent with the idea that a climate of high uncertainty avoidance in large organizations pushes enterprising individuals to go out and create their own businesses (Hofstede et al. 2004; Wennekers et al. 2007). In a joint study with Siegel and Schwartz, using a culture-level value dimension model from Schwartz (1999, 2006), we link higher entrepreneurship levels with lower scores on harmony, a cultural orientation related to societal disapproval of assertive change and of venturing (Siegel et al. 2007a). This relation is observed using data from the Global Entrepreneurship Monitor (GEM) as well as data on firm-age-skewness or firm-employment-size-skewness (Alfaro and Charlton 2006).

The literature on the link between culture and entrepreneurship at the national level is still making its first steps. Because culture is a fundamental, deep-seated social institution, its influence on entrepreneurship flows through numerous causal channels. A central channel is individual value priorities. The cultural theories from Hofstede and Schwartz postulate that cultural orientations may significantly affect individual value priorities in the nation.<sup>13</sup> These value priorities include the ones described above as defining the entrepreneurial spirit – namely, high achievement, self-direction, and stimulation. The propensity to engage in entrepreneurship – in other words, the intensity of entrepreneurial spirit – consequently may be affected by the surrounding culture. It is therefore possible to speak not only about entrepreneurial individuals but also about entrepreneurial nations. These are nations whose cultural profile reflects a lower emphasis on uncertainty avoidance or on harmony.

Against this backdrop, policy makers might wonder whether entrepreneurship can be taught? Some optimistic commentators believe that it can. According to Kuratko (2005), "the question of whether entrepreneurship can be taught is obsolete." More level-headed economists point out that the contributions of Schumpeter, Knight, and Kirzner notwithstanding, economics' "limited concept of uncertainty (mere probabilistic risk) sheds little light on how entrepreneurs make decisions in situations characterized by ambiguity regarding key decision variables" (Klein and Bullock 2006).

Granted, numerous technical aspects of engaging in entrepreneurial action can be taught. For instance, the government can provide information – in training centers, through educational programs, in internet websites, etc.- on such issues

<sup>12</sup>HOFSTEDE (1980, 2001).

<sup>13</sup>I assume for convenience, yet in line with the general literature, that each nation represents a single culture.

619 as different corporate forms and their relative advantages, regulatory requirements  
620 for doing business in various industries, etc. This kind of training may be valuable  
621 for entrepreneurs in that it would lower their learning costs (and transaction costs  
622 more generally). Such training, however, has nothing to do with acquiring entrepre-  
623 neurial inclinations, which, it is argued, stem from value priorities.

624 The mechanisms leading to value acquisition are believed to be effective mostly  
625 at pre-adolescence age. These mechanisms are influenced by an individual's par-  
626 enting and other life circumstance (Goodnow 1997). Studies thus have found  
627 interrelations between parenting style, personality traits, entrepreneurial orien-  
628 tation, and entrepreneurial career prospects among German subjects (Schmitt-  
629 Rodermund and Vondracek 2002; Schmitt-Rodermund 2004). Cultural value  
630 orientations are societies' most basic equilibria on normative issues. Cultural  
631 change in terms of significant shifts in value orientations likely takes place very  
632 slowly, because of the nature of these orientations as equilibria, or in response to  
633 major exogenous shocks. For this and for other reasons, culture is widely believed  
634 to be relatively stable over long time periods (e.g., Roland 2004). The causal link  
635 from cultural orientations to individual entrepreneurial value priorities con-  
636 sequently would be stable as well and difficult to change. The upshot is that cultural  
637 values may induce path dependence in entrepreneurial activity (Woodruff 1999).  
638 Many studies indeed find continuity in a country's proclivity for entrepreneurial  
639 activity (Minniti et al. 2005). In one case, when the British government under  
640 Margaret Thatcher attempted to establish an "enterprise culture" in the United  
641 Kingdom, the result was failure (Della Guista and King 2006).

## 642 **5 Can Legal Measures Foster Entrepreneurship?**

### 643 **5.1 Law in Context**

644 Legal measures are the primary tool in the hands of policy makers to engender  
645 social change. Other than legal reform, the government can intervene with a view to  
646 changing an existing equilibrium in the economy either through fiscal measures or  
647 through engaging directly in business activities. (The latter practice has lost its  
648 luster in most Western economies, however). In light of the theory – and recently,  
649 also evidence – that entrepreneurship is pivotal in processes of economic growth,  
650 the question arises whether legal measures could be used by policy makers to  
651 promote entrepreneurship. This part explores this subject, first, on a general level  
652 and, later, with regard to specific legislation that considers entrepreneurship from  
653 the womb to the tomb – i.e., from setting up a business firm to bankruptcy.

654 A strict construction of the preceding analysis on the role of culture might  
655 suggest that culture fully determines entrepreneurship in a society such that *any*  
656 effort targeted to foster entrepreneurship would be doomed. Acs and Laszlo (2007),  
657 in a recent special journal issue on entrepreneurship policy, thus conclude that

“government policy aimed at promoting entrepreneurship or influencing relevant factors cannot be effective in the short run, primarily because of cultural embeddings.” The present theory on entrepreneurial values elucidates why this may indeed be the case. The lesson for policy makers should be that measures aimed to fostering entrepreneurship probably should take the surrounding culture into account. At the current state of our knowledge, this is more easily said than done.

Entrepreneurship-promotion programs, centers, and documents, prepared by academics and other commentators alike, are aplenty nonetheless. Policy recommendations that are being proposed in connection with promoting entrepreneurship are not significantly different than the standard reform packages that are intended to promote market economies in general. Acs and Laszlo’s (2007) account exemplifies the sweeping character that such policy recommendations could take. Their list includes trade policy, immigration policy, access to foreign technology, education, science and technology policy, and, finally, litigation and regulation. Baumol et al. (2007) offer a similarly broad program (see also Boadway and Jean-François 2005; Dixon et al. 2006). While there is no denying that all of the abovementioned issues may bear on entrepreneurship, for the most part they are not limited to entrepreneurship. These issues define economic policy in general – and sometimes much broader policies than economic alone (consider immigration policy) – such that “entrepreneurship” is merely a rallying cry for economic reform, warranted as it may be. Absent a preexisting political conviction, a general analysis of the different public policy measures that could be taken in connection with entrepreneurship is bound to yield ambiguous conclusions.

## 5.2 Improving Legality

Still on a general level of analysis, a broad consensus among economists holds that social institutions – in particular, “well-defined property rights” and the “rule of law” – are key for economic growth (e.g., Rodrik et al. 2004; Acemoglu and Johnson 2005).<sup>14</sup> The former institution derives from basic welfare theory in economics. In order to enable welfare-enhancing transactions the subject matter of each transaction – who owns what – must be agreed between the parties in privy and also with all third parties.<sup>15</sup> The latter institution, also called “legality”, refers to a set of norms and organizations that together lead to general compliance with formal legal rules. Extending this insight to entrepreneurship is straightforward. Boettke and Coyne (2003, p. 67) argue that “[t]he two most important ‘core’ institutions for encouraging entrepreneurship are well-defined property rights and the rule of law.” What is good for the economy in general is good for entrepreneurs.

<sup>14</sup>This section draws on Licht and Siegel (2006).

<sup>15</sup>It is therefore clear that the scope of “property rights” in this context is broader than the usual legal meaning and includes entitlements to obligatory rights such as debt.

694 Improving legality, runs the argument, will foster entrepreneurship (Baumol 1990;  
695 Harper 1998; Smith and Ueda 2006).

696 Extant evidence largely supports the above proposition. Examining the emer-  
697 gence of new firms in five former soviet countries, Johnson et al. (1999, 2000, 2002)  
698 find that insecure property rights – defined as frequent need to make extralegal  
699 payments (bribes), protection, or inefficient courts – were more inhibiting to  
700 entrepreneurship than inadequate finance. Desai et al. (2003), using a measure  
701 that intertwines both formal delineation and actual protection of property rights,  
702 find that in the emerging markets of Europe, greater fairness and more property  
703 rights protection increase entry rates, reduce exit rates, and lower skewness in firm-  
704 size distribution. Theory and evidence are not limited to transition economies,  
705 however. Laeven and Woodruff (2007) find that in Mexico, states with more  
706 effective legal systems have larger firms, suggesting that a rule-of-law state enables  
707 entrepreneurial firms to grow by reducing idiosyncratic risk. Finally, Perotti and  
708 Volpin (2007) advance a political economy model and evidence suggesting that  
709 lack of political (democratic) accountability and economic inequality hinder entry  
710 through decreased investor protection.

711 The problem with policies intended to improve legality and other related social  
712 institutions such as absence of corruption, is that these institutions prove to be very  
713 stable. In particular, while these institutions exert a strong influence on a host of  
714 social outcomes, including economic development and infant mortality, recent  
715 contributions suggest that economic development feeds back to these institutions  
716 only weakly or not at all (Acemoglu et al. 2005; Kaufmann and Kraay 2002;  
717 Rigobon and Rodrik 2005). In collaborative studies with Schwartz, Siegel, and  
718 Goldschmidt, we show that these fundamental institutions, dubbed social norms of  
719 governance, are strongly affected by cultural orientations – a finding that helps  
720 explain the stability of these institutions (Licht et al. 2007; Siegel et al. 2007b). The  
721 upshot is that significant improvements in entrepreneurship levels through improve-  
722 ment in legality are unlikely to take place in the short run.

### 723 **5.3 Targeted Legislation: Entry**

724 An efficient way to promote entrepreneurship through legislation could be to  
725 eliminate unnecessary transaction costs. Suppose that in a particular country –  
726 say, Italy – an entrepreneur needs to follow 16 different procedures, pay nearly  
727 US\$4,000 in fees, and wait some 62 business days for the necessary permits, while  
728 in another country, Canada, the same process on average takes two business days,  
729 requires only two procedures, and costs about US\$280 in fees (Djankov et al. 2002).  
730 Few legal reforms look more straightforward than cutting down such superfluous  
731 red tape in Italy.

732 The link between entrepreneurship and regulatory costs of entry, measured by  
733 indicators of necessary steps, time, and money required for setting up a simple

business firm, turns out to be more elusive, however. Ho and Wong (2007), using GEM data, distinguish three types of entrepreneurship: opportunity-driven (i.e., when entrepreneurs pursue a perceived business opportunity), necessity-driven (when other options for economic activity are lacking), and high-growth potential (when there are expectations for employment growth, market impact, globalization, and use of new technology). In very simple specifications, regulatory costs were found to be negatively linked only to opportunity entrepreneurship, especially in high-income countries. However, no significant link was found either to necessity-driven entrepreneurship and, more surprisingly, to high-growth potential entrepreneurship. Using a more nuanced empirical specification, André van Stél et al. (2007) find that these regulatory costs are unrelated to the formation rate of either nascent or young (opportunity-driven or necessity-driven) business firms. An exception is minimum capital requirements, which indeed have been criticized in the legal literature as redundant and overly burdensome in general (Enriques and Macey 2001).

More research is warranted beyond these preliminary findings. Van Stél et al. conjecture that their surprising result may be due to creative entrepreneurs who somehow find their way around the number of procedures or the amount of time that is required to start up a business. One may note that according to Djankov et al. countries with heavier regulation of entry have higher corruption, while countries with more democratic and limited governments have lighter regulation of entry. Klapper et al. (2006) document a correlation between more intensive entry regulation and lower firm growth as well as lower entry regulation in less corrupt countries. Regulatory entry barriers have no adverse effect on entry in corrupt countries, however. It may be the case that highly motivated entrepreneurs avoid the bureaucratic burden by paying bribes or simply by operating in the unofficial economy (black market). At the same time, in corrupt countries, entry into the official economy is already strongly deterred by systemic institutional weaknesses, including tax rates, corruption, greater incidence of mafia protection, and less faith in the court system (Johnson et al. 2000). The latter conjecture points again to the predominant role of culture in influencing social norms on corruption.

#### **5.4 Targeted Legislation: Exit**

Facilitating entrepreneurial activity directly through lower transaction costs of entry does not appear to be a promising strategy in light of currently available evidence. Perhaps, then, policy makers could encourage entry indirectly, by ameliorating entrepreneurs' fear of economic loss – e.g., by making business failure less costly in bankruptcy proceedings. Recall, however, that entrepreneurs are already over-optimistic, above and beyond the level of over-optimism documented in the general population. In particular, financial loss does not deter determined entrepreneurs, who are not “in it for the money,” from engaging in new venture creation.

774 Mitigating the financial adversities of business failure therefore may or may not  
775 have the intended effect of increasing entrepreneurial activity.<sup>16</sup>

776 Much of the law and economics theory on bankruptcy has dealt with corporate  
777 bankruptcy. For the entrepreneur, however, the relevant bankruptcy in terms of her  
778 economic incentives is personal bankruptcy, in which she is called to satisfy her  
779 debts from her personal assets. The typical scenario of personal bankruptcy deals  
780 with consumers, such as those defaulting on their credit card debt or mortgage  
781 payments. Entrepreneurs may face personal bankruptcy proceedings if they oper-  
782 ated through an unincorporated firm. In theory, establishing a firm – in most cases, a  
783 corporation of one sort or another – should entitle the entrepreneur *qua* shareholder  
784 to shield her personal assets from the firm’s creditors thanks to the corporation’s  
785 separate legal personality and to her limited liability. In practice, proprietors  
786 of small businesses operating through a corporation are frequently required by  
787 their lender to provide collateral and/or personally guarantee the firm’s debts.  
788 Small entrepreneurs consequently face potential unlimited exposure to their  
789 firm’s liabilities.

790 By declaring bankruptcy the debtor may be able to get a “fresh start” if the  
791 bankruptcy court does not subject her future earnings to her past liabilities. This  
792 type of release is possible under Chap.7 of the US Federal Bankruptcy Code  
793 (11 U.S.C. §701 *et seq.* 2007), which provides for “liquidation,” namely, the sale  
794 of a debtor’s nonexempt property and the distribution of the proceeds to creditors.  
795 Although personal bankruptcy procedures in the United States are primarily tar-  
796 geted for consumers such as those defaulting on their credit card debt or mortgage  
797 payments, entrepreneurs may take advantage of them as well. The Federal Code  
798 leaves room for state legislatures to exempt certain past assets from future liabil-  
799 ities, the most important of which is the homestead exemption.<sup>17</sup>

800 The homestead exemption essentially creates a “wealth insurance” scheme for  
801 the debtor (Wei and White 2003). Even if the business failed, and even if the  
802 entrepreneur had to expose her personal wealth to such failure, the exemptions  
803 provide a sort of cushion to soften the fall. This insight has led academics recently  
804 to advocate a more entrepreneur-friendly bankruptcy law to encourage more vibrant  
805 entrepreneurship activity (Lee et al. 2007; Baumol et al. 2007). Hahn (2006)  
806 tellingly dubbed his proposal for a swifter, more forgiving discharge in bankruptcy  
807 “velvet bankruptcy.”

[AU8]

[AU9]

<sup>16</sup>Another potential adversity of bankruptcy is acquiring a social stigma of failure. I abstract from this aspect here. For a short discussion and further references, see Hahn (2006).

<sup>17</sup>There exists an alternative procedure to Chap.7 liquidation in Chap.13 of the Code. According to Berkowitz and White (2004, p. 71), “exemption levels are likely to have similar effects on credit markets regardless of the chapter that business owners would choose if they filed for bankruptcy.” Another alternative procedure exists when a debtor files for bankruptcy under Chap.11, which provides for reorganization. The debtor usually proposes a plan of reorganization to keep the business alive and pay creditors over time. Baird and Morrison (2005) have found that the vast majority of Chap.11 cases deal with small business entrepreneurs trying to extend the life of their business through these proceedings. Bankruptcy judges are aware of and guard against such efforts.

Such exemptions – and leniency in bankruptcy in general – is a double-edged sword, however. On the one hand, the wealth insurance may promote entrepreneurial initiatives as it ameliorates the entrepreneur’s fear of losing her home. On the other hand, like any other insurance, this exemption may create a moral hazard problem vis-à-vis the entrepreneur’s lenders, thus exacerbating the entrepreneur’s credit constraints. In a theoretical model and numerical simulation, White 2005; see also Akyol and Athreya (2005) argues that

the fresh start is economically efficient except when debtors behave strongly opportunistically. . . . If opportunistic behavior is non-existent or weak, then the optimal policy is the fresh start combined with the highest wealth exemption. . . . However if some or all debtors are strongly opportunistic, then the fresh start policy sometimes becomes inefficient.

Empirical studies by White and colleagues find support for both facets of the dilemma. Fan and White (2003) find that families are more likely to own and start businesses if they live in states with higher bankruptcy exemption levels (see also Armour and Cumming 2005). In tandem, Berkowitz and White (2004) show that lenders are more likely to turn down small firms in states that have higher exemptions. The question which effect dominates thus becomes an empirical one – that is: are potential entrepreneurs highly opportunistic or not? From a policy perspective, the dilemma becomes more complicated because the same set of exemptions is currently available both to consumers and to entrepreneurs. The issues become complex further yet when the entrepreneur can choose to conduct business in a neighboring jurisdiction with more favorable exemptions. Mathur (2005) indeed finds that higher bankruptcy exemptions in neighboring states lower the probability of starting a business in the state of residence. This, in turn, may engender a race among states to attract entrepreneurs to conduct business in and perhaps even migrate to their jurisdiction.

Lest the reader thought that the problem becomes intractable, two recent studies by Hall and colleagues cast a shadow over the entire discussion. These researchers investigated how the bankruptcy homestead exemptions influence rates of entrepreneurship over time in eight US states, with entrepreneurship being represented as the share of business proprietors (regardless if that business is incorporated) in the working-age population. These researchers find an S-shaped relationship between the homestead exemption and entrepreneurship. Specifically, an increase in the homestead exemption from very low or very high levels acts to reduce the number of entrepreneurs, while an increase in the middle range acts to increase the number of entrepreneurs.

The results are striking. Garrett and Wall (2006) unequivocally indicate that the best policy for promoting entrepreneurship is zero exemption. Georgellis and Wall (2006) at first blush suggests that there may be some room for promoting entrepreneurship through a homestead exemption in approximately the 50–70% range. In a personal exchange with the present author, however, Wall advised that the differences between the two studies may stem from a small difference in year coverage of the data and, more importantly, that the positive section of the curve from Georgellis and Wall (2006) may not be significantly different from zero.

853 Stated otherwise, these econometric analyses, which appear the most sophisticated  
 854 thus far, suggest that the best entrepreneurship-promoting policy would advocate  
 855 abolishing the homestead altogether. Perhaps entrepreneurs are too highly opportu-  
 856 nistic, as White has cautioned; perhaps lenders cannot distinguish entrepreneurship-  
 857 debtors from consumption-debtors; perhaps the reason remains to be discovered.

## 858 6 Conclusion

859 Inspired by Schumpeter's seminal depiction of the entrepreneur, this chapter sought  
 860 to recast this heroic portrait in a more rigorous theoretical framework. To this end, I  
 861 leverage a model of value preferences developed by Schwartz. The entrepreneurial  
 862 spirit, it is argued, consists of particular value preferences: high self-enhancement  
 863 and high openness-to-change. These hypotheses are consistent with extant empiri-  
 864 cal evidence. The upshot of this theory – especially when the stability of cultural  
 865 value orientations is taken into account – is that individual propensities to engage in  
 866 new venture creation may not be very amenable to policy measures. Looking  
 867 specifically at legal rules, this chapter attempted to identify measures that could  
 868 be narrowly targeted at promoting entrepreneurship by making entrepreneurs even  
 869 more highly motivated than what they appear to be. Recent research indicates,  
 870 however, that theoretical and empirical issues, which must be resolved before such  
 871 measures could be employed with confidence, are intractable at this point.

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