

# THE ENTREPRENEURIAL SPIRIT AND WHAT THE LAW CAN DO ABOUT IT

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## I. INTRODUCTION

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. This paper therefore asks a simple and at the same time crucial question: What makes some people more entrepreneurial than others? A companion question follows almost immediately: Can policy-makers do something to promote entrepreneurship?

It may come as a surprise to some that until quite recently, the belief that entrepreneurship is socially beneficial has been precisely that—a belief. The empirical literature has been surprisingly small, and studies have not unequivocally established a clear positive role for the level of entrepreneurship in enhancing economic growth.<sup>1</sup> This situation is gradually changing, thanks primarily to the Global Entrepreneurship Monitor (GEM) project, which gathers data on entrepreneurship indicators in a growing number of countries around the world. Studies using the GEM data find that entrepreneurship

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1. For a survey of the literature on entrepreneurship and economic growth, see Martin Carree & A. Roy Thurik, *The Impact of Entrepreneurship on Economic Growth*, in HANDBOOK OF ENTREPRENEURSHIP RESEARCH 437 (David B. Audretsch & Zoltan J. Acs eds., 2003). See generally MARTIN A. CARREE & A. ROY THURIK, THE HANDBOOK OF ENTREPRENEURSHIP AND ECONOMIC GROWTH (2006). For a good institutional discussion, see Peter J. Boettke & Christopher J. Coyne, *Entrepreneurship and Development: Cause or Consequence?*, 6 ADVANCES IN AUSTRIAN ECON. 67 (2003).

may be conducive to economic growth, although the relations may not be monotonic.<sup>2</sup>

Unemployment presents policy-makers with an even more pressing dilemma. Superficial comparisons between the United States and the European Union may lead one to believe that job creation must go hand in hand with dismantling costly social safety nets in order to encourage hiring more workers. Otherwise, goes the argument, developed countries will not be able to compete in the globalizing economy. Sidestepping the merits of this debate, entrepreneurship may present a way out of this conundrum in light of evidence that entrepreneurship increases employment.<sup>3</sup>

To answer the questions posed at the beginning of the text, this article returns to Joseph Schumpeter's *Theory of Economic Development*.<sup>4</sup> I argue that Schumpeter was right when he described entrepreneurs as special people. While there are several economic accounts of the functions entrepreneurs fulfill in the economy, Schumpeter's account remains most insightful in capturing the essential qualities that distinguish entrepreneurs from others in society. The central goal of this article is to recast Schumpeter's depiction of the entrepreneur in modern economic and psychological terms. A sizable body of literature has examined some psychological traits of entrepreneurs. The greatest amount of attention has been paid to entrepreneurs' attitudes toward risk and to their need for achievement. Work has also been done on entrepreneurial perception. In comparison, the motivational goals that guide entrepreneurs as they choose an entrepreneurial course of action have been relatively neglected. These motivational goals, or value preferences, constitute the "entrepreneurial spirit."

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2. See, e.g., André van Stel, Martin Carree & Roy Thurik, *The Effect of Entrepreneurial Activity on National Economic Growth*, 24 SMALL BUS. ECON. 311, 316-18 (2005) (finding that entrepreneurial activity affects economic growth at higher levels of national wealth); Poh Kam Wong, Yuen Ping Ho & Erkkö Autio, *Entrepreneurship, Innovation and Economic Growth: Evidence from GEM Data.*, 24 SMALL BUS. ECON. 335, 345 (2005) (finding that only "high growth potential" entrepreneurship, as defined by GEM, affects economic growth positively); Sander Wennekers et al., *Nascent Entrepreneurship and the Level of Economic Development*, 24 SMALL BUS. ECON. 293, 293 (2005) (finding a U-shape relationship between entrepreneurship and economic development).

3. See Roy Thurik, *Entrepreneurship and Unemployment in the UK*, 50 SCOTTISH J. POL. ECON. 264, 265 (2003). For a short survey of related research, see Rui Baptista, André J. Van Stel & A. Roy Thurik, *Entrepreneurship, Industrial Restructuring and Unemployment in Portugal*, in ENTREPRENEURSHIP, GROWTH, AND INNOVATION: THE DYNAMICS OF FIRMS AND INDUSTRIES 223 (E. Santarelli ed. 2006).

4. JOSEPH A. SCHUMPETER, *THE THEORY OF ECONOMIC DEVELOPMENT* (Redvers Opie trans., Transaction Publishers 1983) (1912).

This article hypothesizes that beyond seeking material success the crucial element in the entrepreneurial spirit is openness to change—an interest in the different and in new experiences while deemphasizing the safe and the proven. It is further hypothesized that when entrepreneurs are guided by their entrepreneurial spirit, they also exhibit a particular mode of information processing, or cognitive style. In both aspects—namely, value preferences and cognitive style—what makes entrepreneurs special is their attitude toward uncertainty more than toward simple risk. Thus depicted, the Schumpeterian portrait of the entrepreneur is not entirely consistent with the standard depiction of economic actors in neo-classical economics. Yet this portrait is truer to reality. It can thus help us understand the cultural and legal institutions that bear on entrepreneurship.

The paper proceeds as follows. Section II surveys the literature on the nature and characteristics of the entrepreneur from two perspectives: economic and psychological. In particular, this section tries to glean the literature's view on whether entrepreneurs are special individuals or rather ordinary people channeled by circumstances to engage in new venture creation. Section III addresses the first part of this article's title by putting forward a small theory on entrepreneurial motivations and arguing that these motivations constitute the entrepreneurial spirit. Entrepreneurial motivations are claimed to stem from particular individual value preferences according to a theoretical model developed by psychologist Shalom Schwartz. Based on this model, this section then derives testable hypotheses, with which Schumpeter's seminal account of the entrepreneur is highly consistent. Section IV briefly discusses the cultural context of entrepreneurship, primarily to underscore the stability of informal social institutions. Section V addresses the latter part of this article's title: Can law help in fostering entrepreneurship? After briefly discussing the importance and (un)likelihood of improving the general legal infrastructure, I address legal measures that regulate the birth of a new venture (i.e., entry) and its death (i.e., bankruptcy). In both cases, it appears, there is disappointingly little room for effective intervention targeted at fostering entrepreneurship. Section VI concludes.

## II. PORTRAITS OF THE ENTREPRENEUR

### A. *Defining Entrepreneurship*

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.<sup>5</sup> The etymology of “entrepreneurship” derives from French and German words for “undertaking” (*entreprendre*, *unternehmen*, respectively). The first to use this term was French economist Richard Cantillon. Cantillon was followed by Scottish and English economic thinkers such as Adam Smith and John Stuart Mill, who introduced “entrepreneur” and “entrepreneurship” into the English language. Yet the linguistic exercise does not convey the full meaning of being an entrepreneur. As David Gumpert noted, entrepreneurship “is the stuff of which American heroes are made.”<sup>6</sup>

A good definition of entrepreneurship thus 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 section 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, Section C reviews some personal psychological traits that have been associated with individuals’ tendency toward entrepreneurship.<sup>7</sup>

### B. *The Entrepreneur in Economics*

In the standard neo-classical economics of the late nineteenth century, the economy is seen from a general equilibrium perspective. Scarce resources find their way to the most productive uses thanks to market transactions that lead to equalizing marginal costs and utilities.

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5. See Jan Ulijn & Terrence E. Brown, *Innovation, Entrepreneurship and Culture: A Matter of Interaction between Technology, Progress and Economic Growth? An Introduction*, in INNOVATION, ENTREPRENEURSHIP AND CULTURE: THE INTERACTION BETWEEN TECHNOLOGY, PROGRESS AND ECONOMIC GROWTH 1 (Terrence Brown & Jan Ulijn eds., 2003).

6. David E. Gumpert, *Stalking the Entrepreneur*, 64 HARV. BUS. REV. 32, 32, cited in Robert F. Hébert & Albert N. Link, *In Search of the Meaning of Entrepreneurship*, 1 SMALL BUS. ECON. 39, 39 (1989).

7. For the present purposes, I abstract from non-economic entrepreneurship. Entrepreneurial action, however, also takes place outside of the business context or even the economic realm. Establishing a new charity is entrepreneurial and establishing a non-governmental organization (NGO), let alone a new political party, are as entrepreneurial as establishing a new start-up company. I believe that the analysis of the entrepreneurial spirit presented here holds with equal force to social entrepreneurship.

This yields the greatest utility subject to existing constraints. In this environment, firms are the economic actors (beyond workers), and the entrepreneur is nothing more than a person owning a firm. Things don't change in such a general equilibrium. There is no room for entrepreneurship.<sup>8</sup> This section reviews the major contributions by economists who nevertheless carved a special role for entrepreneurs.

Prominent economists from the eighteenth and nineteenth centuries have recognized the pivotal role of entrepreneurship in the economy as the source of change, development, and progress.<sup>9</sup> Cantillon (1697–1734) observed that traders may face an uncertain price for a product—say, a finished good for which the raw materials have a certain price. In making the decision to transact, an entrepreneurial trader assumes the concomitant risk. Adam Smith (1723–1790), in his 1776 *Wealth of Nations*, refers to an “enterpriser” as the individual who sets up a firm for commercial purposes, thereby participating and facilitating economic processes. Smith's enterpriser is more of a firm owner, however. In an economy run by the “invisible hand” there was not much place for visible change-inducers. In contrast, French economist Jean Baptiste Say (1767–1832), in an 1803 treatise, gave entrepreneurs pride of place. According to Say, entrepreneurs are individuals that have special skills for identifying ways to fulfill people's economic needs by creating new economic ventures. John Stuart Mill (1806–1873) too had underscored the importance of entrepreneurship for economic growth and argued that entrepreneurship involves special skills. Finally, among the classic economic thinkers mention should be made to Alfred Marshall's (1842–1924) view. Marshall's entrepreneur was primarily an organizational expert but also one who could foresee new products or changes in supply or demand. This required a rare combination of skills.<sup>10</sup>

In a survey of conceptualizations of entrepreneurship, Hébert and Link find no less than twelve distinct themes in the economic

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8. Note that market failures, ranging from public good provision to transaction costs problems, do not derogate from the general observation.

9. The following draws primarily on C. Mirjam Van Praag, *Some Classic Views on Entrepreneurship*, 147 *DE ECONOMIST* 311 (1999), and on Hébert & Link, *supra* note 6. See Howard H. Stevenson & Carlos J. Jarillo, *A Paradigm of Entrepreneurship: Entrepreneurial Management*, 11 *STRATEGIC MGMT. J.* 17 (1990); William B. Gartner, *What Are We Talking About When We Talk About Entrepreneurship?*, 5 *J. BUS. VENTURING* 15 (1990); Raymond W.Y. Kao, *Defining Entrepreneurship: Past, Present and?*, 2 *CREATIVITY & INNOVATION MGMT.* 69 (1993). See generally MARK CASSON, *ENTREPRENEURSHIP* (1990).

10. See van Praag, *supra* note 9, at 317–19.

literature.<sup>11</sup> This is not to say that contemporary economics has resolved the issue of what entrepreneurship is and now fully incorporates entrepreneurship into economic modeling. Quite the contrary.<sup>12</sup> What we have is a number of conceptualizations of entrepreneurs and entrepreneurship, coexisting side by side, to which we now turn.

Schumpeter continued the work of Cantillon by developing a theory of economic development as a dynamic process of change. In a continuing “circular flow of economic life,” the economy never reaches an equilibrium but rather shifts from one disequilibrium to another. The entrepreneur in the Schumpeterian scheme provides the driving force in the mechanism of change. She brings about the famous “constructive destruction” by finding new combinations for production. For Schumpeter, doing something new is a constitutive element of entrepreneurship: “the carrying out of new combinations we call ‘enterprise’; the individuals whose function it is to carry them out we call ‘entrepreneurs.’”<sup>13</sup> The formation of a new firm is the most typical way for effecting a new combination.<sup>14</sup>

The Schumpeterian entrepreneur is a special person.<sup>15</sup> She differs from other providers of resources such as land, financial capital, labor, and even from inventors who provide patents. Although she may perform these tasks too, and may enjoy a particular advantage if she possesses financial resources, the entrepreneur’s main function is to overcome the difficulties engendered by uncertainty.<sup>16</sup> A central premise in Schumpeter’s theory—which is the focus of this article—is that entrepreneurs have special skills for innovation and for dealing with uncertainty, although the latter quality is relatively less prominent in Schumpeter’s account.<sup>17</sup>

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11. Hébert & Link, *supra* note 5, at 41. Specifically, these themes are: (1) the person who assumes the risk associated with uncertainty; (2) the person who supplies financial capital; (3) an innovator; (4) a decision maker; (5) an industrial leader; (6) a manager or superintendent; (7) an organizer and coordinator of economic resources; (8) the owner of an enterprise; (9) an employer of factors of production; (10) a contractor; (11) an arbitrageur; and, (12) an allocator of resources among alternative uses. *Id.*

12. See Gartner, *supra* note 9.

13. SCHUMPETER, *supra* note 4, at 74.

14. Van Praag, *supra* note 5, at 320. In later writings, Schumpeter argued that innovation concentrate in large monopolies. Van Praag, *id.*

15. JOSEPH A. SCHUMPETER, *ESSAYS OF J.A. SCHUMPETER* 248 (1951) (arguing that entrepreneurship requires “no ordinary skill”).

16. Joseph A. Schumpeter, *The Instability of Capitalism*, 38 *ECON. J.* 361, 379–80 (1928) (The difficulty of successful innovation consists in “the resistances and uncertainties incident to doing what has not been done before, it is accessible for, and appeals to, only a distinct type which is rare.”).

17. See *infra*, Section III.C.

Frank Knight (1885–1972) provided sound theoretical underpinnings to the observations made by Schumpeter, and previously by Cantillon, with regard to the unique of role entrepreneurs have in addressing uncertainty. In his seminal 1921 book, *Risk, Uncertainty, and Profit*,<sup>18</sup> Knight introduced a rigorous distinction between risk and uncertainty. Risk represents future events whose occurrence is unknown but the parameters of which—namely, magnitude and probability—are known such that one could sell and buy insurance for such events. Uncertainty stands for the residual category of unknown future events. These events are not insurable. Entrepreneurs' unique role in the economy (and in society more broadly) consists of their willingness to bear uncertainties. The reward for bearing economic uncertainties is, according to Knight, the source of entrepreneurial profits. Because the ability for bearing economic uncertainty is not common, entrepreneurial profits are somewhat akin to monopoly profits. Like Schumpeter and previous writers, Knight too believed that people differ in the qualities necessary to engage in entrepreneurship.<sup>19</sup> Relative to the average person, the entrepreneur is therefore particularly “venturesome,” self-confident, and tends to act independently on her own opinion.<sup>20</sup>

Israel Kirzner presented another conceptualization of entrepreneurship.<sup>21</sup> Kirzner's entrepreneur resembles Schumpeter's in that both are agents of change in the economy. Kirzner's entrepreneur engages in identifying profit opportunities and exploiting them. She matches unmet demand with untapped supply and vice versa; she finds more profitable sources or outlets; she sees the value in modifying outputs. The similarity to Schumpeter's entrepreneur is considerable because both entrepreneurs carry out

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18. FRANK H. KNIGHT, *RISK, UNCERTAINTY, AND PROFIT* (1921), available at <http://www.econlib.org/LIBRARY/Knight/knRUP1.html> (last accessed Jan. 9, 2007).

19. Schumpeter and Knight made their observations about the link between uncertainty and entrepreneurship at roughly the same time, during the 1920s. For further comparative discussions of Knight's and Schumpeter's theories, see Maria T. Brouwer, *Weber, Schumpeter and Knight on Entrepreneurship and Economic Development*, 12 J. EVOLUTIONARY ECON. 83 (2002).

20. KNIGHT, *supra* note 18, at 269

[M]en differ . . . in intellectual capacity to decide what should be done. In addition, there must come into play the diversity among men in degree of confidence in their judgment and powers and in disposition to act on their opinions, to 'venture.' . . . the confident and venturesome 'assume the risk' or 'insure' the doubtful and timid by guaranteeing to the latter a specified income in return for an assignment of the actual results.

*Id.* at 269–70.

21. ISRAEL M. KIRZNER, *COMPETITION AND ENTREPRENEURSHIP* (1973) [hereinafter KIRZNER, *COMPETITION*]; Israel M. Kirzner, *Entrepreneurial Discovery and the Competitive Market Process: An Austrian Approach*, 35 J. ECON. LIT. 60 (1997).

new combinations. Kirzner's entrepreneur operates primarily as a gap-closing arbitrageur, while Schumpeter's archetypal entrepreneur innovates and creates.<sup>22</sup> Furthermore, in both cases there are elements of uncertainty bearing, which bring us closer also to Knight's entrepreneur.<sup>23</sup> In all these cases, the entrepreneurial role is theoretically detached from the actual exploitation of the opportunity. Entrepreneurs qua entrepreneurs need only have the idea; they don't need to have capital because they can borrow. The unique feature distinguishing Kirzner's entrepreneur from the average person in the population is alertness. This entrepreneur sees things that others don't; she observes relevant facts and perceives their economic implications.<sup>24</sup>

Recently, Edward Lazear advanced a theory of entrepreneurship that appears detached from the entire previous literature.<sup>25</sup> In this theory too, the entrepreneur differs from most other people in the population. Counter-intuitively, however, what makes him special is that he doesn't excel in anything in particular. He is "Jack-of-all-trades."<sup>26</sup> According to Lazear, "entrepreneurs differ from specialists in that entrepreneurs have a comparative disadvantage in a single skill, but have more balanced talents that span a number of different skills. Specialists can work for others who have the talent to spot and combine a variety of skills, but an entrepreneur must possess that talent."<sup>27</sup> The theory thus attributes to entrepreneurs the ability to perceive new combinations and to carry them out. As a consequence, Lazear's theory actually continues the Schumpeter-Knight-Kirzner line of thought. In support of this theory, Lazear and others have shown that entrepreneurs have a more varied curriculum as students and tend to work in a greater number of jobs.<sup>28</sup> What factor causes

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22. Israel M. Kirzner, *Creativity and/or Alertness: A Reconsideration of the Schumpeterian Entrepreneur*, 11 REV. AUSTRIAN ECON. 5, 5-8 (1999). Kirzner emphasizes, however, that in terms of the psychological profile typical of real-world entrepreneurs as well as their role in the economy, both his and Schumpeter's portrayals are valid. *Id.* at 16.

23. Israel M. Kirzner, *Uncertainty, Discovery, and Human Action*, in ISRAEL M. KIRZNER, DISCOVERY AND THE CAPITALIST PROCESS (1982).

24. KIRZNER, COMPETITION, *supra* note 21, at 170; Kirzner, *supra* note 22, at 6-7.

25. Edward Lazear, *Entrepreneurship*, 23 J. LABOR ECON. 649 (2005) [hereinafter Lazear, *Entrepreneurship*]; see also Edward Lazear, *Balanced Skills and Entrepreneurship*, 94 AM. ECON. REV. PAPERS AND PROCEEDINGS 208 (2004) [hereinafter Lazear, *Balanced Skills*]. Indeed, Lazear does not even cite Schumpeter, Knight, or Kirzner nor does he mention uncertainty or carrying out new combinations. Query whether this is justified in light of the essence of Lazear's theory.

26. Lazear, *Entrepreneurship*, *supra* note 25, at 649.

27. *Id.* at 650.

28. Lazear, *Balanced Skills*, *supra* note 25, at 208; Joachim Wagner, *Testing Lazear's Jack-of-all-trades View of Entrepreneurship with German Micro Data*, 10 APPLIED ECON. LETTERS



entrepreneurs to pursue such paths of studies and work experience remains unresolved, however. Silva, using panel data from an Italian representative sample, argues that while entrepreneurs tend to have a broader experience, the choice to become an entrepreneur is driven by unobservable factors.<sup>29</sup> Using Swedish data, Åstebro argues that entrepreneurs have a “taste for variety.”<sup>30</sup> Santarelli and Vivarelli, in a discussion of this literature, conclude that the reason may be *ex-ante* innate characteristics.<sup>31</sup>

The economic literature has not delved into this “taste for variety” but two other personal traits of entrepreneurs have attracted some attention, namely, a preference for non-pecuniary rewards and, more specifically, a preference for autonomy.<sup>32</sup>

Hamilton finds that in the United States, median entrepreneur earnings after ten years in business are 35% less than the predicted alternative wage on a paid job of the same duration.<sup>33</sup> According to Hamilton, this evidence supports the notion that self-employment offers substantial nonpecuniary benefits, such as “being your own boss.” Moskowitz and Vissing-Jørgensen find that households are willing to invest in private firms with far worse risk-return trade-offs than public ones.<sup>34</sup> These researchers conjecture that in addition to some secondary pecuniary benefits, possible explanations for such heavy entry into entrepreneurship include high non-pecuniary benefits, entrepreneurs’ risk tolerance, a preference for return distribution skewness to the right, and over-optimism. Kerins et al. provide supporting evidence on very high cost-of-capital levels that entrepreneurs and venture capitalists are willing to bear to engage in

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687, 687 (2003); Thomas Åstebro, *Does it Pay To Be a Jack-of-All-Trades?* 2 (Rotman Sch. Mgmt., Working Paper, 2006), available at <http://ssrn.com/abstract=925221>.

29. Olmo Silva, *The Jack-of-All-Trades Entrepreneur: Innate Talent or Acquired Skill?* 2 (IZA, Discussion Paper No. 2264, 2006), available at <http://ssrn.com/abstract=928815>.

30. Åstebro, *supra* note 28, at 3.

31. Enrico Santarelli & Marco Vivarelli, *Entrepreneurship and the Process of Firms’ Entry, Survival and Growth* 20 (IZA, Discussion Paper No. 2475, 2006), available at <http://ssrn.com/abstract=950922> (“[I]ndividual unobservable characteristics may indeed simultaneously affect both skill accumulation and occupational choice, *i.e.* individuals innately well-versed in a variety of fields would have the incentive both to accumulate more balanced skills and to become entrepreneurs.”).

32. The following paragraphs draw on Amir N. Licht & Jordan I. Siegel, *Social Dimensions of Entrepreneurship*, in *THE OXFORD HANDBOOK OF ENTREPRENEURSHIP* 511 (Mark Casson et al. eds., 2006).

33. Barton H. Hamilton, *Does Entrepreneurship Pay? An Empirical Analysis of the Returns to Self-Employment*, 108 J. POL. ECON. 604, 606 (2000).

34. Tobias J. Moskowitz & Annette Vissing-Jørgensen, *The Returns to Entrepreneurial Investment: A Private Equity Premium Puzzle?*, 92 AM. ECON. REV. 745, 747 (2002).

entrepreneurial activity.<sup>35</sup> Amit et al. compared Canadian entrepreneurs with senior managers who decided not to start ventures in the high-technology sector.<sup>36</sup> In-depth interviews revealed that for entrepreneurs' decision to start a new venture, wealth attainment was significantly less important relative to an aggregate of ten other decision dimensions.<sup>37</sup>

Matthias Benz more recently generalized from this and from additional evidence to argue that in essence, entrepreneurship is a non-profit-seeking activity. According to Benz, entrepreneurs derive non-monetary benefits from engaging in entrepreneurship, primary among which is greater autonomy.<sup>38</sup> Benz's theory improves on Lazear's in that the former broadens the scope of entrepreneurs' motivations in a structured manner. The theory therefore rationalizes behavioral patterns of entrepreneurs that otherwise could have been dubbed—and likely dismissed—as irrational. In a similar vein, another common observation about entrepreneurs concerns their

35. Frank Kerins, Janet K. Smith & Richard Smith, *Opportunity Cost of Capital for Venture Capital Investors and Entrepreneurs*, 39 J. FIN. & QUANTITATIVE ANAL. 385, 387 (2004).

36. Raffi K. Amit et al., *Does Money Matter?: Wealth Attainment as the Motive for Initiating Growth-Oriented Ventures*, 16 J. BUS. VENTURING 119 (2001).

37. However, one would be wrong to interpret the evidence mentioned above as suggesting that entrepreneurs are agnostic or oblivious to financial considerations. Studies conducted in several countries show that individuals are sensitive to capital constraints in their decision to take entrepreneurial positions—in particular, self-employment. See David S. Evans & Boyan Jovanovic, *An Estimated Model of Entrepreneurial Choice under Liquidity Constraints*, 97 J. POL. ECON. 808, 823–24 (1989); David S. Evans & Linda Leighton, *Some Empirical Aspects of Entrepreneurship*, 79 AM. ECON. REV. 519, 520–21 (1989); Douglas Holtz-Eakin et al., *Entrepreneurial Decisions and Liquidity Constraints*, 25 RAND J. ECON. 334 (1994); Mirjam Van Praag & Hans van Ophem, *Determinants of Willingness and Opportunity to Start as an Entrepreneur*, 48 KYKLOS 513, 515–19 (1995); Thomas Lindh & Henry Ohlsson, *Self-Employment and Windfall Gains: Evidence from the Swedish Lottery*, 106 ECON. J. 1515 (1996); David G. Blanchflower & Andrew J. Oswald, *What Makes an Entrepreneur*, 16 J. LABOR ECON. 26, 27–28 (1998); Thomas Dunn & Douglas Holtz-Eakin, *Financial Capital, Human Capital, and the Transition to Self-Employment: Evidence from Intergenerational Links*, 18 J. LABOR ECON. 282, 283–84 (2000); Mirjam Van Praag, *Initial Capital Constraints Hinder Entrepreneurial Venture Performance: An Empirical Analysis 2–4* (CESifo, Working Paper No. 887, 2003), available at <http://ssrn.com/abstract=3867670>.

38. Matthias Benz, *Entrepreneurship as a Non-Profit-Seeking Activity* (Inst. for Empirical Res. Econ., Working Paper No. 243, 2006), available at <http://ssrn.com/abstract=733283>. For further discussion of the idea that autonomy may be a source of inherent utility, see, for example, Matthias Benz & Bruno S. Frey, *Being Independent is a Great Thing: Subjective Evaluations of Self-Employment and Hierarchy*, ECONOMICA (forthcoming 2007); see also Blanchflower & Oswald, *supra* note 37; David G. Blanchflower, *Self-employment in OECD Countries*, 7 LABOUR ECON. 471 (2000); Daiji Kawaguchi, *Positive, Non-Earnings Aspects of Self-Employment: Evidence from Job Satisfaction Scores* (Univ. of Tsukuba Inst. for Pol'y & Planning Sci., Working Paper, 2004); Sjored Beugelsdijk & Niels Noorderhaven, *Personality Characteristics of Self-Employed: An Empirical Study*, 24 SMALL BUS. ECON. 159 (2005); Marco van Gelderen, Paul Jansen & Selwyn Jonges, *The Multiple Sources of Autonomy as a Startup Motive* (SCALES, Working Paper No. 200315, 2003); Marco van Gelderen et al., *Explaining Entrepreneurial Intentions By Means of The Theory of Planned Behavior* (Working Paper, 2006).

seeming over-optimism.<sup>39</sup> If entrepreneurs derive utility from engaging in entrepreneurship per se, because they seek greater autonomy or variety in their life, then economic loss may be compensated by non-pecuniary benefits.<sup>40</sup>

### C. *Psychological Analyses of Entrepreneurial Attributes*

The notion, that entrepreneurs may have special personal attributes in comparison to the general population, hasn't gone unnoticed among psychologists. The literature on this subject is broad but quite unorganized, such that surveying it in full is well beyond the scope of the present article.<sup>41</sup> An influential 1988 article by John Gartner argued that entrepreneurship research should not focus on entrepreneurs' individual personality but rather on entrepreneurial action (i.e., venture creation), which is more socially contextual.<sup>42</sup> 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. thus had concluded that "[t]he search for an entrepreneurial personality profile was largely unsuccessful."<sup>43</sup> In recent years, however, psychologists have been revisiting the empirical literature

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39. See Gholamreza Arabsheibani et al., *And a Vision Appeared Unto Them of a Great Profit: Evidence of Self-Deception among the Self-Employed*, 67 *ECON. LETTERS* 35, 36–38 (2000) (showing that while people in general are over-optimistic, the self-employed are the most over-optimistic of all; arguing that entrepreneurs seem to be driven by wishful thinking); Antonio Bernardo & Ivo Welch, *On the Evolution of Overconfidence of Entrepreneurs*, 10 *J. ECON. & MGMT. STRATEGY* 301, 302–04 (2001) (arguing that individuals may remain over-confident in entrepreneurial settings); see also Amit et al., *supra* note 36; Arnold Cooper, Carolyn Woo & William Dunkelberg, *Entrepreneurs' Perceived Chances for Success*, 3 *J. BUS. VENTURING* 97 (1988).

40. See Åstebro, *supra* note 28; Silva, *supra* note 29; see also Santarelli and Vivarelli, *supra* note 31.

41. The pioneering work is John A. Hornaday & John Aboud, *Characteristics of Successful Entrepreneurs*, 24 *PERSONAL PSYCHOL.* 141 (1971). For detailed surveys of this subject, see Andreas Rauch & Michael Frese, *Psychological Approaches to Entrepreneurial Success: A General Model and an Overview of Findings*, in *INTERNATIONAL REVIEW OF INDUSTRIAL AND ORGANISATIONAL PSYCHOLOGY* 101 (Cary L. Cooper & Ivan T. Robertson eds., 2000); Christopher L. Shook, Richard L. Priem & Jeffrey E. McGee, *Venture Creation and the Enterprising Individual: A Review and Synthesis*, 29 *J. MGMT.* 379 (2003); see also Norris F. Krueger Jr., *The Cognitive Psychology of Entrepreneurship*, in *HANDBOOK OF ENTREPRENEURIAL RESEARCH* 105 (Zoltan J. Acs & David B. Audretsch eds., 2003).

42. William B. Gartner, *Who Is an Entrepreneur? Is the Wrong Question*, 12 *AM. J. SMALL BUS.* 11, 12 (1988). See also William B. Gartner, *Some Suggestions for Research on Entrepreneurial Traits and Characteristics*, 14 *ENTREPRENEURSHIP THEORY & PRACTICE* 27 (1989); James W. Carland, Frank Hoy & JoAnn C. Carland, *"Who is an Entrepreneur?" Is a Question Worth Asking*, 12 *AM. J. SMALL BUS.* 33 (1988).

43. Shook, Priem & McGee, *supra* note 41, at 382.

with the tool of meta-analysis such that clearer patterns are beginning to emerge.<sup>44</sup>

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.<sup>45</sup>

Need for achievement was defined by David McClelland as a motivation to excel in attaining goals in competitive settings through hard work, self-challenging, and persistence.<sup>46</sup> 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.<sup>47</sup> 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.<sup>48</sup>

Having an internal locus of control—a personality factor reflecting a belief that one can influence the outcomes of one’s life<sup>49</sup>—has also been related to an entrepreneurial personality. The extant evidence is mixed, leading Rauch and Frese to conclude that “there seems to be other variables moderating the relationship between internal locus of control and becoming a small business owner.”<sup>50</sup>

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

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44. Meta-analysis is a method for aggregating results from existing studies, where cases are studies. *See generally*, JOHN E. HUNTER & FRANK L. SCHMIDT, *METHODS OF META-ANALYSIS: CORRECTING ERROR AND BIAS IN RESEARCH FINDINGS* (1990).

45. *See* Christian Korunka et al., *The Entrepreneurial Personality in the Context of Resources, Environment, and the Startup Process: A Configurational Approach*, 28 *ENTREPRENEURSHIP THEORY & PRACTICE* 23, 24–26 (2003).

46. In McClelland’s theory of individual motivations, the need for achievement is one of three dominant motivations, together with a need for power and need for affiliation. McClelland further argued for an achievement orientation—a societal-level stance that endorses individual achievement, striving for improvement and excellence in performance. *See generally*, DAVID C. MCCLELLAND, *THE ACHIEVING SOCIETY* (1961).

47. *See* Rauch & Frese, *supra* note 41.

48. Christopher J. Collins, Paul J. Hanges & Edwin A. Locke, *The Relationship of Achievement Motivation to Entrepreneurial Behavior: A Meta-Analysis*, 17 *HUMAN PERFORMANCE* 95, 111–12 (2004).

49. Julian B. Rotter, *Generalized Expectancies for Internal Versus External Control of Reinforcement*, 80 *PSYCHOL. MONOGRAPHS: GENERAL AND APPLIED* 1 (1966).

50. Rauch & Frese, *supra* note 41.

income.<sup>51</sup> A pioneering empirical study by Robert Brockhaus failed to find support for a link between entrepreneurial action and risk-taking propensity, however.<sup>52</sup> The received wisdom about such a link subsequently was that it has not been established empirically.<sup>53</sup> 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.<sup>54</sup>

In a recent meta-analysis of risk propensity differences between entrepreneurs and managers, Wayne Stewart and William Roth 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.<sup>55</sup> While the clarification of the empirical results is commendable, it should be emphasized that the theory of entrepreneurship revolves around Knightian uncertainty, not around risk. More work is needed empirically to test this proposition, for which the currently available evidence is only indirectly relevant.

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51. Richard Kihlstrom & Jean-Jacques Laffont, *A General Equilibrium Entrepreneurial Theory of Firm Formation Based on Risk Aversion*, 87 J. POL. ECON. 719, 720 (1979). Note that while Kihlstrom and Laffont, *id.* at 720, base their theory on Knight's work, they use the term risk aversion. See also C. Mirjam van Praag & J.S Cramer, *The Roots of Entrepreneurship and Labor Demand: Individual Ability and Low Risk*, 68 ECONOMICA 45 (2001).

52. Robert H. Brockhaus, *Risk Taking Propensity of Entrepreneurs*, 23 ACAD. MGMT. J. 509, 517–18 (1980).

53. See Rauch & Frese, *supra* note 41.

54. Simeon Djankov et al., *Who are Russia's Entrepreneurs?*, 3 J. EUR. ECON. ASSOC. 587, 589 (2005) [hereinafter Djankov et al., *Russia's Entrepreneurs*]; Simeon Djankov et al., *Entrepreneurship in China and Russia Compared* (Working Paper, 2006), available at <http://ssrn.com/abstract=893326> [hereinafter Djankov et al., *Entrepreneurship in China and Russia*].

55. Wayne H. Stewart & Philip L. Roth, *Risk Propensity Differences Between Entrepreneurs And Managers: A Meta-Analytic Review*, 686 J. APPL. PSYCHOL. 145, 145, 150 (2001). An interesting exchange about certain methodological issues ensued but did not change the qualitative findings. See John B. Miner & Nambury S. Raju, *Risk Propensity Differences Between Managers and Entrepreneurs and Between Low- And High-Growth Entrepreneurs: A Reply in a More Conservative Vein*, 89 J. APPL. PSYCHOL. 3 (2004); Wayne H. Stewart & Philip L. Roth, *Data Quality Affects Meta-Analytic Conclusions: A Response To Miner And Raju (2004) Concerning Entrepreneurial Risk Propensity*, 89 J APPL PSYCHOL 14 (2004). See also T.J Kamalanabhan, D.L Sunder & Amat Taap Manshor, *Evaluation of Entrepreneurial Risk-Taking Using Magnitude of Loss Scale*, 15 J. ENTREPRENEURSHIP 37 (2006) (arguing that the main deterrent in entrepreneurship is the high stakes involved in terms of magnitude of loss). Entrepreneurs' risk propensity should be seen in a wider perspective, including over-confidence and personality traits. That entrepreneurs tend to take too much business risk is indicated by the evidence on their over-confidence. See *supra* note 39.

There are numerous additional studies examining possible links between psychological variables and entrepreneurial personal qualities. Of these, two factors in particular may be mentioned: personality traits and cognitive factors. One of the impressive trends of convergence toward scientific consensus has taken place during the last two decades with regard to psychological theory of personality traits. Traits are “dimensions of individual differences in tendencies to show consistent patterns of thoughts, feelings and actions.”<sup>56</sup> Psychologists use the five-factor model (FFM, or “Big Five model”) as the dominant approach for representing the human trait structure. The model asserts that five basic factors describe most personality traits: openness to experience, extraversion, agreeableness, conscientiousness, and neuroticism.

Researchers have used the Big Five model to predict individual differences in entrepreneurial attributes. Comparing entrepreneurs to managers, Hao Zhao and Scott Seibert find that entrepreneurs score higher on conscientiousness and openness to experience, and lower on neuroticism and agreeableness.<sup>57</sup> These findings are in line with the findings on entrepreneurs’ risk propensity.<sup>58</sup> Although there is no known direct link from personality traits to entrepreneurial action,<sup>59</sup> the findings suggest that individuals with this personality profile may be more attracted to engaging in entrepreneurship and may find this more satisfying than others do and/or relative to other occupations. Individuals with such personality traits may also be more successful in mobilizing support for their entrepreneurial venture from capital providers, employees, etc.<sup>60</sup>

Kirzner’s theory of entrepreneurship postulates that alertness is the special quality distinguishing entrepreneurs from most others. Howard Stevenson and Jaime Jarillo, among others, define that

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56. ROBERT R. McCRAE & PAUL T. COSTA, JR., PERSONALITY IN ADULTHOOD: A FIVE-FACTOR THEORY PERSPECTIVE 25 (2d ed. 2003); see also Robert R. McCrae & Oliver P. John, *An Introduction to The Five Factor Model and Its Applications*, 60 J. PERSONALITY 175 (1992); Robert R. McCrae & Paul T. Costa, Jr., *Personality Trait Structure as a Human Universal*, 52 AM. PSYCHOL. 509 (1997).

57. Hao Zhao & Scott Seibert, *The Big Five Personality Dimensions and Entrepreneurial Status: A Meta-Analytical Review*, 91 J. APPL. PSYCHOL. 259, 264 (2006).

58. 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. In the former view, higher risk propensity reflects high extraversion and openness and low neuroticism, agreeableness, and conscientiousness. For a brief discussion and references, see *id.* at 259.

59. See Icek Ajzen, *Attitudes, Traits, and Actions: Dispositional Prediction of Behavior in Personality and Social Psychology*, in 20 ADVANCES IN EXPERIMENTAL SOCIAL PSYCHOLOGY 1 (Leonard Berkowitz ed., 1987).

60. Zhao & Seibert, *supra* note 57, at 260.

entrepreneurship as an orientation toward opportunity recognition.<sup>61</sup> These views point to the importance of entrepreneurs' cognitive faculties, including perception, memory, information processing, and decision-making. Entrepreneurs arguably excel in cross-linking and rearranging information in ways that lead them to new projects.<sup>62</sup> Research on these variables among entrepreneurs—what may be called “entrepreneurial cognition”—is still developing.<sup>63</sup> Some researchers question the fruitfulness of this line of research.<sup>64</sup> Work by others, however, suggests ways for progress. Robert Baron argues that entrepreneurial opportunity recognition may be analyzed as a specific case of pattern recognition—of “connecting the dots.”<sup>65</sup> Baron further argues that entrepreneurs are less likely to engage in counterfactual thinking; when they see a pattern they stick to it.<sup>66</sup> 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.

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61. Howard H. Stevenson & J. Carlos Jarillo, *A Paradigm of Entrepreneurship: Entrepreneurial Management*, 11 STRATEGIC MGMT. J. 17, 19 (1990).

62. See, e.g., Connie Marie Gaglio & Jerome A. Katz, *The Psychological Basis of Opportunity Identification: Entrepreneurial Alertness*, 16 SMALL BUS. ECON. 95 (2001); Scott Shane & Jonathan Eckhardt, *The Individual-Opportunity Nexus*, in HANDBOOK OF ENTREPRENEURSHIP RESEARCH 161, 184 (Zoltan J. Acs & David B. Audretsch eds., 2003); Scott Shane & Sankaran Venkataraman, *The Promise of Entrepreneurship as a Field of Research*, 25 ACAD. MGMT. REV. 217, 219 (2000).

63. For reviews, see Nigel S. Wadeson, *Cognitive Aspects of Entrepreneurship: Decision-Making and Attitudes to Risk*, in THE OXFORD HANDBOOK OF ENTREPRENEURSHIP 511 (Mark Casson et al. eds., 2006); Norris Krueger, *The Cognitive Psychology of Entrepreneurship*, in HANDBOOK OF ENTREPRENEURSHIP RESEARCH: AN INTERDISCIPLINARY SURVEY AND INTRODUCTION 105 (2003). For good conceptual discussions, see Ronald K. Mitchell et al., *The Distinctive and Inclusive Domain of Entrepreneurial Cognition Research*, 28 ENTREPRENEURSHIP THEORY & PRACTICE 505 (2004); Ronald K. Mitchell et al., *The Central Question in Entrepreneurial Cognition Research 2007*, 31 ENTREPRENEURSHIP THEORY & PRACTICE 1 (2007); see also Daniel P. Forbes, *Cognitive Approaches to New Venture Creation*, 1 INT'L J. MGMT. REV. 415 (1999).

64. Sharon Alvarez & Jay B. Barney, *Discovery and Creation: Alternative Theories of Entrepreneurial Action* 24 (Ohio State Univ. Fisher Coll. of Bus., Working Paper No. 2006-01-005, 2006), available at <http://ssrn.com/abstract=900200> (arguing that two decades of research find few systematic differences between entrepreneurs and non-entrepreneurs beyond a greater proclivity of entrepreneurs to be more biased in their decision making), citing Lowell W. Busenitz & Jay B. Barney, *Biases and Heuristics in Strategic Decision-Making: Differences Between Entrepreneurs and Managers in Large Organizations*, 12 J. BUS. VENTURING 9 (1997).

65. Robert A. Baron, *Opportunity Recognition as Pattern Recognition: How Entrepreneurs “Connect the Dots” to Identify New Business Opportunities*, 20 ACAD. MGMT. PERSPECTIVES 104, 108 (2006).

66. Robert A. Baron, *Counterfactual Thinking and Venture Formation*, 15 J. BUS. VENTURING 79, 81–82 (2000). See Robert A. Baron, *Psychological Perspectives on Entrepreneurship: Cognitive and Social Factors in Entrepreneurs' Success*, 9 CURRENT DIRECTIONS IN PSYCHOL. SC. 15 (2000); Connie Marie Gaglio, *The Role of Mental Simulations and Counterfactual Thinking in the Opportunity Identification Process*, 28 ENTREPRENEURSHIP THEORY & PRACTICE 533 (2004).

To recap, research on the individual psychology of the entrepreneur after two 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>67</sup> Nor does this proposition deny the importance of the social context in which potential entrepreneurs emerge and operate.<sup>68</sup> 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.<sup>69</sup>

### III. ENTREPRENEURIAL MOTIVATIONS

#### A. *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.

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67. See SCHUMPETER, *supra* note 4, at 78 (“[E]veryone 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. . . . [B]eing an entrepreneur is not a profession and as a rule is not a lasting condition. . . .”).

68. See *infra* Section IV.

69. “Entrepreneurial orientation” refers to the organizational processes, methods, styles, practices, and decision-making activities employed by entrepreneurs that lead to new entry. See G.T. Lumpkin & Gregory Dess, *Clarifying the Entrepreneurial Orientation Construct and Linking it to Performance*, 21 ACAD. MANAG. REV. 135 (1996); G.T. Lumpkin & Gregory G. Dess, *Linking Two Dimension of Entrepreneurial Orientation to Firm Performance: The Moderating Role of Environment, Firm Age, and Industry Life Cycle*, 16 J. BUS. VENTURING 429 (2001).



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.

While the survey in the preceding part cannot possibly be exhaustive, it covers the major psychological factors discussed in the entrepreneurship literature. The issue of entrepreneurs' motivational goals has been virtually neglected.<sup>70</sup> One strand of the literature—namely, the studies dealing with entrepreneurs' need for achievement—comes close to addressing this subject. Other variables—such as personality traits, risk propensity, etc.—may correlate partially with motivational goals but they are conceptually different.

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

### *B. Entrepreneurial Values*

To generalize from the literature surveyed in Section II, the debate over the nature of the entrepreneur essentially asks whether entrepreneurs are special individuals or could anyone, under certain conditions, equally likely be an entrepreneur. In the context of motivations, this debate thus suggests our first hypothesis: People who become entrepreneurs have a particular set of motivational goals. Stated otherwise, entrepreneurs stand out in terms of the issues that

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70. 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 is Ellen A. Fagenson, *Personal Value Systems Of Men And Women Entrepreneurs Versus Managers*, 8 J. BUS. VENTURING 409 (1993), which is discussed in more detail below. See *infra* note 102 and accompanying text.

they consider important and worth pursuing in life. The null hypothesis therefore is that entrepreneurs' goals are not significantly different from the goals of the general population.

As already noted, there is evidence, gathered mostly by economists, that entrepreneurs seek autonomy more than wealth attainment.<sup>71</sup> Some preliminary evidence suggests that they also seek variety.<sup>72</sup> However, deriving a general hypothesis from these sporadic observations requires first a general theory of motivational goals. To this end, I use Shalom Schwartz's theory on individual-level value preferences.<sup>73</sup> Values are defined as conceptions of the desirable that guide the way individuals select actions, evaluate people and events, and explain or justify their actions and evaluations. In this view, values are trans-situational criteria or goals (e.g., security, wealth, justice), ordered by importance as guiding principles in life. Values are not objective, cold ideas. Rather, when values are activated, they become infused with feeling. The trans-situational nature of values means that values transcend specific actions and contexts. Obedience, for example, is relevant at work or in school, in sports or in business, with family, friends, or strangers.<sup>74</sup>

Milton Rokeach, in 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.<sup>75</sup> Shalom Schwartz and Wolfgang Bilsky analyzed cross-national data based on a survey instrument developed by Rokeach and confirmed the existence of certain value types in each country.<sup>76</sup> Later, Schwartz 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

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71. See *supra* text to note 32–40 and accompanying text.

72. See Åstebro, *supra* note 28.

73. The following text draws on Peter B. Smith & Shalom H. Schwartz, *Values*, in 3 HANDBOOK OF CROSS-CULTURAL PSYCHOLOGY 70 (J.W. Berry et al. eds., 2nd ed. 1997) and PETER B. SMITH, MICHAEL HARRIS BOND & CIGDEM KAGITCIBASI, UNDERSTANDING SOCIAL PSYCHOLOGY ACROSS CULTURES 12–19 (3d ed. 2006).

74. See generally Clyde Kluckhohn, *Value and Value Orientations in the Theory of Action*, in TOWARD A GENERAL THEORY OF ACTION 383 (Talcott Parsons & Edward A. Shils eds., 1951); MILTON ROKEACH, THE NATURE OF HUMAN VALUES (1973); Shalom H. Schwartz, *Universals in the Content and Structure of Values: Theoretical Advances and Empirical Tests in 20 Countries*, in ADVANCES IN EXPERIMENTAL SOCIAL PSYCHOLOGY 1 (Mark Zanna ed., 1992).

75. ROKEACH, *supra* note 74.

76. See Shalom H. Schwartz & Wolfgang Bilsky, *Towards a Universal Psychological Structure of Human Values*, 53 J. PERSONALITY & SOC'L PSYCHOL. 550, 560 (1987); Shalom H. Schwartz & Wolfgang Bilsky, *Towards a Theory of Universal Content and Structure of Values*, 58 J. PERSONALITY & SOC'L PSYCHOL. 878 (1990).

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cultures, including Asian and African ones.<sup>77</sup> Table 1 provides definitions of the ten values types distinguished by Schwartz and value items that reflect them.

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77. See Schwartz, *supra* note 74; Shalom H. Schwartz, *Are There Universal Aspects in the Content and Structure of Values?* 50 J. SOC'L ISSUES 19, 28–29 tbl. 2 (1994).

**Table 1**  
**The Schwartz Individual Value Types and Values that Represent Them**

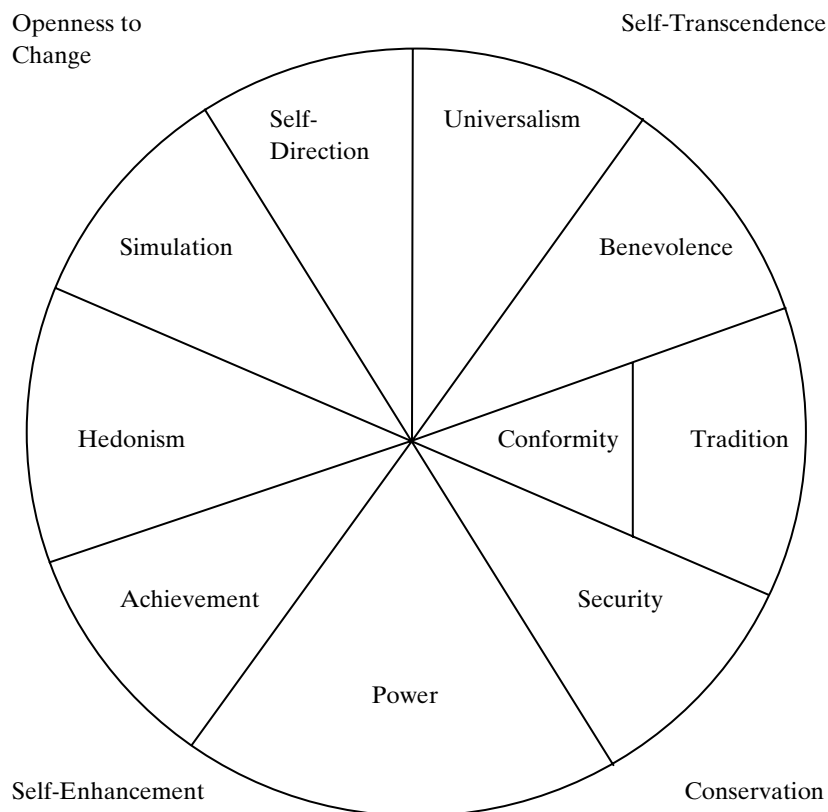
<b>Self-Direction</b>	Independent thought and action-choosing, creating, exploring (creativity, freedom, independent, curious, choosing own goals)
<b>Stimulation</b>	Excitement, novelty, and challenge in life (daring, a varied life, an exciting life)
<b>Hedonism</b>	Pleasure and sensuous gratification for oneself (pleasure, enjoying life)
<b>Achievement</b>	Personal success through demonstrating competence according to social standards (successful, capable, ambitious, influential)
<b>Power</b>	Social status and prestige, control or dominance over people and resources (social power, authority, wealth)
<b>Security</b>	Safety, harmony, and stability of society, of relationships and of self (family security, national security, social order, clean, reciprocation of favors)
<b>Conformity</b>	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)
<b>Tradition</b>	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)
<b>Benevolence</b>	Preservation and enhancement of the welfare of people whom one is in frequent personal contact (helpful, honest, forgiving, loyal, responsible)
<b>Universalism</b>	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)

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 benevolent 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).

**Figure1**  
**The Structure of Relations among Individual Values**



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 self-transcendence, opposes power and achievement values to universalism and

benevolence values. The dimension of openness to change versus conservation opposes self-direction and stimulation to security, conformity, and tradition values. Hedonism values share elements of both openness to change and self-enhancement.<sup>78</sup> The Schwartz model thus provides a nearly universal description of the content and structural relations of human values at the individual level.<sup>79</sup> Values have been conceptualized as the core of one's personal identity.<sup>80</sup> Value priorities in this model relate systematically with personality traits under the Big Five model.<sup>81</sup> Value priorities furthermore have been linked to behavior in a number of studies.<sup>82</sup> The path from values to behavior is not direct and involves mediating factors, however.<sup>83</sup>

From an economic analysis perspective, the Schwartz theory provides a comprehensive model of human motivations. Representing the set of conceptions of the desirable, the distinct ten values can be seen as ten distinct arguments in individuals' utility functions. This theory thus may help in advancing the debate over the meaning of rationality among law and economics scholars that took

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78. See Smith & Schwartz, *supra* note 73, at 87–88.

79. There is now substantial supportive evidence that the Schwartz model indeed reflects a universal structure of human values. See Shalom H. Schwartz et al., *Extending the Cross-Cultural Validity of the Theory of Basic Human Values with a Different Method of Measurement*, 32 J. CROSS-CULTURAL PSYCHOL. 519, 520 (2001); Wolfgang Bilsky & Mareike Koch, *On the Content and Structure of Values: Universals or Methodological Artefacts?*, in SOCIAL SCIENCE METHODOLOGY IN THE NEW MILLENNIUM (Jörg Blasius et al. eds., 2002).

80. Steven Hitlin, *Values as the Core of Personal Identity: Drawing Links between Two Theories of Self*, 66 SOC. PSYCHOL. Q. 118, 118 (2003).

81. Sonia Roccas et al., *The Big Five Personality Factors and Personal Values*, 28 PERS. SOC. PSYCHOL. BULL. 789 (2002). Specifically, positive correlations exist between openness to experience and self-direction, universalism, and stimulation; between agreeableness and benevolence and tradition; and between extraversion and hedonism, achievement, and stimulation. Conscientiousness splits between conformity and security, and achievement.

82. See Anat Bardi & Shalom H. Schwartz, *Values and Behavior: Strength and Structure of Relations*, 29 PERSONALITY & SOC'L PSYCHOL. BULL. 1207 (2003); Shalom H. Schwartz, *Value Priorities and Behavior: Applying a Theory of Integrated Value Systems*, in ONTARIO SYMPOSIUM ON SOCIAL AND PERSONALITY PSYCHOLOGY: VALUES 10 (Clive Seligman, James M. Olson & Mark P. Zanna eds., 1996); Marina Barnea & Shalom H. Schwartz, *Values and Voting*, 19 POL. PSYCHOL. 17 (1998); Gian Vittorio Caprara et al., *Personality and Politics: Values, Traits, and Political Choice*, 27 POL. PSYCHOL. 1 (2006).

83. One would be misguided to expect a unique deterministic link between values and behavior—in the least, because many value items that belong to opposing values are viewed positively by many people (see Table 1). Contradicting values thus may be activated as a matter of course. Cf. Connie M. Kristiansen & Alan M. Hottel, *Morality and the Self: Implications for When and How of Value-Attitude-Behavior Relations*, in ONTARIO SYMPOSIUM ON SOCIAL AND PERSONALITY PSYCHOLOGY: VALUES 77 (Clive Seligman, James M. Olson, & Mark P. Zanna eds., 1996) (questioning the causal relations between values and behavior); Kwok Leung, Michael Harris Bond & Shalom H. Schwartz, *How to Explain Cross-Cultural Differences: Values, Valences, and Expectancies?*, 1 ASIAN J. PSYCHOL. 70 (1995) (discussing mediating factors); Bas Verplanken & Rob W. Holland, *Motivated Decision-Making: Effects of Activation and Self-Centrality of Values on Choices and Behavior*, 82 J. PERS. SOC. PSYCHOL. 434 (2002).

place at the turn of the century.<sup>84</sup> In particular, by providing a framework for generating and testing falsifiable hypotheses, this theory may help in meaningfully integrating non-material, non-self-utility into economic analysis.<sup>85</sup> 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. It wasn't that long ago that 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.<sup>86</sup> A large body of evidence shows that people may incur substantial costs 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>87</sup> Particular other-regarding preferences have been dubbed "fairness," "reciprocity," etc.<sup>88</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.<sup>89</sup>

Within the Schwartz model, self-regarding and other-regarding preferences map onto the self-enhancement versus self-transcendence

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84. The definitions of rationality, utility, and similar related terms offered by prominent proponents of law and economics tend to be so broad as to verge on the tautological. *See, e.g.*, RICHARD A. POSNER, *ECONOMIC ANALYSIS OF LAW* 17 (6th ed. 2003) ("Rationality means little more to an economist than a disposition to choose, consciously or unconsciously, an apt means to whatever ends the chooser happens to have."); LOUIS KAPLOW & STEPHEN SHAVELL, *FAIRNESS VERSUS WELFARE* 18 (2002) (the notion of "well-being . . . incorporates in a positive way everything that an individual might value.") and at 465 (well-being is "all-encompassing (and thus not limited to wealth or other tangible elements).") For critical reviews, *see* Anita Bernstein, *Whatever Happened to Law and Economics?*, 64 MARYLAND L. REV. 303 (2005); Jeanne L. Schroeder, *Rationality in Law and Economics Scholarship*, 79 OR. L. REV. 147 (2000).

85. *See generally*, THE LIMITS OF RATIONALITY (Karen Schweers Cook & Margaret Levi, eds., 1990); MARK BLAUG, *THE METHODOLOGY OF ECONOMICS* (2d ed. 1992).

86. *See* Colin Camerer & Ernst Fehr, *When Does "Economic Man" Dominate Social Behavior?* 311 SC. 47 (2006); Matthew Rabin, *A Perspective on Psychology and Economics*, 46 EUR. ECON. REV. 657 (2002).

87. "Other-regarding preferences" is a more accurate term than "social preferences" because the latter might mistakenly connote group preferences.

88. *See, e.g.*, Matthew Rabin, *Incorporating Fairness into Game Theory and Economics*, 83 AM. ECON. REV. 1281 (1993); Joyce Berg, John Dickhaut, & Kevin McCabe, *Trust, Reciprocity, and Social History*, 10 GAMES & ECON. BEHAVIOR 122 (1995).

89. Ernst Fehr & Klaus M Schmidt, *A Theory of Fairness, Competition and Co-operation*, 114 Q. J. ECON. 817 (1999) (introducing a model of inequality aversion); Gary Charness & Matthew Rabin, *Understanding Social Preferences with Simple Tests*, 117 Q. J. ECON. 817 (2002) (a model of fairness).

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,<sup>90</sup> 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 indicates that people have an ambiguity aversion, or Knightian uncertainty aversion (distinguished from risk aversion).<sup>91</sup> 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.<sup>92</sup> 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.<sup>93</sup> Specifically, a higher need for cognitive closure is conceptually related to greater emphasis on conservation and vice versa. The emphasis on preserving the status quo—whether real or an imaginary ideal thereof (consider “family values”)—is especially clear in such value items as respect for tradition, honoring parents and elders, and social order. The preference for certainty and stability over ambiguity and change is

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90. *Id.*

91. See Daniel Ellsberg, *Risk, Ambiguity, and the Savage Axioms*, 75 Q. J. ECON. 643 (1961). For further theoretical treatments, see, e.g., Uzi Segal, *The Ellsberg Paradox and Risk Aversion: An Anticipated Utility Approach*, 28 INT'L ECON. REV. 175 (1987); Yoram Halevy & Vincent Feltkamp, *A Bayesian Approach to Uncertainty Aversion*, 72 REV. ECON. STUD. 449 (2005).

92. See, e.g., Yoram Halevy, *Ellsberg Revisited: An Experimental Study*, *ECONOMETRICA* (forthcoming 2007) (reviewing literature and providing evidence).

93. Amir N. Licht, *The Maximands of Corporate Governance: A Theory of Values and Cognitive Style*, 29 DELAWARE J. CORP. L. 649, 668 (2004). For a review of the psychological literature on motivated cognition, see John T. Jost et al., *Political Conservatism as Motivated Social Cognition*, 129 PSYCHOL. BULL. 339 (2003).



also reflected in seemingly innocuous value items like cleanliness, that convey a sense of clarity.<sup>94</sup>

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

First, at a high level of generality, entrepreneurs would score higher on openness-to-change values than on conservation values. The role ascribed to entrepreneurs in economic theory is that of agents of change. Whether thanks to greater uncertainty tolerance a la Knight, or to an urge for seeking new combinations a la Schumpeter, or to their superior alertness to new information a la Kirzner, entrepreneurs are expected to feel more comfortable with changing circumstances. Relative to the general population, entrepreneurs are expected to ascribe lower desirability to keeping with the "tried, tested, and true," to following what their bosses or elders tell them to do, etc. (the latter reflecting higher priority for conservation values). More specifically, one should expect to see entrepreneurs giving especially high priority to self-direction (reflected, for example, in being independent, curious, creative, and able to choose one's own goals) and also to stimulation (reflected, for example, in being daring and in seeking a varied life).

Second, entrepreneurs would score higher on self-enhancement values than on self-transcendence values. This hypothesis might seem somewhat less novel than the preceding hypothesis because a central value in self-enhancement is achievement. Schwartz defines the achievement value as "personal success through demonstrating competence according to social standards."<sup>95</sup> This definition is close to McClelland's definition of the need for achievement motive.<sup>96</sup> McClelland's need for achievement construct furthermore has been theoretically and empirically linked to the Schwartz achievement value.<sup>97</sup> Thus, we would expect entrepreneurs more than others to consider personal success as a central goal in their life. The Schwartz model predicts that, concomitantly with the greater emphasis on personal success, entrepreneurs will ascribe lesser importance to benevolence and universalism values, which constitute the self-

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94. Cf. Jost et al., *id.*, at 346.

95. See Table 1.

96. See *supra* text to note 46.

97. Shalom H. Schwartz, Studying Basic Values: Recent Theoretical Developments, Methodological Advances, & Findings, keynote speech delivered at the meeting of the International Association of Cross-Cultural Psychology, July 2004, Xian, China (presentation materials on file with author); Wolfgang Bilsky & Shalom H. Schwartz, Measuring Motivations: Integrating Content and Method, working paper (2006) (on file with author).

transcendence pole. Entrepreneurs will thus be relatively less inclined to endorse other-regarding preferences.

To my knowledge, no study has investigated entrepreneurs' value preferences in the Schwartz framework.<sup>98</sup> Only a handful of researchers have drawn on Rokeach's theory to posit a link between individual value preferences and a proclivity to entrepreneurship. Rokeach postulated a distinction between terminal and instrumental values. The former represent preferred end-states of being or global goals in life, while the latter represent preferred modes of conduct toward such 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.<sup>99</sup> 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."<sup>100</sup>

Ellen Fagenson, in 1993, reported results from the only theory-driven study of differences in value priorities among U.S. managers and entrepreneurs, using the Rokeach framework.<sup>101</sup> 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 hypotheses advanced above. Specifically,

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98. Several studies attempted linking values with entrepreneurship but they suffer from serious methodological weaknesses. For a critical survey see Barbara J. Bird & Candida G. Brush, *What Is Entrepreneurial Vision and How Does It Work?*, (American University, Working Paper #2003-19, 2003).

99. BARBARA BIRD, *ENTREPRENEURIAL BEHAVIOR* (1989), cited by Bird & Brush, *id.*, at 12-13.

100. *Id.* The latter conjecture strongly echoes Schumpeter's analogy between entrepreneurship and sportsmanship from the entrepreneur's vantage point. SCHUMPETER, *supra* note 4, at 93. See below, text to note 114.

101. Fagenson, *supra* note 70. Apparently, Fagenson was unaware of Bird's contribution.

entrepreneurs score 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.<sup>102</sup> 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 take to be an *ex-ante* innate characteristic,<sup>103</sup> likewise is consistent with higher openness to change. Similarly, with regard to Lazear's model, the Schwartz model provides a motivational theory on *why* some people tend 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.

### C. 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.

Among the theories of the economic role of the entrepreneur, Schumpeter's theory stands out as the most comprehensive. As noted above, Knight's theory of the entrepreneur as a bearer of uncertainty may be subsumed into Schumpeter's theory. Kirzner himself, in recent writings, pointed to the consistency between his theory and Schumpeter's theory with regard to alertness to new combinations of information.<sup>104</sup> Lazear's theory is devoid of reference to motivation but is nonetheless premised on combinations of skills and experiences that lead one to pursue new venture creation.

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102. See *supra* note 33 *et seq.* and accompanying text.

103. Santarelli and Vivarelli, *supra* note 31.

104. Kirzner, *supra* note 22.

Writing nearly a century ago,<sup>105</sup> Schumpeter's account remains insightful, rich, and vivid. It would be a mistake to take it as romantic. Schumpeter likely appreciated the entrepreneurial type ("our type," in his words). Yet the attributes he ascribed to the entrepreneur were not merely romantic embellishments.<sup>106</sup> These attributes derive from his analysis of entrepreneurs' role in the economy. Even today, Schumpeter's analysis is so sharp that to the extent possible, the following section draws on his own words for the presentation of his arguments. I limit myself to providing headlines and to suggesting some interpretation.

### 1. It's the Motivations, . . .

Schumpeter had identified the weak points in the standard economic account of economic agents. These lifeless agents could not bring about economic change and development. Schumpeter thus saw the crux of being an entrepreneur as having an unusual set of motivations.

We shall finally try to round off our picture of the entrepreneur in the same manner in which we always, in science as well as in practical life, try to understand human behavior, viz. by analysing the characteristic motives of his conduct.<sup>107</sup>

### 2. Psychology Can Inform Economic Analysis

In order to develop a decent account of entrepreneurial motivations economists may draw on psychology. Schumpeter was thus reflecting an interdisciplinary mode (and mood) of analysis, which had had more currency but later went out of fashion.<sup>108</sup> In an effort to preempt objections from advocates of the strict "revealed

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105. 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, *supra* note 4, at ix.

106. Schumpeter in fact takes pains to underscore this point: "our analysis of the role of the entrepreneur does not involve any "glorification" of the type, as some readers of the first edition of this book seemed to think. We do hold that entrepreneurs have an economic function as distinguished from, say, robbers. But we neither style every entrepreneur a genius or a benefactor to humanity." *Id.*, at 90.

107. *Id.*

108. The gulf that currently lies between economics and psychology, which some scholars are now trying to bridge, was not always there. Early twentieth century economics was receptive to psychological analyses. The schism took place at a later stage. See Shira B. Lewin, *Economic and Psychology: Lessons from Our Own Day from the Early Twentieth Century*, 34 J. ECON. LIT. 1293 (1996).

preferences” approach, he nevertheless emphasizes that his theory is testable even by the standards of revealed preferences.

Any attempt to [analyze the motives of entrepreneurs’ conduct] must of course meet with all those objections against the economist’s intrusion into “psychology” which have been made familiar by a long series of writers . . . [N]one of the results to which our analysis is intended to lead stands or falls with our “psychology of the entrepreneur,” or could be vitiated by any errors in it. Nowhere is there . . . any necessity for us to overstep the frontiers of observable behavior. Those who do not object to all psychology but only to the kind of psychology which we know from the traditional textbook, will see that we do not adopt any part of the time-honored picture of the motivation of the “economic man.”<sup>109</sup>

### 3. Entrepreneurs are Rational Agents, But Their Self-utility Stems from Other Sources

Practicing what he was preaching, Schumpeter’s account of the entrepreneur and her motivational goals is a masterful demonstration of constructive destruction. Schumpeter 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.

[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. . . .<sup>110</sup>

However, it is impossible to analyze entrepreneurship if self-utility is limited to material consumption and sensuous gratification to oneself. Schumpeter thus foreshadowed the current debate in economics over interpreting rationality.<sup>111</sup>

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

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109. SCHUMPETER, *supra* note 4, at 90.

110. *Id.* at 91.

111. *See supra* notes 84–85 and accompanying text.

also mean something in the way of self-gratification. But this would reduce our definition to tautology.<sup>112</sup>

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.<sup>113</sup>

#### 4. Beyond Hedonism: Achievement and Power

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 read like textbook descriptions of Schwartz's self-enhancement values—achievement and power.

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 "satisfaction of wants" in the sense defined above, or from, to put the same thing into other words, "hedonistic adaptation."<sup>114</sup>

#### 5. Beyond Hedonism: Self-Direction and Stimulation

The desire to demonstrate achievement and power (but mostly achievement) does not exhaust entrepreneurial motivations. Next, Schumpeter turns to the more elusive motivations, those of openness-to-change in the Schwartz model—self-direction and stimulation.

Finally, there is the joy of creating, of getting things done, or simply of exercising one's energy and ingenuity. This is akin to a ubiquitous motive, but nowhere else does it stand out as an independent factor of behavior with anything like the clearness with which it obtrudes itself in our case. Our type seeks out

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112. SCHUMPETER, *supra* note 4, at 92.

113. *Id.*, at 92–93.

114. *Id.*, at 93.

difficulties, changes in order to change, delights in ventures. This group of motives is the most distinctly anti-hedonist of the three.<sup>115</sup>

#### IV. THE CULTURAL CONTEXT

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

[We should] recognise that economic motive so defined varies in intensity very much in time; that it is society that shapes the particular desires we observe; that wants must be taken with reference to the group which the individual thinks of when deciding his course of action - the family or any other group, smaller or larger than the family . . . that the field of individual choice is always, though in very different ways and to very different degrees, fenced in by social habits or conventions and the like.<sup>116</sup>

Ample research indeed documents the importance of family background, prior education, social connections and networks, and so forth for effectuating entrepreneurial potential.<sup>117</sup> In particular, social norms in individuals’ environments have been shown to affect their choice to become entrepreneurs even for a lower income.<sup>118</sup>

At the highest level of social context, there is virtual consensus in the entrepreneurship literature that culture bears a profound impact on all facets of entrepreneurship in societies.<sup>119</sup> This literature almost

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115. *Id.*, at 93–94.

116. *Id.*, at 91.

117. See, e.g., Scott Shane, *Prior knowledge and the Discovery of Entrepreneurial Opportunities*, 11 *ORG. SC.* 448 (2000). In the mainstream economics literature there is now a surge in research on the importance of entrepreneurs’ social background. See, e.g., ANNALEE SAXENIAN, *LOCAL AND GLOBAL NETWORKS OF IMMIGRANTS IN SILICON VALLEY* (2002); Luigi Guiso & Fabiano Schivardi, *Learning to be an Entrepreneur*, (CEPR Discussion Papers 5290 2005); Paul Gompers, Josh Lerner & David Scharfstein, *Entrepreneurial Spawning*, 60 *J. FIN.* 577 (2005); Djankov et al., *Russia’s Entrepreneurs*, *supra* note 54; Djankov et al., *Entrepreneurship in China & Russia*, (2006), *supra* note 54.

118. See Mariassunta Giannetti, & Andrei Simonov, *On the Determinants of Entrepreneurial Activity: Social Norms, Economic Environment, and Individual Characteristics*, 11 *SWEDISH ECON. POLICY REV.* 269 (2004).

119. For a literature review, see James Hayton et al., *National Culture and Entrepreneurship: A Review of Behavioral Research*, 26 *ENTREPRENEURSHIP THEORY & PRACTICE* 33 (2002); Licht & Siegel, *supra* note 32. See generally, Jan Ulijn & Terrence E. Brown, *Innovation, Entrepreneurship and Culture: A Matter of Interaction between Technology, Progress and Economic Growth? An Introduction*, in *INNOVATION, ENTREPRENEURSHIP AND CULTURE: THE INTERACTION BETWEEN TECHNOLOGY, PROGRESS AND ECONOMIC GROWTH*. (Terrence Brown & Jan Ulijn eds., 2003).

invariably draws on a theory of cultural value dimensions advanced by Geert Hofstede.<sup>120</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.<sup>121</sup> Much of this literature exhibits considerable methodological disarray, however.<sup>122</sup> According to Hofstede, low uncertainty avoidance "implies a greater willingness to enter into unknown ventures."<sup>123</sup> 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.<sup>124</sup> In a joint study with Jordan Siegel and Shalom Schwartz, using a culture-level value dimension model from Schwartz,<sup>125</sup> we link higher entrepreneurship levels in countries with lower scores on harmony, a cultural orientation related to societal disapproval of assertive change and of venturing.<sup>126</sup>

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>127</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

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120. GEERT H. HOFSTEDÉ, *CULTURE'S CONSEQUENCES: INTERNATIONAL DIFFERENCES IN WORK-RELATED VALUES* (1980); GEERT HOFSTEDÉ, *CULTURE'S CONSEQUENCES: COMPARING VALUES, BEHAVIORS, INSTITUTIONS, AND ORGANIZATIONS ACROSS NATIONS* (2d ed. 2001) (hereinafter HOFSTEDÉ, *COMPARING VALUES*).

121. Hayton et al., *supra* note 119.

122. See Licht & Siegel, *supra* note 32.

123. HOFSTEDÉ, *COMPARING VALUES*, *supra* note 120, 164.

124. See Geert Hofstede et al., *Culture's Role in Entrepreneurship: Self-Employment Out of Dissatisfaction*, in Ulijn & Brown, *supra* note 119; Sander Wennekers et al., *Uncertainty Avoidance and the Rate of Business Ownership Across 21 OECD Countries, 1976-2004*, (ERIM Report Series Reference No. ERS-2006-065-ORG, 2006).

125. Shalom H. Schwartz, *Cultural Value Differences: Some Implications for Work*, 48 *APPL'D PSYCHOL. INT'L REV.* 23 (1999); Shalom H. Schwartz, *A Theory of Cultural Value Orientations: Explication and Applications*, 5 *COMP. SOCIOLOG.* 137 (2006).

126. Jordan I. Siegel, Amir N. Licht & Shalom H. Schwartz, *Egalitarianism, Cultural Distance, and FDI: A New Approach*, working paper (2006).

127. I assume for convenience, yet in line with the general literature, that each nation represents a single culture.



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 Donald Kuratko, “the question of whether entrepreneurship can be taught is obsolete.”<sup>128</sup> Other 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.”<sup>129</sup>

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 Web sites, etc.—on such issues as different corporate forms and their relative advantages, regulatory requirements for doing business in various industries, etc. This kind of training may be valuable for entrepreneurs in that it would lower their learning costs (and transaction costs more generally). Such training, however, has nothing to do with acquiring entrepreneurial inclinations, which, it is argued, stem from value priorities.

The mechanisms leading to value acquisition are believed to be effective mostly at pre-adolescence age. These mechanisms are influenced by an individual’s parenting and other life circumstances.<sup>130</sup> Studies thus have found interrelations between parenting style, personality traits, entrepreneurial orientation, and entrepreneurial career prospects among German subjects.<sup>131</sup> Cultural value orientations are societies’ most basic equilibria on normative issues. Cultural change in terms of significant shifts in value orientations

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128. Donald F. Kuratko, *The Emergence of Entrepreneurship Education: Development, Trends, and Challenges*, 29 *ENTREPRENEURSHIP THEORY AND PRACTICE* 577 (2005).

129. Peter G. Klein & J. Bruce Bullock, *Can Entrepreneurship Be Taught?*, 38 *J. AGRICULTURAL & APPLIED ECON.* 429 (2006).

130. See Jacqueline. J. Goodnow, *Parenting and the Transmission and Internalization of Values: From Social-Cultural Perspectives to Within-Family Analyses*, in *PARENTING AND CHILDREN’S INTERNALIZATION OF VALUES: A HANDBOOK OF CONTEMPORARY THEORY* 333 (J.E. Grusec & L. Kuczynski eds. 1997).

131. Eva Schmitt-Rodermund & Fred W. Vondracek, *Occupational Dreams, Choices, and Aspirations: Adolescents’ Entrepreneurial Prospects and Orientations*, 25 *J. ADOLESCENCE* 65 (2002); Eva Schmitt-Rodermund, *Pathways to Successful Entrepreneurship: Parenting, Personality, Competence, and Interests*, 65 *J. VOCATIONAL BEHAVIOR* 498 (2004).

likely takes place very slowly, because of the nature of these orientations as equilibria, or in response to major exogenous shocks.<sup>132</sup> For this and for other reasons, culture is widely believed to be relatively stable over long time periods.<sup>133</sup> The causal link from cultural orientations to individual entrepreneurial value priorities consequently would be stable as well and difficult to change. The upshot is that cultural values may induce path dependence in entrepreneurial activity.<sup>134</sup> In one case, when the British government under Margaret Thatcher attempted to establish an “enterprise culture” in the United Kingdom, the result was failure.<sup>135</sup>

## V. CAN LEGAL MEASURES FOSTER ENTREPRENEURSHIP?

### A. *Law in Context*

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

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132. See Shalom H. Schwartz & Anat Bardi, *Influences of Adaptation to Communist Rule on Value Priorities in Eastern Europe*, 18 POL. PSYCHOL. 385 (1997) (arguing that cultural orientations in former soviet bloc countries changed in response to life under soviet rule); Shalom H. Schwartz, Anat Bardi & Gabriel Bianchi, *Value Adaptation to the Imposition and Collapse of Communist Regimes in East-Central Europe*, in POLITICAL PSYCHOLOGY: CULTURAL AND CROSS-CULTURAL FOUNDATIONS 217 (Stanley A. Renshon & Duckitt John eds. 2000) (same; showing short-run stability of cultural orientations).

133. See Ronald Inglehart & Wayne Baker, *Modernization, Cultural Change, and the Persistence of Traditional Values*, 65 AM SOC. REV. 19 (2000). See also Amir N. Licht, Chanan Goldschmidt, & Shalom H. Schwartz, *Culture Rules: The Foundations of the Rule of Law and Other Norms of Governance*, (working paper 2006); Jordan I. Siegel, Amir N. Licht & Shalom H. Schwartz, *Egalitarianism and International Investment* (Working Paper 2006); see generally, Gérard Roland, *Understanding Institutional Change: Fast-Moving and Slow-Moving Institutions*, 38 STUD. COMP. INT'L DEVELOPMENT 109 (2004) (arguing that culture is a slow-moving institution).

134. See Christopher Woodruff, *Can Any Small Firm Grow Up?: Entrepreneurship and Family Background in Mexico* (University of California San Diego Working Paper 1999).

135. See Marina Della Giusta & Zella King, *Enterprise Culture*, in THE OXFORD HANDBOOK OF ENTREPRENEURSHIP 629 (Mark Casson et al. eds., 2006).

A strict construction of the preceding analysis on the role of culture might suggest that culture fully determines entrepreneurship in a society such that *any* directed effort to foster entrepreneurship would be doomed. Zoltan Acs and Laszlo Szerb, 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.”<sup>136</sup> 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 Szerb’s 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.<sup>137</sup> While there is no denying that all of the abovementioned issues may bear on entrepreneurship, for the most part they do not focus on 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.<sup>138</sup>

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136. Zoltan J. Acs & Laszlo Szerb, *Entrepreneurship, Economic Growth and Public Policy*, SMALL BUS. ECON. (2006), online version, DOI 10.1007/s11187-006-9012-3.

137. *Id.*

138. For an open-ended discussion, see Robin Boadway & Jean-François Tremblay, *Public Economics and Start-up Entrepreneurs*, in VENTURE CAPITAL, ENTREPRENEURSHIP, AND PUBLIC POLICY 181 (Vesa Kannianen & Christian Keuschnigg eds., 2005). For a discussion of regulatory burden on entrepreneurship with a clear anti-regulation intonation, see Lloyd Dixon et al., *The Impact of Regulation and Litigation on Small Business and Entrepreneurship: An Overview* (RAND Institute for Civil Justice Working Paper WR-317-ICJ 2006).

*B. Improving Legality*<sup>139</sup>

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.<sup>140</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>141</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. Peter Boettke and Christopher Coyne argue that “[t]he two most important ‘core’ institutions for encouraging entrepreneurship are well-defined property rights and the rule of law.”<sup>142</sup> What is good for the economy in general is good for entrepreneurs. Improving legality, runs the argument, will foster entrepreneurship.<sup>143</sup>

Extant evidence largely supports the above proposition. Examining the emergence of new firms in five former soviet countries, Simon Johnson et al. find that insecure property rights—defined as a frequent need to make extralegal payments (bribes), protection, or inefficient courts—were more inhibiting to entrepreneurship than inadequate finance.<sup>144</sup> Mihir Desai et al., using a measure that

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139. This section draws liberally on Licht & Siegel, *supra* note 32.

140. Licht & Siegel, *supra* note 32. For representative studies, see William Easterly & Ross Levine, *Tropics, Germs, and Crops: How Endowments Influence Economic Development*, 50 J. MONETARY ECON. 3 (2003); Dani Rodrik, Arvind Subramanian & Francesco Trebbi, *Institutions Rule: The Primacy of Institutions over Geography and Integration in Economic Development*, 9 J. ECON. GROWTH 65 (2004); Daron Acemoglu & Simon H. Johnson, *Unbundling Institutions*, 113 J. POL. ECON. 949 (2005).

141. 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.

142. Peter J. Boettke & Christopher J. Coyne, *Entrepreneurship and Development: Cause or Consequence?*, 6 ADVANCES IN AUSTRIAN ECON. 67 (2003).

143. For general discussions, see William J. Baumol, *Entrepreneurship: Productive, Unproductive, and Destructive*, 98 J. POL. ECON. 893 (1990); David A. Harper, *Institutional Conditions for Entrepreneurship*, in 5 ADVANCES IN AUSTRIAN ECONOMICS 75 (Peter J. Boettke, Israel M. Kirzner & M. J. Rizzo eds., 1998). For a discussion of the role of courts in promoting entrepreneurship, see Gordon D. Smith & Masako Ueda, *Law & Entrepreneurship: Do Courts Matter?* (University of Wisconsin Legal Studies Research Paper No. 1029, 2006) (conjecturing that common law countries update their laws more frequently than civil law countries through judicial intervention and thereby encourage entrepreneurship).

144. Simon Johnson, John McMillan & Christopher Woodruff, *Property Rights, Finance, and Entrepreneurship* (Working Paper 1999); Simon Johnson, John McMillan & Christopher Woodruff, *Entrepreneurs and the Ordering of Institutional Reform: Poland, Slovakia, Romania, Russia and the Ukraine Compared*, 8 ECON. TRANSITION 1 (2000) [hereinafter Johnson et al.

intertwines both formal delineation and actual protection of property rights, find that in the emerging markets of Europe, greater fairness and more property rights protection increase entry rates, reduce exit rates, and lower skewness in firm-size distribution.<sup>145</sup> Theory and evidence are not limited to transition economies, however. Luc Laeven and Christopher Woodruff find that in Mexico, states with more effective legal systems have larger firms, suggesting that a rule-of-law state enables entrepreneurial firms to grow by reducing idiosyncratic risk.<sup>146</sup> Finally, Enrico Perotti and Paolo Volpin advance a political economy model and evidence suggesting that lack of political (democratic) accountability and economic inequality hinder entry.<sup>147</sup>

The problem with policies intended to improve legality and other related social institutions such as absence of corruption, is that these institutions prove to be very stable. In particular, while these institutions exert a strong influence on a host of social development indicators, including economic development and infant mortality, recent contributions suggest that economic development feeds back to these institutions only weakly or not at all.<sup>148</sup> In collaborative studies with Schwartz, Siegel, and Chanan Goldschmidt, we show that these fundamental institutions, which we dub social norms of governance, are strongly affected by cultural orientations—a finding that helps explain the stability of these institutions.<sup>149</sup> The upshot is that significant improvements in entrepreneurship levels through improvement in legality are unlikely to take place in the short run.

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(2000)]; Simon Johnson, John McMillan & Christopher Woodruff, *Property Rights and Finance*, 92 AM. ECON. REV. 1335, (2002).

145. Mihir Desai, Paul Gompers, & Josh Lerner, *Institutions, Capital Constraints and Entrepreneurial Firm Dynamics: Evidence from Europe* (NBER Working Paper No. 10165, 2003). Skewness in firm-size distribution serves as a proxy for entrepreneurship because in more entrepreneurial economies more people own more small firms. For further background, see Saul Estrin, Klaus E. Meyer & Maria Bychkova, *Entrepreneurship in Transition Economies*, in OXFORD HANDBOOK OF ENTREPRENEURSHIP 693 (Mark Casson et al. eds., 2006).

146. Luc A. Laeven & Christopher M. Woodruff, *The Quality of the Legal System, Firm Ownership, and Firm Size*, (World Bank Policy Research Working Paper No. 3246 2004)

147. Enrico C. Perotti & Paolo F. Volpin, *Lobbying on Entry* (University of Amsterdam Working Paper 2006).

148. See Daron Acemoglu, Simon H. Johnson, & Pierre Yared, *Income and Democracy* (MIT Department of Economics Working Paper No. 05-05, 2005); Daniel Kaufmann & Aart Kraay, *Growth Without Governance*, 3 ECONOMIA 169 (2002); Roberto Rigobon & Dani Rodrik, *Rule of Law, Democracy, Openness, and Income: Estimating the Interrelationships*, 13 ECON. TRANSITION 533 (2005).

149. Licht, Goldschmidt & Schwartz., *supra* note 133; Siegel, Licht & Schwartz, *supra* note 133.

### C. Targeted Legislation: Entry

An efficient way to promote entrepreneurship through legislation could be to eliminate unnecessary transaction costs. Suppose that in a particular country, say, Italy, an entrepreneur needs to follow sixteen different procedures, pay nearly \$4,000 (U.S.) in fees, and wait some sixty-two business days for the necessary permits, while in another country, Canada, the same process on average takes two business days, requires only two procedures, and costs about \$280 (U.S.) in fees.<sup>150</sup> Few legal reforms look more straightforward than cutting down such superfluous red tape in Italy.

Taking advantage of the World Bank's dataset and of data on entrepreneurship levels from the GEM project,<sup>151</sup> two teams of researchers investigated the link between entrepreneurship and regulatory costs of entry, measured by indicators of necessary steps, time, and money required for setting up a simple business firm. Ho and Wong, following GEM, 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).<sup>152</sup> 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.<sup>153</sup> Using a more nuanced empirical specification, André van Stél et al. find that these regulatory costs are unrelated to the formation rate of either nascent or young (opportunity-driven or necessity-driven) business firms.<sup>154</sup> An exception is minimum capital requirements, which indeed have been

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150. Simeon Djankov et al, *The Regulation of Entry*, 117 Q. J. ECON. 1 (2002).

151. The World Bank dataset and additional background materials are available at the World Bank's website on Regulatory Costs of Business. See <http://www.doingbusiness.org>. See GEM's Web site at <http://www.gemconsortium.org/>.

152. Yuen-Ping Ho & Poh-Kam Wong, *Financing, Regulatory Costs and Entrepreneurial Propensity*, SMALL BUS. ECON. (2006), online version, DOI 10.1007/s11187-006-9015-0.

153. High-growth potential entrepreneurship is the only type of entrepreneurship that exhibited a link to economic growth. See Wong et al., *supra* note 2.

154. André van Stel, David Storey & Roy Thurik, *The Effect of Business Regulations on Nascent and Young Business Entrepreneurship*, SMALL BUS. ECON. (forthcoming 2007).

criticized in the legal literature as redundant and overly burdensome in general.<sup>155</sup>

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.<sup>156</sup> Leora Klapper et al. 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.<sup>157</sup> 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.<sup>158</sup> The latter conjecture points again to the predominant role of culture in influencing social norms on corruption.<sup>159</sup>

#### D. Targeted Legislation: Exit—Bankruptcy

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. It should be noted from the outset, however, that entrepreneurs are already over-optimistic, above and beyond the

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155. See Luca Enriques & Jonathan R. Macey, *Creditors versus Capital Formation: The Case against the European Legal Capital Rules*, 86 CORNELL L. REV. 1165 (2001).

156. Djankov et al., *supra* note 150.

157. Leora Klapper, Luc Laeven & Raghuram Rajan, *Entry Regulation as a Barrier to Entrepreneurship*, 82 J. FIN. ECON. 591 (2006).

158. Johnson, McMillan & Woodruff, *Entrepreneurs and the Ordering of Institutional Reform*, *supra* note 144.

159. See Licht, Goldschmidt & Schwartz., *supra* note 133. In the same spirit, another set of regulations found by van Stél et al., *supra* note 154, to affect entrepreneurship is labor regulation, in particular, rigidity of hours and rigidity of employment. In this context, Siegel, Licht & Schwartz., *supra* note 133, also find a robust relations between labor regulations and cultural egalitarianism.

level of over-optimism documented in the general population.<sup>160</sup> Financial loss does not deter determined entrepreneurs, who are not “in it for the money,” from engaging in new venture creation. Mitigating the financial adversities of business failure therefore may or may not have the intended effect of increasing entrepreneurial activity.<sup>161</sup>

Much of the law and economics theory on bankruptcy has dealt with corporate bankruptcy.<sup>162</sup> For the entrepreneur, however, the relevant bankruptcy in terms of her economic incentives is personal bankruptcy, in which she is called to satisfy her debts from her personal assets. The typical scenario of personal bankruptcy deals with consumers, such as those defaulting on their credit card debt or mortgage payments. Entrepreneurs may face personal bankruptcy proceedings if they operated through an unincorporated firm. In theory, establishing a firm—in most cases, a corporation of one sort or another—should entitle the entrepreneur *qua* shareholder to shield her personal assets from the firm’s creditors thanks to the corporation’s separate legal personality and to her limited liability. In practice, proprietors of small businesses operating through a corporation are frequently required by their lender to provide collateral and/or personally guarantee the firm’s debts. Small entrepreneurs consequently face potential unlimited exposure to their firm’s liabilities.<sup>163</sup>

By declaring bankruptcy the debtor may be able to get a “fresh start” if the bankruptcy court does not subject her future earnings to her past liabilities. This type of release is possible under Chapter 7 of the Federal Bankruptcy Code,<sup>164</sup> which provides for “liquidation,” namely, the sale of a debtor’s nonexempt property and the distribution of the proceeds to creditors. Although personal bankruptcy procedures in the United States are primarily targeted for consumers such as those defaulting on their credit card debt or mortgage payments, entrepreneurs may take advantage of them as

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160. See sources cited *supra*, at note 39.

161. 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 David Hahn, *Velvet Bankruptcy*, 7 THEORETICAL INQUIRIES IN L. (Online Edition) No. 2, Article 9, 544-545 (2006), available at <http://www.bepress.com/til/default/vol7/iss2/art9>.

162. See generally, THOMAS H. JACKSON, *THE LOGIC AND LIMITS OF BANKRUPTCY LAW* (1986).

163. See Jeremy Berkowitz, & Michelle J. White, *Bankruptcy and Small Firms' Access to Credit*, 35 RAND J. ECON. 69 (2004); see also Allen N. Berger & Gregory F. Udell, *Relationship Lending and Lines of Credit in Small Firms Finance*, 68 J. BUS. 351 (1995); Robert B. Avery et al., *The Role of Personal Wealth in Small Business Finance*, 22 J. BANKING & FIN. 1019 (1998).

164. 11 U.S.C. §701 *et seq.* (2007).



well. The Federal Code leaves room for state legislatures to exempt certain past assets from future liabilities, the most important of which is the homestead exemption.<sup>165</sup>

The homestead exemption essentially creates a “wealth insurance” scheme for the debtor.<sup>166</sup> Even if the business failed, and even if the entrepreneur had to expose her personal wealth to such failure, the exemptions provide a sort of cushion to soften the fall. This insight has led legal and business academics recently to advocate a more entrepreneur-friendly bankruptcy law to encourage more vibrant entrepreneurship activity.<sup>167</sup> David Hahn tellingly dubbed his proposal for a swifter, more forgiving discharge in bankruptcy “velvet bankruptcy.”<sup>168</sup>

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, Michelle White shows 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.<sup>169</sup>

Empirical studies by White and colleagues find support for both facets of the dilemma. Wei Fan and White find that families are more

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165. There exists an alternative procedure to Chapter 7 liquidation in Chapter 13 of the Code. According to Berkowitz & White, *supra* note 163, at 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 Chapter 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 have found that the vast majority of Chapter 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. Douglas G. Baird & Edward R. Morrison, *Serial Entrepreneurs and Small Business Bankruptcies*, 105 COLUM. L. REV. 2310 (2005).

166. See Fan Wei & Michelle J. White, *Personal Bankruptcy and The Level of Entrepreneurial Activity*, 46 J. L. & ECON. 545 (2003).

167. Seung-Hyun Lee, Mike W. Peng & Jay B. Barney, *Bankruptcy Law and Entrepreneurship Development: A Real Options Perspective*, 32 ACAD. MGMT. REV. 257 (2007).

168. Hahn, *supra* note 161.

169. Michelle J. White, *A General Model of Personal Bankruptcy: Insurance, Work Effort, and Opportunism* (Working Paper 2005). For a similar analysis, see Ahmet Akyol & Kartik Athreya, *Exemptions: Limited Enforcement Encouraging Entrepreneurship?* (York University Working Paper 2005).

likely to own and start businesses if they live in states with higher bankruptcy exemption levels.<sup>170</sup> In tandem, Jeremy Berkowitz and White show that lenders are more likely to turn down small firms in states that have higher exemptions.<sup>171</sup> 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 yet more complex when the entrepreneur can choose to conduct business in a neighboring jurisdiction with more favorable exemptions. Aparna Mathur indeed finds that higher bankruptcy exemptions in neighboring states lower the probability of starting a business in the state of residence.<sup>172</sup> 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 Howard Hall and colleagues, Thomas Garrett and Yannis Georgellis, cast a shadow over the entire discussion.<sup>173</sup> These researchers investigated how the bankruptcy homestead exemptions influence rates of entrepreneurship over time in eight U.S. 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 level 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. Figure 2 reproduces the above authors' figures showing the S-shaped curves. The Y axis shows the changes in

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170. Fan & White, *supra* note 166; see also Aparna Mathur, *A Spatial Model of the Impact of State Bankruptcy Exemptions on Entrepreneurship* (University of Maryland Working Paper 2005) (finding that the bankruptcy exemption in one's own state has a significant and positive impact on entrepreneurship.); compare John Armour & Douglas J. Cumming, *Bankruptcy Law and Entrepreneurship* (University of Cambridge Centre for Business Research Working Paper No. 300, 2005) (constructing an index of bankruptcy law "forgiveness"; finding that personal bankruptcy law affects self employment rates in 15 countries more than a variety of other legal and economic factors).

171. Berkowitz & White, *supra* note 163.

172. Mathur, *supra* note 170.

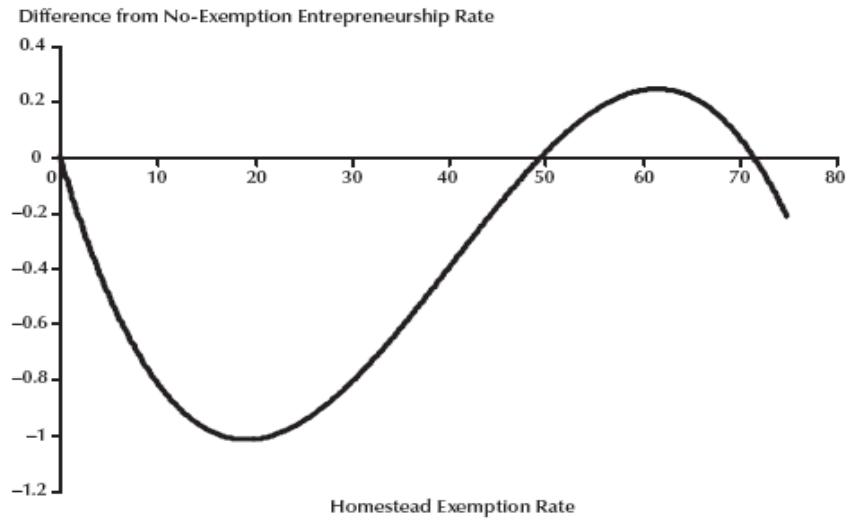
173. Yannis Georgellis & Howard Wall, *Entrepreneurship and the Policy Environment*, 88 FEDERAL RESERVE BANK OF ST LOUIS REV. 95 (2006) [hereinafter Georgellis & Wall, *Entrepreneurship*]; Thomas A. Garrett & Howard J. Wall, *Creating a Policy Environment for Entrepreneurs* (Federal Reserve Bank of St. Louis, Working Paper 2005-064B, 2006) (hereinafter Garrett & Wall, *Creating a Policy Environment*).

entrepreneurship as a function of the degree of homestead exemptions—from no exemption at all up to about 80% exemption of the homestead value. The graph from Garrett and Wall indicates that the best policy is zero exemption. At first blush, the graph from Georgellis and Wall still leaves 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 curves 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 may not be significantly different from zero.<sup>174</sup> Stated otherwise, these econometric analyses, which appear the most sophisticated thus far, suggest that the best entrepreneurship-promoting policy would advocate abolishing the homestead exemption altogether. Perhaps entrepreneurs are too highly opportunistic, as White has cautioned; perhaps lenders cannot distinguish entrepreneurship-debtors from consumption-debtors; perhaps the reason remains to be discovered.

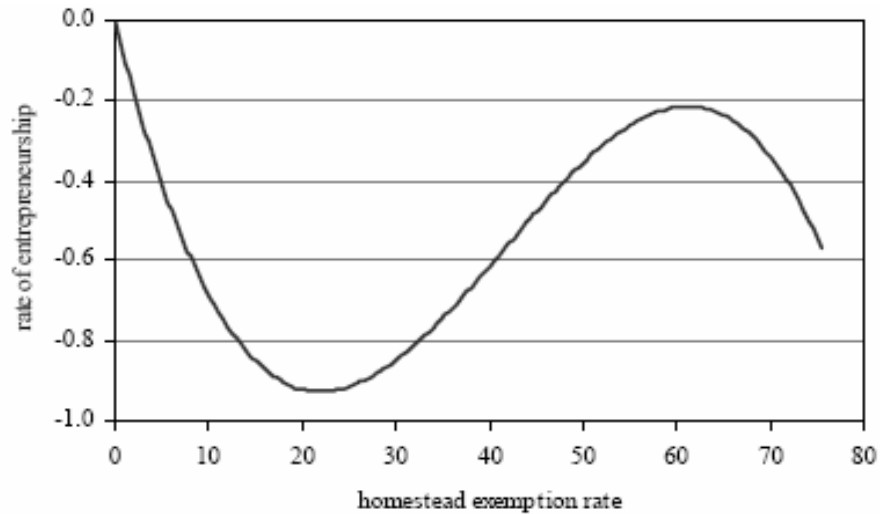
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174. Letter from Howard J. Wall, Director, Center for Regional Economics (CRE8), Federal Reserve Bank of St. Louis, to Author (Feb. 3 2007) (on file with author).

**Figure 2**  
**Entrepreneurship and the Homestead Exemption**



**Source:** Georgellis and Wall<sup>175</sup>



**Source:** Garrett and Wall<sup>176</sup>

175. Georgellis & Wall, *Entrepreneurship*, *supra* note 173.

176. Garrett & Wall, *Creating a Policy Environment*, *supra* note 173.

## VI. CONCLUSION

Inspired by Schumpeter's seminal depiction of the entrepreneur, this article sought to recast this heroic portrait in a more rigorous theoretical framework. To this end, I leverage a model of value preferences developed by Shalom Schwartz. The entrepreneurial spirit, it is argued, consists of particular value preferences: high self-enhancement and high openness-to-change. 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 amenable to policy measures. Looking specifically at legal rules, this article attempted to identify measures that could be narrowly targeted at 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.

