Entrepreneurship and Development: The Role of Information Asymmetries

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This article reviews the literature on the relationship between entrepreneurship and economic development and introduces four symposium articles. A common thread is that information asymmetries are important determinants of access to finance in young entrepreneurial firms. Policy recommendations are proposed that would increase the positive role of entrepreneurship in economic development. JEL codes: G18, G38, L51, M13

The relationship between entrepreneurship and economic development is often studied but seldom agreed on, perhaps because of the complexity of the term entrepreneurship. There are numerous definitions of entrepreneurship but little agreement among researchers on the appropriate analytical framework (Venkataraman 1997). This article briefly surveys the research on entrepreneurship in a development context and introduces the four articles included in this special symposium issue.

Most discussions of entrepreneurship and economic development arrive at some sort of distinction between innovative entrepreneurs and replicative entrepreneurs (Baumol 2010). Innovative entrepreneurs introduce a new technology or bring an existing idea to a new market (also known as gazelles, high impact entrepreneurs, and opportunity entrepreneurs). Schumpeter (1934) was likely referring to innovative entrepreneurs when he extolled entrepreneurs as the engine driving the creative destruction central to capitalism. Others, too, see entrepreneurship as a driving force of economic growth (Hause and Du Rietz 1984; Schramm 2006; Acs, Desai, and Hessels 2008; Baumol 2010).

This positive view of entrepreneurship has led policymakers to focus time and resources on programs to aid entrepreneurs. For instance, U.S.

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policymakers have called for more government support of entrepreneurs to help the country regain a competitive lead in the world economy (Schramm 2006; Baumol and Strom 2007). The European Union’s Lisbon Declaration of March 2000 explicitly identifies entrepreneurship as the key to the European Union becoming the most competitive world region by 2010 (Naudé 2008).

Cross-country comparisons are greatly hampered by the shortage of internationally comparable data on entrepreneurship. The 2010 World Bank Entrepreneurship Snapshots, which measure new firm entry in the formal private sector in 112 economies, make a valuable contribution. Using these data, Klapper and Love (2010) find a positive and significant relationship between income level and new firm entry (figure 1). An important drawback of the data is the exclusion of the informal sector, where the majority of survival entrepreneurs function. However, because high-growth entrepreneurs are more likely to formally register their firms, the data allow researchers to consider which form of entrepreneurship is more likely to have a positive impact on growth and development.

However, if entrepreneurship is defined by its most common manifestation, a different conclusion emerges. Worldwide, most entrepreneurs are replicative entrepreneurs (also known as necessity entrepreneurs and survival entrepreneurs) rather than innovative entrepreneurs. A large number of these entrepreneurs have been forced into entrepreneurship and are likely to be

![Figure 1: The Relationship between Economic Development and Formal Entrepreneurship, Average 2004–09](source: World Bank 2010)

self-employed, without other employees in their establishment. The relationship between this form of entrepreneurship and economic development has been consistently documented to be negative (Kuznets 1966; Acs, Audretsch, and Evans 1994; Acs and Varga 2005; Schneider, Buehn, and Montenegro 2010). Data on self-reported employment status from the 105 countries included in the 2010 Gallup World Poll (Gallup 2011) confirm these findings (figure 2).

The articles in this symposium issue cover many forms of entrepreneurship. It may therefore make sense to consider the group as a whole, which leads to the literature arguing for a U-shaped relationship between entrepreneurship and economic development (GDP per capita). By this view, poor countries have high levels of necessity entrepreneurs; middle-income countries have few entrepreneurs, as their economies are driven by large manufacturing firms; and high-income economies have many innovative entrepreneurs, likely concentrated in the services sector (Blau 1987; Acs, Audretsch, and Evans 1994; Carree and others 2002; Wennekers and others 2005). This aligns with Porter, Sachs, and McArthur’s (2002) classification of the three stages of economic development: factor driven, efficiency driven, and innovation driven.

The U-shaped model has been criticized, however, for its empirical limitations and lack of explanatory depth (Carree and others 2007; Acs, Desai, and Hessels 2008). In response, Acs (2008) uses data from the Global Entrepreneurship Monitor to develop an opportunity entrepreneur–necessity entrepreneur ratio, which results in a low ranking for countries with high levels of replicative entrepreneurship and restores a positive linear relationship between economic development and entrepreneurship. (For a more detailed discussion, see Acs 2008).
Still unanswered, however, is whether the relationship between entrepreneurship and economic development (whether U-shaped or linear, positive or negative) is a result of distortionary policies or whether it represents the efficient distribution of capital and labor at different stages of development. If the relationship is indeed U-shaped, can countries move more quickly from stage two to stage three by implementing reforms to spur new firm creation, or will the rate of new firm creation remain stubbornly tied to the natural pace of economic development? Gollin (2008) provides a partial answer using a Japan-based model to demonstrate that it is efficient in poor countries for many lower skilled people to remain self-employed.

If there is any consensus emerging from the entrepreneurship literature, it is that more research is needed on both a cross-country and a micro level. The articles in this issue each contribute cutting-edge research and methods to the study of entrepreneurship and expand our understanding in several directions.

I. INFORMATIONAL BARRIERS TO ENTREPRENEURSHIP

It is difficult to understand the macroeconomic dimensions of entrepreneurship and the appropriate policy measures to promote high-growth entrepreneurship without understanding the micro dimensions of how firms are created, grow, and survive. Understanding firm dynamics, especially for young firms, is a valuable stream of entrepreneurship research. An important question is how the informational asymmetries of new and young firms can impede access to new capital. Unlike large firms, which can leverage their internal funds and reputations to access formal financing, small firms must often resort to costly informal financing, which can be risky and constrain firm growth (Myers and Majluf 1984; Bulan and Yan 2009; Brealey and Myers 2002; Djankov and others 2002; Carpenter and Rondi 2000).

In the first article in this symposium issue, Chavis, Klapper, and Love (2011) use the World Bank Enterprise Survey data, a comprehensive dataset on 70,000 firms in over 100 countries, to empirically demonstrate systematic differences in the use of financing sources for new and older firms. Across all country income groups, the authors find that younger firms rely less on bank financing and more on informal financing. For instance, the percentage of firms using bank financing increases as firms mature and almost doubles by the time firms reach 13 years, relative to new firms. This work contributes to the literature linking information asymmetries and access to finance. For instance, new firms have more severe financing constraints because of lack of existing banking relationships (Carpenter and Rondi 2000; Bulan and Yan 2009), while mature firms can leverage their internal funds and reputations to obtain bank financing (Myers and Majluf 1984; Bulan and Yan 2009; Brealey and Myers 2002; Carpenter and Rondi 2000).

2. Survey data are available at www.enterprisesurveys.org.
Informational asymmetries also likely contribute to the disconnect between formal financing and small firms in low-income countries, where formal education and financial access are often restricted to the upper class. De Mel, McKenzie, and Woodruff (2011) make an important contribution to the emerging body of research on informational asymmetries impeding financial access and firm growth. Using a randomized experiment in Sri Lanka designed to reduce informational and procedural barriers to access to finance, the authors find that loan take-up increases significantly when entrepreneurs receive information on loan products and lending requirements are relaxed. Their work contributes to the literature on impact of well-targeted information on behavior (Jensen 2010; Dupas 2006; Duflo and Saez 2003).

Taking a marketing angle, Gine, Mansuri, and Picon (2011) also extend the literature on informational asymmetries in access to finance. Their work touches on the importance of women in entrepreneurship, a topic receiving greater attention over the past decade (Yunus 1999). In a randomized controlled trial, the authors find a gender bias in marketing for a microfinance product targeting entrepreneurs. Men were more likely to respond to images of male business owners, while potential women entrepreneurs had no significant response to images of woman business owners. The results suggest that more powerful cues might be necessary to generate responses to role models for women. This work also relates to the literature on the role of information in the behavior of entrepreneurs.

The article by Lederman, Rodriguez-Clare, and Xu (2011) provides a novel description of the contribution of new exporting firms, products, and market destinations to the growth of exports of a successful middle-income country, Costa Rica, and compares the results with those in the nascent international trade literature focusing on the “extensive” margin of trade. The findings might appear to be consistent with the pessimistic view that new formal exporting firms contribute little to annual export growth, even though new exporting firms account for more than 30 percent of total exporting firms in a given year. More than 95 percent of annual export growth is due to incumbent exporting firms. Since the authors’ data from customs transactions cover only formal firms, this finding might appear at odds with the view that entrepreneurship is low in middle-income countries, but it is consistent with the view that entrepreneurship contributes little to overall economic growth (to the extent that export growth is pro-growth). However, the real contribution of export entrepreneurs to national export growth might transcend what is visible in accounting exercises: new exporting firms or new export products might provide information to incumbent firms about how and where to export new products, even if the new entrepreneurs fail. Thus, the informational contribution of new exporting firms can be an important support to growth and development (see also Lederman, Olarreaga, and Payton 2006; Fajnzylber, Guasch, and Lopez 2009; Volpe and Carballo 2008).
II. Conclusion

The articles in this symposium issue highlight the information barriers for new firms and the importance of information sharing and transparency for firm entry, growth, and survival. The articles suggest that policymakers need to recognize the importance of relaxing information asymmetries to promote high-growth entrepreneurship that can contribute to job creation and macro-economic growth.

In particular, the articles address some of the key information asymmetries of new and young firms, an endemic barrier to entrepreneurship worldwide. First, entrepreneurs’ limited track record with suppliers and buyers affects new firms’ ability to obtain external finance. Second, inadequate information on the loan application process and loan terms may limit the ability of entrepreneurs to obtain loans and grow their businesses. Third, gender biases may lessen the ability of targeted interventions and policies to increase access to finance. Finally, new exporters can help overcome information disadvantages, enabling incumbent firms to grow their exports.

Taken together, these articles suggest that policies to improve institutions by promoting information sharing may disproportionately help new firms. For instance, credit bureaus and registries that allow entrepreneurs to build personal and business credit histories can alleviate information asymmetries with creditors and improve access to start-up financing. Similarly, financial consumer protection laws requiring disclosure of credit terms, fees, and policies to improve business education and financial literacy can aid less experienced small borrowers. Finally, export-promotion policies and agencies can assist small exporting firms in dealing with the challenges of information gathering on prices, market, and financing opportunities.

References


