Entrepreneurship in a Post-Crisis Era

Is European Entrepreneurship in Crisis?

Wim Naudé[1]

The European Commission has adopted an Entrepreneurship 2020 Action Plan as its 'answer to challenges brought by the gravest economic crisis in the last 50 years' (European Commission 2013). European governments spend huge amounts of money trying to support new firm start-ups and promote innovation. Much of this enthusiasm for entrepreneurship in policymaking circles is due to three reasons: (i) conventional scope for manoeuver in terms of economic policy is shrinking, (ii) an inadequate understanding of the relationship between economic development and entrepreneurship, and (iii) ideological and real capture by interest groups, including entrepreneurs and big business.

There is no doubt that entrepreneurship can and did contribute to economic development in Europe. But, as is argued here, entrepreneurship does not automatically, straightforwardly or unambiguously boost economic development. Indeed, entrepreneurship may even be exacerbating many of Europe's economic woes. Because this is not a generally recognised fact, the currently high expectations of entrepreneurs are likely to be disappointed. In this article I discuss such concerns. It is time for Europe to look afresh at how to galvanise entrepreneurship that promotes development, starting with the realisation that a more sober view of its potential is required.

Entrepreneurship – often a last resort policy

'Victor Hugo once remarked "You can resist an invading army; you cannot resist an idea whose time has come". Today entrepreneurship is such an idea' (The Economist 2009).

When faced with crisis, policymakers often call on entrepreneurs to save the day when other more conventional economic policies fail to have the desired impact. The above quote is from an article in *The Economist* magazine, published in 2009 in the midst of the global financial crisis, when it carried a special section on entrepreneurs as 'Global Heroes' (Wooldridge 2009). The only previous occasion on which *The Economist* had published such an enthusiastic endorsement of entrepreneurship was during the 1970s recession. Its 25 December 1976 edition carried an article entitled 'The coming entrepreneurial revolution: a survey' (Macrae 1976). On both occasions entrepreneurship was lauded largely because policymakers and academics had run out of other policy options (read money) to restore growth. And in both cases the articles and sections in *The Economist* were actually wrong: the subsequent deregulation and free-marketeering widely adopted in the 1980s and staunchly promoted by the likes of Thatcher and Reagan heralded a period of unbridled growth in the incomes and wealth of the top 0.1 percent of the population in the US and Europe (Atkinson, Piketty and Saez 2011), while stimulating the corporate greed and risk-taking that directly contributed to the 2009 financial crisis.

Since the 2000s 'entrepreneurship' has stagnated and even declined in the US and many European countries. In Europe, for instance, the relative earnings of the self-employed compared to those of the wage-employed have declined significantly – by 20 percent in the UK since 2006/2007, for example (Hatfield 2015). And, as *The Economist* (2012) – accurately this time – pointed out, 'the vast majority of Europe's big companies were born around the end of the last century'. Since the 1980s 'nearly no international businesses [i.e. fortune 500 companies] have been developed in Europe' (Lirzin 2013).

Undermining the notion that the knowledge economy has heralded an 'entrepreneurial economy' in Europe, as some would like to believe, a recent Harvard Business School report found that Europe is in a 'digital recession', with only three European economies making it to the top of Harvard's digital evolution index, with a further nine European countries only making it to the

[1] Maastricht School of Management; Maastricht University; IZA, Bonn.

bottom slots of the index's top 50. Moreover, in terms of venture capital funding in excess of USD 100 million for high-tech start-ups, Europe ranked 'a distant third behind North America and Asia' (Chakravorti and Chaturvedi 2015). It is far from clear that entrepreneurship is 'an idea whose time has come' in Europe.

Entrepreneurship – no magic bullet for development

'This is one of those cases in which the imagination is baffled by the facts' – Adam Smith

Adam Smith, the 'father' of modern economics, was not very fond of entrepreneurs or businessmen. He would have been baffled as to why many scholars and policymakers so enthusiastically cling to the belief that entrepreneurship is the panacea for development, especially as the empirical evidence in this case is far from conclusive.

As I argue in more detail elsewhere (Naudé 2011), statistical results do not seem to be robust with regard to definitions, time-periods, quality of data, or estimation methods; reverse causality always crops up – indeed, based on the statistical evidence it seems more reasonable to conclude that economic growth drives entrepreneurship and small business start-ups rather than vice versa. Some economists even report a negative relationship between entrepreneurial activity and economic growth. Wong, Ho and Autio (2005), for example, find evidence for 'the existence of entrepreneurial activities that do not contribute to economic growth'; while Parker (2006) reports that there is no unambiguous empirical relationship between the rate of self-employment and unemployment.

Based on a broad survey of published empirical studies, mostly focusing on entrepreneurship in Europe, Van Praag and Versloot (2007) find that (i) entrepreneurs do not spend more on R&D; that (ii) entrepreneurs create lower quality and less secure jobs, and that (iii) 'the relative contribution of entrepreneurs to the value of productivity levels is low' (p.377).

Oosterbeek, Van Praag and Ijsselstein (2010) use a difference-in-differences approach to evaluate the impact of Europe's Junior Achievement Young Enterprise student mini-company (SMC) programme. They find that the programme had no positive impact: it did not enhance students' self-assessed entrepreneurial skills, and 'the effect on the intention to become an entrepreneur is even significantly negative' (p.443).

Most recently Daunfeldt, Halvarsson and Mihaescu (2015) have found that even focusing on so-called high-growth entrepreneurship (as the European Commission calls for) is problematic, since most high-growth firms in a Swedish sample were not very profitable and financially weak, casting doubt over whether they could sustain growth.

If entrepreneurship were indeed a magic bullet for development, as many like to suggest, it should not be so difficult to find even some shreds of empirical evidence for a positive and causal relationship between the various measures of entrepreneurship and of development.

Entrepreneurs often capture the policymaking process

'Throughout history there has been a tussle between those who make their way by honest but unimaginative toil and the gamblers, pirates, hucksters' – Silberman (1956).

Iceland was once hailed a 'miracle economy' and an example of an entrepreneurial economy par excellence that compared favourably with that global bastion of entrepreneurship, the US. 'Iceland is a European country with an American labour market' reported Kaiser (2008) in the *Huffington Post*. Indeed, by 2008 Iceland's entrepreneurs had created a financial sector that was worth ten times its GDP. As the sub-prime mortgage crisis started to unfold, however, the country's bloated financial sector collapsed in October 2008. This was rapidly followed by the collapse of the country's government in January 2009. What went wrong with the miracle entrepreneurial economy?

What happened was that entrepreneurs had captured the financial system and the policymaking process. Only three entrepreneurial families, who made their fortunes in the shipping, brewing and frozen food industries, reportedly obtained complete control over the country's banks, the Glitnir, Landsbanki and Kaupthing (Mason 2008). Emboldened by the ideology of free markets, financial deregulation and financial engineering, they seemed to have convinced and lobbied policymakers as to the soundness of their business model (read pyramid scheme); convincing them that there were no conflicts of interest between them owning Iceland's bank and running many large businesses in other sectors of the Icelandic economy.

Much has now been written on the government and policy capture that caused the financial crisis in Europe and the US (for a good account, see Johnson and Kwak 2011). With Greece's economic meltdown jeopardising the entire Eurozone, it is worthwhile recalling that a report in *Der Spiegel* (8 February 2010) entitled 'How Goldman Sachs Helped Greece to Mask its True Debt' explained how the lingering euro-crisis can at least be traced back to the ideological support and free hand of unscrupulous entrepreneurship – of the financial 'pirates and hucksters' – in Europe (Balzli 2010).

Despite the lack of political and other regulatory oversight in Europe that twisted the incentives of entrepreneurs and businesses in the financial crisis, little has been done to resist run-away entrepreneurialism. This phenomenon was, for instance, highly visible in 2015 in the scandals of Volkswagen, one of Europe's largest automobile manufacturers, and of the Swiss-based FIFA. In both cases the free hand enjoyed by these organisations led them to act opportunistically, corruptly, and against the public interest – in other words, to behave like 'pirates and hucksters'. And in both cases it was thanks to US-instigated investigations, and not European inquiries, that the culprits were found out.

In 2015 Europe had to accommodate millions of refugees fleeing conflict and economic destitution in the Middle East and North Africa. Although there has been much criticism of the EU's poor handling of the migration crisis, a full discussion is beyond the scope of this article. For present purposes, however, and with growing scepticism over the EU governance system as a result of the scale and scope of the activities of at least 30,000 lobbyists in Brussels (Traynor et al. 2014), the EU's responses to this crisis cannot be free of entrepreneurial policy capture. Andersson (2012) disconcertingly describes the new business of 'illegality' as containing elements in common with the financial crisis: "European states are taking yet another leap with Eurosur and the investments this system entails: surveillance machinery, coordination centres, patrol vehicles and manpower. For the border guards, defence contractors, international organizations and aid agencies involved, clandestine migration has become big business. […] In this growing industry, careers are made, networks created, knowledge and imagery circulated, and money channeled in increasing amounts. […] Here Frontex, pushing the securitization analogy, works much like the offshore 'special purpose vehicles' used in derivatives banking before the crisis – spreading risks off-balance-sheet, diffusing accountability away from sovereign states and their elected governments."

The examples cited above are proof of the truth that Baumol (1990) recognised 25 years ago, namely that '… at times the entrepreneur may even lead a parasitical existence that is actually damaging to the economy. How the entrepreneur acts at a given time and place depends heavily on the rules of the game – the reward structure of the economy – that happen to prevail'.

In contemporary Europe the 'reward structure of society' is making it increasingly difficult for small businesses to grow and innovate, and steadily encouraging a privileged economic and business elite to resort to unproductive and even destructive actions, including patronage, corruption and rent seeking. Policies too often end up prolonging the life of inefficient and low-productivity firms. Even well-intentioned policies may be fundamentally flawed, because an EU over-eager to raise the number of entrepreneurs will push too many people who lack entrepreneurial ability into the market, with negative spillover effects on those entrepreneurs who do have the skills to start and run a business.

The (slow) reversal of fortune

Although prosperous, Europe is in relative and absolute decline. It is in relative decline as the income and wealth gaps between Europe and many emerging and developing countries are shrinking. It is in absolute decline as many gains made after the Second World War seem to be reversing in several European countries as reflected, for instance, in access to health and education, in rising and stubbornly high unemployment rates, and in Europe's loss of global political influence (see e.g. Applebaum 2015). Ferguson (2015) refers to this phenomenon as an 'institutional degeneration' in Europe.

In contrast to today, European powers back in 1494 were so powerful that Portugal and Spain divided the non-European world between the two of them at the Treaty of Tordesillas. But by 2010 Portugal and Spain had become 'submerging economies' (Collier 2013) with unemployment rates of around 11 and 25 percent respectively. In 1900 the sun never set on the British Empire. In 2016 the UK has been reduced to 'an island in the Atlantic somewhere between mainland Europe and the Americas' voting to leave the EU and with not a single British firm among the Top 100 Innovating Firms worldwide (according to Thomson Reuters 2015).

The rise and fall of the city of Glasgow is a metaphor for Europe's entrepreneurs. As Frisby (2014) chronicles, Glasgow rose during the 18th and 19th centuries through entrepreneurs seizing on its favourable location as a harbour and seafaring hub (exploiting the trade winds) and the inventions of the industrial revolution, to become the British Empire's second greatest city by 1900. Glasgow was considered the best-governed city in Europe and adapted innovatively to many changes in external circumstances: When it lost its position in the tobacco trade after American Independence it moved on to cotton; when steam ships made its position on the trade winds irrelevant, it became a major producer of ships, producing one fifth of the world's ships between 1890 and 1914. But after 1914 its long and slow relative decline set in. Today Glasgow has, as reported by Frisby (2014), a 30 percent unemployment rate, the UK's highest homicide rate, and its lowest life expectancy. It is no longer a manufacturing hub. Glasgow's 'entrepreneurship', which helped it to buffer many changes and shocks in the 18th and 19th centuries, was powerless to prevent its decline.

Perhaps the single most serious challenge facing Europe is a demographic one. Europe's population is in decline and ageing. Its working age population stopped growing in 2014. This trend will continue notwithstanding current immigration, and even in the face of an (unlikely) baby boom (Falkingham, Heran and Vaupel 2011). The implications for productivity, the social security system, inequality and growth are ominous. This trend will result in older entrepreneurs, as well as more people who enter entrepreneurship for the first time at an older age. Self-employment amongst 50 to 65 year-olds is already increasing sharply in many European countries, particularly in the Netherlands and the UK; in the latter one in five persons in the 50 to 65 year-old age category is self-employed compared to only one in seven in younger age categories (Hatfield 2015).

The age-structure of business firms in Europe will also get older along with its population, with the accompanying effect of older business firms being less innovative and less dynamic, and less likely to employ new labour than younger firms.

Conclusions

The millions of small businesses dotting European cities are not driving growth, are faring more and more poorly in terms of earnings compared to wage earners, and are increasingly run by older entrepreneurs.

Big businesses in Europe, by contrast, are a thing of the past, with many depending heavily on the Brussels gravy train. When they innovate it is increasingly to reduce dependency on labour in the face of a shrinking working force and sluggish labour productivity growth. Some leave Europe or outsource their jobs, so as to take better advantage of emerging markets and escape altogether from Brussels' bureaucracy. Some are taken over by more efficient competitors from outside: In 2015 the value of acquisitions of EU-based firms from outside reached its highest level since 1970[2].

Demographic changes and institutional shortcomings are thus shaping the profile of entrepreneurship in Europe to look a lot like entrepreneurship in poor countries, where 'survivalist' entrepreneurial firms outnumber their 'transformative' counterparts and where political influence matters more to business growth than technical abilities. This changes the relationship between entrepreneurship and development. Without taking into account these factors, and without a better understanding of the relationship between economic development and entrepreneurship, the European Commission's 'answer to challenges brought by the gravest economic crisis in the last 50 years' is likely to remain a half-baked response.

References

Andersson, R. (2012), "Boat Migration and the Business of Bordering Europe", *Anthropology Today* 28 (6), 7–11.

Applebaum, A. (2015), "Does Europe Even Matter? Dysfunction has Sucked Brussels Dry of Any Foreign Policy Power or Relevance", *Foreign Policy*, December.

Atkinson, A. B., T. Piketty and E. Saez (2011), "Top Incomes in the Long Run of History", *Journal of Economic Literature* 49 (1), 3–71.

Balzli, B. (2010), "Greek Debt Crisis: How Goldman Sachs Helped Greece to Mask its True Debt", *Der Spiegel,* 08 February, online edition, http://www.spiegel.de/international/europe/greek-debt-crisis-how-goldman-sachs-helped-greece-to-mask-its-true-debt-a-676634.html (accessed 27 July 2016).

Baumol, W. J. (1990), "Entrepreneurship: Productive, Unproductive and Destructive", *The Journal of Political Economy* 98 (5), 893–921.

Chakravorti, B. and R. S. Chaturvedi (2015), "Europe's Other Crisis: A Digital Recession", *Harvard Business Review*, 27 October, online edition, https://hbr.org/2015/10/europes-other-crisis-a-digital-recession (accessed 26 July 2016).

Collier, P. (2013), "Europe's Submerging Economies", *Social Europe*, 11 March, online edition, http://www.socialeurope.eu/2013/03/europes-submerging-economies/ (accessed 26 July 2016).

[2] In recent years prominent European-based firms taken over by foreign competitors included Cadbury's taken over by Kraft; Pirelli taken over by China's CNCC; Volvo taken over by Geely's; Nokia's mobile phone division taken over by Microsoft; Skype taken over by eBay; Czech airlines bailed out by Korean Air.

Daunfeldt, S.–O., D. Halvarsson and O. Mihaescu (2015), "High-Growth Firms: Not so Vital after All?" *Ratio Institute Working Paper* no. 263.

European Commission (2013), The Entrepreneurship 2020 Action Plan COM (2012) 795 Final, http://ec.europa.eu/growth/smes/promoting-entrepreneurship/action-plan/ (accessed 26 July 2016).

Falkingham, J., F. Heran and J. Vaupel (2011), Population and Policy Compact: Europe's Citizens Should have a Choice. Toward a New Policy of Life-Course Flexibility, Max Planck Society for the Advancement of Sciences on behalf of the collaborative network "Population Europe", Berlin, available online at: http://www.population-europe.eu/file/238/download?token=J6OaR5lv (accessed 26 July 2016).

Ferguson, N. (2015), "The Degeneration of Europe", *Prospect Magazine*, November.

Frisby, D. (2014), "Glasgow: The Rise and Fall of a Start-Up Hub", *Virgin Entrepreneur*, 1 August, http://www.virgin.com/entrepreneur/glasgow-the-rise-and-fall-of-a-start-up-hub (accessed 26 July 2016).

Hatfield, I. (2015), *Self-Employment in Europe*, Institute for Public Policy Research, London.

Johnson, S. and J. Kwak (2011), *13 Bankers: The Wall Street Takeover and the Next Financial Meltdown*, Random House, New York.

Kaiser, M. (2008), "Who Could Have Predicted Revolution in Iceland?", *The Huffington Post*, 25 December.

Lirzin, F. (2013), "Entrepreneurs at the Heart of Economic Recovery in Europe", *Foundation Robert Schuman Policy Paper* no. 284.

Macrae, N. (1976), "The Coming Entrepreneurial Revolution: A Survey", *The Economist*, 25 December, p. 41–65, online available at: http://normanmacrae.ning.com/forum/topics/entrepreneurial-revolution (accessed 26 July 2016).

Mason, R. (2008), "Iceland Falls out of Love with Its Billionaires", *The Telegraph*, 19 October, online edition, http://www.telegraph.co.uk/finance/financialcrisis/3227409/Iceland-falls-out-of-love-with-its-billionaires-financial-crisis.html (accessed 26 July 2016).

Naudé, W. (2011), "Entrepreneurship is Not a Binding Constraint on Growth and Development in the Poorest Countries", *World Development* 39 (1), 33–44.

Oosterbeek, H., M. Van Praag and A. Ijsselstein (2010), "The Impact of Entrepreneurship Education on Entrepreneurship Skills and Motivation", *European Economic Review* 54 (3), 442–54.

Parker, S. C. (2006), "Entrepreneurship, Self-Employment and The Labour Market", in M. Casson, B. Yeung, A. Basu and N. Wadeson, eds., *The Oxford Handbook of Entrepreneurship*, Oxford University Press, Oxford.

Silberman, L. (1956), "The Evolution of Entrepreneurship in the Process of Economic Development", *Annals of the American Academy of Political and Social Science* 305 (1), 32–44.

The Economist (2009), 14 March, Supplement p.6.

The Economist (2012), "European Entrepreneurs. Les Miserables", 28 July, Briefing section.

Thomson Reuters (2015), *Thomson Reuters Top 100 Global Innovators Report*.

Traynor, I., B. Kuraś, P. Ricard, I. Fariza Somolinos, J. Cáceres and M. Zetterin (2014), "30,000 Lobbyists and Counting: Is Brussels under Corporate Sway?", *The Guardian,* 8 May, online edition, http://www.theguardian.com/world/2014/may/08/lobbyists-european-parliament-brussels-corporate (accessed 26 July 2016).

Van Praag, C. M. and P. H. Versloot (2007), "What is the Value of Entrepreneurship? A Review of Recent Research", *Small Business Economics* 29 (4), 351–82.

Wong, P. K., Y. P. Ho and E. Autio (2005), "Entrepreneurship, Innovation and Economic Growth: Evidence from GEM Data", *Small Business Economics* 24 (3), 335–50.

Wooldridge, A. (2009), "Global Heroes", *The Economist,* 12 March, online edition, http://www.economist.com/node/13216025 (accessed 26 July 2016).