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## Economic development and entrepreneurship

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### Abstract

Several dynamic forces, such as technological disruption, fluctuating economies or demographical changes, have brought new opportunities and threats for organizations, and transformed societies from all over the world. In order to cope with these shifting forces, governments, public and private organizations, and the public are more and more aware of the importance of entrepreneurship. Entrepreneurship is a multifaceted phenomenon, being analysed as a process, a resource or a state-of-being. According to the Schumpeterian view, the entrepreneurial process constitutes one of the key factors in the economic development of a country/region. However, researchers have expressed different views about the relationship between the stages of economic development and entrepreneurship during the time. The aims of the paper are to examine in brief the concepts of economic development and entrepreneurship, and to emphasize the role of entrepreneurship in economic development. The methodological approach is literature review. Our paper provides a theoretical model that highlights some of the main factors involved in the relationship between entrepreneurship and economic development. More than ever in the history, economic development and entrepreneurship have become strongly interconnected.

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*Keywords:* entrepreneurship, economic development, entrepreneurs, growth, small and medium enterprises;

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## 1. Introduction

Several dynamic forces, such as technological disruption, fluctuating economies or demographical changes, have brought new opportunities and threats for organizations, and transformed societies from all over the world. In order to cope with these shifting forces, governments, public and private organizations, and the public are more and more aware of the significance of entrepreneurship. The role of entrepreneurship in society has become prominent since the end of the last century. Entrepreneurship matters because it is, above all, a human characteristic (Bessant and Tidd, 2011). In modern open economies it has become more important for economic growth and development than it has ever been.

In the past decades, there has been a growing interest regarding the concepts of economic development and entrepreneurship. On the one hand, there are several studies in the literature related to these two important notions (Ács et al., 2013; Szirmai et al., 2011; Naudé, 2011; Braunerhjelm, 2010; Caree and Thurik, 2010; Walzer, 2009; Wennekers et al., 2009; Audretsch et al. 2006; van Stel et al., 2005; Harper, 2003; Dejardin, 2000). Researchers have concluded that although “economic development theory can still be argued to lack a ‘general theory’ of entrepreneurship, one that could encompass a variety of development outcomes, progress has been made in extending the notion and understanding of entrepreneurship in economic development” (Naudé, 2008, p. 1). On the other hand, international organizations, governments and policy makers have shown a greater attention to the function fulfilled by entrepreneurship in generating economic development. Economic experts have abandoned their traditional approach to economic development based mainly on recruiting large companies with different financial and fiscal inducements. Today they are relying more on the small and medium enterprises (SMEs) and new ventures than in the past. Entrepreneurship is spreadingly recognized by government officials throughout the world not only as “a key mechanism for enhancing economic development, particularly in regions where entrepreneurial activity was once vibrant and is now lagging”, but also as “a good solution because it provides a relatively non-controversial way to increase the proverbial pie, creating jobs and enhancing per capita income growth” (Shane, 2005, p. 1). That is why “entrepreneurs need access to resources and markets to succeed, and this is where national policies play a vital role” (Kressel and Lento, 2012, p. 6).

However, when it comes to know how the mechanism operates, little is known, either on how entrepreneurship can be best promoted or on how entrepreneurship influences economic performance (Wennekers and Thurik, 1999). Arising from the above discussion emerges the following question: What is the relationship between economic development and entrepreneurship?

The aims of the paper are to examine in brief the concepts of economic development and entrepreneurship, and to emphasize the role of entrepreneurship in economic development. Also, our paper provides a theoretical model that highlights some of the main factors involved in the relationship between entrepreneurship and economic development. The methodological approach is literature review.

The paper is divided in three parts. The first section examines the conceptual framework of the notions of economic development and entrepreneurship. The second section presents the relationship between the two concepts and its theoretical model. Paper ends with conclusions.

## 2. Theoretical perspectives on economic development and entrepreneurship

Understanding the role of entrepreneurship and entrepreneurs in the process of economic development requires the decomposition of the concepts. There are hundreds of definitions for the notions of entrepreneur and entrepreneurship. Ever since the first writings about entrepreneurship there has never been an accord over a definition of the concept. The central explanation lies in the fact that entrepreneurship represents a multifaceted phenomenon, being analysed as a process, a resource or a state-of-being (Naudé, 2013). That is why there is no shortage of definitions of entrepreneurship because it is too complex to be explained through a single set of factors. During the time, the scholarly views of entrepreneurship have evolved into three main categories (Naudé, 2013):

- behavioral definitions (e.g., Schumpeter, Kirzner);
- occupational definitions (e.g., Evans and Jovanovic);
- synthesis definitions (e.g., Gries and Naudé).

In some ways, the entrepreneur has intrigued the researchers in social sciences in the same way in which the elementary particles challenged the physicists (Rogoff and Lee, 1996). The effect may be observed, but the thing is in itself evanescent and invisible. Just like the physicists, who study the traces of the particle action on the electronic microscope screen, the researchers from the entrepreneurship domain have examined its economic results: new enterprises, more jobs, new products invented and services offered. But when it comes to determining what exactly created these phenomena, very few experts agree with each other.

The term 'entrepreneur' seems to have been introduced by R. Cantillon. In his opinion, the central component of the definition of the entrepreneur gravitates around risk assuming. Later, J.-B. Say stated that the entrepreneur shifts economic resources out of an area of lower productivity and moves them into an area of higher productivity.

The progress achieved in understanding entrepreneurship is largely due to J. A. Schumpeter. He adopted a different approach, underlying the role of innovation. Entrepreneurs are not only innovators and, therefore, agents of change, but also coordinators of production. He suggested that entrepreneurship occurs under five conditions of newness: new goods, new production methods, new markets, new sources of materials, or new organizations (Schumpeter, 1911). According to the Schumpeterian view, the entrepreneurial process constitutes one of the key factors in the economic development of a region/country.

On his turn, Kirzner stated that in economic development „the entrepreneur is to be seen as responding to opportunities rather than creating them; as capturing profit opportunities rather than generating them” (Kirzner, 1973, p. 74). Later, Gilder (1980) considered that the entrepreneur is a superman who knows the hidden laws of economy and who contributes to progress. Also, he fights against poverty by creating new jobs. Other researchers adopted different approaches as follows:

- „Entrepreneurship is a purposeful activity to initiate, maintain and develop a profit oriented business.” (Cole, 1968, p. 65)
- “Entrepreneurship is the set of behaviours that initiates and manages the reallocation of economic resources and whose purpose is value creation through those means.” (Herron and Robinson, 1993, p. 283)
- “Entrepreneurship is the resource, process and state of being through and in which individuals utilize positive opportunities in the market by creating and growing new business firms.” (Gries and Naudé, 2011, p. 217)

However, a quasi-general accepted, and now popular, process and people oriented definition of entrepreneurship has emerged in the business literature: “Entrepreneurship is a process that involves the discovery, evaluation, and exploitation of opportunities to introduce new products, services, processes, ways of organizing, or markets” (Shane and Venkataraman, 2000, p. 219).

Entrepreneurship is therefore a creative human process, one which mobilizes resources from one level of productivity to another, a superior one. It implies the individual's will of taking on responsibilities and the mental ability of carrying out the task from idea to implementation. Another component of entrepreneurship consists in identifying opportunities where other people find only chaos, contradictions, or confusion. The essence of entrepreneurship lies in walking against time with wisdom and maturity, and in serving as an agent for change.

The modern theories of economic development appeared principally after the Second World War. The term 'economic development' was rarely used in economic literature before that time (Arndt, 1987). These theories were greatly influenced, initially at least, by the post-war experience of Europe and the great destructions that the war caused to the productive infrastructure of European countries.

No single definition incorporates all of the different features of economic development. Economic development can be described in terms of goals (e.g., creation of jobs, improvement of the quality of life) or as a process that influences growth in order to enhance the economic well-being of a community/society. In this respect, economic development represents “the process of structural transformation of an economy towards a modern, technologically advanced economy based on services and manufacturing” (Naudé, 2008, p. 18). In other words, economic development refers to “sustainable improvements in the material well-being of a society, as measured for instance by GDP per capita, GDP growth, productivity and employment” (Naudé, 2011, p. 7). In its broadest sense, economic development encompasses the following three major areas:

- “Policies that government undertakes to meet broad economic objectives including inflation control, high employment and sustainable growth.
- Policies and programs to provide services including building highways, managing parks and providing medical access to the disadvantaged.

- Policies and programs explicitly directed at improving the business climate through specific efforts, business finance, marketing, neighborhood development, business retention and expansion, technology transfer, real estate development and others” (IEDC, p. 3).

In conclusion, economic development and entrepreneurship are both complex concepts. Also, they are related to each other as our paper demonstrates in the next section.

### 3. Relating entrepreneurship to economic development through a theoretical model

Entrepreneurship is important because it is the economic mechanism through which inefficiencies in economies are identified and mitigated (Baum et al., 2007). According to OECD (1998) “entrepreneurship is central to the functioning of market economies”. The U.S. Small Business Administration (1998) went even further, to declare that “the crucial barometer of economic freedom and well-being is the continued creation of new and small firms in all sectors of the economy by all segments of society”.

Let us regard things in retrospect. When human society entered the 20<sup>th</sup> century the spotlights were on the ‘big things’- ‘big’ used to be beautiful and respectable, or the political ‘establishment’. ‘Big’ was the future. It provided a scale economy based on mass production which brought welfare to the people, if not exactly wealth. In this way, the Western democracies kept the ordinary man in his place. Those times bore their own professional elite: the managers (Burns, 2011).

In most developed economies, the first two post-war decades represented a success for the great enterprise, considered the only one capable to conform itself to the code of the industrial society, expressed in six essential principles: standardization, specialization, synchronization, concentration, maximization and centralization. The small enterprise seemed doomed to remain the Cinderella of the economies, maybe even a brake on their way towards development.

At the beginning of the 1970s, the literature started to refer to the role of the SMEs in the economy. There was ample evidence that economic activity moved away from large firms to small firms in the 1970s and 1980s. But did this mean that the small companies, a David of business, had triumphed over the Goliath of the big enterprises? In fact, the small companies, the new companies and the entrepreneurs had always been there. Therefore, in the latter part of the past century the perception began to change. Schumacher (1973) asserted that the giant organizations and the growth of specialization would lead to economic inefficiency at the macroeconomic level, to pollution and to improper working conditions and offered as an alternative a system of intermediary technologies based on small production units. It seemed that the orthodoxy of the big enterprise had not brought mankind the economic success it had expected (Burns, 2011).

In the 1980s stagflation and high unemployment caused a higher interest in the supply side economics and in identifying the factors determining economic growth and development. Simultaneously, the 1980s and 1990s witnessed a re-evaluation of the role of small firms and a renewed attention for entrepreneurship (Wennekers and Thurik, 1999).

People started to value the importance of the SMEs. Around the 1980s the special contribution that the SMEs brought to the labor market began to be much more appreciated as more than 80% of all new jobs were created by small enterprises (below 500 employees) in the United States of America (USA). Since then this pattern has been kept until today. In the USA, the SMEs generate more than a half of the gross domestic product (GDP) and more than 50% of all the exports are carried out by companies with less than 20 employees.

After being focused for years on massive investments and having courted the multinational companies, governments from Latin America realized that the SMEs are the true source of jobs. As the vast majority of companies (80-90%) are micro-enterprises, they have reduced the bureaucracy a lot to make sure that the requirements of the SMEs have been taken into account.

As far as the Asian world is concerned, it is a well-known fact that some of the best performing economies in the world (e.g., Taiwan, Hong Kong), are deeply anchored in the small enterprises. More than 80% of the total number of Japanese employees is working in SMEs, where an enterprise hires an average of 9 employees, as compared with an average of 4 employees in the European Union (EU). In Germany, enterprises with fewer than five hundred employees produce two-thirds of the GDP, train nine out of ten apprentices, and employ four of every five workers.

In recent years, entrepreneurship has constituted a major source for job creation and has contributed to economic

growth, and to national prosperity. As a consequence, considerable efforts have been made in the attempt to understand the phenomenon. All over the world, researchers have analyzed behaviors and put forth hypotheses; the result was a rich and complex literature belonging to several schools, each with its own theory. The explanations which seem to very well fit a group of entrepreneurs are less suitable for another group.

Entrepreneurship has to do with individuals, people with their own traits and actions (roles). Various roles of the entrepreneur can be distinguished in the business world. In order to express the connection between entrepreneurship and economic growth and development, two major roles of the entrepreneur can be singled out. The first has to do with ‘new entry’ and the second with ‘newness’ in general. Firstly, the entrepreneur is the founder of a new business: “. . . someone who creates and then, perhaps, organizes and operates a new business firm, whether or not there is anything innovative in those acts”. Secondly, the entrepreneur plays a more general innovative role in economic life: “. . . the entrepreneur as the innovator – as the one who transforms inventions and ideas into economically viable entities, whether or not, in the course of doing so they create or operate a firm” (Wennekers and Thurik, 1999). Thus, newness through start-ups and innovations are some of the most relevant factors linking entrepreneurship to economic growth.

The traditional theories tended to suggest that entrepreneurship impeded rather than encouraged growth. Classical economics focused on optimising existing resources within a stable environment and treated any disruption, such as entrepreneurial new firms creating whole new industries, as “God sent” external forces. Schumpeter created the connection between entrepreneurship, innovation and growth.

More recently, theories of ‘industrial evolution’ have directly linked entrepreneurship with economic growth. These theories focus on change as the central factor and emphasize the role knowledge plays in charting a way through this. The new evolutionary theories, supported by empirical evidence, state therefore that entrepreneurship encourage growth for three reasons (Burns, 2011):

I. It stimulates competition by increasing the number of enterprises. Whilst this increases growth in itself, it is a cumulative phenomenon because competition is more conducive to knowledge externalities- new ideas – than is local monopoly. And so, entrepreneurship encourages entrepreneurship.

II. It facilitates the “knowledge spillovers”– transmission of knowledge from its points of origin to other individuals or organizations. Knowledge spillover is an important mechanism underlying endogenous growth and start-ups. In other words, entrepreneurs spot opportunities and innovate.

III. It generates diversity and variety among enterprises in any location. Each enterprise is in some way different or unique and this influences economic growth.

Different views about the relationship between the stages of economic development and entrepreneurship have been expressed during the time. In the earlier stages of economic development, the contribution of entrepreneurship is considered to be less important than in the later stages (Naudé, 2013). Moreover, entrepreneurship can be productive, unproductive or destructive (Baumol, 1990) in all stages, and, consequently, may affect economic development in a positive or in a negative manner. That is why our paper proposes a theoretical model that aims to link entrepreneurship and economic development (Fig. 1).

Starting from the Global Entrepreneurship Monitor Report 2012, our model constitutes a synthesis of the previous researches of authors regarding the analysis of the SMEs sector in the world and in Romania. In this country the entrepreneurial tradition has been brutally interrupted and thoroughly denied ideologically almost 60 years, along with the idea of the free enterprise itself. The model identifies some of the main factors that have to act in the context of transferring the theoretical importance of the SMEs sector in the reality of the major players from a healthy market economy.

Someone coming from a 250 years of established culture of capitalism might find the model peculiar. And rightly so: our model rather describes an emerging free market situation. In this case more variables should be considered as significant. On one side, any society needs entrepreneurs. They appear if certain conditions are met (e.g., economic freedom). The optimal situation would be that of a country where entrepreneurial tradition and education are at home. An apparent paradox emerges: countries with centuries of entrepreneurial tradition – where free enterprise lays in their DNA, being informally transmitted from one generation to another– allocate significant resources to formal entrepreneurial education in schools and universities. In this respect, some countries reached excellence in this: Great Britain, USA and Israel. This favorable environment creates a suitable entrepreneurial potential (e.g., a desired percentage of the active population takes into consideration the entrepreneurship as an important option).

When this potential is materialized, the proper conditions will occur, especially the market opportunities and the infrastructure. On the other side, governmental policies and institutions are crucial (High, 2009), in order to issue the proper rules of such a game, and to create some mechanisms in order to make the market and the finance to go smoothly. Also, a complete and stable set of coherent laws should be issued, in order to simply and clearly define the way through which the respective country understands to turn to profit its own strong points. In the same time, the fiscal policy should be very carefully weighed and pondered, and then modified as seldom as possible, and only in very serious circumstances.

There is a particular characteristic of our model, concerning the financial institutions: an emerging free market economy presents bigger risks to the investors and that leads to higher costs of the capital and, even to considerable reluctance from the banks to provide credit. This situation creates an objective and major handicap to the entrepreneurs that operates in such an environment versus their competitors from developed countries. That is why government should take measures to compensate this handicap. If not, that economy will be doomed to failure. On the other side, in this turbulent period, with unclear issues and inadvertent behaviors, the presence of an independent and neutral referee is essential. This would be the justice. If the referee obeys orders and looks the other side when some of the players are bending the rules in their favor, or even changes the rules during the game, the progress of the society as a whole is impossible. If these conditions are fulfilled, society may reach a critical mass of viable and healthy ventures and then, economic development is going to be achieved.

There are at least two action fields known that have a bigger than unit yield potential (the results exceed quantitative and qualitative the costs of obtaining them): agriculture and entrepreneurship. One can make an analogy between them that might explain also the algorithm of the proposed model. What do we need for a good crop? Good seeds, in sufficient amount. Concerning the source of entrepreneurs, apart tradition, we need a consistent educational effort from society. We need a fertile soil, suitable to our desire (e.g., the quality of the infrastructure). There is no doubt that the climate conditions are important (e.g., governmental policies), if not decisive. And, it is worth to mention, the opportunity of some particular crop in the actual market context (e.g., opportunities and markets), in an era of accelerated globalization.

In sum, entrepreneurship influences economic development. Firstly, the process of economic development is “the overall, unintended outcome of a complex of myriad individual acts of entrepreneurial discovery” (Harper, 2003, p. 2). It is needless to say that “entrepreneurs can contribute to economic development by facilitating the reallocation of resources from less to more productive uses” (Szirmai et al., 2011, p. 3). As a development strategy in today’s changing economic environment, entrepreneurship has become prominent “especially in the past decade as practitioners recognize the limited number of firms relocating and the resulting competition for these businesses” (Walzer, 2009, p. 2). Secondly, entrepreneurship is considered to be “an important mechanism for economic development through employment, innovation and welfare” (Acs and Szerb, 2010, p. 5). Thirdly, entrepreneurship is “essential to a growing economy in large part because its innovations create demand for new products and services that were not previously available” (Kressel and Lento, 2012, p. 6). Therefore, government officials frequently search for mechanisms “to enhance entrepreneurial activity in their regions, whether those mechanisms are tax policies, financing subsidies or other tools” (Shane, 2005, p. 1).

## Conclusions

The focus of scientific research on the topic of economic development and entrepreneurship has evolved during the time. Both concepts have proved to be important subjects of study for scholars all over the world. Moreover, the relationship between economic development and entrepreneurship has gained a growing interest in explaining economic performance from one historical period to another.

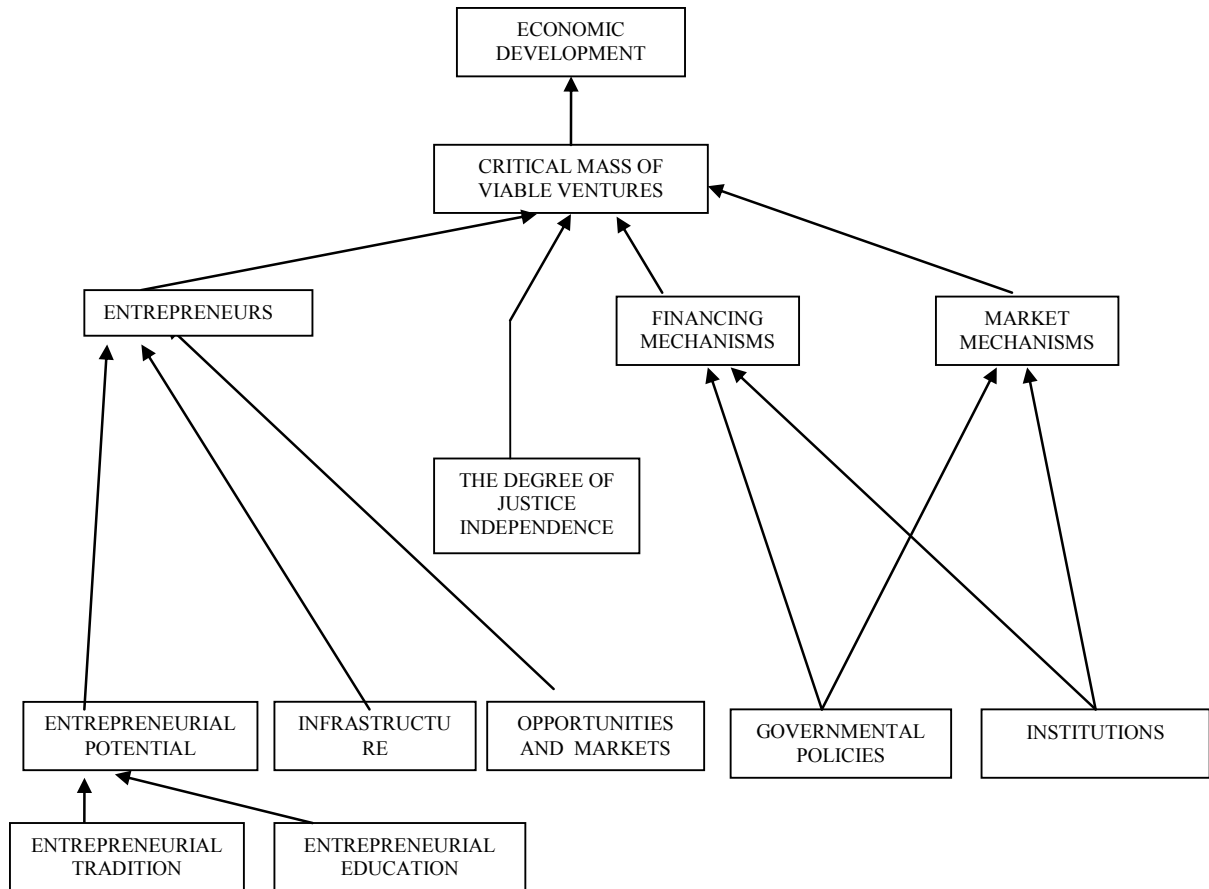
As an omnipresent aspect of human activity, entrepreneurship plays a key role in economic development. Today entrepreneurship is widely recognized both by academics and practitioners as a fundamental factor of economic development throughout the world. However, entrepreneurship may influence economic development positively as well as negatively.

Our research bears out the results of other researches (Naudé, 2013; Audretsch, 2007) that state that, more than ever in the history, economic development and entrepreneurship have become strongly interconnected. As our theoretical model shows, the emergence of a critical mass of viable ventures may lead to economic development. On



the one hand, entrepreneurial tradition and education are engines of the entrepreneurial potential. On the other hand, the institutions, the governmental policies and the legal framework can stimulate or block entrepreneurial initiatives. Future researches can be carried out in order to improve this theoretical model.

### Appendix A. A theoretical model of linking economic development and entrepreneurship



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