The Dynamics of Entrepreneurship

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Abstract

It is difficult to overstate the importance of entrepreneurial activity for developing countries. In Thailand, for example, small firms employ 60% of the work force and account for approximately 50% of GDP.[1] Using cross-sectional data from rural and semi-urban Thailand, we examine how financial constraints affect who becomes an entrepreneur and how existing businesses are run. The data allow us to control for both household and firm characteristics. In addition, the data were collected from two distinct geographic areas in Thailand. This distinction allows us to contrast the impact of financial constraints in the Central region, where household wealth is relatively high and financial markets are comparatively well developed, with their impact in the much poorer and more remote Northeast.

The analysis uses non-parametric and reduced form techniques. The results indicate that financial constraints play an important role in shaping the patterns of entrepreneurship in Thailand. In particular, wealthier households are more likely to start businesses. In the Central region, wealthier households are also more likely to invest greater amounts in their businesses and to face fewer constraints. In addition, education plays an important role in facilitating business start-ups in the Northeast and is associated with higher investment levels in both the Northeast and the Central region. We also provide evidence that financial constraints place greater restrictions on entrepreneurial activity in the Northeast compared to the Central region.[2]

Despite the importance of small firms in the overall economy, we know very little about the dynamics of operating a small business. What makes one small firm succeed and another fail? How does access to initial and on-going capital affect these outcomes? How does individual ability affect the decision to start a firm? How does it affect the on-going operations of the firm? How variable are firm revenues and expenses?

In on-going work, we make use of new panel data from Thailand to address these questions, adding to the insights gained from the analysis of the cross-sectional data. The panel data provide annual information on 950 households from 1997 to 2001. In 1997, approximately 20% of the households had a small business. By 2001, more than 40% of the households had a small business.

Small firms are notoriously fragile – coming into existence and failing with astonishing rapidity. This churning in the composition of small businesses allows us to use household fixed effects to control for the effect of unobserved entrepreneurial ability. Having controlled for individual heterogeneity, we can isolate the impact of wealth and draw stronger conclusions about the importance of financial constraints for entrepreneurs and potential entrepreneurs. This is an important improvement compared to existing work (including our own) where data limitations prohibit a thorough treatment of individual characteristics that are not observed by the econometrician.

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[1] The importance of small firms in the overall economy is not just a feature of the developing world. In the U.S. approximately 50% of the workforce is employed in a small firm and small firms account for 38% of GDP. In addition, the typical small firm is very small. In both Thailand and the U.S. the vast majority of small firms have just one or two employees.

[2] These results are described in the accompanying paper.