

## **Lecture – 2**

**Understand the concept of entrepreneurship and economic development**

Course overview

In this video I will discuss about the Role and importance of entrepreneur in economic development

### **Role of Entrepreneurs in Economic Development**

Everything you need to know about the role of entrepreneurs in economic development. Economic development essentially means a process of upward change whereby the real per capita income of a country increases over a period of time.

Entrepreneur plays a vital role in economic development. Entrepreneurs serve as the catalysts in the process of industrialization and economic growth.

Technical progress alone cannot lead to economic development, unless technological breakthroughs are put to economic use by entrepreneurs.

Some of the roles of entrepreneurs are:- 1. Capital Formation 2. Improvement in Per Capita Income 3. Generation of Employment 4. Balanced Regional Development 5. Improvement in Living Standards 6. Economic Independence 7. Backward and Forward Linkages

8. Inspire Others towards Entrepreneurship 9. Create Knowledge Spillovers 10. Augment the Number of Enterprises 11. Provide Diversity in Firms 12. Organising of Society's Productive Resources 13. Production of New Articles 14. Development of New Production Technique and a Few Others.

### **Role of Entrepreneurs in Economic Development**

**Role of Entrepreneurs in Economic Development – 7 Ways: Capital Formation, Improvement in Per Capita Income, Generation of Employment and a Few Others**

Economic development essentially means a process of upward change whereby the real per capita income of a country increases over a period of time. Entrepreneur plays a vital role in economic development. Entrepreneurs serve as the catalysts in the process of industrialization and economic growth. Technical progress alone cannot lead to economic development, unless technological breakthroughs are put to economic use by entrepreneurs.

It is the entrepreneur who organizes and puts to use capital, labour and technology. Accordingly, “development does not occur spontaneously as a natural consequence when economic conditions in some sense are right. A catalyst is needed and this requires entrepreneurial activity to a considerable extent, the diversity of activities that characterizes rich countries can be attributed to the supply of entrepreneurs.”

The entrepreneur is the key to the creation of new enterprises that energize the economy and rejuvenate the established enterprises that make up the economic structure.

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## **Entrepreneurs initiate and sustain the process of economic development in the following ways:**

### **1. Capital Formation:**

Entrepreneurs mobilize the idle savings of the public through the issues of industrial securities. Investment of public savings in industry results in productive utilization of national resources. Rate of capital formation increases which is essential for rapid economic growth. Thus, an entrepreneur is the creator of wealth.

### **2. Improvement in Per Capita Income:**

Entrepreneurs locate and exploit opportunities. They convert the latent and idle resources like land, labour and capital into national income and wealth in the form of goods and services. They help to increase net national product and per capita income in the country, which are important yardsticks for measuring economic growth.

### **3. Generation of Employment:**

Entrepreneurs generate employment both directly and indirectly. Directly, self-employment as an entrepreneur offers the best way for independent and honorable life. Indirectly, by setting up large and small scale business units they offer jobs to millions. Thus, entrepreneurship helps to reduce the unemployment problem in the country.

#### **4. Balanced Regional Development:**

Entrepreneurs in the public and private sectors help to remove regional disparities in economic development. They set up industries in backward areas to avail various concessions and subsidies offered by the central and state governments.

Public sector steel plants and private sector industries by Modis, Tatas, Birlas and others have put the hitherto unknown places on the international map.

#### **5. Improvement in Living Standards:**

Entrepreneurs set up industries which remove scarcity of essential commodities and introduce new products. Production of goods on mass scale and manufacture of handicrafts, etc., in the small scale sector help to improve the standards of life of a common man. These offer goods at lower costs and increase variety in consumption.

#### **6. Economic Independence:**

Entrepreneurship is essential for national self-reliance. Industrialists help to manufacture indigenous substitutes of hitherto imported products thereby reducing dependence on foreign countries. Businessmen also export goods and services on a large scale and thereby earn the scarce foreign exchange for the country.

Such import substitution and export promotion help to ensure the economic independence of the country without which political independence has little meaning.

#### **7. Backward and Forward Linkages:**

An entrepreneur initiates change which has a chain reaction. Setting up of an enterprise has several backward and forward linkages. For example- the establishment of a steel plant generates several ancillary units and expands the demand for iron ore, coal, etc.

These are backward linkages. By increasing the supply of steel, the plant facilitates the growth of machine building, tube making, utensil manufacturing and such other units.

Entrepreneurs create an atmosphere of enthusiasm and convey a sense of purpose. They give an organization its momentum. Entrepreneurial behavior is critical to the long term vitality of every economy. The practice of entrepreneurship is as important to established firms as it is to new ones.

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### **Role of Entrepreneurs in Economic Development of India**

Economic development essentially means a process of upward change where by the per capita income of a country increases over a long period of time.

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The economic history of the presently developed countries like America, Germany, and Japan leads to support the fact that the economy is an effect for which entrepreneurship is the cause. The crucial role played by the entrepreneurs in the development of the western countries has made the people of under-developed countries too much conscious of the significance of entrepreneurship for economic development.

Now people have begun to realise that for achieving the goal of economic development, it is necessary to increase entrepreneurship both qualitatively and quantitatively in the country. It is only active and enthusiastic entrepreneurs who fully explore the potentialities of the country's available resources land, tech., capital, material etc.

The role of entrepreneurship in economic development varies from economy to economy depending upon its material resources, industrial climate and the responsiveness of the political system to the entrepreneurial function. The entrepreneurs contribute more in favourable opportunity conditions.

1. In underdeveloped/developing regions, due to lack of funds and skilled labour, the atmosphere is less conducive for innovative entrepreneurs.

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2. Under the conditions of paucity of funds and the problem of imperfect market, the entrepreneurs are bound to launch their enterprises on a small scale. Also initiator entrepreneurs are preferred in such regions. Thus, initiation of innovations introduced in developed regions on a massive scale bring about rapid economic-development in underdeveloped/developing regions.

3. Further India aims at decentralized industrial structure to reduce regional imbalances in levels of economic development.

4. Generation of employment

5. Balanced regional development

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6. Improvement in standard of living

7. Backward and forward linkages

8. Creator of wealth (securities, issues etc.).

Thus, small scale entrepreneurship in such industrial structure plays an important role to achieve balanced regional development, generation /creator of wealth etc.

**Important role that entrepreneurship plays in the economic development of our economy (India) are:**

### **1. Improvement in Per Capita Income:**

Entrepreneurs locate and exploit opportunities. They convert the latent and idle resources like land, labour and capital into national income and wealth in the form of goods and services. They help increase Net National Product and Per Capita Income in the country.

### **2. Generation of Employment:**

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Entrepreneur generate employment both directly and indirectly. By starting their business they present an opportunity to others for work by offering jobs.

### **3. Balanced Regional Development:**

Entrepreneurs help to remove the regional disparities in the economic development of areas. They set up industries in backward areas to avail various substitutes and bring up the development of that region.

### **4. Improvement in Living Standards:**

Entrepreneur set up industry which introduce new products on a mass scale. They are at lower costs and this helps to improve the standard of life of a common man.

### **5. Economic Independence:**

Entrepreneurship is essential for national self-reliance. Industrialists help to manufacture substitutes of imported products thereby reducing dependence on foreign countries. These businessmen also export products thereby earning foreign exchange for the country.

Entrepreneurship does not emerge and grow spontaneously. There are various factors having both positive and negative influence on the growth of entrepreneurship. (Positive influence imply facilitating and conducive conditions whereas negative influences refer to factors inhibiting the emergence of entrepreneurship).

**Facilitating Factors:**

1. Technical knowledge
2. Entrepreneurial training
3. Market contacts
4. Family business
5. Availability of capital
6. Successful role models
7. Local manpower
8. Government and institutional support

**Barriers:**

1. Lack of technical skills
2. Lack of market knowledge
3. Lack of business knowledge
4. Time pressure and distractions
5. Legal and bureaucratic constraints
6. Patent inhibitions
7. Political instability
8. Non-cooperate attitude of banks and other institutes

**I. Economic Conditions:**

Economic environment exercises the most direct and immediate influence on entrepreneurship. Capital, labour, raw materials and markets are the main economic factors.

**(a) Capital:**

It is one of the most important prerequisites to establish an enterprise. Availability of capital facilitates the entrepreneur to bring together the land of one, machine of another and raw material of yet another to combine them to produce goods. With an increase in capital investment, capital-output ratio also increases.

This results in increase in profit which ultimately goes to capital formation. This suggests that as capital supply increases, entrepreneurship also increases (e.g., Russia – how lack of capital for industrial pursuits impeded entrepreneurship).

### **(b) Labour:**

The quality rather than quantity of labour is another factor which influence the emergence of enterprise. Adam Smith considered division of labour as an important element in economic development. According to him, division of labour, which itself depends upon the sizes of the market leads to improvement in the productive capacities of labour due to an increase in the dexterity of labour.

(But it appears that one labour problem clearly does not prevent entrepreneurship from emerging, for example, the problem of low cost immobile labour can be circumvented by plunging ahead with capital intensive technologies, as Germany did.)

### **(c) Raw Materials:**

The accessibility of raw material for establishing any industrial activity, is indisputable. In the absence of raw materials, no enterprise can be established. Of course in some cases technological innovation can compensate for raw material inadequacy e.g., Japan.

### **(d) Market:**

The fact remains that the potential of the market constitutes the major determinant of probable rewards for entrepreneurial function. The size and composition of market both influence entrepreneurship in their own ways. Practically, monopoly in a



particular product in the market become more influential for entrepreneurship than a competitive market.

However, the disadvantages of competitive market can be cancelled to some extent, by improvement in transportation system, facilitating the movement of raw materials and finished goods and increasing the demand for goods. For example, Germany and Japan are prime e.g., where rapid improvement in market was followed by rapid entrepreneurial activities.

## **II. Social Factors:**

Social environment in a country exercises a significant impact on the emergence of entrepreneurship.

**The various sub factors are:**

### **(a) Legitimacy of Entrepreneurship:**

The social factors give emphasis to the relevance of a system of norms and value, within a sociocultural setting for the emergence of entrepreneurship. This system is referred to as “legitimacy of entrepreneurship” in which the degree of approval or disapproval granted entrepreneurial behavior influences its emergence and characteristics if it does not emerge. Some scientists call it appropriate social climate for entrepreneurship and some call it cultural sanctions.

### **(b) Social Mobility:**

It involves the degree of mobility, both social and geographical and the nature of mobility channels within a system. Some are of the view that a high degree of mobility is conducive to entrepreneurship (e.g., openness of a system and need for flexibility in role relations imply the need for the possibility of mobility within a system for entrepreneurship development).

In contrast, there is another group of scholars who express the view that a lack of mobility possibilities promotes entrepreneurship. The third opinion is a combination of first two, i.e., the need for both flexibility, the denial of social mobility. Thus a system should not be too rigid nor too flexible. (If too

flexible individual will move towards other roles, if too rigid, entrepreneurship will be restricted along with other activities).

### **(c) Marginality:**

A group of scholars hold a strong view that social marginality also promotes entrepreneurship. They believe that individuals or groups on the perimeter of a given social system or between two social systems provide the personnel to assume the entrepreneurial role.

They may be drawn from religious, cultural, ethnic or migrant minority groups and their marginal, social position is generally believed to have psychological effects which make entrepreneurship particularly attractive for them.

## **III. Psychological Factors:**

### **(a) Need Achievement:**

E.g., David Mc Clelland's theory of need achievement. According to him high need of achievement is the major influencing factor for entrepreneurship development therefore if the average level of need achievement in a society is relatively high, one would expect a relatively high amount of entrepreneurship in that society.

Mc Clelland says that need achievement can be developed through the intensive training programmes.

### **(b) Withdrawal of Status Respect:**

Hagen attributed the withdrawal of status respect of a group to the genesis of entrepreneurship e.g., Japan developed sooner than any non-western society except Russia due to two historical differences.

First, Japan had been free from 'colonial disruption' and secondly, the repeated long continued withdrawal of expected status from important groups (like Samurai) in her society drove them to retraction which caused them to emerge alienated from traditional values with increased creativity.

This very fact led them to the technological progress entrepreneurial roles. Hagen believes that the initial condition leading to eventual entrepreneurial behaviour is the loss of status by a group.

**He postulates that four types of events can produce status withdrawal:**

- (i) The group may be displaced by force
- (ii) It may have, its valued symbols denigrated
- (iii) It may drift into a situation of status inconsistency
- (iv) Not accepted the expected status on migration in a new society

**He further postulates that withdrawal of status respect would give rise to four possible reactions and create four personality types:**

- (i) Retreatist- He who continues to work in a society, but remains different to his work and position.
- (ii) Ritualist- He who adopts a kind of defensive behaviour and acts in the way accepted in his society but no hopes of improving his position.
- (iii) Reformist- He is a person who forms a rebellion and attempts to establish a new society.
- (iv) Innovator- He is a creative individual and is likely to be an entrepreneur.

Hagen maintains that once status withdrawal has occurred, the sequence of change in personality formation is set in motion. He refers that status withdrawal takes a long period of time – as much as five or more generations to result in the emergence of entrepreneurship.

**Others:**

### **Govt. Actions:**

The government by its actions or failure to act also does influence both the economic and non-economic factors for entrepreneurship. By creating basic facilities, utilities and services and by providing incentives and concessions, the government can provide the prospective entrepreneurs a facilitative socio-economic setting. Such conducive setting minimizes the risks which the entrepreneurs have to encounter.

Various factors stated above for emergence of entrepreneurship are interlocking, mutually dependent and mutually reinforcing.

### **Entrepreneur and His Role:**

A change in the connotation of an entrepreneur from captain of Industry to an elusive character, where the entrepreneur is characterised as one who garners profits at the expense of others had distorted the concept of entrepreneurship. The concept of entrepreneurship has been revised by an economist, Joseph Schumpeter.

Schumpeter described entrepreneurship as a force in creative destruction, whereby established ways of doing things are distraught by the creation of new and better ways to get things done. Hence Schumpeter described entrepreneurship as a process and entrepreneurs as innovators who use the process to shatter the status quo through new combinations of resources and new methods of commerce.

### **Joseph A. Schumpeter thus writes:**

“The entrepreneur in an advanced economy is an individual who introduces something new in the economy a method of production not yet tested by experience in the branch of manufacture concerned, a product with which consumers are not yet familiar, a new source of raw-material or of new markets and the like”. He further states the entrepreneur’s function is to “reform or revolutionise the pattern of production by exploiting an invention or more generally, an untried technological possibility for producing a new commodity or producing an old one in a new way, by opening up a new source of supply of

materials or a new outlet for products.... Entrepreneurship, as defined, essentially consists in doing things that are not generally done in the ordinary course of business routine”.

Peter Drucker describes entrepreneurial role as one of gathering and using resources. But Drucker’s view of entrepreneurship occurs when resources are redirected to progressive opportunities, not used to ensure administrative efficiency. This redirection of resources distinguishes the entrepreneurial role from that of the traditional management role. Some other definitions of entrepreneurs are given by the following authors.

Frank Young describes entrepreneur as a change agent. Noah Webster thinks entrepreneur is one who assumes the responsibility of the risk and management of business. Francis A. Walter observes that the true entrepreneur is one who is endowed with more than average capacities in the risk of organising and coordinating the various other factors of production.

Karl Vesper found that psychologists tend to view entrepreneur in behavioural terms as achievement oriented individuals driven to seek challenges and new accomplishments. Hence he suggests in a market economy entrepreneurs can be viewed as pillars of industrial strength the movers and the shakers who constructively disturb the status quo.

The term ‘entrepreneur’ may be properly applied to those who incubate new ideas, and provide added value to society based on their independent initiative. The person who establishes a fast food franchise chain is called an entrepreneur, but the local restaurant owner is called a small business person.

Distinguishing factors are that entrepreneurs have vision for growth, commitment to constructive change, persistence to gather necessary resources and energy to achieve unusual results. The small business person may exhibit these characteristics, but only coincidentally, not as a prerequisite to establishing an enterprise.

The concept of entrepreneurship does not exclude managers in large organisation from being entrepreneurs if they combine

resources in unusual ways to create innovative new product or services. However, because entrepreneurs take personal investment risks and corporate managers very rarely do, corporate entrepreneurship, sometimes referred to as entrepreneurship at has to be differentiated from the concept of entrepreneurship proper.

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### **Role of Entrepreneurs in Economic Development**

Entrepreneurs create organizations that offer employment to millions of people. They convert resources into useful products and services. They create goods and services and improve the living standards of people in a country. They are, in fact, creators of wealth. Through constant innovations, they try to cut down costs, improve quality and create demand.

They are able to put local resources and talent to the best use. Rural entrepreneurship, if handled well by the government through encouraging policies, can radically transform the lives of people living in underdeveloped areas of a country. This way they can be instrumental in preventing the concentration of economic power. Entrepreneurship also helps in increasing productivity and capital formation of a nation. When they are able to achieve success and are able to expand their operations, they would be laying a solid foundation for the steady growth of a nation.

### **Role of Entrepreneurs in Economic Development – Create Employment Opportunities, Inspire Others towards Entrepreneurship, Create Knowledge Spillovers and a Few Others**

Entrepreneurs play an important role in the economic development of a region. From the fall of Rome (AD 476) to the eighteenth century, there was virtually no increase in per capita wealth generation in the West. With the advent of entrepreneurship, however, per capita wealth generation and income in the West grew exponentially by 20 percent in the 1700s, 200 percent in the 1800s, and 740 percent in the 1900s (Drayton, 2004).

## **The various ways in which the entrepreneurial activity results in economic development and growth are:**

### **Role # 1. Create Employment Opportunities:**

By creating a new venture, entrepreneurs generate employment opportunities for others. Unemployment is a major issue, especially in the context of developing economies like India. Educated youth often are unable to get a suitable employment for themselves. Thus, entrepreneurs do a Yeoman's service by not only employing themselves into their entrepreneurial ventures, but also by employing others.

Within the last 15 years, Fortune 500 companies and large corporations have endured major retrenchment and eliminated millions of jobs, whereas discoveries in the entrepreneurial sector have yielded an average of 600,000 new incorporations per year and generated millions of job opportunities.

### **Role # 2. Inspire Others towards Entrepreneurship:**

The team created by an entrepreneur for his new venture often provides the opportunity for the employees-cum-teammates to have a first-hand experience of getting involved in an entrepreneurial venture. This often leads eventually for these employed to become entrepreneurs themselves after being inspired by their earlier experience of working for an entrepreneur. Thus, this process helps in forming a chain reaction of entrepreneurial activity which directly contributes to the health of the economy.

### **Role # 3. Create Knowledge Spillovers:**

When a scientist, an engineer, or a knowledge worker (i.e. an economic agent with endowments of new economic knowledge) leaves an organization to create a new firm, knowledge acquired by her in the organization gets spilled over to the new firm. Hence, entrepreneurship serves as a mechanism by which knowledge spills over to a new firm in which it is commercialized. Naturally, the new firm gets benefited by the experience and knowledge gained by the founder in her erstwhile organization.

Knowledge is embodied in a worker and the new firm is created through the worker's effort to appropriate the value of his knowledge by way of innovative activity. Lucas (1988) established that knowledge spillovers are an important mechanism driving economic growth.

**Role # 4. Augment the Number of Enterprises:**

When new firms are created by entrepreneurs, the number of enterprises based upon new ideas/concepts/products in a region (say, a city, state, or country) increases. Not only does an increase in the number of firms enhance the competition for new ideas, but greater competition across firms also facilitates the entry of new firms specializing in a particular new product niche.

This is because the necessary complementary inputs are more likely available from small specialist niche firms than from large, vertically integrated producers (Jacobs, 1969). Glaeser et al. (1992) as well as Feldman and Audretsch (1999) found empirical evidence supporting the hypothesis that an increase in competition within a city, as measured by the number of enterprises, is accompanied by higher growth performance of that city.

**Role # 5. Provide Diversity in Firms:**

Entrepreneurial activity in a region often results into creation of a variety of firms in a region. These firms operate into diverse activities and it has been found that it is this diversity in firms which fosters economic development and growth rather than homogeneity. According to Jacobs (1969), it is the exchange of complementary knowledge across diverse firms and economic agents that yield an important return on new economic knowledge.

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**Role of Entrepreneurs in Economic Development**

The industrialisation of a country and its pace of economic development depend on the entrepreneurs. A country may be inherited with plenty of natural resources, but its economic



development cannot be possible in the absence of efficient entrepreneurs. This was reason that developing countries like India remained underdeveloped for many years. It is the entrepreneur who contributes towards the balanced development of a country by optimum uses of its resources.

Entrepreneur is considered to be the focal point in the process of economic development. This may the reason that Jale Brozen writes, entrepreneur is the essential means of economic development. He is the person who uses the untapped natural resources, labour and capital in an optimum manner, sets the wheel of economic development moving forward. He makes available always new and improved products to the people and takes all the efforts to improve the living standard of the people.

Renowned economist, Marshall observes that entrepreneur is the captain of the industry, and builder of economic structure of a country.

**Keeping these aspects in mind, the contribution of entrepreneur/entrepreneurship in an economy are described below:**

### **1. Organising of Society's Productive Resources:**

The important role of entrepreneurship is the optimum uses of productive resources of the country for the benefits of the people. James Burna observes that an entrepreneur is the organiser of society's productive resources. While explaining the contribution of entrepreneurs Prof. Karvar writes, the services of an entrepreneur are such which a paid manager cannot perform. In the absence of entrepreneurs, all the productive resources remain idle.

### **2. Production of New Articles:**

Entrepreneur performs important role in producing and presenting new products in the market. He innovates and identifies the possibility of producing new products on the basis of innovation.

### **3. Development of New Production Technique:**

Entrepreneur uses the new methods of production techniques, and brings in the market varieties of products at reasonable prices. He makes efforts to bring improvement in the present technology of production.

### **4. Promotes Capital Formation:**

In a developing economy, the entrepreneur only can promote capital formation by investing in industrial activities. The entrepreneurial activity is the base for the development of capital market in a country like India.

### **5. Contributes towards Creation of Industrial Climate:**

Entrepreneur plays important role in building industrial climate in the country. He motivates other entrepreneurs also to invest in industrial activities.

### **6. Contributes towards Providing Employment:**

Entrepreneur introduces new products and new techniques. This results into the development, new industries, leading to opportunities for direct and indirect employment to the people.

### **7. Contributes towards Increasing Standards of Living of People:**

The entrepreneurs have development and diversified new techniques and new products according to the needs of the time. This has given opportunity for the people to consume different kinds of items of their choice. The uses of substitute products have increased. This way, the enterprise news has contributed towards increasing the standard of living of the people.

### **8. Ambassador of Social Changes:**

Entrepreneurs are ambassadors of social changes in an economy. New inventions cultivated scientific outlook among the people leaving their traditional beliefs and attitudes.

## **9. Removal of Regional Disparities:**

Entrepreneurs contribute towards removal of geographical imbalances and economic backwardness. Really speaking an entrepreneur bears the risk in setting up industry in backward areas of the country in his efforts for balanced development of the country.

## **10. Contribution towards Economic Development of the Country:**

Entrepreneur also contributes towards the development of national economy. He sets up industry in priority areas by the government in its Five Year Plan programmes. He makes available the source of employment to the people. By optimum use of resources, he contributes towards increase in the national income.

He encourages for capital formation in the country. In the modern time, an entrepreneur is a wheel of economic development and kingpin of every economy. He is one of the most important inputs in the economic development of a country.

most of them.