

Entrepreneurship and Economic Development

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Abstract: This article examines the importance of the entrepreneurship in the economic development and explains the relationship between small firms and entrepreneurship. Entrepreneurship is generally recognized to be one of the important factors in economic growth. Entrepreneurs may introduce important innovations by entering markets with new products and/or production processes. Small businesses are considered a vehicle for entrepreneurship and a source of employment and income and contribute to innovative and competitive power.

Schumpeterian entrepreneurs are found mostly in small firms. They make at least four main contributions to the economic development: they are entrepreneurs, they are the source of substantial innovative activity and play significant roles in the process of technological modifications, and they encourage industrial development, and constitute an important share of the newly created jobs in recent years.

Keywords: Entrepreneurship, Economic Development, Small Firms

1. Introduction

In the economic literature, small firms and entrepreneurship recently viewed to have more important role in the economy than had been previously recognized. Small firms make a significant entrepreneurial contribution, because they are the source of considerable innovation activities. However, entrepreneurship and small business are related but not synonymous concepts. Entrepreneurs, business owners who desire to engage in new ventures and enlarge their businesses are distinguished from other small business owners who have no ambition to enlarge their business.

Schumpeterian entrepreneurs and intrapreneurs influence and finally renew the economic activities by beginning new ideas, new products and services. When these

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entrepreneurial initiatives are combined and assessed in terms of economic influences at a territorial level, it might indicate economic growth (Dejardin, 2000: 5).

Acs and Audretsch (1990: 2) stated that entrepreneurship may affect economic growth because they may introduce important innovations by entering markets with new products or production processes. Entrepreneurship is generally recognized to be a key factor in economic growth in the Schumpeterian model (1934). In the Schumpeterian model, the innovating entrepreneur plays the major role, however the imitators have a minor part in the growth process. Entrepreneurship is strongly related to economic growth because the level of entrepreneurial activity explains 76 percent of the difference in economic growth among G-7 countries. (GEM, 2003: 8).

The objectives of this article are as follows: 1) to contribute to the understanding of the entrepreneurship development process (German, Neo-classical and Austrian tradition schools) 2) to review the studies regarding the entrepreneurial dimensions and economic growth, 3) to explain the linking entrepreneurship and small business. The challenge is to synthesize these insights to provide a broad picture of how economic growth is linked to entrepreneurship.

2. Entrepreneurship Development Process

There are three schools of theoreticians who have explained the entrepreneurship process. The first is the German tradition of von Thunen, Schumpeter and Baumol, the second the (neo) classical tradition of Marshall, Knight and Schultz and the third the Austrian tradition of Menger, Von Mises, and Kirzner (Wennekers and Thurik, 1999: 31). In this section, we focus on four entrepreneurial roles, emphasized by Schumpeter, Baumol, Knight, and Kirzner respectively.

The first use of the term entrepreneur in an economic context is attributed to Richard Cantillon in 1755. He refers to the entrepreneur as any individual who works under conditions where expenditures are known and certain, but incomes are unknown and uncertain and the uncertainty of income arises as future market demand is not perfectly forecast (Binks and Vale, 1990: 9-10).

It is clear that Cantillon's implicit description is very broad. The unique features of Cantillon's entrepreneur are foresight and the confidence to work under conditions of uncertainty. Cantillon connects risk and uncertainty with the administrative decision-making processes of entrepreneurs. He also recognizes the entrepreneurial income or profit, which occurs through decision-making and risk-taking rather than 'orthodox effort' (Binks and Vale, 1990: 10).

The Schumpeterian entrepreneur is an innovator who introduces new technological process or products. The Schumpeterian entrepreneur alters technological possibilities and alters convention through innovative activity, and lifts up production constraints. According to Schumpeter, the main driving force behind the economic growth is the introduction of new combination of resources and services, not the creation of new possibilities:

“Whatever the type, everyone is an entrepreneur only when he actually carries out new combinations and loses that character as soon as he has built up his businesses, when he settles down to running it as other people run their businesses”(Schumpeter, 1934: 78).

“They have not accumulated any kind of goods; they have created no original means of production, but have employed existing means of production differently, more appropriately, more advantageously. They have carried out new combinations. They are the entrepreneurs. And their profit, the surplus to which no liability corresponds, is the entrepreneurial profit” (Schumpeter, 1934: 132).

According to Schumpeter, the carrying out of new combinations can be classified into five groups: 1) the introduction of a new good, 2) the introduction of new methods of production, 3) the opening of a new market, 4) the invention of a new source of supply of raw materials or half-manufactured goods, 5) the carrying out of new organization of any industry, like the creation of a monopoly position.

Baumol (1990: 893-921) stated there are several types of entrepreneurs among societies and overall environment plays an extremely significant role in the determination of each type of entrepreneurship. Baumol’s basic hypothesis is that,

“While the total supply of entrepreneurs varies among societies, the productive contribution of the society’s entrepreneurial activities varies much more because of their allocation between productive activities such as innovation and largely unproductive activities such as rent seeking or organized crime” (Baumol, 1990: 893).

To him, entrepreneurship will be allocated in productive or unproductive directions depending on the relative payoffs to different entrepreneurial activities, which can significantly affect the strength of the economy’s productivity growth.

The productive entrepreneurship is fostered “by incentives for entrepreneurs to devote themselves to productive innovation rather than to innovative rent-seeking (the non-

productive pursuit of economic profit such as occurs in inter-business lawsuits), or event to destructive occupations, such as criminal activities” (Baumol, 2002: 5).

Baumol stated that the entrepreneur is an innovator and this idea is motivated by Schumpeter’s work.

According to Knight (1921), the entrepreneur is a risk taker whose reward-profit is the return for bearing uncertainty and is an uninsurable risk. The opportunity for profit arises out of uncertainty that develops because of change. The entrepreneur is someone who is prepared to take on risk in an uncertain world.

Knight made a significant difference between risk and uncertainty. Risk exists when we have uncertain results but those results can be forecasted with a certain degree of probability. Uncertainty occurs when the probability of results cannot be computed. The entrepreneur is someone who is willing to accept the remaining risk that cannot be moved through insurance.

For Kirzner (1973: 16-17), the entrepreneur is someone who is alert to cost-effective opportunities for trade. Recognizing the possibilities for trade allows the entrepreneur to take advantage by behaving, as a ‘middleman’ who facilitates the trade. Entrepreneur can identify suppliers and customers and act as the intermediary. Also, there is no need to own resources and profit arises out of the intermediary role.

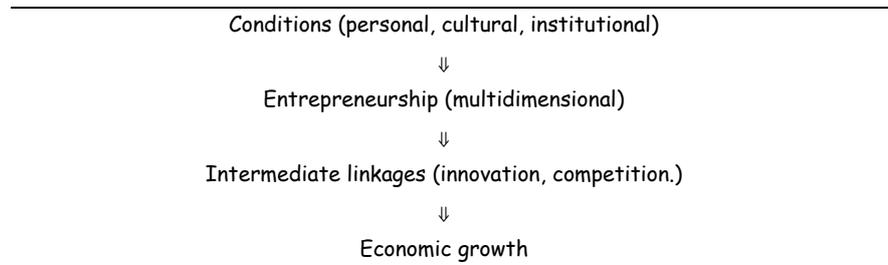
The role of knowledge in the market place is significant for the Kirznerian entrepreneur. Market exchange itself is an entrepreneurial process, but people can benefit from exchange due to information gaps in the market. In this view, the entrepreneur may be seen as little more than a market trader, gaining advantage of opportunities to trade; for Kirzner, the entrepreneur is someone who is still creative. The possession of additional information provides opportunities for creative discoveries. However, in contrast to the Schumpeterian sight, anyone could potentially have the additional information and be alert to opportunities for exchange and trade.

According to the above survey, there are three basic entrepreneurial roles: the first is the role of innovator (Schumpeter’s innovating entrepreneurship). The second is the role of perceiving profit opportunities (Kirznerian entrepreneurship). The third role is that of assuming the risk associated with uncertainty (Knightian entrepreneurship). A lack of entrepreneurial activity in the economy is related to low rates of innovation, to unseen profit opportunities and to risk-averse attitudes which would cause lack of economic development.

3. Entrepreneurship and Economic Development

The OECD strongly emphasizes the significance of entrepreneurial activity as one of the main factors in economic growth because entrepreneurship provides new ideas, and innovation, both of which are positive sources of economic growth and development. The OECD defines the entrepreneurship “is the ability to marshal resources to seize new business opportunities. Entrepreneurship defined in this broad sense, is central to economic growth” (OECD, 1998: 41). The increasing role of entrepreneurs in economic growth encourages governments to promote entrepreneurship via reducing the financial constraints that entrepreneurs face; either through preferential loans to new businesses, or preferential tax treatment for new or small businesses. Among other policies, the OECD (2003) recommends stable economy, deregulation of monopoly sectors, establishing property rights and political stability, better education, investment in human capital, efficient capital and financial markets, avoiding excessive red tape.

Wennekers and Thurik’s (1999: 30-35) explanation of the role of the entrepreneurship in the process of economic growth is reproduced in Figure 1. They state that we need this framework because there is no direct link between entrepreneurship and economic growth. The definition of the entrepreneurship has not been an easy task. Therefore, various the intermediate variables or linkages (innovation, competition) are needed to explain how entrepreneurship affects economic growth. According to the framework, personal characteristics are important conditions for entrepreneurship. Cultural (open-mindedness towards other cultures, acceptance of risk, determination, valuation of wealth and savings, competitiveness) and institutional (incentives, competition rules, property right, possibilities for trade and specialization) conditions stimulating entrepreneurial characters and behaviour, as well as influencing the intermediate linkages. Entrepreneurship has two major roles regarding the linking entrepreneurship to economic growth. The first is related to ‘new entry’. New entry can be accomplished by entering new business and a firm start-up is a major form of new entry. The second is related to innovation role of entrepreneurs. An innovation could be accomplished by a firm start-up. Start-ups and innovations as well as competition are the most relevant factors linking entrepreneurship to economic growth.

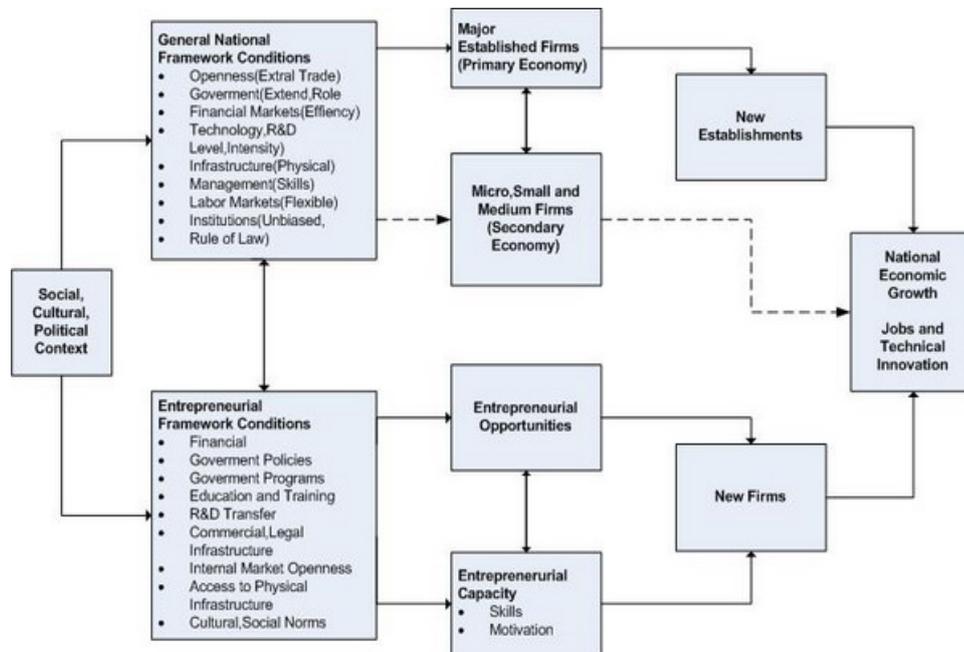
Figure 1: Introductory Framework

Source: Wennekers and Thurik (1999: 30).

According to Global Entrepreneurship Monitor (GEM), economic growth depends on two parallel sets of interrelated activities: those (national framework conditions) associated with established firms (the top part of Figure 2) and those (entrepreneurial framework conditions) related to the entrepreneurial opportunities (the bottom part of Figure 2) (GEM, 2004: 14).

Unlike traditional analysis of economic growth, which focuses on only large firms and ignores small firms, the GEM Conceptual Model considers the economic contribution of all business in the country. The model identifies national framework conditions and entrepreneurial framework conditions with related the social, cultural, and political context of each country. General national framework conditions encompass the role of government, the level of research and development, the quality and strength of the physical infrastructure, the efficiency of the labour market, and the efficiency of legal and social institutions. The national framework conditions affect the competitiveness of the major established firms. The increased competitiveness causes increase of demand, and this increases opportunities for micro, small, and medium firms. Entrepreneurial framework conditions determine the decision of potential entrepreneurs to start a business. The entrepreneurial framework conditions include financial support, government's programs, and policies, education and training, barriers to entry, or market openness, infrastructure, and cultural and social norms.

Figure 2: GEM Conceptual Model



Source: GEM, 2004: 14

The national economic growth is associated with newer and smaller firms as well as established firms (GEM 2005: 14). Economic efficiency is promoted by small and new firms which cause innovations, fulfil market niches, and increase competition. Consistent evidence from GEM data shows that there is a systematic relationship between the level and growth of per capita GDP and its level and type of entrepreneurial activity in country. At low levels of per capita income, the entrepreneurial sector offers job opportunities and the creation of new markets. As per capita income increases, the increasing demand from growing markets is filled by larger and established firms which increase their relative role in the economy. Therefore, the number of new firms is reduced and people have opportunities to find stable employment in a large industrial plant. Further increase in income leads to an increase of the role of the entrepreneurial sector again, since more individuals have the resources to go into business, to exploit the opportunities for themselves.

The role of the entrepreneur as prime cause of economic development dates back at least to Schumpeter (1934: 45-46). He explains how the innovating entrepreneur confronts incumbent firms by introducing new inventions that make current tech-

nologies and products obsolete. This process of creative destruction is the main characteristic of what has been called the Schumpeter Mark I regime; Schumpeter (1950: 134) focuses on innovative activities by large and established firms. He explains how large firms outperform their smaller counterparts in the innovation and process via strong positive feedback loop from innovation to increased R&D activities. This process of creative accumulation is the main characteristic of the Schumpeter Mark II regime. Industries in a Schumpeter Mark II regime are likely to develop a more concentrated market structure in contrast to industries in a Schumpeter Mark I regime where small firms will grow.

From a viewpoint of linking entrepreneurship to economic growth, the brief review provided in this section is confined to some of studies reported in the literature.

Baumol (1993: 198) stated that when searching for links between entrepreneurship and economic growth, the major roles of entrepreneurship could be “new entry” and “newness” in general. Hence, the entrepreneur is the founder of a new business, but also plays an innovative role in economic life.

Shane’s study (1995:110-114) showed the relationship between independent entrepreneurs (those in which the owner is the manager) and economic growth. He utilized time series regression analysis to explain the effect of organizational formation on real rates of economic growth in the United States from 1947 to 1990. This study revealed that economic growth happen in part because the opportunity to form new organizations provides individuals who have entrepreneurial ability with the incentive to create new combinations of resources that produce surplus value.

Iyigun and Owen (1998: 454-457) developed a two-period overlapping-generations model that individuals prefer to allocate fewer resources toward entrepreneurship in a more developed economy due to less risk. This model includes some important implications for the dynamic behaviour of the human-capital stock. The important results of their model are as the following:

- Initial stocks of human capital are significant for the process of development.
- Economies that have a little of either entrepreneurial or professional human capital may finish up in a development trap with very low investment in human capital.
- Entrepreneurial human capital is more important in middle-income countries, whereas professional human capital is more abundant in richer economies. Thus, as an economy grows, individuals choose to assign an increasing proportion of their time to the accumulation of professional skills.

Yu (1998: 897-911) acknowledged that the entrepreneurship was one of the important factors in the development of Hong Kong. This study highlighted the impor-

tance of the entrepreneurial approach to economic problems. It argues that the dynamics of Hong Kong's economy were attributed to adaptive entrepreneurs who were alert to opportunities, maintain a high degree of flexibility in their production and react rapidly to change. Hong Kong manufacturers have learnt from foreign firms and imitated their products using entrepreneurial strategies. Their efforts led Hong Kong to catch up with economically more advanced economies.

Minniti (1999: 31-42) mentioned that entrepreneurs are the vehicles for economic growth because they generate a networking externality that endorses the creation of new ideas and new market formations.

Çetindamar (2002) and Tosunoğlu (2003) compared the national conditions and national entrepreneurial conditions of developed countries with Turkey. They found that the financial institutions, the legal framework, the level of education and training, the physical infrastructure, and the government policies were not supporting an entrepreneurial economic growth process in Turkey.

Henderson (2002: 45-70) showed that entrepreneurs influence economic activity considerably through increasing job creation, wealth and local income, and linking domestic economies to larger, global economy.

GEM (2004: 42-43) examined whether entrepreneurship might be considered a determinant of economic growth. Data on total entrepreneurial activity were gathered from the Global Entrepreneurship Monitor (GEM) and Adult Population Survey which were built on surveys of - on average - some 3,000 respondents per country (37 countries in 2003). They found that inappropriate policies concerning to entrepreneurship may adversely affect the level of economic growth with in the country.

Kreft and Sobel (2005: 595-616) assume that entrepreneurial activity is a main factor in economic growth and examine the direction of causality between venture capital and entrepreneurial activity. They suggest that main difference between these competing development strategies is a question of the direction of causation between entrepreneurial activity and the quantity of venture capital. These results are:

- The conduit between economic freedom and economic growth is entrepreneurial activity and an area's degree of economic freedom significantly impacts the underlying level of entrepreneurial activity.
- Fundamental economic freedoms generate growth as they encourage underlying entrepreneurial activity.
- An environment of low taxes, low regulations, and secure private property rights are what is necessary to encourage the entrepreneurial activity that is vital to produce economic growth.

Entrepreneurship has to do with activities and behavioural characteristics of individual persons. Entrepreneurship is the ability and willingness of individuals who observe and create new products, new production methods, new organizational schemes and new product-market combinations, within and outside existing organizations, and to bring their ideas to the market, in the face of uncertainty and other barriers, by making decisions on the spot. (Wennekers and Thurik, 1999: 46). Therefore, relating entrepreneurship to economic growth means relating the individual to aggregate levels.

4. Entrepreneurship and Small Business

Throughout the first three-quarters of the last century, large scale firms dominated the economy and the importance of entrepreneurship and the role of small business were decreased in North America and Western Europe. During this period, small businesses were generally less efficient than large firms and were only marginally involved in innovative activity and generated lower levels of employee opportunities (Audretsch and Thurik, 2004: 3). However, the importance of small business and the role of entrepreneurship increased since the mid 1970s. Audretsch and Thurik (2001: 795-821) explain the re-emerge of entrepreneurship on the basis of increased globalization, which has shifted the comparative advantage towards knowledge-based economy that is dependent on innovative activity. In today's world small businesses are seen more than ever as vehicles for entrepreneurship, contributing not just to employment and social and political stability, but also to innovative and competitive power.

Brock and Evans (1989: 7-20) stated that the following reasons are promoting the small business sector: the importance of scale economies in manufacturing sector is reduced by technological change, the changing composition of the labour force, decreasing real wages, increasing level of education; changes in consumer tastes; relaxation of (entry) regulations.

The move from larger to smaller business creates a renewed attention to the role of entrepreneurship. The main difference between a large and a small firm is the role of ownership and management. In a small firm usually there is one person or a very small group of persons, who control and shape the firm and its future. The role of such a person or group is often described with the term "entrepreneurship" (Wennekers and Thurik, 1999: 29).

Schumpeterian entrepreneurs are found mostly in small firms. They possess and manage independent firms that are innovative and change existing market structures.

Managerial business owners (entrepreneurs in a formal sense) are to be found in the large majority of small firms. Sometimes these entrepreneurial employees, either in teams or on their own, spin off, set up new enterprises or become Schumpeterian entrepreneurs. (Wennekers and Thurik, 1999: 48).

As put by Acs (1996:52) small firms make at least four main contributions to the world economy:

1. Small firms play vital entrepreneurial contribution to the economy, serving as agents of change in modern economy.
2. They are the source of substantial innovative activity and play significant role in the process of technological change.
3. They play important role in the process of industrial development.
4. They make up an important share of the newly created jobs in recent years.

In other words, small firms have particular characteristics that are related to many significant economic questions including economic growth, competitiveness, and unemployment.

Small manufacturing firms can be more productive than large firms because the flexibility and creativity. Small businesses are generally more innovative than large businesses in terms of innovations per dollar of research and development, and innovations per employee (Bannock, 1981; Acs and Audretsch, 1988; LaFalce, 1990; Pratten, 1991; Almedia and Kogut, 1997).

Thurik (1996: 126-152) reports that the increasing number of small firms has had a positive effect on percentage change in gross national product for a sample of 12 European countries in the period 1988 through 1990. Robbins, Pantuosco, Parker, and Fulter (2000: 293-302) examined the influence of small business employment on economic activity at 48 U.S. States for a ten-year period to evaluate the contributions of small businesses to growth in Gross State Product (GSP), unemployment, and wage inflation at the state level. The study showed that states with a higher proportions small firms experience higher levels of productivity growth and GSP growth, while having less wage inflation and lower unemployment rates. The researches show that small firms serve as agents of change through their entrepreneurial activity, being source of innovative activity, stimulating industrial evolution, and creating an important share of the newly generated jobs.

6. Conclusion

This paper has provided an overview of the different aspects of entrepreneurship and the research on the relationship between entrepreneurship and economic development.

We focused on three entrepreneurial roles, emphasized by Kirzner, Schumpeter and Knight, respectively. According to Kirzner, the entrepreneur is someone who is alert to profitable opportunities and acts as a middleman between suppliers and customers. For this view, the entrepreneurs may be seen as little more than a market trader and operates on opportunities that arise out of new technology. By contrast, Schumpeter's entrepreneur is an innovator, who brings about change through the introduction of new technologies, processes or products. The Knightian entrepreneur is anyone who is prepared to undertake the risk of setting up their own business and the reward for this is profit for bearing uncertainty and an uninsurable risk. In general, definitions of entrepreneurship cover different entrepreneurial activities. The definition might include many aspects of entrepreneurship from being a creative and an innovator to dealing with uncertainty and spot profit opportunities. Entrepreneurship is a necessary ingredient in the process of economic development: it serves as the catalyst for market transformation and provides for economic growth, employment, and increased per capita income.

The small firms play an important role in the economy since the economic activity moved away from large firms to small firms because of their entrepreneurial activities. Therefore, small businesses are observed as a vehicle for entrepreneurship and a source of employment and income and contributing to innovative and competitive power. They also provide social and political stability. The increasing role of small firms forces us to pay attention to the role of entrepreneurship on economic development. The role of entrepreneurship in carrying out innovations and enhancing competition are important for economic growth. Entrepreneurship has to do with activities and behavioural characteristics of individual persons. Therefore, relating entrepreneurship to economic growth means relating the individual level to aggregate levels.

This study also showed that the role of entrepreneurship in the economy has changed dramatically over the last half century and entrepreneurship has become the engine of economic and social development throughout the world. Small firms and entrepreneurship are playing a much more important role in the economy than had been previously acknowledged.

In this regard, future research should be focused on the role of entrepreneurship in economic development of Turkey and measuring the level of entrepreneurial activity and revealing factors leading to appropriate levels of entrepreneurship in Turkey.

The increased importance of entrepreneurship is also recognized by policy makers. Therefore, further research can also be undertaken regarding the key factors for building a climate in which entrepreneurial initiative and business activities can thrive, and policy measures to boost the levels of entrepreneurship, adopting the

most appropriate approach for producing more entrepreneurs and for getting more firms to grow in Turkey.

Giriřimcilik ve Ekonomik Kalkınma

Özet: Bu makale, küçük ve orta ölçekli firmalarda girişimciliğin önemini ve girişimciliğin ekonomik gelişme sürecindeki önemi tartışılacaktır. Giriřimcilik, ekonomik büyümeyi sağlayna önemli faktörlerden biri olarak düşünölmektedir. Giriřimciler üretim süreçlerinde ve/veya yeni ürünlerle pazara girerek önemli yenilikler yapabilirler. Küçük işletmeler, girişimciliğin kaynağı olarak değeriendirilirler. İstihdam olanaklarının, gelir düzeyinin artmasına ve yenilikçiliğe katkıda bulunarak, rekabet gücünün gelişmesini sağlayabilirler.

Schumpeter girişimcileri genellikle küçük işletmelerde bulunurlar. Ekonomik gelişmeye en azından dört alanda katkıda bulunurlar: küçük işletmeler girişimcidirler, onlar önemli yenilikçi faaliyetlerin kaynağıdır ve teknolojiyi geliştirme sürecinde önemli rolleri vardır, onlar sanayileşmeye katkıda bulunurlar ve son yıllarda yeni yaratılan mesleklerin oluşumunda önemli katkıları vardır.

Anahtar Kelimeler: Giriřimcilik, Ekonomik Kalkınma, Küçük İşletmeler.

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