**THEORIES OF ENTREPRENEURSHIP**

**Economic Theories:**

The importance of entrepreneurship for economic development has always been stressed in economics but the existence of entrepreneurship in economic theory has been very limited. The reason apparently is that with the introduction of entrepreneurship in traditional economic theory most models run the risk of losing their consistency. For this reason, the entrepreneur still remains unnoticeable in traditional economic theory.

There are diverse opinions in economics about the nature of entrepreneurship and whether it exists in a dynamic, static or turbulent economic system; and the role it plays in such a system. The majority of economic approaches attempt to explain how entrepreneurship works and the function it serves in the economic system. However, there is still little agreement about what the “entrepreneurial” function actually entailed. There are, however, some clear differences in study and these have been categorized into three groups: equilibrium, disequilibrium and revolution-equilibrium approaches.

**Equilibrium approach**

This approach seeks to identify fundamental “laws” to explain the economic system, and assume that there are general principles explaining society, as is evident in general equilibrium theory. In these approaches, individual human action does not play a significant role and even at the collective level human behavior is explained by general principles. Change within economic systems also tends to be modelled according to stable state or equilibrium philosophies.

Because of the excessive obsession with “equilibrium” in the economy, economists have traditionally considered entrepreneurs to be an external factor in the economic analyses. Their contribution to understanding entrepreneurship in modern theory has further been complicated by the growing intra-disciplinary conflict between macro- and microeconomics, and the growing dominance of the theory of the firm in the microeconomic theory.

Both macroeconomic theory and the theory of the firm de-emphasize the role of individually initiated behavior; proposing that entrepreneurs just like buyers and sellers are “non-decision makers” who follow set rules in carrying out their day-to-day functions. The assumption is that even selfish consumers and selfish producers; each with their own self interests, could always strike acceptable bargains that could always move the market to equilibrium. This implying that entrepreneurs were just players responding to, but never creating, consumer needs. This is an assumption that cannot coexist with entrepreneurship, which requires rule-violating behavior.

These approaches neglect the entrepreneurial function because they tend to disregard the power of human action, and limit the capacity for entrepreneurial behavior. This explains why the “entrepreneurial” concept is not addressed directly by microeconomic theory. In this approach the “firm” represents its own “reality”, which is independent of the motivations, rationality and fallibility, associated with individuals. The assumptions of rational choice and perfect information create further abstractions in the theory by assuming that everything is known.

**Disequilibrium Approach**

These approaches incorporate concepts of entrepreneurship into variations of mainstream economics. These have included two forms of transaction cost economics. The first introduced a theory of regularity in exchange processes based on the cognitive limits of human actors, which moved away from assumptions based on human rationality and perfect choice. The second sought to directly link concepts based on theories of information, information exchange and information markets to the process of entrepreneurship. Disequilibrium theorists do not attempt to construct equilibrium models of the economic system based on general principles but sought explanations based on observations of experience. The models created tend to be descriptive rather than prescriptive and tend to observe that equilibrium did not occur in the “real” economy.

Models based on disequilibrium suggest that there are opportunities for profit within economic systems because of inequalities between supply and demand and “entrepreneurial” actions are designed to exploit these opportunities, driving economic systems toward equilibrium. Kirzner (1973) also argued that markets by nature are in a state of disequilibrium, and that the role of entrepreneurs is to exploit information asymmetries in the markets in order to bring the markets to eventual equilibrium.

The disequilibrium theorists assume a more complex human action and greater uncertainty in social systems; moving away from the assumption of perfect knowledge, while retaining elements of bounded rationality. This therefore, provides a complex disagreement between humans as positive actors and negative abusers of opportunity. At once being the guiding force behind equilibrium and being the exploiters of disequilibrium.

These approaches provide an assumption about human behavior that is quite different from that applied in equilibrium theories. They assume more voluntarism and less determinism than equilibrium theories; showing greater evidence of human action, bounded rationality and concepts of information exchange. The nature of society within the disequilibrium group is viewed to be more unstable and open to unpredictable changes, the future is already implied in the very notion of action.

They allow for human influence over economic structures, recognizing the limits of knowledge, information and expecting greater unknown disequilibrating forces to impact on economic systems in unexpected ways.

**Revolution-equilibrium Approach**

The principal philosophies of this approach originate from the work of Schumpeter, and are based on three assumptions - a greater emphasis on human action and choice, radical rather than incremental changes in economic and social systems, and a greater linkage between historical “facts” and abstract models.

Joseph Schumpeter (1934) developed a rule-breaking theory of economics in which he described a "creative destruction" of industrial cycles. He argued that a normal healthy economy was not one in equilibrium, but one that was constantly being disrupted by technological innovation. Disruption is the normal state of a healthy, vibrant economy. Although, such a state can cause losses in its path and can sometimes be painful, it simultaneously creates new opportunities for growth. "Creative destruction", initiates and sustains the process of development, and is what entrepreneurship does. Entrepreneurship, he added, is a process of creative destruction that initiates and sustains the process of development and helping to move the economy from one state of equilibrium to another.

This takes the concepts of human action further by arguing that the key function of the “entrepreneur” is to innovate; conceptualizing human action at the individual rather than the collective level. These concepts broaden the meaning of entrepreneurs to include not only those business owners, but all who actually fulfill the innovation function even if they are employees of a company. On the other hand, the concept narrows down the interpretation of entrepreneurs in that it does not include all heads of firms or managers or business owners who merely operate an established business without actually performing the innovation function.

The difference for the individual is related to behavior, in the sense that in a static system the individual can become accustomed to his/her own abilities and experience and their usefulness. In a dynamic system, however, the individual must become accustomed to uncertainties and must interact with them. Operating a business in conditions of uncertainty is quite different from operating one where certain knowledge exists.

Assumptions about human action, therefore, differ from those applied by theorists in the disequilibrium group because individuals create new opportunities rather than respond to existing ones. This conception may derive from focusing on the nature of social systems, which holds that economic systems go through radical discontinuous changes. Schumpeter moves away from equilibrium theories by arguing that creative destruction involves periods of stability in economic systems followed by periods of transformation, within which he places the entrepreneurial function. This perspective of the “entrepreneurial” function involves the destruction of the current social order not its maintenance.

**Motivation to Entrepreneurship**

Contemporary theories tend to concentrate on the motivations that create entrepreneurs. How the entrepreneur acts at a given time and place depends heavily on the reward structure in the economy or the prevailing rules of the game that govern the payoff” to entrepreneurship. Entrepreneurs are ingenious and creative people who strive add to their own wealth, power, and prestige; and choose to be entrepreneurs when or because their utility (from wealth, power, and prestige) is maximized by so doing.

Individual chooses to be entrepreneurs if the expected net present value of profit from entrepreneurship is positive, otherwise they will opt to supply wage labour. Individual’s attitude toward risk and the monetary value of the psychic costs and benefits of entrepreneurship have to be incorporated as a monetary equivalent in the NPV calculation.

Economists argue that the decision to be an entrepreneur is a utility-maximizing career choice made by an individual—people choose to be self-employed if the total utility they expect to derive (via income, independence, risk bearing, work effort, and perquisites), is greater than from their best employment option.

## Sociological Theories

Sociological theories try to explain entrepreneurial behavior as a function of the person and environmental conditions or the reality individuals live in. The environment and the ideological values shape people’s attitudes and beliefs, which in turn influence the potential entrepreneur’s view, behavior and perspective.

The nature of populations influences the distribution of resources and indirectly shapes entrepreneurial processes. This implies that Entrepreneurship is situational and varies among nations and regions, over time, and among individuals. Sociologist view environmental factors (that include culture, networks, access to capital, mobility, and government policies) as key in fostering entrepreneurship.

Different sociological models have been developed to try and explain entrepreneurship, and they include;

**The social development model**

The model attempts to explain and understand entrepreneurial start-up decisions in terms of the situations encountered, and the social groups to which individuals relate. This can also be used to distinguish between various entrepreneurs and would-be entrepreneurs. The factors researched in sociological research are the environmental institutional forces that affect the founding rate of organizations. Institutional factors are thought to have their largest impact when a new form of organization is being founded. Institutional environmental forces are responsible for the shape of organizational forms. The shape organizations take has important social consequences. The new forms contribute to the diversity of organizations in society.

Several features of the local environment may affect founding rates. Availability of low-cost facilities or land is important to new company formations. Accessibility to transportation is also often important. New organizations are usually founded where the entrepreneur resides; therefore the quality of life and local educational institutions are often mentioned as important local variables. Economic environments with high rates of business establishment are conducive to entrepreneurship through creation of new markets and activity.

**The Demographic approach**,

This approach uses demographic information and variables such as family background, birth order, role model, marital status, age, educational level of parents and self, socio-economic status, previous work experience and work habits to profile entrepreneurs and potential entrepreneurs. It assumes that people with similar background possess similar underlying characteristics, and that by identifying demographic characteristics of known entrepreneurs, it is possible to predict entrepreneurship in unknown populations.

**The so cio–cultural dimensions**

These explain entrepreneurship in terms of the social and cultural values attitudes and practices including the value attached to innovation, risk taking, entrepreneurship, hard work and independence, the scorn associated with failure and error, and reactions to change in a society is of primary importance in encouraging people to venture into entrepreneurship.

The cultural climate in different areas may lead to higher rates of organizational founding. This may be viewed through the formation of individual value systems. A society with a social system that places a high value on entrepreneurship will have a high founding rate. In these societies, individuals in times of transition will be more likely to choose an entrepreneurial venture. Research on family, peers, previous work experience, ethnic groups, classmates, colleagues, and mentors; have shown them to have significant effects on the value systems of entrepreneurs.

Availability of venture capital is also important in the cultural environment. Availability of capital creates favourable conditions for the entrepreneur. The more capital available, the less it will cost. The capital is needed to purchase inputs for the organization. The availability of capital will also depend on the culture of the society. This culture will influence whether excess capital is made available to entrepreneurs or if established firms are favoured. There will be more company formations when financial resources are available. Capital from personal savings and from relatives is most often used to start companies. Next, private individuals in the local community are used. Often ethnic groups have developed financial institutions to support new businesses.

**Social learning theory**

The theory proposes that learning can occur not only through formal education, but also and more importantly through the observation of behavior in others, often referred to as models. *Role models* are very important because knowing successful entrepreneurs make the act of becoming one self seem much more credible. Would-be entrepreneurs come into contact with role models primarily in the home and at work. If you have a close relative who is an entrepreneur, it is more likely that you will have a desire to become an entrepreneur yourself, especially if that relative is your mother or father.

 This transmits social norms, language, and aspirations and shapes career preferences through observational learning and modelling. This is associated with increased education and training aspirations, task self-efficacy, and expectancy of an entrepreneurial career.

**Social Networking**

Entrepreneurs have to figure out how to get access to required resources and whether the necessary competence to combine these resources is available. Some of the resources and competencies can be inherent to the entrepreneur; others have to be acquired on the market or otherwise. It is important to stress the importance of an entrepreneur’s social network as a main source of help to obtain resources and competencies to start a business.

Researchers recognize that establishing a business is embedded in social and emotional contexts, where social networks become important. Networks may facilitate or constrain linkages between aspiring entrepreneurs, resources and opportunities. Entrepreneurs use the social relationships to access information and resources needed to launch and operate their businesses. The presence or of networks plays a role in influencing the development of entrepreneurship since access to information and resources often depends on "know-who".

Being in contact with a diverse set of individuals is important for entrepreneurs because it gives them access to information and other resources. However, not all networks are entirely useful. Networks cost time, money and other resources to develop and maintain. The structure of the network determines its usefulness to the entrepreneur. Social networks are beneficial if they provide complementary information and resources that can help the entrepreneur to start and run his business. In this case, diversity of the network is required to achieve the required mix of resources; and is defined by the entrepreneur’s background, education, occupation, experience, and ability to provide alternative resources to the network. The functioning of the network will depend on:

1. The size and extension of the network
2. Number of strong ties and number of weak ties in the network
3. Frequency of contact
4. Number and Multiplicity of relationships
5. Time used to develop and maintain the network
6. Range of intensity
7. Number of indirect ties
8. Number of bridges in the network
9. Degree of redundancy – the level of overlap between the entrepreneur’s contacts. People closely connected to each other tend to possess the same information resulting in redundancy.

Some Scholars have argued that entrepreneurs value their independence too much to be interested in networks that could lead to dependency. However, research shows a positive correlation between entrepreneurship and networks, and many believe that networking does not create dependency but a generic dependency/ independence paradox that entrepreneurs are bound to enjoy. In contrast to the transaction cost approach, social network theories emphasize trust, not opportunism, as an integral part of the relationship. Social control and economic exchange factors interact closely in long term relationships. The life course context involves analyzing the life situations and characteristics of individuals who have decided to become entrepreneurs.

**The human capital perspective**

This focuses on the influence of human resources, in particular the level of education, and managerial, technical and business skills (for the entrepreneur and the environment in which he operates) in fostering entrepreneurship.

**Influence of Education:** Several studies have shown that years of formal education of the entrepreneur before founding a new firm were related to the eventual performance of the firm. The chances of staying in and reentering business increased with increasing education. Less-educated entrepreneurs may face financial or human capital constraints which limit their business pursuits. A social sciences and/or arts educational background can restrict or discourage an entrepreneur from turning to start-up ventures in manufacturing, finance or technology.

**Previous Experience:** The influence of previous entrepreneurial experience upon the success of small businesses has been tested in several studies. Longer, more successful entrepreneurial careers are a function of earlier career starts and involvement in multiple ventures. Prior start-ups, years of formal education, years of entrepreneurial experience and years of industrial experience correlate significantly with increase in employment. Studies have found that entrepreneur who had previous experience in the field of their venture had a better chance of successfully expanding than those who did not have experience. It can be concluded that the antecedent influences of the entrepreneur do in fact affect business survival and growth.

**Effects of Management Skills on Performance:** Business skills and particularly strengths in generating ideas and dealing with people were important in establishing a business. Relatedly, there is a growing body of research examining the effects of planning on performance, finding that strategic planning has a significant, positive association with performance in small firms.

## Psychological Theories

Psychology examines how primary motivations or needs may vary across individuals and how these differences may influence entrepreneurial activity. It also considers various aspects of the psychological makeup and problem-solving style of entrepreneurs.

Unlike the sociological theories that relate the development of entrepreneurship to the environment and the situation that an individual encounters, psychological theories ascribe entrepreneurial tendencies to the individual’s personality, mental and physical make-up. Psychological theories include

* **The Traits approach** which suggests that Individuals with certain characteristics always find the path to entrepreneurship regardless of the environmental conditions. It observes that personality patterns (or characteristics) in individuals exert a dominant influence on the subsequent success of their ventures, and that possessing a greater number of the right personality patterns contributes to a greater likelihood of success. It is therefore, used to explain both entrepreneurial intentions and entrepreneurial success. Research has found various linkages between personal characteristics and entrepreneurship. Although these relationships are usually quite weak, they do attempt to explain entrepreneurship to a limited degree.
* **The cognitive Theory** suggests that entrepreneurial success is closely related to the way entrepreneurs perceive information, think and process knowledge, and that this can be used as a basis for distinguishing between entrepreneurs and other persons. This perspective advises that different people think and process information differently and that such variations may help differentiate people.