



Start-up incentives: Entrepreneurship policy or active labour market programme?

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ABSTRACT

As several European governments develop new start-up programmes during recessions, the appropriateness of these policies recently has become a *hot* policy issue. This study suggests that the contribution of these incentives is dubious, if aimed to combat economic and jobs crises as part of the entrepreneurship policy, and can be shaped by various country-specific factors, such as the economic situation and the stringency of labour laws. To provide support for these claims, this paper investigates the underlying determinants of an individual's decision to switch from unemployment to self-employment in Europe and stresses the need to devote special attention to the role of *three* essential dimensions: (i) the existing heterogeneity within self-employment, by considering self-employed individuals who hire employees (employers) and self-employed individuals without personnel (own-account workers) as separated groups; (ii) the effects of different measures of social capital and network contacts, as forms of *micro level institutional factors*; and (iii) the explanatory power of cross-country differences in the state of the economy, expenditure on start-up incentives, and the stringency of labour laws, as forms of *macro level institutional factors*. This study has useful theory and policy implications for entrepreneurship development.

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1. Executive summary

The European entrepreneurship policy has traditionally highlighted the need to create the best possible micro and macro-environment for small business and entrepreneurship. However, as a clear sign of the distance between political speech and political action, its more remarkable initiatives have revealed a marked bias in favour of measures promoting transitions from unemployment to self-employment, which has been used as an instrument within the active labour market policies as a way to reduce unemployment. Nevertheless, because the self-employed can be considered a heterogeneous group, wherein only a minority hire other workers and/or are entrepreneurs in the sense of creating firms that generate both innovation and wealth, more self-employment is not necessarily better. Furthermore, entrepreneurs should not be viewed as isolated and autonomous decision makers but as actors involved in a particular micro and macro context. Understanding how these context-related factors may affect the relative weight of *true* entrepreneurs over other categories within self-employment could be crucial in improving the effectiveness of the measures aimed to stimulate self-employment among the unemployed.

Simultaneously addressing all these questions is precisely the main aim of this work—that is, to provide additional empirical evidence concerning the underlying determinants of transitions from unemployment to self-employment in Europe, devoting special attention to (i) the effects of the different measures of social capital and network contacts, as a form of *micro level institutional factors*; and (ii) the explanatory power of cross-country differences in the state of the economy, expenditure on start-up incentives, and the stringency of labour laws, as a form of *macro level institutional factors*. Furthermore, to account for the existing heterogeneity within self-employment, we distinguish between self-employed individuals with and without employees. This

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distinction separates self-employment into those employers who hire external labour (and contribute to the job-generation process) and those who work on their own (own-account workers), who can be considered as proxies for *true* entrepreneurs and less entrepreneurial forms of self-employment, respectively. To this aim, multinomial discrete choice models are applied to data drawn from the European Community Household Panel for the EU-15.

As regards the evidence obtained and related implications, *first*, our results confirm the need to consider self-employment as a heterogeneous group. Therefore, an effort to incorporate proxies aimed at capturing the heterogeneous character of the entrepreneurial activity in official statistics seems crucial to contribute to the development of future research in this area. In addition, our results stress the risk of using a unique receipt from a public policy perspective when defining instruments for self-employment promotion.

Second, the results of this paper unequivocally support the consideration of entrepreneurs as actors embedded in a particular social context. Thus, social capital and network contact variables were found to be very strong and consistent predictors in the individual decision to start a new business. Despite the existing difficulties in the operationalisation of social capital, our results are of significant policy importance because they appear to attribute positive effects on opportunity recognition by entrepreneurs to social sources of opportunity-related information, including participation in business networks. Hence, although government participation fostering professional forums might lead to inefficient and over-sized networks, indirect measures favouring environments where business networks can emerge naturally seems to be appropriate.

Third, our results also shed new light on the important but underresearched issue of the relationship between the individual decisions to start a new business and the *macro level* environment, in particular, (i) the economic situation; (ii) the expenditure on start-up incentives; and (iii) the degree of employment protection. In this sense, the coexistence of recession periods, start-up incentives, and strict employment protection increases the likelihood of becoming an own-account worker from unemployment and may be distorting the occupational choice against *true* entrepreneurs in favour of certain less entrepreneurial forms of self-employment. Therefore, public expenditure designed to move the unemployed back to employment might be detrimental for employment rights and the social protection of workers by favouring the development of atypical forms of employment that are outside the scope of labour laws. As a consequence, to avoid some unexpected (and undesired) effects, the interaction of different *macro level institutional factors* (i.e. labour market institutions and the business cycle) should be considered when defining the regulatory environment.

2. Introduction

The global economy faces a *threatening downward spiral* as a result of the financial and economic crisis of 2008. In some European economies, the problem is strongly exacerbated by a substantial increase in unemployment rates. Therefore, the challenge is not just to start and strengthen the economic resurgence, but also to ensure this recovery is accompanied by employment growth. Towards this end, academics and policymakers are still debating over what demand-side policies (i.e., fiscal and monetary) the governments should implement. On the supply side, however, there is near consensus that successful microeconomic reforms should recognise entrepreneurship as a key element.¹

In this regard, the 2006 Nobel Prize laureate Edmund Phelps, in his letter to report to the G20 on the Conference “Post-Crisis Economic Policies” (Berlin, December 2009), highlighted that:

The policy responses to the current crisis have focused on the “demand side” through fiscal stimuli, liquidity support to banks and very low central bank interest rates. [...] the challenge in the post-crisis era can be primarily found on the supply side. (Phelps, 2010, p. 598).

Indeed, the European entrepreneurship policy has traditionally highlighted the need to create the best possible micro and macro-environment for small business and entrepreneurship. Its more remarkable initiatives have revealed, however, a marked tendency or bias in favour of measures promoting transitions from unemployment to self-employment, which has been used as an instrument within the active labour market policies (hereafter ALMPs) as a way to reduce unemployment (see Kluve and Card, 2007).² As a clear sign of the distance between political speech and political action with respect to entrepreneurship promotion measures, Santarelli and Vivarelli (2007) highlight the non-selective use of these subsidies:

It is a matter of fact that most local, national and international authorities seem to have favoured “erga omnes” policies, characterised by general and often automatic entry subsidies. This is obviously very unfortunate. (Santarelli and Vivarelli, 2007, p. 475).

¹ The key role of entrepreneurship as a major driver of economic growth, job creation, and competitiveness in global markets has been well documented in academic publications (see, for instance, recent works by Acs, 2008; Carree and Thurik, 2008; Parker, 2009; or Thurik et al., 2008). Policy reports also place special emphasis on entrepreneurship (see, for instance the *European Charter for Small Enterprises* adopted in Lisbon in 2000, the *Green Paper: Entrepreneurship in Europe* presented in 2003, the *Action Plan: the European Agenda for Entrepreneurship*, presented in 2004, the *Small Business Act for Europe* presented in 2008, or the new *Europe 2020 strategy*, the EU's growth strategy for the coming decade).

² The design of the whole spectrum of policies, programmes and initiatives relevant to Europe's small and medium-sized enterprises by European authorities seems to be defined in terms of the overall objective of unemployment reduction. Some of its main targets include the following: (i) encouraging young entrepreneurs; (ii) encouraging women entrepreneurs; (iii) opening doors to ethnic minority groups to set up and run a business; and (iv) tackling the stigma attached to business failure.

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