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Out of sight, out of mind: Migration, entrepreneurship and social capital[☆]

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ABSTRACT

The aim of this paper is to investigate whether return migrants are more likely to become entrepreneurs than non-migrants. We develop a theoretical search model that puts forward the trade off faced by returnees since overseas migration provides an opportunity for human and physical capital accumulation but, at the same time, may lead to a loss of social capital back home. We test the predictions of the model using data from Egypt. We find that, even after controlling for the endogeneity of the temporary migration decision, an overseas returnee is more likely to become an entrepreneur than a non-migrant. Although migrants may lose their social capital, they accumulate savings and experience overseas that increase their chances of becoming entrepreneurs.

1. Introduction

What makes an entrepreneur? This question has been the focus of few previous studies, which have tended to analyze the determinants of self-employment in developed countries and transitional economies (see, for example, Blanchflower and Oswald, 1998; Evans and Jovanovic, 1989; Evans and Leighton, 1989; Djankov et al., 2005). Yet, very few papers have attempted to study this question for developing countries. Meanwhile, the wealth and poverty of developing countries are linked to the entrepreneurial nature of their economies. Entrepreneurship plays an important role in economic growth, innovation, and competitiveness as first highlighted by Schumpeter in 1911, but may also play a role in poverty alleviation (Landes, 1998). It is thus crucial to understand what makes an entrepreneur in developing countries.

The rather small literature on this issue has put forward the importance of financial constraints in becoming an entrepreneur. Access to credit is seen as a major obstacle for entrepreneurship (see, e.g., Banerjee and Newman, 1993). Limited personal and family savings and lack of access to credit are seen to severely limit the growth prospects of promising startups in developing countries. Thus, policymakers and international organizations, interested in economic development, have supported micro-credit programs in developing countries as a means to encourage entrepreneurship. More recently, international migration has played an important role in allowing this liquidity constraint to be overcome. Temporary migration has been a conduit through which individuals have the opportunity to accumulate savings that can be used upon their return for setting up businesses.

Several studies have been interested in how international migration provides a channel for accessing credit through overseas savings by focusing on the impact of savings on the occupational choice of returnees and in particular on self-employment and entrepreneurship. Using cross-sectional data from Pakistan, Ilahi (1999) finds that, upon return, savings become a significant factor in the choice of self-employment over waged employment. Mesnard (2004) models migration as a way to overcome credit constraints in the presence of capital markets imperfections. She finds that the majority of entrepreneurial projects started by Tunisian returnees were totally financed through overseas savings.[1] Dustmann and Kirchkamp (2002) develop a model where migrants simultaneously decide on the optimal migration duration and their after return activities. They find that among Turkish returnees more than half of them are economically active and engage in entrepreneurial activities. McCormick and Wahba (2001) add a

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[1] In another paper, Mesnard and Ravallion (2006) examine not only the effect of credit constraints (wealth) but also wealth inequality among return migrants in Tunisia.

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different insight by showing that savings matter more than human capital acquisition for the probability of entrepreneurship of illiterate Egyptian returnees. However, for the educated returnees, both access to credit, through overseas savings, and human capital accumulation are significant determinants of entrepreneurship upon return. Woodruff and Zenteno (2007) find that migration networks help overcome capital constraints in Mexico. Using a survey of self-employed workers and small firm owners in Mexico that have access to remittance flows, they estimate the impact of attachment to migration networks on the level of capital investment, the capital-output ratio, sales, and profits of microenterprises.[2] However most of those studies limit their analysis to return migrants only, while Woodruff and Zenteno (2007) consider households of migrants receiving remittances rather than return migrants. Yet, one important question is whether return migrants are more likely than non-migrants to become entrepreneurs (set-up businesses). The issue of whether return migrants are more or less likely to become entrepreneur has not been addressed before.

Although physical capital is an important determinant of entrepreneurship and has been seen as an important factor by economists, there are potentially other factors that may impact on the individual's decision of setting up a business. Sociologists have stressed the importance of social capital as a determinant of entrepreneurship: entrepreneurs rely on their contacts for information and services (see, e.g. Greve and Salaff, 2003). This is an issue that has not really been tackled by economists. An exception is the work by Djankov et al. (2005, 2006) who provide suggestive evidence on the role played by social networks on entrepreneurship. They find that individuals whose relatives and school friends are entrepreneurs are themselves more likely to be entrepreneurs. Indeed, several economic studies have examined the role of social networks in migration (see e.g. Munshi, 2003; McKenzie and Rapoport, 2010) and others have studied the role of social networks in job acquisition (see e.g. Wahba and Zenou, 2005). This migration literature has focused on the role played by social networks in the migration decision through reducing migration cost, for example, and in finding jobs upon arrival in the host country. However, the role played by the *origin* social networks in entrepreneurship has not attracted previous attention. Moreover, no one has examined the possible loss of social capital at country of origin as a result of emigration and whether this impacts on the entrepreneurial decision upon return.

The aim of this paper is to study what makes an entrepreneur and to address the following questions. Are return migrants more likely to become entrepreneurs than non-migrants? Does emigration result in loss of social capital, hence out of sight, out of mind, and thus negatively affect the entrepreneurship decision? As a result, this paper attempts to address this important policy question regarding the determinants of entrepreneurship and whether return migrants are more likely to become entrepreneurs compared to non-migrants. This should impact on policies directed towards encouraging entrepreneurship and providing micro-credit in many developing countries.

To answer the above questions, one needs to control for the potential endogeneity of the migration decision and the entrepreneurial decision upon return. On the one hand, migration might increase the probability of entrepreneurship but, on the other, it could be that individuals planning to be an entrepreneur are more likely to migrate. First, we develop a theoretical search model where we endogenize the migration and the entrepreneurship decisions and show the trade off faced by returnees since overseas migration provides an opportunity for human and physical capital accumulation but, at the same time, may lead to a loss of social capital back home. Then, we test these predictions using the Egyptian Labour Market Survey in 1998 by looking at both overseas returnees and non-migrants. We control for the potential endogeneity between temporary migration and entrepreneurship. We find that, controlling for the temporary migration decision, a returnee is more likely to become an entrepreneur than a non-migrant. Although migrants may potentially lose their social capital, they accumulate savings and experience overseas that increase their entrepreneurship.

The paper is organized as follows. Section 2 develops the theoretical model. In Section 3, we describe the data, while the econometric model is presented in Section 4. The empirical findings are examined in Section 5 and further robustness checks are discussed. Finally, Section 6 concludes.

2. Theory

2.1. The model

Consider a continuum of individuals whose mass is n in a given country (Egypt in the data). Ex ante, individuals are heterogenous in two dimensions: their (innate) entrepreneurship *talent*, which we denote by t, and their migration costs c. Talent t is drawn from a cumulative distribution $F(t)$, which is continuous on the support interval $[\underline{t}, \bar{t}]$. The migration cost c is drawn from a cumulative distribution $G(c)$, which is continuous on the support interval $[\underline{c}, \bar{c}]$. We assume that there are no correlations between $F(t)$ and $G(c)$ so that, for example, a very talented person may have a very high migration cost because he/she has a large family and/or because he/she is older.[3]

The timing is as follows. In the first stage, each individual in the home country (Egypt in the data) decides whether to migrate to another country or not without knowing their talent t. In our model, as it is the case in our data for Egypt (see below), we are only focusing on *temporary migration* , which means that when an individual decides to migrate, he/she knows with certainty that he/she will return to the home country.[4] Then, those who have migrated return to their home country. We refer to them as *returnees* while those who have never migrated are referred to as *non-migrants*. An individual i is identified with the subscript $i = \text{re}$ in the former case and $i = \text{nm}$ in the latter. The mass of returnees and non-migrants are denoted by n_{re} and n_{nm}, with $n_{\text{re}} + n_{\text{nm}} = n$. In the second stage, talent t is revealed to each individual i and each of them has to decide whether to become an entrepreneur or a waged worker.

2.2. The labor market

We use a standard search-matching model (Mortensen and Pissarides, 1999; Pissarides, 2000) to describe the labor market.

2.2.1. Matching function

The allocation of jobs is modeled as in the simplest case analyzed in Pissarides (2000, Chapter 1), with an important modification necessitated by the introduction of entrepreneurs. Suppose that, at some time t, entrepreneurs have created and are managing a total of $m + v$ jobs, with m of them occupied by workers and v of them vacant. There are $m + u$ workers in this market, one in each occupied job and u unemployed. Each of the m occupied jobs produces a constant flow of output y and continues producing this output until a negative shock arrives. When the negative shock arrives, an event that takes place at rate δ, the job is closed down, the worker becomes unemployed and the entrepreneur opens another job to replace it. Workers share the surplus from the job according to the Nash solution to an implicit wage bargaining. There is *no* on-the-job-search since all jobs are identical and therefore

[2] See also Oswald and Blanchflower (1998) who study who becomes an entrepreneur in the UK.

[3] We could assume that these two distributions are correlated in some way. This would make the analysis easier but also less interesting.

[4] Over 90% of Egyptian migration is temporary in nature.