THE EFFECT OF BUSINESS ENVIRONMENT ON ENTREPRENEURSHIP IN OECD COUNTRIES

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ABSTRACT

The quick evolution and alterations of international community, transition from conventional society to an informational one, in addition to conversion from a national economy to a worldwide, require various policies which can provide the society with the capability of economic growth and development. The adverse business conditions, will pose the less significant small and middle-sized corporations besides entrepreneurs, more exposed to difficulties compared with larger companies. Hence, more focalizations have paid recently on business environment as a prerequisite to entrepreneurship development. Doubtlessly, the entrepreneurship has a crucial and consistent effect on the economic development and consistency of all communities. In the current research, the effect of business environment on entrepreneurship has been investigated, besides the improvement and modification of indices related to business environment as a key factor in promotion and development of entrepreneurship, has been noticed. Therefore, the ongoing research will not only consider the various indices corresponding to business environment and OECD countries ranking, but also it will conceptually define the entrepreneurship. The statistical sample utilized in the current work, comprises the statistical data associated with OECD countries which has been gathered from World Bank databases. The acquired results demonstrate that the business environment indices affect the entrepreneurship directly.

Keywords: Business Environment, Entrepreneurship, Economic Growth

INTRODUCTION

Since economic activities further lead to the growth of investment, employment, income, taxes and wellbeing of the society; all countries try to create business environment by economic actors and entrepreneurs, and take many reformative actions. Regarding the fact that developing a private sector in a market economy depends on a complex set of rules, physical and organizational infrastructures, a stable macroeconomics environment, development of financial markets, attraction of direct investment from abroad, development of small and medium
industries, labor market regulations, technology enhancement systems, education and learning to be able to go on with a path of permanent changes of development dimensions. And, the provision of the set to implement the development pattern in an economy does not happen automatically; hence, establishing organizational and fundamental infrastructures for developing and removing business obstacles are of the basic requirements of administering this policy and are in the group of obligatory tasks of the government and civil agencies (including the chamber of commerce and guardianship of trades). As a development engine, entrepreneurship plays a key role in the economic growth of countries and creation of employment opportunities. Regarding the role and importance of entrepreneurship and the brilliant background of entrepreneurs in the development of countries, providing the scene for supporting them is of prime significance – especially for developing countries.

In this study, the effect and role of business environment on entrepreneurship will be examined and the improvement and modification of business environment indices as the main factor of development and entrepreneurship expansion will be discussed. Accordingly, the present article explains the concept of entrepreneurship as well as exploring and representing various indices of business environment. Then, the base model will be extrapolated. The statistical sample used in here comprises the information and statistics of OECD countries collected from the global bank. In the end, considering the results of the model estimation, the hypothesis of the study will be either approved or rejected and suggestions will be presented for the development and expansion of entrepreneurship.

1. THEORETICAL BACKGROUND

2-1- BUSINESS ENVIRONMENT

By business environment, we mean the factors affecting the function of economic units like the quality of dominant systems, the stability of rules and regulations, the quality of infrastructures and ... changing them goes beyond the economic agencies managers’ authorities. If “business” is defined in terms of any repetitive economic activity such as production, trading off goods and services to gain economic advantages, different types of business will include: 1) domestic business, 2) familial business 3) rural business, 4) internet business, 5) small and medium business and 6) big businesses (Tehran Chamber of Commerce Industries and Mines, 2010).

2-1-1- THE NECESSITY TO CONSIDER THE ISSUE OF BUSINESS ENVIRONMENT

So far, the scholars and policymakers in different countries have taken various policies to achieve wellbeing and solve economic problems of the society (economic development). The improvement of business environment is considered to be a famous economic solution. For some scholars, this strategy is a complement and even prerequisite of privatization strategy. Some also believe that removing the obstacles of private sector or the same improving the business environment must replace the privatization. This strategy is called “bottom-up growth of the private sector”, and “the natural growth of the private sector” respectively by Josef Stieglitz – the winner of Nobel Award of Economy – and ZhanousKornai – the well-known economist of Harvard University (Midri&Ghodjani, 2008).
Global experience – both theoretically and practically – shows that private sector growth is possible by applying one of the two trends or exploiting them simultaneously. Delegating governmental companies and assets to private sector known as privatization in the literature of economics is the first trend and the second is to remove the private sectors obstacles or improve business environment. Although theoretically the sum of the two is possible, usually countries aiming at privatization neglected the removal of the obstacles and improvement of business environment and countries chosen the strategy of improving business environment did seek for privatization. The emphasis of all development strategies on the necessity to create and develop economic activities, enhance employment level and making attempts to achieve economic prosperity at both macro and micro levels has followed the same concept known as “business environment”, today (Chamber of Commerce Industries and Mines, 2010).

**2-1-2- FACTORS AFFECTING BUSINESS ENVIRONMENT**

The factors affecting business environment can be divided into three main groups: 1- the status and role of the government’s policies and plans, 2- economic agencies and official and nonofficial mechanisms dominant over them and 3- legal and judicial system.

**2-1-2-1- GOVERNMENT:** Affects economic activities in different aspects and paths; so that its political and macroeconomic policies lead to the formation of a intact, prosperous, transparent, and powerful economic system and/or the underground development of the economy and corruption and consequently a weak and inefficient economy.

**2-1-2-2- ECONOMIC AGENCIES:** the formation of appropriate relationships between different economic sectors, the arrangement of the relationship between employees and the employees, gaining the credit required for economic actors from the structured and general system and many other connections and relations in the light of economic organs without the formation and promotion of which necessary reliability will not be provided for the investors.

**2-1-2-3- LEGAL SYSTEMS:** from the entrepreneurs’ views, investment requires economic security the provision of which will be possible in the light of efficient rules and legal system warranting its execution. To put more clearly, the investor must be ensured that his capital is exposed to no risk (Chamber of Commerce Industries and Mines, 2010).

**2-1-3- THE TECHNIQUES OF ASSESSING BUSINESS ENVIRONMENT**

There are two methods for examining or recognizing the problems of business environment and the growth obstacles existing in the private sector. The first is to conduct survey and inquiry among the business theorists and researchers. The global assembly of economy is among the centers assessing the business using the method. Since 1997, the institute has been distributing a questionnaire between the managers or owners of big companies in sixty countries and measuring the amount of business obstacles by combining numerical values.

Another method is to measure the official costs and time the work steps. To recognize the obstacles of growth of private sector, the global bank uses this method in various countries. In this regard, the global bank has established a center called business in 2000 which compares the
business obstacles of different countries annually and provides solutions for improving business environment using the experiences of the countries (Midri & Ghodjani, 2008).

2-1-4- BUSINESS ENVIRONMENT INDICES

Ten indices of business totally known as the feasibility indices of business and applied to analyze the economic consequences and detect the required terms in various sectors include:

1. Starting a Business
2. Dealing with Construction Permits (including all processes required from gaining permits to run a workshop)
3. Getting Electricity
4. Registering Property (the process required for registering the property in official documents office)
5. Getting Credit
6. Protecting Investors (Stockholders)
7. Paying Taxes
8. Trading Across Borders
9. Enforcing Contracts
10. Closing a Business (liquidating an activity)
11. Extra Index: Employing Workers

Each of the above indices is divided into secondary indices, as well. The measurement and comparison basis of business environment with other countries is the feasibility of executing the above ten activities. The rank of each country is determined based on time, cost and the steps of fulfilling each of the activities; the quicker the fulfillment of an activity and the less its official steps and costs, the more suitable its business environment and the better its rank (compared to other countries) (Midri & Ghodjani, 2008).

2-1-5- ENTREPRENEURSHIP

Entrepreneurship was first considered by economists in sixtieth century and developed in economic theories and then entered the entrepreneurial schools and theories of other humanities fields. Cantion (1755) who invented the word entrepreneurship regards the entrepreneur as a risk-taker buying the goods at a certain price and selling it at an uncertain one. JeanBatist C takes the entrepreneur as the coordinator and integrator of production factors; namely, a person integrating the production factors (land, labor and capital) to produce goods and/or provide
services. He is called entrepreneur and his work entrepreneurship (Ostadzadeh, 2003). Another
definition for entrepreneurship is by Shompitere. In his book “the theory of economic
development”, he distinguishes between the concept of innovation and invention and considers
innovation as the use of invention risk for creating a commercial product or service. Finally, a
comprehensive definition of entrepreneurship by Webster dictionary (1961) is: entrepreneur is
the organizer of a person’s economic activity who organizes, manages, and takes the risks of a
commercial activity (Hefdahtan, 2010).

2-1-5-1- ROLE OF ENTREPRENEURSHIP IN ECONOMIC GROWTH AND
DEVELOPMENT

The major feature of the today economy is its quick changes. Hence, countries can be successful
in such conditions that have the capability of adapting to the changes. With a glance at the
historical theories of the economic development, it can be realized that the newest theories
emphasize that the development of industry and economy is based on changing the ideas and
innovations without which no countries will be successful. Naturally, the main tool which can
help us with accomplishing our goal is entrepreneurship. In an entrepreneurship-based economy,
the innovators and the owners of ideas and thoughts are taken to be the critical capitals of an
economic agency and the main factors of the sustainable development. Due to the special role
and status of entrepreneurs in the trend of economic development and growth of the society,
many developed governments and countries make attempts to direct a number of the society’s
people with entrepreneurship qualities toward training and entrepreneurship and entrepreneurial
activities by exploiting the latest facilities and research results (Divsalar & Bozorgi, 2012). In fact,
entrepreneurs are the best choice for founding successful companies. If the organization be
founded, in the organization’s growth, development and maturity steps, we need organizational
entrepreneurship so as to be able to respond the environment changes suitably and not lose the
competition by creativity and innovation (Ahmadpour Dariani & Erfanian, 2007).

2-2- LITERATURE REVIEW

2-2-1- NATIONAL STUDIES

In his study, Mehdi Forghani Moghadam (2011) implies the capital accumulation as one of the
basic needs in the economic growth process and can be provided by in- and out-house resources.
This study makes attempts to examine the relationship between the direct foreign investment and
the feasibility index of business with economic growth. Results show that the regulations of
business environment negatively affect the economic growth and direct foreign investment
positively affects the economic growth of the countries under study.

In her study, Maryam Ahmadiam (2010) puts that the investment plays an effective role in the
economic growth and development of each country and the study and recognition of the factors
affecting the private sector investment can lead to the better and more accurate policymaking for
the increasing growth and participation of the sector. She tries to formulate an indigenous index
of business environment in Iran based on the main economic quantitative variables. In the end,
estimating the investment function with respect to the indigenous index indicates that the
improvement of business environment leads to the increase of the private investment in Iran.
In their study, Fatollah Tari and Said Gholami Baghi (2007) – with respect to discussion of privatization and Article 44 of Constitution – one of its requirements and prerequisites are considered to be the facilitation of business environment and indicate the modification and improvement of the business conditions as an effective factor in the economic growth of the country. In the end, they conclude that modifying the business environment in the line with facilitating respective regulations is the first step for achieving the desirable production level, productivity in the official sector, creating occupational opportunities and the possibility for implementing the supportive policies and critical for executing the general policies and development of non-governmental sector activity.

In his study, Vahid Ahmadi (2008) tries to compare between Iran business indices and other countries across the world and explain the importance and necessity of facilitating the formation process of an economic activity as an accepted and increasing phenomenon in the world. Finally, he concludes that only by doing modifications in five indices of gaining permits, supporting the investors, employing workers, registering property and liquidating activity (end of business), Iran will be able to promote its status from its present one desirably.

In his study, Mahmoud Ahmadpour Dariani and Amir Erfanian (2007) explain the relationship between economic development, business, entrepreneurship, and its development requirements. Doing so, they concluded that creating the culture of business and entrepreneurship in the society, teaching general skills of business to people and appropriate policymaking by government comprise factors that can lead to the spread and development of entrepreneurship in the society. Now, if the capital factor and entrepreneurship be put together, they will end in the development of business, as well.

In their study, Samaneh Divsalar and Farshad Bozorgi (2012) present the quick and intensive changes of the international society and the national economy change into global economy, and strategies for providing economic growth and development in the society. In this article, they pointed out the role and status of entrepreneurship in economic growth and sustainable development and the entrepreneur is also considered to be the main driving force of the societies’ development. In the end, they conclude that the major effects of developing entrepreneurship, increasing innovation, enhancing technology level, increasing employment, producing technical knowledge and the production and distribution of income at society level which consequently can increase the national wealth and economic growth of the society.

2-2-2- INTERNATIONAL STUDIES

In their study, Diaz Casero, Diaz Aunion, Sanchez Escobedo, Coduras, and Hernandez Mogollon (2012) empirically examined whether the economic openness affects the entrepreneurship activity of the three groups of countries classified based on economic development. Results from the relationship and correlation analyses of the variables indicate that the economic openness has a close relationship with respective entrepreneurship activity.

In their study, Yo and Ramanathan (2012) investigate the effects of business environment on the function strategy including the competitive priorities in retail sector in China. Results show that
companies interested in their businesses in new markets face many challenges regarding new business and different aspects of it which can affect the function of their strategies.

In his study, Gilmore (2011) examines the marketing and its relationship with the entrepreneurs and small and medium agencies and how the entrepreneurs and owners and managers of small and medium agencies use marketing for the company’s especial needs. In the end, he concludes that there is a mutual relationship between marketing and entrepreneurship and the entrepreneurs provide their economic agencies’ needs by means of adapting to the market and innovative marketing.

In their study, Putkaradze and Abramishvili (2009) investigate the role of entrepreneurship and development of small and medium agencies in the developing economies. They conclude that the agency inefficiency and gaps lead to the increase of entrepreneurship development obstacles and small and medium agencies (SME). The inefficiency and gaps appear mainly due to the inefficient tax system and financial framework.

In his study, Volha (2005) examines the effect of business environment on the private sector share of GDP and non-official economy as a share of gross national income. In the end, he concludes that the status of business environment plays a significant role in forming the nature of entrepreneurs’ activities and the dynamicity of new companies. Heavy and complex rules and regulations spread a high level of corruption and lead to the weakness of the motivation for doing economic activities. Also, results of the study show that the government’s rules have negative effect on the development of small and medium businesses. Moreover, the tough regulations of entering business result in more corruption and bigger non-official economy.

In their study as “the pivotal role of entrepreneurship in developing economies”, MacMillan and Woodruff (2002) explain the entrepreneurship patterns in developing countries. They believe that developing markets in each developing country happens spontaneously; with different speeds, yet. Some governments nurture entrepreneurship and entrepreneurs by supporting market infrastructures. In the end, they conclude that the success or failure of the developing economies can affect the great part of that economy’s entrepreneurs’ function.

2. RESEARCH MODEL

3-1- PRESENTING THE MODEL

Regarding the theoretical principles and empirical evidences implied in the previous sections of the articles, the effect of business environment on entrepreneurship can be extrapolated in terms of the following model:

\[
NEWFIRMS_i = \beta_0 + \beta_1 \text{PROCEDURE}_i + \beta_2 \text{DAY}_i + \beta_3 \text{COST}_i + \beta_4 \text{CAPITAL}_i + \beta_5 \text{TAX}_i \\
+ \beta_6 \text{PROTECT}_i + \beta_7 \text{LEGALRIGHTS}_i + u_i
\]
Where:

\( NEWFIRMS_i \): The number of agencies (companies) already registered in country \( i \) (as an index for the entrepreneurship created)

\( PROCEDURE_i \): The required steps in registering company in country \( i \)

\( DAY_i \): The time (day) required for registering company in country \( i \)

\( COST_i \): The cost required (a percentage of income per capita) for registering company in country \( i \)

\( CAPITAL_i \): The least capital required (a percentage of income per capita) for the beginning of business in country \( i \)

\( TAX_i \): Total tax rate (a percentage of company’s profit) in country \( i \)

\( PROTECT_i \): Investor support ability index in country \( i \) (0=weaker, 10=stronger)

\( LEGALRIGHTS_i \): Legal rights power index in country \( i \) (0=weaker, 10=stronger)

In the forthcoming, we will present each variable, how to calculate them and statistical resources.

3-2- PRESENTING MODEL VARIABLES

3-2-1- DEPENDENT VARIABLE

As implied in the above model, entrepreneurship is the dependent variable. Since entrepreneurship is a quantitative and uncountable concept, another variable must be used directly or indirectly showing the created entrepreneurship. For instance, variables like the number of jobs created, employment rate, the number of workers and employees employed already and …; yet, since the variables include all economic sectors (both governmental and private) and also due to the low efficiency and productivity and lack innovation in the governmental sector, the private sector or in fact the same entrepreneurs have more extensive role in increasing production and productivity and consequently economic growth. So, we would rather use another variable like newly founded agencies showing the motivation and power of entrepreneurs in administering a new business (considering the similar cases in Dashkowich and Volha’s thesis as “business environment and entrepreneurial activity” implied earlier).

3-2-2- INDEPENDENT VARIABLE

As implied earlier, business environment includes ten main indices and one extra which can be applied as independent variables yet all may not affect entrepreneurship and/or even some are superior to others. For instance, entrepreneur who has aimed at domestic market as his target market does not need to know international commerce conditions (however in short term, because he may gain considerable success in his business across the national borders in long term). Also, when an entrepreneur begins his business and registers his company, it means that
he is informed of the conditions of getting credit, gaining permits, employing workers, tax rates and ... and consequently began his business. So, the index beginning business is superior to other indices in terms of significance. As result, regarding what is mentioned, the sub-indices of starting business (the steps of beginning business (number) – time (day) – cost (percentage of income per capita) – minimum capital required (percentage of income per capita)) as well as total tax rate (percentage of profit), investors support ability index and legal rights power index are taken as independent variables. These variables are adopted from Dashkowich and Volha’s thesis variables.

3-3- INFORMATION AND DATA

Since 2003, Global Bank has annually issued the reports of business environment in countries across the world and an organization known as Doing Business (affiliated to Global Bank) is in charge of doing these researches. Related data is available in global bank site in general and in doing business site in details. Data from both sites are used in this study and due to the lack all data from OECD countries (i.e. Canada, Portugal, Greece, Poland, Estonia, and Israel), 2008 was chosen as the year under study in this research and the model is calculated sectional terms.

3-4- ESTIMATING THE MODEL AND ANALYZING THE RESULTS

Results of estimating the model (1) using Ordinary Least Squares (OLS) method are listed in Table 1.

<table>
<thead>
<tr>
<th>P value</th>
<th>Coefficient</th>
<th>Regressive variable</th>
<th>Regressive variable</th>
</tr>
</thead>
<tbody>
<tr>
<td>0.0313</td>
<td>33095</td>
<td>( \text{PROCEDURE}_i )</td>
<td>Registration steps No.</td>
</tr>
<tr>
<td>0.0109</td>
<td>-3633</td>
<td>( \text{DAY}_i )</td>
<td>Days</td>
</tr>
<tr>
<td>0.0074</td>
<td>-6975</td>
<td>( \text{COST}_i )</td>
<td>Registration cost</td>
</tr>
<tr>
<td>0.0787</td>
<td>-358</td>
<td>( \text{CAPITAL}_i )</td>
<td>Min investment for beginning business</td>
</tr>
<tr>
<td>0.0475</td>
<td>2442</td>
<td>( \text{TAX}_i )</td>
<td>Total tax rate</td>
</tr>
<tr>
<td>0.043</td>
<td>33866</td>
<td>( \text{PROTECT}_i )</td>
<td>Investors support ability index</td>
</tr>
<tr>
<td>0.0457</td>
<td>21327</td>
<td>( \text{LEGALRIGHTS}_i )</td>
<td>Legal rights power index</td>
</tr>
<tr>
<td>0.015</td>
<td>-481519</td>
<td>( \beta_0 )</td>
<td>Intercept</td>
</tr>
</tbody>
</table>

Resource: research results

As seen in Table 1, most coefficients are significant (%5).

The high value of the company registration steps number indicates that the variable has a great effect on the dependent variable (number of registered agencies). Although apparently the great numbers is not seemed to be rational and suitable but it must be noted that companies have high transparency at the time of registration and foundation. For instance, legal transparency, financial and capital resources of the company, the clearance of company’s function and field of activity (to prevent from renting and trading activities), essential inquiries from legal officials to find the clean legal and judicial background of the founders and ... can be implied sum of which can
affect the function and competitiveness of other economic agencies and as a result total economy. So, it is seen that high or low number of registration steps can be of significance only when all of them are passed in a less time. For example, maybe the number of registration steps be small in a country yet the time for passing them be long, yet the exactly opposite in another country with lower costs; the shorter the steps of registration is, the faster the agency will start its activity and production of products or services and the faster will be the process of entrepreneurship and creation of employment and increase of national production. The less the amount of the variable “cost required for the registration of company” is, the more insignificant the obstacle it will create for registering companies. While the amount of this coefficient is more than the previous variable and indicates more influence on dependent variable. Minimum capital for successfully beginning the business is regarded as an obstacle but regarding the coefficient of the variable, it can be realized that it has less significance compared to two previous variables. This is because definitely the beginning of any business requires investment and financial resources. Now, the further the amount of the capital required, the less the entrepreneurs will to invest and work in the field. Unlike the underdeveloped countries and developed ones which consider tax as force money and not paying it as a clever act, it is seen as a tool for helping the government for better serving people and companies and … in developed countries. Since the present study is done on OECD countries and most of them are among the developed ones, obviously they consider the tax and paying it as an essential task for enhancing the government’s service delivery and do it. The high coefficient of the index “the ability to support investors (stockholders)” shows that the variable plays an important and even key role in creating entrepreneurship and has significant effect on production and economic activities of the entrepreneurs. So, to achieve quick and short term objectives like increasing entrepreneurship, enhancing employment, promoting production and consequently economic growth are of the best policies in increasing entrepreneurship. Legal rights are those delegated by a legal system to real or legal persons and in fact prevent their rights from being violated. The coefficient of this variable again shows the significance and role of the variable in entrepreneurship. The more the people and especially the entrepreneurs be assured of the power of legal system in reviving their rights, the more and with less worries they will tend to production and economic activities. So, the variable is also considered another alternative suitable for enhancing and promoting entrepreneurship.

The positive coefficients show the direct relationship between dependent and independent variables. As seen, the number of the steps required in registering new company has direct relationship with the number of new companies registered. While the variables of the time required, cost required, and the least capital required for the company’s registration and beginning of the business have indirect relationship with the number of new companies registered. Also, total tax rate variables, the index “the investors support ability” and index “legal rights power” have direct relationship with the number of companies newly registered.

3. CONCLUSION

In this study, the effect of business environment on entrepreneurship was examined in case terms in OECD countries. The adverse environment of business exposes small and medium companies and entrepreneurs to further issues compared to big companies. So, recently the attention of environment business is considered as one of the requirements of developing entrepreneurship.
In any country with costly and challenging rules and regulations of agencies, they tend more to act in non-official part. Regarding the matter that there is no room for the big investments and development of agencies’ activities in non-official sector, the scale of these agencies usually remains small and do not reach bulk production and advantages from increasing efficiency based on production scale and consequently the small economic growth will be gained and less jobs will be created. The government’s encouraging actions and the implementation of modification policies in the same vein of facilitating the business regulations lead to the creation of growth and development space for agencies’ activity and its transfer from non-official economy and official economy, the increase of the number of official jobs in the economy and development of the support for economic actors. Removing the obstacles and improving the indices of business indices will provide the motivation necessary for considerable presence and start of an economic activity and bring the development and expansion of entrepreneurship. Based on the estimated model the coefficients gained, the number of steps required for registering new company is in direct relationship with the number of companies already registered. While the variables time, cost and the least capital required for registering company and beginning business are in indirect relationship with the number of newly registered companies. Also, the variables tax rate, the investors support ability index and legal rights power index have direct relationship with the number of newly registered companies. Regarding the results from the relationship between business environment indices and entrepreneurship created, a direct relationship is observed between business conditions and entrepreneurship. Although results of the study are extrapolated for all OECD countries, it can be said that they can be used in Iran for achieving objectives like creating more and further extensive entrepreneurship opportunities, reducing unemployment, increasing production and economic growth rate in short and intermediate terms in Iran by implementing the following strategies:

1. Developing insurance for supporting probable risks
2. Formulating the financial and tax rules and regulations encouraging entrepreneurial activities
3. Seriously fighting the economic and official corruption
4. Formulating support rules and regulations from entrepreneurs and economic actors
5. Promoting and removing problems and gaps of legal system for proper and low-cost and quick revival of the people’s rights
6. Facilitating and accelerating the registration of companies like shortening the time of reviewing and reducing the costs in the light of accuracy and transparency of the information

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