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Beyond individual success stories: Promoting entrepreneurship through institutional reform

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Article at a glance

- Traditional approaches to promoting entrepreneurship focus too much on individual skills-building at the expense of institutional reforms needed to remove barriers to doing business.
- Through institutional reform it is possible to empower entrepreneurs to transition from micro-enterprises to small and medium-sized business that can create jobs, innovate, take advantage of economies of scale, and increase productivity.
- Private sector organizations can play a vital role in removing barriers to entrepreneurship through public policy advocacy and community engagement.

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In search of private enterprise, jobs, and economic growth

Ahmed Muhammad Sayyid was an Egyptian student with a university degree who had high hopes and aspirations for a successful career in tourism. Instead, he ended up living with his mother and working as a driver for less than \$100 a month.¹ Certainly, this was not the future to which he aspired, especially having higher education in a country where about one-third of the population is illiterate. Frustrated by his inability to get a job, make money, and start a family, Sayyid lost hope in himself and in the government's ability to help him.

Sayyid is not alone. Millions of youth in the Middle East and North Africa (MENA) region enter the workforce with high hopes and cannot find jobs. Left on the sidelines of development, young people lose faith in governments and instead close themselves off from a society that has no place for them. They are the "generation in waiting," confined to idleness in the streets and spend their time drinking tea, smoking arghileh, and waiting for jobs to arrive.²

The problem of unemployment goes beyond youth and beyond the MENA region. Although a lack of skill contributes to the problem, something else is responsible for persistently high unemployment in some parts of the world and the inability of the small business sector to become an engine of growth. Something else is preventing individuals from opening their own businesses and keeping existing firms stuck at the micro-level in the informal sector, unable to expand and create jobs for others. Even individuals who learn how to put together business plans, keep financial records, develop a business strategy, and create new products and services are stymied in their pursuit of success. What is preventing all of these potential growth engines from lifting off?

The answer has much to do with the quality of the enabling environment for doing business and broader institutional failures. As countries seek

to jump start their economies, create jobs, and support and unleash the entrepreneurial spirit of their citizens, they must take to heart the secret of economic development. That secret, captured by Nobel Laureate Douglass North, is that countries with sustainable economic growth trajectories are able to establish institutional structures that allow them to move from personal interactions to impersonal exchanges.

In other words, countries that succeed in developing stable economies move beyond simple individual cash transactions with family and friends to establish economies that resemble the likes of Amazon or Ebay – millions of transactions with anonymous actors. An individual's ability to engage in business is reinforced by institutions such as formal and informal norms, rules of behavior, laws, and regulations. The strength and reliability of these institutions is the fundamental key to economic development and unleashing entrepreneurship.

Institutional deficiencies and entrepreneurship

Increasingly, governments around the world talk about the importance of entrepreneurship and supporting small business, recognizing that in many cases it is the only option that can meet the growing youth demand for jobs in the private sector. Governments speak about establishing an entrepreneurial economy, adopting new technologies, and promoting innovation in national development plans, electoral campaigns, and policy debates. However, such calls too often remain simply rhetoric, especially in those countries where the lack of democratic mechanisms leaves public officials largely unaccountable. Delivering on promises – not just making statements – requires a fundamental rethinking of how countries are governed.

In many parts of the world, institutional barriers prevent people from becoming entrepreneurs or render existing firms, especially small business, incapable of growing and creating jobs for others. As such, efforts to educate individual entrepreneurs,

support individual firms, create venture capital funds, and help youth develop business plans and obtain financing are not sufficient. They can be quite effective in creating individual success stories but they often fail to address institutional barriers that are the core of the problem. Such efforts move some people out of poverty but fail to reach many others.

The link between entrepreneurship and institutions is not immediately obvious. When we think of successful entrepreneurs we think of innovators, risk-takers, or people with great ideas exhibiting determination, hard work, and dedication. But in entrepreneurial economies, individual skills are not the only thing in play – the rules within which interactions occur matter just as much, if not more. As Douglass North explains, institutions as “rules of the game” largely determine the outcome of that game. In sports, one team can have the most talented, strongest, and best athletes, but if the rules heavily favor the other team and the referees call fouls and penalties only one way, the chances of winning are slim. A similar concept applies to entrepreneurship – an individual entrepreneur can have the best talents, skills, and ideas, but if the government penalizes selectively or provides preferential treatment through corruption, if your access to resources is limited while others enjoy it in full – that entrepreneur is less likely to succeed than it would be in a fair, competitive environment.

The barriers that hamper entrepreneurship are indicative of deep governance failures that not only undermine the economies of many countries, but also damage their democratic prospects.

There are many components to entrepreneurship that developed countries often take for granted. Even the most fundamental things, like registering a business, can become a real problem in developing countries. In the United States, we rarely think twice about registering a business – it can be done practically overnight, with minimal costs. This is not the case in much of the world. And it is not just about the number of forms you need to fill out or the fees you need to pay, though according to the *World Bank Doing Business* rankings even those differences can be astounding between various countries. The process of registering a business itself can be a deterrent to doing business or becoming an entrepreneur.

In Tanzania and Sri Lanka, a business must be registered in a central registration office in a major city. While this may not present many problems to those living in Dar es Salaam or Colombo, aspiring entrepreneurs who live in smaller towns are more directly affected. Not everyone has the resources and time to get on the bus and spend several days to register a business. Add to this travel the numerous registration forms and offices an entrepreneur has to visit and it becomes clear why so much of the economic activity in the developing world takes place in the informal sector. In some countries, as much as 70 percent of GDP is generated outside of the formal economic system.

Even after registration, operating a business can be quite problematic in many countries. For example, in Lebanon a survey of 250 small and medium enterprises conducted by Center for International Private Enterprise (CIPE) and the Lebanese Transparency Association revealed that 65 percent of respondents have to pay bribes to facilitate government-related procedures.³ In some countries, like Ethiopia, tax inspectors simply estimate the operating budget of an entrepreneur, levying tax based on their own understanding of how the business is operating rather than basing due tax on reality. In Yemen, tax inspectors may refuse to provide a tax form unless they are paid a bribe, meaning that businesses have to struggle to be honest and pay their taxes. In Russia, CIPE

frequently hears small business owners complain that more than three-quarters of their time is spent dealing with various public officials, inspectors, and bureaucrats rather than running their business.

Closing a business can also be problematic. In some MENA countries, business owners can go to jail for defaulting on loans due to weak bankruptcy laws. This happens because lenders find it difficult to take ownership of collateral if business people default on loans, so they make borrowers write post-dated checks – in which case defaulting on a loan becomes a criminal offence. Obviously, this serves as a profound disincentive to potential entrepreneurs, for whom the price of failure is prohibitively high. That, in turn, undermines the fundamental risk-taking nature entrepreneurship. In a number of countries bankruptcy procedures for business do not even exist.

Dealing with barriers to entrepreneurship

Between opening, running, and closing their businesses, potential businesspeople in many countries face barriers that prevent entrepreneurial activity. Entrepreneurs in developing countries may have problems with enforcing contracts, defending against criminal groups, struggling to overcome pervasive corruption, dealing with complex licensing procedures, navigating conflicting and burdensome customs regulations, seeking credit, finding reliable employees, complying with export requirements, and striving to follow overly complicated laws and regulations. Add to this lack of transparency, lack of trust, lack of market competition, and lack of the rule of law – and it becomes clear why doing business in emerging markets is so difficult.

The barriers that hamper entrepreneurship are indicative of deep governance failures that not only undermine the economies of many countries, but also damage their democratic prospects. Non-democratic states, along with new and fragile democracies, are disproportionately those where

the nexus of non-existent or weak democratic and market institutions makes entrepreneurship difficult. In this case, the key element of improving governance is economic in nature: reforms that generate greater transparency and accountability in the political decision-making process translate into more transparency and accountability in the marketplace, making it possible for individuals to build wealth through their own effort and initiative in the private sector, not thanks to selective favors from the state.⁴ In the absence of democratic governance, there are many aspiring entrepreneurs that continue to overcome these barriers, but there are many more who are discouraged by them. While there are small businesses that continue to succeed despite the odds, there are many more that fail to grow and expand their operations.

Legal and regulatory barriers and institutional failures affect business in multiple ways. They discourage new companies from being created, which is one side of entrepreneurship. At the same time, they discourage existing firms from growing their operations and expanding their business, which is another side of entrepreneurship not often considered. The key to job creation is not only individual entrepreneurship. It is in fact small business development and the growth of firms that can create jobs on a larger scale. What we find in a lot of countries is that through microcredit and similar programs you get a lot of people who start a private enterprise, often informally, but those same people still find it nearly impossible to expand into the small business category, which is where innovation and gains in productivity actually happen.

Only when the right institutional climate is in place can individual success stories become prevalent; only then they become a norm rather than the exception.

Educational systems are failing entrepreneurs as well. Schools and universities in many countries stick to outdated curricula, equipping students with skills that the private sector can no longer utilize. In fact, companies have to invest a considerable amount of resources in re-educating new entrants to the labor force. A survey conducted in 2009 by CIPE and the American Chamber of Commerce in Kyrgyzstan highlights some of these trends. Academic institutions are focused too much on teaching theory rather than practical applications of ideas and concepts and there is a lack of participation of business in higher education. Students never meet their potential employers and business does not participate in developing the curriculum. As a result, companies find it difficult to hire employees with relevant skills, especially small businesses that are very sensitive to the costs of labor and rely on individuals to perform a variety of tasks.

At the same time, young people find it difficult to start a business because they have never been exposed to the practical experience of developing products, ideas, or maintaining financial records. Universities teach them about how things ought to work but then people find that the reality is quite different. For example, an entrepreneur may not be able to get a loan because a loan officer in a bank expects a bribe. It may be difficult to clear goods through customs if a business person does not pay a separate company to facilitate the transaction. Universities do not teach these things and how to deal with them. We hear about that not only in Kyrgyzstan, but around the world – from Egypt and Morocco to Thailand and the Philippines.

More fundamentally, in some countries entrepreneurship is conceptually misunderstood in a negative light. When understanding and teaching entrepreneurship to citizens, some consider entrepreneurs as profiteers or even criminals who make their living at the expense of others, rather than as job-creators and contributors to the economy.

This lack of understanding of what entrepreneurship means is compounded by another barrier: language. In Arabic, for instance, there is no one consistent term to define entrepreneurship and entrepreneurs. Several related terms are used, ranging from a business person or leader to a self-employed or a self-starter, but none of these phrases succinctly capture the essence of entrepreneurship. Even the name of our organization – the Center for International Private Enterprise – is translated in Arabic as the Center for International Private Projects. How can one build an entrepreneurial economy if one cannot say it?

Building entrepreneurial economies

The recipe for building entrepreneurial economies is simple: build market institutions; remove barriers to starting, operating, and growing a business; reform educational systems; create a boarder awareness and understanding of what entrepreneurship means; and deepen appreciation for entrepreneurs' contributions to the development of societies. It is more about systemic, institutional changes than individual success stories. Only when the right institutional climate is in place can individual success stories become prevalent; only then they become a norm rather than the exception.

As simple as the recipe for entrepreneurship-driven development may be, the implementation of necessary reforms is much more complex. Institutional change takes time, effort, determination, and, above all, dedicated reformers. Governments are often regarded as the leading force in building entrepreneurial economies, but although the political will to implement reforms is key, no government can legislate the creation of an entrepreneurial economy from the top down. By definition, such economy needs active and engaged entrepreneurs who can work with the government and provide guidance on reform priorities and policy solutions. Otherwise you may have a disconnect with the informal sector because although there may

be rules, procedures, and initiatives, a majority of the economic system could still operate outside of those rules, procedures, and initiatives. Therefore, business can and should become the leading force of reform.

That can happen on multiple levels. Business associations and chambers of commerce can play a leading role in removing barriers to doing business through policy advocacy. They have a natural interest in doing so as every new business that succeeds is both a contributor to the national wealth of a country as well as their own membership base. More importantly, through their members business organizations have the grassroots knowledge of what and how reforms need to be implemented, thus they can help governments engineer solutions. For example, in both Sri Lanka and Tanzania, national chambers have reached an agreement with their respective governments to provide registration services to new businesses in remote parts of the country so that aspiring entrepreneurs do not have to make long journeys to register their businesses.

In Russia, associations are leading the fight against corruption, which has proven to be one of the major barriers to starting and growing a business. They are equipping small businesses with tools to resist extortion by public officials and are enlisting the help of hotlines and lawyers to help in cases of corporate raiding, whereby companies are illegally overtaken by unbalanced competition or corrupt government officials.⁵ Similarly, Russian associations are also working to change laws and regulations to ensure that they are more consistent and fair – for instance, by defending the right of small businesses to participate in procurement and ensuring that local governments provide loans as promised. In doing so, business associations are not only improving the country's business climate, but they are also opening up a democratic space for dialogue with the government and holding officials accountable.

In Kyrgyzstan, members of the business community are engaging in the national educational system to help ensure that university curricula

are more geared towards the real business world. They are not only building the skills of individual entrepreneurs or job seekers – they are changing the whole system of education in the country. In Afghanistan and Pakistan, CIPE is leading an effort to provide entrepreneurship education to school children, shaping an understanding of what entrepreneurship is, helping to create a greater understanding of the economic system, and developing students' skills as relevant for the workplace. As part of this program, CIPE is seeking to reform the curricula for all the schools so that children throughout the country can take advantage of these opportunities. Business associations in Kenya are also providing mentorship to aspiring entrepreneurs – their member companies spend time to educate and help young people to start their businesses.

As countries around the world face a growing youth unemployment crisis, governments must look for new solutions to create jobs. Public sector jobs – the traditional engine of employment in many developing countries – can no longer absorb millions of new graduates who instead end up chronically unemployed with their hopes and aspirations for a better future crushed. Entrepreneurship can provide a much-needed alternative for those young people and reinvigorate the economies of their countries, but only if institutional shortcomings that make starting and growing business difficult are addressed.

CIPE's experience around the world shows that entrepreneurs themselves can become a driving force for such reforms. When they work together and make their voices heard through business associations and chambers of commerce, they can formulate concrete reform recommendations and engage in a constructive dialogue with government. In doing so, businesses can go beyond the immediate value of goods and services they deliver to their customers and provide greater value to the country as a whole. They can become an integral part of the complex institutional transformation necessary for democratic and entrepreneurial economies to flourish.

Endnotes

- ¹ Ahmed Muhammad Sayyid's story was profiled in the New York Times http://www.nytimes.com/2008/02/17/world/middleeast/17youth.html?_r=1
- ² Navtej Dhillon and Tarik Yousef, eds., *Generation in Waiting: The Unfulfilled Promise of Young People in the Middle East*, Brookings Institution Press, 2009
- ³ CIPE, "New Lebanese Publications Enhance Anti-corruption Efforts," *Overseas Report*, No. 46, Fall 2010, p. 9, <http://www.cipe.org/pdf/cipeOR46.pdf>
- ⁴ Larry Diamond, *The Spirit of Democracy: How to Make Democracies Work*, Nov 28, 2008, p. 8, <http://www.cipe.org/publications/fs/pdf/112808.pdf>
- ⁵ Alexander Settles, "Evolving Corruption: Hostile Takeovers, Corporate Raiding, and Company Capture in Russia," *CIPE Feature Service*, Aug 31, 2009, <http://www.cipe.org/publications/fs/pdf/083109.pdf>

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